

Minimising Litigation on Presentation of Documents under Letters of Credit: An Alternative Approach to the Uniform Customs and Practice for Documentary Credits

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by

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Abstract

It is a well-known fact that international trade contracts bear inherently more risk than the trade contracts entered by the parties from the same country. This is due to the differences in business methods and practices used, trade cultures of the parties involved, laws and regulations in the respective jurisdictions. Under these circumstances, it is very important for the seller to have the assurance of that he receives the payment for the goods dispatched and for the buyer to receive the goods what has been ordered. One effective way of having such an assurance is to rely on a letter of credit as an international payment method. But for exporters in particular, this payment method has presented difficulties in meeting the compliance requirements necessary for the payment to be triggered.

The UCP 600 published by the International Chamber of Commerce provide the rules that govern letters of credit transactions. At the introduction of the UCP 600, it was aimed to remove wording that could lead to inconsistent application and interpretation, as against the language and style used in the previous version, namely the UCP 500. Highlighting the experiences under UCP 500, the ultimate focus of the revision of the UCP was to minimise the level of litigations that had arisen under the rules provided in the UCP.

In several surveys, it has been reported that, nearly 50% of the first presentation for payment under letters of credit are rejected by the banks. This situation implies the fact that the provisions which cover letters of credit transactions are not either clear enough or well understood by the parties involved. Similarly, the decisions made by Courts around the world on issues related to letters of credit have taken different approaches when applying and interpreting the rules. This can clearly be seen by a myriad of controversial judicial standards which have been applied to similar mistakes in documents presented to the bank for payment.

This thesis is an investigation into those issues to find out the optimal standards that could be applied to solve the said problems. In doing so, this thesis will strive to ascertain what remedial measures could be taken to address the issues related to examination of documents, the rejection of payment and fraud exception.

Key words: International Trade, International Trade Law, Law of Letters of Credit, Uniform Customs and Practice for Documentary Credit 600, Examination of Documents and communicating the decision.

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LIST OF ABBREVIATIONS

ICC - International Chamber of Commerce

ISBP - International Standard Banking Practice (2013 Revision) (Also referred as ISBP745)

UCC - Uniform Commercial Code of the United States of America (1995 Revision)

UCP 400 – Uniform Customs and Practice for Documentary Credits (1983 Revision)

UCP 500 - Uniform Customs and Practice for Documentary Credits (1993 Revision)

UCP 600 - Uniform Customs and Practice for Documentary Credits (2007 Revision)

UNCITRAL - United Nations Commission on International Trade Law

UNCITRAL Convention - United Nations Convention on Independent Guarantees and Stand-by Letters of Credit

Chapter 1

Introduction

1.1 Letters of credit

As an important method of payment which facilitates international trade transactions, letters of credit (herein after also referred as the Credit) have been described by English Judges as “the life blood of international commerce”¹. It is the most preferred way of payment in international trade². It is believed that this way of method of payment was formulated nearly 3000 years ago³. These transactions are mainly preferred over single, short cross-border sales transactions, where the respective traders are unknown to each other. In addition they may still be at the initial stages of establishing a long term trade relationship⁴. In simple terms, when the parties involved in trade are located in two different countries, the letters of credit can be used as the method of payment, because it reduces uncertainties⁵ between them over the performance and completion of the sale transaction.

However, irrespective of the vital part played by letters of credit as a viable means of payment which have facilitated international trade transactions, it is often found difficulties in processing these transactions smoothly due to complications arising over the requirements of documentary compliance expected by the banks. On the other hand, banks are also facing difficulties in complying with some of the rules provided in the Uniform Custom and Practice for Documentary Credit, especially

¹ R D Harbottle Limited. v. National Westminster Bank (1977) 2 All ER 862

² Hans Van Houtte, The Law of International Trade (2nd edition Sweet & Maxwell, London 2001) at 8.02

³ It is believed that the Phoenician merchants used letters of credit in extending their commerce to cities in the Mediterranean and The merchant bankers of Venice, Genoa, Florence, and other commercial cities of Europe freely used letters of credit in the fourteenth century - Mitchell J William 'Oei and Kools de Visser v. Citibank, N.A.: Southern District of New York Finds Letter of Credit Applicant Has No Implied Time Limit to Bring Wrongful Honor Claim' St. John's Law Review: Volume. 71: Issue. 4, Article 7. Published in 2012, Available at: <<http://scholarship.law.stjohns.edu/lawreview/vol71/iss4/7>> , accessed 27 January 2017

⁴ Ronald Mann, Clayton Gillette, 'The Role of Letters of Credit in Payment Transactions', Michigan Law Review; August 2000, Vol. 98 Issue 8, at 2519

⁵ Uncertainties derive from risks involved in trade; Exporters run the risk of buyers failing to pay for goods, while importers may risk paying but never receiving anything. Because of the distances involved among parties, it may be difficult to resolve any disputes.

when deciding whether to make the payment to the beneficiary or issuing notices to the parties involved and halting payments on the suspicion of fraud.

For example, it was reported that in the United Kingdom the refusal rate is nearly 60% on first time documents presentation to banks for examination under letters of credit and on that basis it could be estimated that the United Kingdom is losing around Stg. 100 million GDP in each year⁶. In 2005, it was reported that in the United States the rate of refusal on first time submission of documents was edging over the 55% mark for both the import and the export letters of credit⁷. These rejection rates have resulted in more controversial Court decisions which appear to have been made neglecting the provisions contained in the UCP. It has transpired that Courts have applied various differing standards to similar type of matters. For example, in the documents examination process by a bank in order to make the payment to the beneficiary, in some jurisdictions, it will interpret the document examination as a proof reading exercise while in another jurisdiction the bank expects only the data to be consistent with each document⁸. From a commercial point of view, this situation has created uncertainty among the parties involved in international trade. Neither the seller nor the buyer is assured under which legal principle their issues are going to be resolved.

In order to reduce the risk and uncertainty faced by parties involved in international trade, the International Chamber of Commerce introduced the above mentioned Uniform Custom and Practice for Documentary Credits. The Uniform Customs and Practice for Documentary Credits attempted to harmonise the law applicable to letters of credit which is also referred to as documentary or commercial credits, from its inception in 1933⁹. The UCP has been revised several times from time to time and having considered more than 5,000 comments from various country committees, the International Chamber of Commerce released the sixth and latest revision of the rules called the UCP 600. It was a product of more than three years of research and work. The aim of introducing the UCP 600 was focused on bringing a more understandable and comprehensive set of rules that can help to minimise the level of litigation that was then taking place in respect of letters of credit.

It must also be noted that the UCP 600 offers valuable solutions to some of the problems associated with its predecessor (UCP 500). It is certainly shorter and

⁶ Report on the use of Export Letters of Credit 2001/2002 (SITPRO Report dated 11th of April 2003)

⁷ Kim Sindberg, 'From Beginning to Beginning, Selected published in 2012, Trade Finance Articles from 2003 to 2011', (BoD – Books on Demand, 2012 publication) page 107: referring to the DC-PRO Letters of Credit Market Intelligence Survey carried out in 2005.

⁸ Despite the fact that the concept of 'Strict Compliance' is widely accepted as a fundamental principle, the UCP has intentionally ignored to acknowledge it - Ravi Mehta, 'Does UCP 600 Soften or End the Doctrine for Strict Compliance?' LC Views, Newsletter No. 101, March 2007, available at <www.lcviews.com/LCVIEWS_PDF/LCVIEWS101.pdf> accessed on 18 April 2015

⁹ Carole Murray, David Holloway and Darren Timson-Hunt, 'Schmitthoff's The Law and Practice of International Trade', (12th edition Sweet & Maxwell, London 2012), page 191

easier to read as compared to the UCP 500. The users are benefited by a useful component that has a more logical and consistent structure than its predecessor. It has a more useful built in definition and interpretation guidelines¹⁰.

However, despite the evolution of letters of credit as a viable method of payment in International Trade, a fairly large number of the exporters, importers and banks still tend to make errors and mistakes when dealing with the documents mentioned in the credit agreement. It is seen that this does not depend on whether the exporters or manufacturers or merchants new to exporting or experienced firms, large or small in size, or whether located in city or rural areas as the tendency in making errors can be seen commonly.

1.2 Objectives and Scope of the thesis

The analysis in this thesis covers the aspects involved with letters of credit, especially, from the submission of the documents to the bank for examination, the decision making process¹¹ by the bank and the communication of the bank's decision¹². There are discussions on discrepancies in the documents, the time available for banks to make the decisions, giving of notice to the beneficiary and approaching the parties for negotiations and/or compromise and when the fraud exception rule should be applied.

This thesis studies the reported cases on the relevant areas and refers to other international conventions to extract the important elements that would be required to frame more comprehensive rules to cover the deficiencies in the current rules.

The outcome of the thesis suggests an amendment to the rules of the Uniform Customs and Practice for Documentary Credits on the issues of examination of documents, permitted time period for examination and giving of notices to the parties. In addition, there will be an attempt to identify the main elements of the fraud exception, in order to provide general guidelines as to when and how the exception can be applicable, when a fraud is claimed.

It is hoped that the changes suggested by this thesis will contribute to aid understanding of the rules provided in the UCP among those concerned with the mechanism of letters of credit. Apart from that, this dissertation aims to find out whether the parties to the letter of credit have been benefited from the provisions of the UCP 600 in terms of avoiding such errors that can arise when dealing with

¹⁰ Carole Murray, David Holloway and Darren Timson-Hunt, 'Schmitthoff's The Law and Practice of International Trade', (12th edition Sweet & Maxwell, London 2012), page 192-193

¹¹ Article 14 of the UCP 600.

¹² Article 16 of the UCP 600.

international trade. There is discussion on the role which the UCP 600 plays as an important mechanisms when dealing with main legal issues that can arise out of major functions in the letter of credit process.

On perusal of the case law decided under rules of the UCP, it is clear that, the high volume of cases have been reported in respect of four main stages of the process relating to letters of credit.

1. Examination of documents by the bank to decide that the presentation is compliant in order to make the payment to the beneficiary. (discrepancies in the presentation)
2. Time limit available to banks for document examination
3. Approaching the parties to cure or waive off the discrepancies and issuing final notices to beneficiary
4. Halting the payment to the beneficiary on the suspicion of a fraud.

After the seller or the beneficiary to the credit has submitted the documents to the bank, it is expected to check whether those documents are in compliance with the terms of the credit¹³. When the letters of credit are drafted, it is required to mention the set of documents which the seller is expected to submit to the bank to receive the money for the goods that he has shipped under the sales agreement. More often, the required documents contain the bill of lading, commercial invoices, insurance documents, quality assurance reports and any other documents requested by the letter of credit¹⁴. However, the way banks determine whether the documents are in compliance with the requirements mentioned in the letter of credit has always been the subject of controversy. The provisions contained in the UCP 600 may be deemed as not providing clear and definitive answers to this issue. Therefore, this thesis aims to find an optimal solution for these issues that can be acceptable in any jurisdiction.

After the submission of documents by the beneficiary, the bank has 5 days¹⁵ to decide whether the documents are in compliance with the terms provided in the credit. The previous version of UCP 600 provided 7 days for banks to examine documents and the reduction of the allowed time period by 2 days in the UCP 600 has had both negative and positive effects. The issue of the allowed time period can become a crisis, if the submission for examination is made when the life span of the credit is about to expire. In addition, there are some controversial wordings in the provisions of the UCP 600 which relates to the permitted time period for examination. This thesis will focus on arriving at the right formula for calculating the allowed time period for examination in order to create an alternative to what has been prescribed in the UCP 600.

¹³ Article 14(a) of the UCP 600

¹⁴ Carole Murray, David Holloway and Darren Timson-Hunt, 'Schmitthoff's The Law and Practice of International Trade', (12th edition Sweet & Maxwell, London 2012), page 206

¹⁵ Article 14(b) of the UCP 600

A Bank's obligation under the credit does not cease as soon as it has made the decision on document compliance. A Bank is required to give proper notices¹⁶ to parties stating whether it accepts the documents or not. In addition, a bank is under an obligation to return the documents to the presenter in due course. However, there have been reported cases where banks have been held liable for not giving the proper notices to the beneficiary. Also, the provisions in the UCP 600 relating to the return of documents are not clear and conclusive. Therefore, this thesis will attempt to draft a format that can be used for refusal and document return notices which can be applicable worldwide and acceptable in all jurisdictions.

Banks have an option to halt the payment if there is a complaint or suspicion about a fraudulent act by the beneficiary. Though this option is not available under the UCP 600 and thus, such option is exercised as a banking practice/custom that had been used in the trade for many decades¹⁷. In addition, under local jurisdictions, aggrieved parties can obtain injunctions from Courts preventing banks from making payment to the beneficiary. Although, the UCP 600 does not cover this option, in contrast, the English law, American law and some other international conventions have recognized the fraud rule in their respective jurisdictions. The primary implication of the fraud rule is that the perceived impregnability of documentary credits is no longer absolute with some circumstances justifying interference with the autonomy doctrine. The application of the fraud rule in a foreign jurisdiction may create doubt as the parties are not well aware of under what criteria the fraud is defined. Especially, the seller would be worried about an intervention by a foreign court's ruling which may not be interpreted in the same manner under his local jurisdiction. As the UCP 600 is silent about this issue, currently it is up to the relevant local jurisdiction to decide as to which elements can be defined as fraudulent. Therefore, this thesis will attempt to evaluate and identify the main elements which formulate the fraud, if claimed by the buyer.

By doing what has been stated above, this dissertation is expected to contribute in finding out;

1. the challenges faced by exporters, importers and the banks in keeping with the rules contained in the UCP 600 as to the subject area of this thesis
2. how they can be benefited from the UCP 600 and make the best use of it.
3. how the exporters have been positively or negatively affected by the rules of UCP 600.
4. what changes need to be made in future versions.
5. overall evaluation of the UCP 600 with vital recommendations.

In making suggestions for amendment to the current rules of the UCP 600 on the subject area of this thesis, the recommendation made will attempt to contribute in

¹⁶ Article 16 of the UCP 600

¹⁷ Peter Ellinger, 'The Law of Letters of Credit', page 218, published in 1987.

minimising the level of litigation that has arisen as a result of the respective rules of the UCP 600. In addition, the major changes suggested herein would benefit the parties in the international trade as they will contain valuable practical hints.

1.3 Sources and Methodology

This research will be mainly based on reference to library and internet sources.

The primary source is a thorough study of the UCP which is the set of rules that has a voluntary regulating nature. The current version of the UCP came into force on the 1st of July 2007 replacing, the UCP 500¹⁸. According to the estimation of the International Chamber of Commerce, despite the fact that the UCP rules are required to be incorporated into the sales contract to be a force, over 90% of letters of credits worldwide are issued subject to the provisions of the UCP 600¹⁹.

The UCP 600 also refers to the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP). Due to the fact that the rules of the UCP are general in nature, the ISBP was introduced²⁰ to define the terms in greater detail. After the introduction in 2002, the ISBP was subject to a few revisions and the latest version was published in 2013 which is called ISBP 275.

In addition to the above two sources, the UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit published in 1995 will be studied as a primary source based on the ground of it having been drafted to cover the areas of demand guarantees and standby letters of credit. The UNCITRAL was established by the United Nations General Assembly in the year 1966. It was promulgated to promote the progressive harmonization and unification of International Trade Law. The important feature of the UNCITRAL is that it provides exceptions to the independent nature of standby letters of credit and demand guarantees.

The Uniform Commercial Code, can be described as the most comprehensive code which covers matters related to commercial law²¹. It is often considered as one of the most developed areas in American law. The UCC was published by the National

¹⁸ The UCP 500 published in 1993 by the International Chamber of Commerce.

¹⁹ Hans Van Houtte 'The Law of International Trade', 2nd Second edition, Published in 2002 by Sweet & Maxwell London, Chapter 8 page 271

²⁰ Brooke Wunnicke, Paul S. Turner, 'Standby and Commercial Letters of Credit', Aspen Publishers Online, 2000 at S 5A-40

²¹ Ross P. Bukley & Xiang Gao, 'The Development of the Fraud Rule In Letter of Credit Law – The Journey So Far and the Road ahead', 23 University of Pennsylvania J. Int'l L. 663 (2002), page 683, Available at: <<http://scholarship.law.upenn.edu/jil/vol23/iss4/2>>, (Accessed on 21 September 2016): where it says Since the promulgation, it has been utilized regularly and successfully by Courts and the Parties to letters of credit in the United States on a regular basis.

Conference of Commissioners on Uniform State Laws in collaboration with the American Law Institute. This code was drafted by a group comprised of Attorneys, Judges, Legislators and Academics who represent all States in the USA. The Uniform Commercial Code does not have legal effect unless its provisions are enacted by the individual state legislatures as a statute. At present, the UCC, either in whole or in part has been enacted, subject to legal variations, in all 50 States. The UCC will also be used as a primary source to complete this thesis.

Finally, primary sources will also comprise of Court decisions which relate to the rules of the UCP and letters of credit which have been made in different jurisdictions.

The secondary sources are Text books, information data bases, Journals, Articles contained with relevant information, the legal aspects and case law and internet sources such as E-libraries, E-journals and texts available online.

This thesis will explore, recognize, evaluate and analyse the issues associated with provisions of the UCP 600 and compare those technical issues with case law to understand the practical aspects applicable to those issues. In addition, there will be discussions on other international conventions and experts' comments to find answers for the issues associated with the UCP 600.

1.4 Structure of the thesis

The whole thesis contains 6 chapters, starting with an introduction which discusses about International Trade and Letters of credit as a means of payment. The second chapter compares and analyses changes made to the UCP by the introduction of its latest version with regard to the examination of documents. The third chapter contains a series of cases and the law that has arisen as a result of the discrepancies in the documents. The analysis made in this chapter will be used to find answers for the issues related to the examination of documents. The fourth chapter will discuss about the bank's liability in communicating its decision to the beneficiary. It will be comprised of a case study concluding with suggestions to solve the issues involved in the related rules. The 5th chapter discusses about the fraud exception rule, which is enforceable by either the bank or Courts. As the UCP 600 does not have any provision relating to "fraud exception", there will be a discussion about the necessity of identifying main elements which can be helpful to define a fraud. It is expected to conclude the chapter by listing important elements on fraud exception, which may aid to enhance the understanding of the rule. The last chapter will summarise the overall discussion of the thesis and will contain recommendations to solve the issues discussed about the rules of the UCP.

1.5 Contributions made by the thesis

In addition to the contribution mentioned above to enhance the productivity level of the UCP as a universally applicable set of rules, this thesis seeks to make a contribution to the legal literature on letters of credit, international trade, export trade and import trade. It is sought to achieve this by a constructive debate surrounding the issues relating to letters of credit as a way of payment in international trade. Especially, it will compare the circumstances where the law can become applied differently during the process.

It must be acknowledged fact that, there is a considerable amount of scholarly contribution made to the law on Documentary of credit and yet there is a vacuum in legal literature which analyses the practical aspects of judicial pronouncements, which has a theoretical significance. Therefore, this thesis seeks to address these issues through a contribution to the literature on this subject.

Further to above, it is expected by this thesis to offer practical hints for Importers, Exporters and Bankers on the matters relating to international trade transactions particularly in keeping with the rules of the UCP 600. The contribution made herein is expected to be useful to the law practitioners who are specialized in the law relating to commercial disputes and those who provide advice on matters relating to letters of credit.

Finally, this entire work seeks to make a significant contribution to the future legislative enactments and policy development in the UCP in the wake of emerging alternative transactions methods in international trade.

1.6 The role of Letters of Credit

Letters of credit are a method of payment which is utilised to facilitate international trade transactions. As mentioned, they have been described as the life blood of international sales transactions.²² This method is considered less secure than payment in advance and thus, secure than documentary collections or open account as far as the seller's rights are concerned.

However, among methods of payment available in international trade, letters of credit are considered as the most preferred payment method²³. This is due to the fact that,

²² R D Harbottle Limited. v. National Westminster Bank, (1977) 2 All ER 862

²³ Nearly 55% in International Trade transactions are subject to Letters of Credit that values trillions each year; Source: 'Rethinking trade finance', ICC publication, October 2016, page 45, available at http://www.iccgermany.de/fileadmin/user_upload/Content/Banktechnik_und_praxis/ICC_Global_Trade_and_Finance_Survey_2016.pdf) accessed on 18th December 2016.

letters of credit offer a balance of security among the parties involved. The guarantees received by their respective banks give assurance to both the buyer and the seller and makes sure that the operation of letters of credit work without any hindrance.

As the process of the letters of credit transaction is transparent, the whole system runs efficiently. The payment process that the letters of credit provides was described as a bridge between the period of the shipment and the time of obtaining payment against documents²⁴. The main advantage of this method of payment is that the assurance which the beneficiary receives, simply because he relies on the bank's creditworthiness instead of the importer. However, the assurance which the beneficiary receives is subject to the condition that he presents the right set of documents, which have been mentioned in the letter of credit, to the bank for examination. It must be noted that, despite having rigorous document presentation requirement, letters of credit are the front runner among methods payment used in international trade transactions, with a value transacted of over USD 1 trillion per annum²⁵.

A letter of credit can be negotiable. The issuing bank under the instruction of the seller and conditions of the credit pays the beneficiary directly or via a nominated bank. The beneficiary has the right to nominate a third party as the person who has the right to draw, if the letter of credit is made as transferable. The Buyer may be required to provide securities or cash to the bank prior to issuing the credit. Banks charge for the service they offer depending on the nature of the transaction.

There are few types of letters of credit. The most common type is the commercial letter of credit where the issuing bank makes direct payment to the beneficiary upon successful presentation of documents. The standby letter of credit is an undertaking by the issuing bank to make the payment to the beneficiary if the holder of the credit fails. A confirmed letter of credit is a type, that a bank other than the issuing bank guarantees the payment on the letter of credit. Typically, the guarantee can be made by the beneficiary's bank upon the request of the seller's bank. The guarantee provided in here assures the seller that he will be paid if either the seller or his bank fail to do so. Despite having numerous types of letters of credit, the subject matter of this thesis will be confined only to commercial letters of credit.

²⁴ T. D Bailey, Son & Co. Y. Ross T. Smyth & Co. Ltd. (1940) 56 T.L.R. 828

²⁵ C H Klein, 'Letter of Credit Law Developments' Jenner & Block LLP, published in 2006

1.7 Process of Letters of Credit.

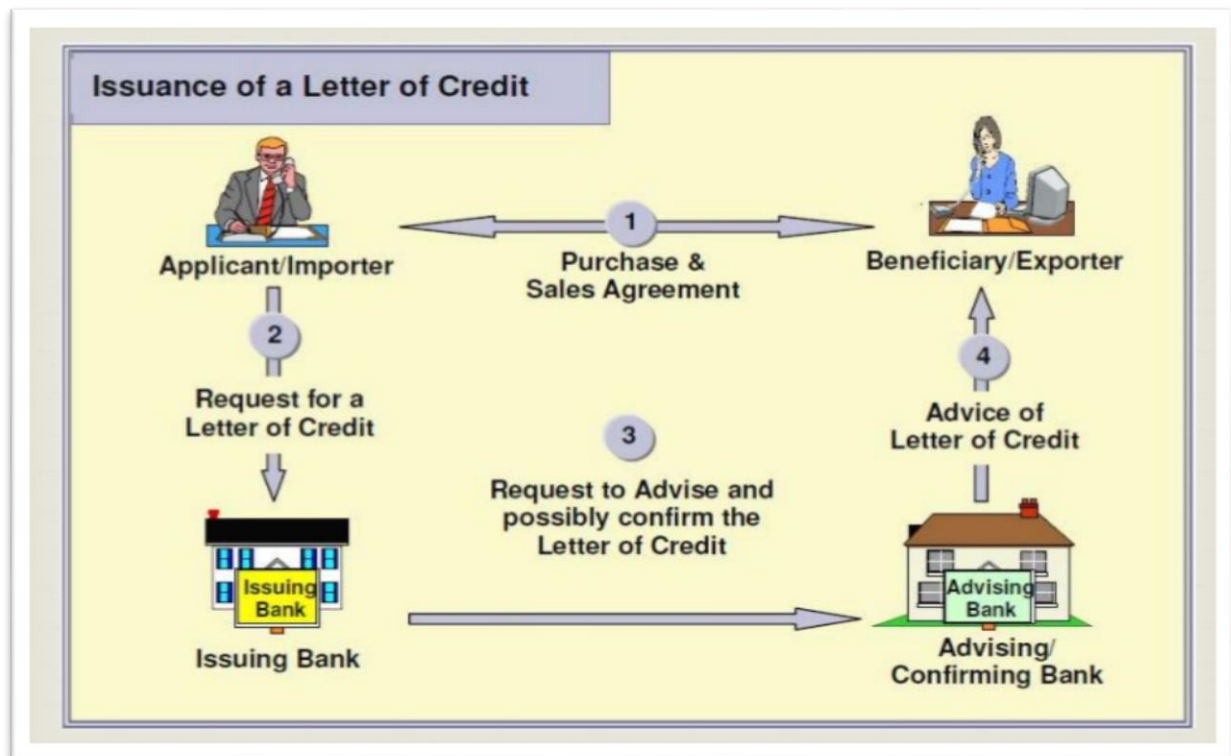


Figure 1

1. The importer and the exporter come to an agreement in their sales contract on the price for goods, specifications, the manner of transportation, the bearer of freight cost and also the payment is to be made by a letter of credit.

2. After having chosen a letter of credit as the way of making payment, the buyer instructs the issuing bank to open a letter of credit in the name of the exporter with specified terms which the exporter has to satisfy when the demand for payment is made. The requirements which the exporter has to satisfy are typically to present documents which are mentioned in the letter of credit. As far as the contract between the importer and his bank is concerned, the issuance of the letter of credit acts as a short-term loan provided by the bank. The Bank may ask the buyer to repay the amount by instalments or in some cases payment by the buyer to the bank prior to issuing of the credit.

3. Then the issuing bank requests the buyer's bank or a bank which is local to the seller (hereinafter referred as the confirming bank or advising bank) to confirm that it is willing to negotiate, accept and make the payment on submission of documents specified in the letter of credit. The confirming bank's informs the seller about opening of the credit.

4. Upon receiving the confirmation from the bank, the exporter as the beneficiary to the credit is expected to check the terms specified in the credit to find whether they match with terms he agreed in the sales contract. If there is any discrepancy between the terms of credit and what both parties have agreed in the sales contract, the beneficiary should contact the buyer to amend the terms in question in the credit. Until the amendments are done, the exporter should not ship the goods to the importer.

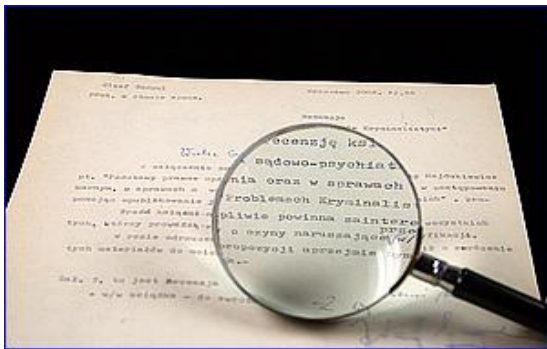
5



6



7



8

Outcome

- i. Compliant - Accepted
- ii. Ask for a waiver - from buyer
- iii. Cure the deficiency - by seller
- vi. Reject the presentation

Figure 2

5. After receiving the confirmation from the bank and there is no amendment to be made in the terms of the letter of credit, the exporter ships the goods and obtains the bill of lading from the shipping company.
6. After collecting all the documents required, the exporter (also referred to as the seller or beneficiary) submits the documents to the confirming bank for examination. The documents are sent to the issuing bank for examination, when the confirming bank is not assigned carry out the examination.

7. The bank then starts the process of examination in order to ascertain whether the documents are in compliance with the requirements mentioned in the letter of credit. If the documents are in right order, the issuing bank then, debit the buyer and remit the money to the confirming bank to be delivered to the seller. The time available for a bank to conclude the examination and communicate its decision to the beneficiary is limited and if the bank fails to communicate within the allowed period, the bank will be precluded from claiming that the submission is not in compliance, even if the bank finds any discrepancy in a document.
8. During the period of examination, if the bank finds any discrepancy in the submitted documents the bank can ask the seller to cure the deficiency or the buyer to waive off such discrepancy. However, even if the bank is adopting one of the above two options, it is not permitted to exceed the time period allowed for document examination. It must be noted that, it is the bank's discretion to follow the above two options and banks will not be legally liable for not following both or either of such options. If the bank finds documents are discrepant, the bank may refuse the payment on the grounds of non-compliance.

1.8 Liabilities of the parties.

During the transaction process, all the parties to the credit have a duty to perform their parts in the transaction with due diligence. If one party fails to act upon the conditions stated in the letter of credit, it is highly likely to be legally liable for such failure on its part.

In most cases, litigation in this regard often involves either the issuing bank or the confirming bank and sometimes it may be between the issuing bank and the confirming bank.

The buyer – can be sued by the issuing bank to recover the money paid for the transaction

The issuing bank – can be sued by;

- a) the buyer for making unlawful payment either to seller or the confirming bank
- b) the confirming bank for non-payment of the money which the confirming bank paid to the seller.

- c) the seller for unlawful refusal to make the payment under the letter of credit²⁶.

The confirming bank – can be sued by:

- a) the buyer for making unlawful payment to the seller
- b) the issuing bank for unlawful acceptance of the presentation and making payment to the beneficiary
- c) the seller for unlawful refusal to make the payment under the letter of credit²⁷.

In addition to the above, there may be few instances where legal action is taken against other parties for diverse reasons.

1.9 Fundamental Principles

Throughout the period when letters of credit came into usage, the law applicable to letters of credit has been based on two major principles²⁸. From time to time, the interpretation of the law applicable to these principles became subject to minor changes. However, the core elements of these two principles still remain untouched.

The Independence Principle.

Article 4(a) of the UCP 600 makes provision to cover this principle. In terms of this principle the letters of credit are totally separate from and independent of the underlying sales contracts²⁹. Article 4(a) of the UCP 600 states that;

*'a bank which operates a credit is in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit'*³⁰.

If the beneficiary of the letter of credit (usually the seller) submits the correct documents that have been stated in the letter of credit, the bank is obliged to pay regardless of any existing dispute between the seller and the buyer over the performance of the underlying sales contract. In addition to that, if the seller has

²⁶ In addition to the unlawful refusal to make the payment, the issuing bank can be sued on the grounds of preclusion (unable to give the refusal notice on time or failure to issue the right refusal notice or failure to return the documents to the presenter promptly) or taking unnecessary time to make the decision on document examination.

²⁷ Circumstances stated in the above foot note is applicable.

²⁸ Carole Murray, David Holloway and Darren Timson-Hunt, Schmitthoff's The Law and Practice of International Trade, (12th edition Sweet & Maxwell, London 2012), page 194

²⁹ Hamzeh Malas v British Imex Industries Limited (1958) 2QB 127

³⁰ Article 4(a) of the UCP 600

submitted the right documents complying with the credit, the bank is obliged to pay the beneficiary, even under circumstances where the buyer is unable to pay the bank for the amount paid to the seller under the letter of credit or any other charges due to the bank.

The buyer cannot ask the bank or a Court to stop payment to the seller even if it is found that the goods delivered do not conform to what had been stated in the underlying contract. The only exception to this is that, banks can and/or a Court may interfere to stop the payment if it is satisfactorily proved that despite fact that the documents in compliance with the credit, the document(s) submitted are fraudulent and the seller was involved in such act³¹.

Doctrine of strict compliance

When documents are presented to bank by the beneficiary for examination, the bank checks whether the documents satisfy the requirements stipulated in the terms of the credit. A minor discrepancy may tempt the bank to reject the presentation and refuse the payment³². The adherence by the bank to examine the documents strictly to ascertain whether the documents are in compliance is called the doctrine of strict compliance. This principle assures the buyer that, the bank will make the payment to the seller only under the circumstances of that the documents presented for examination do strictly comply with the terms of the credit, which have been stipulated in accordance with the requirements of the buyer. On the other hand, this concept ensures that, upon the successful presentation of documents the seller will be paid, even if the buyer declines to accommodate the payment. However, if the seller makes a minor mistake and submits the documents with a trivial discrepancy, the bank may not pay him, even after he has shipped the right goods to the buyer.

Over many years, the yardstick which measures the strictness of document examination standards had always been subject to controversy. The definitions given by the UCP in respect of this principle were often vague and was the cause of contention between parties. Whilst the majority of Courts have applied this principle in the strictest possible manner, some Courts have tended to take a much more lenient view by applying the substantial documents complying standards. This will be discussed in details in chapter 2.

³¹ Carole Murray, David Holloway and Darren Timson-Hunt, Schmitthoff's The Law and Practice of International Trade, (12th edition Sweet & Maxwell, London 2012), page 194

³² Paul Todd, 'Discrepancies between Bills of Lading and Letters of Credit', Letters of Credit Update (Government Information Service, USA) (1999) pp. 14-19 at page 474, where it says, the original common law position is that the triviality of a defect was irrelevant.

1.10 The Uniform Customs and Practice for Documentary Credits

The UCP is a set of rules which governs the use of letters of credit. Currently, the UCP is utilized worldwide in international trade. Over the centuries, the banks and trade practitioners have developed practice and techniques to use in letters of credit in international trade finance. Those practices and customs were standardized by the ICC, by publishing the UCP in the year 1933. The UCP was thereafter subject to many amendments and updated throughout its history. By bringing the existing practices and customs together through the UCP, the ICC has developed a comprehensive set of rules that can be applied to the operation of letters of credit. The success of the ICC's effort in harmonizing the law in respect of letters of credit is evident from the UCP's universal adaptation. The current version of the UCP was approved by the Banking Commission of the ICC at its meeting held in Paris on the 25th October 2006. This latest version is called the UCP 600 and came into effect from 1st of July 2007. This was the 6th revision of the UCP since its publication in 1933.

The UCP is recognized as one of the most successful set of private rules for trade ever developed. The application of the UCP comes into effect, only if the parties to the credit incorporate them into their contract³³. Under the English law, the UCP does not have the force of law³⁴ and it can only be applied, if the parties have incorporated them into their contract. However, as a practice, the British banks often incorporated the UCP into their contracts and consequently, the English Courts are familiar with the rules of the UCP and frequently interpret them³⁵. In the United States, the provisions of the Uniform Commercial Code on letters of credit are replaced by the UCP where the parties have agreed to apply them or where they are customarily applicable³⁶.

When the letter of credit is issued under the UCP 600, the terms in the credit will be interpreted in accordance with 39 articles of the UCP. However, exceptions to the rules can be applied if the parties have expressly agreed to the modification or exclusion of terms. For example, under the UCP 600, it is not mandatory for the bank to contact the buyer to waive off a discrepancy in a document submitted by the seller for payment. However, if the parties expressly agreed in the terms of the credit the

³³ Article 1 Application of UCP 600 provides 'The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 ("UCP") are rules that apply to any documentary credit ("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. They are binding on all parties thereto unless expressly modified or excluded by the credit.'

³⁴ Royal Bank of Scotland V Cassa di Risparmio (1992) 1 Bank L.R. 251

³⁵ Leo D'Arcy, Carole Murray and Barbara Cleave, 'Schmittoff's Export Trade, The Law and Practice of International Trade' (10th edition, Sweet & Maxwell, London 2000), page 168.

³⁶ *ibid*

bank can mandatorily be directed to approach the buyer for a waiver in the case of a discrepancy before making the final decision.

1.11 International Standard Banking Practice (ISBP 745)

The previous version of the UCP (UCP 500) contained reference to the International Standard Banking Practice. However, until the year of 2003, there was no any published paper which contained the relevant articles. However, in the year of 2003, the International Chamber of Commerce published the 1st version of the ISBP which provides guidance as to the process of document examination.

The ISBP rules were introduced to serve along with the UCP as a guidance on the implementation of the rules of the UCP. The ISBP was thereafter subject to several revisions and the latest version was introduced in 2013, called the ISBP 745. This publication supplements as a necessary companion to the UCP 600 for the determination process on compliance of documents against the terms of letters of credit.

1.12 Important interpretations.

Letter of Credit - "Credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation."³⁷

The applicant – the party who makes application to open the credit³⁸

The issuing bank – the bank which issues the letter of credit³⁹

The beneficiary – the party in whose favour a credit is issued⁴⁰

The advising bank – the bank that advises the credit to the beneficiary⁴¹

The confirming bank – the bank that adds its confirmation to a credit⁴².

The nominated bank – the bank nominated to make the payment to the beneficiary.

³⁷ Article 2 of the UCP 600

³⁸ *ibid*

³⁹ *ibid*

⁴⁰ *ibid*

⁴¹ *ibid*

⁴² *ibid*

Chapter 2

Examination of documents

2.1 Introduction

One of the fundamental concepts associated with the operation of letters of credit is the 'principle of strict compliance'. International trade is a process which involves carriage of goods overseas and when engaging in that process, sellers would need to be assured that the standards applied by banks in scrutinising documents do not vary from country to country. Therefore, it is vital to have this guarantee from banks since, if the documents are rejected, it can cause negative effects on the parties in the way of delays, additional expenses in selling the goods and losing potential customers and a share of the market.

The strict compliance rule requires the seller to present a set of documents mentioned in the letter of credit in order to claim payment for the goods sold. The principle of strict compliance comes into application during the process of checking the documents when they are presented to the bank for payment. In this process, only the bank is allowed to examine and decide whether or not the documents submitted are complied with the terms contained in the credit. Alan Davidson describes the strict compliance rule as the legal principle that provide authority to the banks to reject documents which do not strictly comply with terms of the of credit⁴³. In addition, this rule ensures that it protects all the parties to the credit as long as they comply with the terms stated in the letter of credit.

Especially, this principle will protect the buyer who does not have an opportunity to examine the goods he bought physically and does not see the process of loading the goods in a port which may be thousands of miles away from his country. Therefore, the documents mentioned in the credit are the only security which the buyer can rely on. Those documents can assures the buyer that the right goods have been shipped which are described in the sale contract.

In the same manner, this principle also protects the seller by ensuring that he receives the quick payment if he complies in accordance with terms of the credit. Once he complies under the credit, he does not have to wait until the byer receives the goods to claim the payment. However it is mandatory that, the presented

⁴³ Alan Davidson, 'Commercial Laws in Conflict – An Application of the Autonomy Principle in Letters of Credit', 6th INT'L TRADE & BUS. L. ANN. 65 (2001).

documents by the seller must reflect the right details of the goods which the buyer has ordered.

In addition to the above mentioned two parties, it is very clear that the banks' interest are also protected under this concept. The bank under protection from any legal repercussions when the decision of making the payment to the seller was made after adhering to this rule at examination of documents. The bank can disregard the condition of the goods that have been shipped as it is not their concern and they should only determine whether the documents that are required have been submitted and are in order. Bankers are not experts in the fields selling goods and shipping. Therefore, it cannot be expected them to know the every elements the goods and service business. For example in **J H Rayner & Company V Hambros Bank** it was revealed that, 'Coromandel groundnuts' is also known under the trade name of 'machine-shelled groundnuts kernel'⁴⁴, which the banker did not know at the time of examination of the documents. Lord Denning in his judgement made in **Power Curber International v National Bank of Kuwait SAK**⁴⁵ explained this principle succinctly, that in majority of cases, the banks do not even pay attention to the fact that what types of goods are transacted between the seller and the buyer. Therefore, even in an event that, there is a claim about the quality or quantity of the goods delivered, the buyer cannot come after the bank and the bank cannot be held liable for realising the payment to the seller when the documents presented are in compliance with the terms of the credit. In the light of above, it is settled that the banks are not required to have an assurance from the seller that the goods have been delivered to the buyer and it is not the bank's duty to be interested in ascertaining the contents of the shipment.

2.2 How strict should the compliance be?

The most controversial issue related to the application of the strict compliance rule in letters credit is the way of identifying the parameters that meet the right standards of compliance. Generally, the standards of compliance are recognised under two categories, namely as the **Literal** Compliance and the **Substantial** compliance standard.

This Literal compliance standard requires a 100% picture perfect compliance. However, this compliance pattern has often attracted criticism as it can lead to a situation where an honest beneficiary can be denied of payment due to trivial error in a document which does not do any harm to the performance of the sale contract. Under this pattern of compliance, missing a comma or an asterisk can be considered as material that allows the bank to reject the document as non-compliant. On the

⁴⁴ (1943) K. B. 37 (C.A.)

⁴⁵ (1981) 2 Lloyds Law Report 394

bright side, the literal compliance pattern gives an advantage by making sure, that the seller has shipped what the buyer has requested, before the buyer becomes obligated to pay. It must be noted that, there may be instances that, though the presentation of the document confirms complying standard, it may not reflect that fact that seller has shipped the right goods that have been ordered under the sales contract⁴⁶. For an instance, the seller in collusion with the shipping company can provide forged documents.

The adoption of the Substantial compliance pattern means that, the acceptance of documents as complying when they are considerably in compliance with the requirements of the credit. In this scenario, as Professor Boris Kozolchyk describes⁴⁷, 'the issuing bank is expected to accommodate as a trusted financial institute rather than an investigator who finds reasons for dishonour the payment. The banks are required to possess with knowledge to calculate the impact of the non-complying document as far as the performance of sales contract is concerned'.

It is certain that, the Substantial compliance standard enables banks to exercise its discretion in the document examination process protecting its loyal customers from the threat of non-payment on trivial errors in the submission. However, the negative effect of this pattern is that, it can harm the certainty factor which associates with document examination. For example, banks may adopt various standards to demarcate the line between these two standards. This situation imposes a heavy burden upon banks to determine the minimum requirement which can fulfil the elements for the substantial compliance standard.

2.2.1 The Courts' approach

Traditionally, the requirements for compliance have been interpreted in strict manner by the courts in England. Irrespective of the provisions of the UCP, the English courts decisions were mostly made in favour of the 'strict compliance rule'. The leading case related to the principle of strict compliance is the decision made by the House of Lords in **Equitable Trust Company of New York v. Dawson Partners**⁴⁸, which is often described as the main authority on the principle of strict compliance under English law.

In this case there was a dispute between parties over an agreement to sell Vanilla. The seller was located in Batavia and the letter of credit was issued by the defendant

⁴⁶ Lee W Dellas, 'Letters of Credit: What does revised article 5 have to offer to Issuers, Applicants and Beneficiaries?' (1996) Commercial Law Journal, Vol. 101 Issue 3, at 29 of 234

⁴⁷ Boris Kozolchyk, U.C.C. Article 5 Symposium: Strict compliance and reasonable documents checker, (1990) 56 Brooklyn Law Rev. 45 available at www.lexisnexis.com

⁴⁸ (1927) 27 Lloyd's Law Rep.49

at the request of the buyer who was the plaintiff. Under the terms of the credit, the seller was required submit a set of documents including the bill of lading and a certificate of quality issued by '**experts who are sworn brokers**' to claim the money on the credit. However, there was a miscommunication between the issuing bank and the advising and the telegraphic message was read as 'quality certificate to be issued by '**expert who is sworn broker**'. After receiving the confirmation, the seller shipped the goods to the buyer and upon successful presentation of document, he received payments from the bank. However, the documents submitted to the bank contained only one expert's certificate.

When the seller received the goods, he discovered that more than 99% of the goods contained waste. When this matter came to court, the House of Lords stated that, the defendant bank is not entitled to receive the payments from the plaintiff as the defendant has breached one of the fundamental conditions which was to obtain a quality certificate from '**experts who are sworn brokers**'. Making finance available on a quality certificate issued by an expert who was a sworn broker indicates that bank has acted against the instruction of the credit.

Lord Viscount Sumner speaking for the House of Lords said:

'There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines. The bank's branch abroad, which knows nothing officially of the details of the transaction thus financed, cannot take upon itself to decide what will do well enough and what will not. If it does as it is told, it is safe; if it declines to do anything else, it is safe; if it departs from the conditions laid down; it acts at its own risk.'

The approach described in the above statement of Lord Sumner was reaffirmed by the judgment made in **Scottish and Australian Bank Ltd V. Bank of South Africa**⁴⁹, in which it was held that,

'When a person who ships relying on terms of the credit, must follow the exact requirements of compliance provided in the terms, the banks are not under obligations or entitled to accept drafts if those drafts are not accompanying documents in strict accord with the letter of credit'.

In addition to that, a decision made in **Fidelity National Bank V Dade County**⁵⁰ illustrates that, the American Courts also, in equally convincing language affirmed the substance of the judgement delivered in Equitable Trust Co. of New York V Dawson Partners Limited. Judge Schwartz stated that;

⁴⁹ [1922] 13 Lloyd's Law Rep 24

⁵⁰ (1979) 371 S0.2d 545

‘Compliance requirement under the terms of a letter of credit is not like pitching horseshoes. No points are awarded for being close’.

Even under the regime of the UCP 500, the courts, on some occasions, have tended to interpret the rule strictly. For example, both the banking community and sellers in international trade were concerned over the impact of the Court of Appeal decision given on 8 of November 1995 in **Glencore International AG & Bayerische Vereinsbank V Bank of China**⁵¹.

Glencore, as sellers of two batches of aluminium ingots, presented documents under two separate letters of credit issued by the Bank of China for the bank's Chinese customer, a Chinese trading corporation. The credits were subjected to UCP 500.

The Bank of China rejected the documents presented by Glencore (through its bankers, Bayerische Vereinsbank AG) on, *inter alia*, the ground that a beneficiary's certificate required under the terms of the credit was not marked as 'original'.

The document in question had been generated by the seller's word processor and it was copied many times after that. One copy was signed by the seller to submit to the bank for examination. However, it did not bear the word 'original' but bore an original signature in blue ink.

The Court of Appeal upheld the rejection by Bank of China of the document on the basis of the provisions provided in UCP500⁵², which states that documents produced or appearing to have been produced by "reprographic, automated or computerized systems" will only be accepted as original documents if marked as original. The court, in the judgment stated that, the signature appears in the document is irrelevant in this respect irrespective of the fact that it appears to be genuine.

Sir Bingham M.R in his conclusion, speaking for the Court of Appeal stated that "article 20(b) of the UCP 500 requires documents produced in a certain way (whether original or not) to be treated in a certain way"⁵³. As an effect of the judgment, such documents whether handwritten or manually typed must be marked as original and failing to adhere to this requirement may result in the paying bank being compelled to reject such documents and to refuse payment.

In the judgment, the Master of the Rolls stated that, the court was confident that the right decision has been made where the Court of Appeal finds difficulties to see

⁵¹ [1996]1 Lloyd's Rep 135

⁵² Article 20 of UCP 500.

⁵³ [1996]1 Lloyd's Rep 153

otherwise. As a result of such decisions made by Courts, the vague⁵⁴ nature of Article 20 of the UCP 500 was the subject of urgent discussions by the International Chamber of Commerce Banking Commission. As an outcome of these discussions the ICC issued a policy statement⁵⁵ which is now reflected in Article 17 of the UCP 600⁵⁶.

The judgment made in the above mentioned Glencore case was scrutinized in the judgment made in **Kredietbank Antwerp V Midland Plc**⁵⁷ where it was stated that, a document which was clearly an original document, in the sense that it contained the relevant contract, and which was not itself a copy of some other document, was not precluded from being an original document for the purposes of the Uniform Customs and Practice for Documentary Credits, 1993 revision, ICC Publication No 500, because it had been produced by means of a word processor and printer.

In this case, the Midland had opened a letter of credit through Kredietbank. The buyer was Karaganda Ltd. The terms of the letter of credit, which was subject to the Uniform Customs and Practice for Documentary Credits, 1993 revision, ICC Publication No 500, (UCP 500), required, inter alia, an "original insurance policy or certificate".

The documents tendered were in fact the original and duplicate of the policy. Both documents bore ink signatures. There were two documents because one of the express insurance conditions provided: "This policy is issued in original and duplicate, one of which to be accomplished, the other to stand void." One document was stamped "DUPLICATE". The other bore no equivalent marking.

The duplicate was a photocopy of that document. Midland refused to accept the original document, notwithstanding that it was the original, because it was not marked "original" as required by article 20(b) of UCP 500. On that ground, inter alia, Midland refused to indemnify Kredietbank.

⁵⁴ Over a period of several years there have been a number of queries raised with the ICC Banking Commission as to the determination, by banks, of what is an "original" document under a letter of credit and the necessity, if any, for such a document to be so marked : 'The determination of an "original" document in the context of UCP 500 sub-article 20(b)', page 1, (July 12 1999) ICC publication, available at <<http://www.iccmex.mx/uploads/banca/posturas/The-determination-of-an-Original-document-in-the-context-of-UCP-500-sub-Article-20-b-.pdf>>, accessed on 14 January 2015

⁵⁵ 'The determination of an "original" document in the context of UCP 500 sub-article 20(b)', , (July 12 1999) ICC publication, available at <http://www.iccmex.mx/uploads/banca/posturas/The-determination-of-an-Original-document-in-the-context-of-UCP-500-sub-Article-20-b-.pdf>, accessed on 14 January 2015

⁵⁶ Article 17(c) of the UCP 600, "unless otherwise indicated, bank will also accept a document as original if it appears to be written, typed, perforated or stamped by the document issuer's hand or appears to be the document issuer's original stationary or state that it is original, unless the statement appears not to apply to the document presented".

⁵⁷ (1999) 1 All ER (Comm) 801

The buyer brought separate proceedings against Midland disputing its own liability to indemnify Midland, and the judge found in favour of Kredietbank. Midland and the buyer appealed.

On the appeal it was submitted for Kredietbank, *inter alia*, that the two insurance documents clearly satisfied the requirements of article 34 of UCP 500, namely that "insurance documents must appear on their face to be issued and signed by insurance companies or underwriters or their agents".

Midland contended however, that article 20(b), as interpreted in *Glencore v Bank of China* [1996] 1 Lloyd's Rep 135, meant inevitably that the documents failed to conform. The first document had been produced "by reprographic, automated or computerised systems" within article 20(b)(i) and so was subject to the proviso that it should be "marked as original", which it was not.

Lord Justice Evans said that the purpose of the rule now contained in article 20(b) of UCP 500, was clear. Previously, banks had been entitled to reject documents which were not originals. Henceforth they would accept certain documents which would previously have been rejected as non-originals, provided that specified safeguards were observed. That applied expressly to photocopies ("reprographic systems") and to carbon copies. Those were by their nature copies of some other document which was their original.

A document which was clearly the original, in the sense that it contained the relevant contract, and which was not itself a copy of some other document, was certainly an original for the purposes of the rule.

In the present case, the first insurance document was clearly the original policy and was not a copy of some other document, nor did it appear that it might be a copy document. Kredietbank had, accordingly, been entitled to accept the document tendered as the original insurance policy, and Midland had been wrong to reject the payment.

The above mentioned issue discussed again in the case of *Credit Industriel et Commercial v China Merchants Bank*⁵⁸, where the China Merchant refused the documents citing discrepancies and refused to make payment under the letter of credit. In their refusal, China Merchant, *inter alia*, claiming that the Credit Industriel has failed to tender an original of the packing list, certificate of quantity and certificate of quality.

The documents tendered had the seller's name, address and telephone number stamped on the document and an ink signature applied to them. However, the documents were not marked with the word 'original'. There was no evidence before the court as to how the documents were generated. The court found that the document, while not appearing to have been produced on a typewriter, could have been produced by a computer-controlled printer and also could have been a photocopy.

⁵⁸ (2002) 2 All ER (Comm) 427

At the appeal, China Merchant relied upon the above mentioned *Glencore v Bank of China* in support of their argument that the documents presented were discrepant. In contrast *Credit Industriel* relied upon *Kredietbank Antwerp v Midland Bank Plc* in support of its argument that the documents presented were not discrepant.

The court stated that, sub-article 20(b) widened the categories of acceptable documents from original documents to include documents produced in the manner specified in the sub-article provided that such documents are marked original and signed. Accordingly, the court held that there was no requirement that original documents, even if produced by the means specified in the sub-article, had to be marked original.

On the facts of the case, the court found that the document presented was clearly an original document, albeit generated by an automated or computerized system, and that there was no need for it to be marked original.

In his judgment, Mr Justice Steel had to synthesize and apply the principles of both *Glencore* and *Kredietbank* to the facts of the case. He reached the conclusion that the ratio in *Glencore* was 'directed to the treatment of documents appearing or known to be copies or, in some analogous respect, of a class not prior thereto treated as originals'. In reaching such a conclusion, the judge seemed to prefer the express reasoning contained in the *Kredietbank* decision.

The evidence before the court was that the documents in the present case would have been treated as originals prior to the introduction of UCP 500. Therefore, the documents were not required to conform to the requirements of sub-article 20(b) and were not, therefore, discrepant.

The judge concluded that, 'a complaint that could be made of *Kredietbank* was that it 'established an unworkable distinction between documents produced by electronic means which were obviously original and those which were not'.

This is a landmark case on documentary credits. It resolves a serious tension between the competing Court of Appeal authorities of *Glencore* and *Kredietbank*.

However, contrary to the above position taken by the courts, there are some instances where the strict compliance rule has not been adopted by the courts in such a strict manner. A lenient approach to the above rule was taken in ***Midland Bank V Seymour***⁵⁹, where it was held that, the compliance may be gauged from all the documents providing each is correct and complete in itself and documents are consistent with each other.

In this case, the seller, a Hong Kong company, sold a cargo of duck feathers to the defendant, a British importer. Payment was expected to be made by way of a letter of credit against the presentation of the documents consisting of the bill of lading, the invoice, and the certificate of origin.

⁵⁹ [1955] 2 Lloyd's Law Rep 147

The tendered documents as a whole provided all details relating to the price, weight and condition of the goods and both the bill of lading and the invoice gave the shipping mark. The bill of lading, however, noted the cargo as 12 bales Hong Kong duck feathers, where the invoice described the goods as 'Hong Kong duck feathers – 85% clean' and gave the quantity of the goods as '12 bales each weighing about 190 lbs. At the same time, the letter of credit was also unhelpful and its words were ambiguous as to whether the defendant required particular details to be contained in any particular document or in the documents as a whole.

The court held that, the bank has acted lawfully in deciding to pay against such documents providing that each documents, in itself, was valid and that, **taken as a whole**, the documents were consistent with each other. There would be sufficient compliance with the letter of credit, if the wording of the bill of lading contained a proper description of goods.

It is also important to mention that, in terms of the provisions provided in the UCP 500, it was permitted to have margin of error with regard to the quantity of goods and the contents of documents tendered⁶⁰.

The above approach of considering all documents together rather than separately has been approved by the court as a practical and sensible approach in the decided case of **Midland Bank Ltd v Seymour**⁶¹. In this case a merchant in England bought a quantity of ducks feathers from seller in Hong Kong. In the letter of credit, the instructions to the bank were that the documents had evidence 'shipment from Hong Kong to Hamburg of the undermentioned goods', and then, under 'Description, Quantity and Price' it was stated 'Hong Kong duck feathers- 85% clean; 12 bales each weighing about 190 lb.; 5s per lb'. The bill of lading described the goods merely as '12 bales; Hong Kong duck feathers, but all the documents, namely the bills of lading, invoices, weight account and certificate of origin, when read together, contained a complete description of the goods. The seller had shipped worthless goods and the buyer claimed that the bank was not entitled to debit him with the credit since the bill of lading did not contain a full description of the goods. However, Devlin J. rejected this claim and held that the bank had complied with its mandate.

The judgment made in the above-mentioned case was approved by McNair J. in **Soproma SpA V Marine & Animal By-Products Corp**⁶². In this case, the terms of the credit required that the bill of lading should state at the moment of loading of the goods the temperature does not exceed 37.5 Celsius and thus, the freight collect bill of lading showed the temperature as 100 Fahrenheit which was 5% above the required limit. The court held that this was a discrepancy in the tender after taking into account all the facts stated in the entire documents tendered.

⁶⁰ Under the provisions of articles 39(b) and 37(c).

⁶¹ (1955) 2 Lloyd's Law Rep 147

⁶² (1966) 1 Lloyd's Law Rep 367.

In the light of above-mentioned decided cases, it is transpired that, most of the courts have preferred to apply strict standards when deciding the requirement for compliance. However, there are reported instances where the courts have shown some flexibility when defining the compliance rule. This is evident from the above mentioned cases where the court relaxed the strict aspects of the rule allowing deviations which would not do any obvious harm⁶³.

However, entrusting courts to define the rule entirely irrespective of the guidelines provided by the UCP can render uncertainty over the application of the rule. Roy Goode criticises this situation pointing out, that, the judicial pronouncement on document examination standards bears an unavoidable danger. It allows courts to consider various options beyond the actual legal requirements. He claims that, this situation has occurred due to the failure of providing 'objective factors' to the rules of UCP⁶⁴.

From the observation made above, the conclusion can be drawn is that, there has been a struggle to identify the right formula for standards for compliance required under the rules of letters of credit. This has led to a situation where different interpretations are used for the requirements for compliance.

2.2.2 Not to go beyond the documents

In determining whether the document are in compliance with the terms of credit, the banks are required to stick with the presented documents and not to go beyond what they have been presented with. In addition to that, as reflected by decided cases which related to the principle of strict compliance, it transpired that, the courts do not expect banks to have thorough checks on the authenticity of the documents submitted. For example, in **Gian Singh v Banque de l' Indochine**⁶⁵, it was stated that the bank was not under obligation to check the authenticity of documents under the strict compliance rule.

In this case, payment under an irrecoverable documentary credit was to be made against documents which included a certificate signed by one 'Balwant Singh who was a holder of a Malaysian passport. The Bank accepted the documents presented for examination and made the payment against them. The applicant then went to

⁶³ Kyle Roane, 'Hanil Bank v PT. Bank Negara Indonesia (PERSERO): CONTINUING THE QUANDARY OF DOCUMENTARY COMPLIANCE UNDER INTERNATIONAL LETTERS OF CREDIT' (2004), 41 Houston Law Review 1053. Available at www.lexisnexis.com accessed on 22nd April 2015.

⁶⁴ Roy Goode, 'Abstract Payment Undertakings and Rules of the International Chamber of Commerce' (1995), 39 St. Louis Law Journal 725. Available at www.lexisnexis.com, accessed on 22nd April 2015

⁶⁵ [1974] 2 Lloyd's Law Rep 1

court against the issuing bank on the ground that the certificate was a forgery. Whilst dismissing the applicant's claim, Lord Diplock stated that;

'the fact that, a document presented for examination under a letter of credit is in fact forgery does not prevent the bank from recovering from the seller as long as the document in question fulfils the requirement of the credit. The bank's responsibility is limited to examine the document with reasonable care to find out that the document in question is on its face appeared to be complying with the terms of the credit'.

The question is whether the above mentioned approach taken by the court can diminish the effect of fraud rule which has been recognised by courts for many years. The UCP always maintains the position that, the credit are separated from the underlying contract and performance of the contract will not be questioned by the bank. In that, aspect, the UCP clearly expects banks to confine their examination only to the document presented by the beneficiary. Any doubt cast regarding possible fraud will be decided by the court and not by the bank.

2.2.3 Conclusion

It must be acknowledged that finding the right formula⁶⁶ to apply in the examination process to find out whether the documents are in compliant with the terms of the credit, is not an easy task. The fact that the producer of the document would be in one country and the document checks would be done in another country certainly would not help this case. Therefore, the UCP, as the main authority should have taken the initiative to build a right formula as it associates with most of the commercial contracts. However, one draws the irresistible conclusion that they have failed to find an acceptable solution for this controversial issue and therefore, uncertainty over the examination process remains the same even after many revised editions of the UCP.

The ICC should concentrate on finding the right path to address this issue. They should decide whether they should or should not focus on the strict compliance rule as opposed to focusing on the substantial compliance rule. The criticism is that over the years the ICC has been unsure about their stance and this is evident from the various methods they have adopted and tried out in different editions of the UCP.

Therefore, it can be suggested that, as a first step, it is vital to identify the right manner of addressing this issue and then, upon that understanding, to progress gradually to build up the right formula to overcome this longstanding issue.

⁶⁶ A well-defined strategy for the examination process, ability to implement it to all types of cases and universal applicability.

The next subchapter of this thesis will be dedicated to discuss further the position taken by the UCP over issues of the document examination process with the purpose of focusing to find a right formula to apply when deciding whether the documents are compliant or not.

2.3 Standards of compliance under the UCP 500 and 600

2.3.1 Introduction

A research carried out by the International Chamber of Commerce (ICC) suggests that, in recent years, as many as 70% of documents presented for examination under letters of credit were found discrepant or exhibited inconsistencies from negotiated terms and deemed insufficient to allow payment to proceed⁶⁷. The current version, UCP 600 was ratified by the ICC Committee aiming, *inter alia*, to find answers for problems relating to documents compliance standards and the discrepancies in documents which were associated with the application of the UCP 500. As described by the ICC, one purpose of bringing the UCP 600 was to create a proper mechanism that can help to reduce the amount of rejected documents that often occurred due to discrepancies. The Drafting group of UCP 600 considered the high volume of rejections due to discrepancies found in the seller's documents under the regime of UCP 500 to come up with new version in 2007.

In contrast to what has been said by the ICC and the various views and comments expressed on the current version of the UCP which is considered as more customer-friendly and rich with easy to use terms compared to the earlier version of the UCP, this research will be aimed at analysing those comments to find out whether the law relating to the strict compliance rule remains the same under both the UCP 500 and 600 regimes.

2.3.2 The UCP approach

It is important to note that, despite being one of the fundamental issues associated with letters of credit, the phrase of the principle of 'Strict compliance' have not been contained in any version of UCPS that have been published⁶⁸. Therefore, the guidance provided in the UCP with regard to the level of compliance required was often subject to different interpretations. Consequently, various standards have been adopted by courts when defining the required level of compliance. On perusal of all

⁶⁷ International Chamber of Commerce, ICC Response to the Basel Committee Consultative Document on "Strengthening the Resilience of the Banking System," annex 1(A), ICC Document No. 470/1139 (April 16, 2010) at 4

⁶⁸ Mehta Ravi, Does UCP 600 soften or end the doctrine of Strict compliance?, LC Views, Newsletter No.101, March 2007, available at <www.lcviews.com/LCVIEWS_PDF/LCVIEWS101.pdf> accessed on 18 March 2014

the revisions, from its inception, the approach taken by the UCP on this regard has been varied from one revision to another. The reason behind such irregularity may be based on the fact that, if the UCP is to provide exact guidelines for compliance, it may lead to a situation which would create more complications and litigation. It is important to understand that, the parties involved in letters of credit transactions come from different legal, cultural and geographical backgrounds. The circumstances related to one letter of credit can be different from another and therefore, it is not practically possible to have uniform and exact set of guidelines for compliance.

In view of the above circumstances, it is clear that the UCP 600, including its predecessors, have attempted to maintain a reasonably clear distance from the 'strict compliance rule' when drafting the documents complying standards. The current version has introduced⁶⁹ a standard called "complying presentation" which has been interpreted in Article 2 and it, to some extent, defines the compliance requirement under the UCP. It must be noted that, as there were no sufficient standards or parameters provided by any revisions prior to the UCP 600, the burden of determining the requirements, which meet the standards of compliance in documents, mostly remained with the courts.

In comparing the provisions provided in relation to the documents examination standards some major differences can be identified under the two regimes. Article 13 of the UCP 500 sets out the standards for examination of documents in Letters of Credit;

Standard for Examination of Documents

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.

Documents not stipulated in the Credit will not be examined by banks. If they receive such documents, they shall return them to the presenter or pass them on without responsibility.

B. The Issuing Bank, the Confirming Bank, if any, or a Nominated Bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the

⁶⁹ Article 14(a) of the UCP 600.

documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.

C. If a Credit contains conditions without stating the document(s) to be presented in compliance therewith, banks will deem such conditions as not stated and will disregard them.

Under the UCP 600, article 14 covers the area which came under the purview of article 13 of the UCP 500.

Article 14 Standard for Examination of Documents

a. 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.

b. 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* 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.*

c. A presentation including one or more original transport documents subject to articles 19, 20, 21, 22, 23, 24 or 25 must be made by or on behalf of the beneficiary *not later than 21 calendar days after the date of shipment as described in these rules, but in any event not later than the expiry date of the credit.*

d. Data in a document, when read in context with the credit, the document itself and international standard banking practice, *need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit.*

e. In documents other than the commercial invoice, the description of the goods, services or performance, if stated, may be *in general terms* not conflicting with their description in the credit.

f. If a credit requires presentation of a document other than a transport document, insurance document or commercial invoice, without stipulating by whom the document is to be issued or its data content, banks will accept the document as presented if its content appears *to fulfil the function of the required document* and otherwise complies with sub-article 14 (d).

g. A document presented but not required by the credit will be disregarded and may be returned to the presenter.

h. If a credit contains a condition without stipulating the document to indicate compliance with the condition, banks will deem such condition as not stated and will disregard it.

i. A document may be dated prior to the issuance date of the credit, *but must not be dated later than its date of presentation.*

j. When the addresses of the beneficiary and the applicant appear in any stipulated document, *they need not be the same as those stated in the credit or in any other stipulated document, but must be within the same country as the respective addresses mentioned in the credit. Contact details (telefax, telephone, email and the like) stated as part of the beneficiary's and the applicant's address will be disregarded. However, when the address and contact details of the applicant appear as part of the consignee or notify party details on a transport document subject to articles 19, 20, 21, 22, 23, 24 or 25, they must be as stated in the credit.*

k. The shipper or consignor of the goods indicated on *any document* need not be the beneficiary of the credit.

l. A transport document may be *issued by any party other than a carrier, owner, master or charterer* provided that the transport document meets the requirements of articles 19, 20, 21, 22, 23 or 24 of these rules.

Although the strict compliance rule had not been spelt out in the UCP, article 13 (a) of the UCP 500 provided some guidelines in relation to the examination of documents. It recognised that the compliance with the terms of credit must be determined in accordance with 'international standard banking practice. Under the UCP 500, the concluding words of article 13 (a) "as reflected in these Articles" were not thought to confine banks solely to the standards embedded within the UCP itself and reference to the UCP could be supplemented by considering the standard practice rules established by financial institutions in particular regions⁷⁰. Thus, article 14(d) of the UCP600 appears to establish the same effect by making reference to "international standard banking practice". It is clear that, the UCP 600 revision does not amount to a dramatic overhaul of the UCP 500 as far as examination of documents is concerned. The underlying structure, obligations and principles which are fundamental to examination rules remain untouched. The only difference is, by the time of introduction of the UCP 500, there was no regulated and codified International Banking practice. The International Standard Banking Practice (here in after referred as the ISBP) was introduced in the year of 2002 and it was 9 years after the codification of the UCP 500.

⁷⁰ Commentary on UCP 600, by the UCP Drafting Group, ICC publication, (Publication Number 680E, 2007) page 16

When it comes to comparison of both article 13 of the UCP 500 and article 14 of UCP 600, it is vital to discuss key elements which govern the paying bank's liability in relation to examination of documents.

2.3.3. The documents should be complied with on their face

Article 13(a) of the UCP 500 required banks to examine the documents to ascertain whether “on their face” they appeared to comply with the terms and conditions of the credit. However, the exact meaning of the phrase “on their face” was controversial. This phrase appeared in a number of different Articles in the UCP 500 and the meaning was varied according to the context in which it was found. It is clear that, in relation to examination of documents, it should be confined to the fact that, the banks' examination is confined to the documents alone. This led to a situation which, in the past, some banks have assumed that they must simply pay regard to the front page of the document. Therefore, the general thrust of the UCP 600 revision was to reduce this uncertainty by removing vague or ambiguous phrases. According to ICC drafting group,

“It had been suggested that the phrase was redundant and should be removed entirely from the new draft. However, the eventual consensus was that it should be retained in relation to examination of documents in Art.14, but that it should be removed from all other provisions in the UCP 600. The Phrase’ as it is used in relation to the examination of documents, was seen to be well established concept understood by those in the legal profession and experienced documentary credit practitioners. The concept ‘on their face’ does not refer to simple front versus back of the document, but extends to the review of data within a document in order to determine that a presentation complies with international standard banking practice and the principles contained in UCP. Because the term remained in the UCP in relation to the examination of documents in general, the drafting group did not see any reason to repeat it in other articles, as was the case in UCP 500. Banks are not obliged to go beyond the face of a document to establish whether or not a document complies with a requirement in documentary credit or with any requirement in the UCP⁷¹.”

2.3.3.1 Vagueness and Uncertainty

Retaining of the words of “on their face” can still constitute a great uncertainty as to

⁷¹ ICC publication, Commentary on UCP 600, ICC publication, (Publication Number 680E, 2007) page 62.

whether the banks should act to avoid reliance of such general principle and rely on positively identifiable discrepancies. In an event where the documents “on their face” appears to correspond with the requirements in credits and thus still holds minor discrepancies, the precise manner to identify whether the banks have acted duly can probably be questioned. On the other hand, the documents are “regular on their face”, but do not comply with bank’s knowledge of custom of trades and it finances, the natural law concept of “due diligence” can make a situation which banks are unsure of what decision they should make. The similar view was discussed in **J H Rayner & Co v Hambros bank**⁷² and it was held that, deciding whether the document is in compliance, a bank should not be affected with knowledge of customs of the many trades that it finances. In this case, the letter of credit needed the consignment to be described as “Coromandel Groundnuts and thus, the bill of lading described it as Machine Shelled Groundnut Kernels’ which gives the same meaning in its trade. However, the bank refused to accept the document and at the court it was stated by MacKinnon LJ;

“the bank must do exactly what its customer requires it to do and if the customer says “I require a bill of lading for Coromandel groundnuts, the bank is not justified in paying against a bill for anything except Coromandel groundnuts.”

Similarly, the concept of strict compliance followed in many courts’ decisions could come into question if the banks are to rely merely upon the phrase of “on their face”. As justice Viscount Sumner stated in **Equitable Trust Co of New York v Dawson Partners Ltd**⁷³;

“the accepting bank can only claim indemnity if the conditions on which it is authorised to accept are in the matter of the accompanying documents strictly observed. There is no room for documents which are almost the same, or which well do just as well.”

Irrespective of the fact that, what have been written in the UCP, the proposition of “regular on their face” should not lead to a situation where it creates more controversies or leads to litigation. This position was cited in **M Golodetz & Co In v Czarnikow Ronda Co Inc**⁷⁴ where it implicated that, vagueness of the term is vulnerable to different interpretation in different jurisdictions.

The main issue still remains even after the introduction of the UCP 600 as it has failed to provide a crystal clear interpretation of the phrase “on their face”. It is yet to issue clarifications on;

⁷² (1943) 1 K B 37

⁷³ (1927) 27 Lloyd’s Law Rep.49

⁷⁴ (1980) 1 W LR 495

- a) Whether the documents should match each other word to word
- b) Must the whole of each of the documents obviously relate to the same transaction, that is, should each bear a link with the others on its face?⁷⁵
- c) Whether the documents should simply contain features that are consistent with each other.

In order to answer the above question, the only helpful link available is the ICC drafting group's publication of "Commentary on UCP 600" which states that,

"the concept of on their face does not refer to a simple front versus the back of the document but extends to **review** of data within a document in order to determine that a presentation complies with **international standard banking practice and the principles contained in UCP. Banks are not obliged to go beyond the face of a document** to establish whether or not a document complies with a requirement in documentary credit or with any requirement in the UCP."

2.3.3.2 Testing bank's own judgment.

It is clear that, the wordings of "on their face" tend to discourage the practice of strict compliance which was liberally used by the courts. As explained in the Commentary on UCP 600, 'the phrase "on its face" does not mean the front as opposed to the back of a document. Rather the phrase indicates the review of a document in line with international standard banking practice and the features of the document itself⁷⁶.' Therefore, the phrase of 'on their face' deviates from the rigours requirement embedded in the strict compliance rule.

The controversial debates and litigations still remain over how strict the compliance must be. While the bankers are not expected to oblige to consider how relevant the discrepancies may be, the examination of documents still requires some judgment by the bank. It should not be a simple exercise of comparing each other. The requirements of exercising banker's own judgment was discussed in **Krediet Bank Antwerp V Midland Bank Plc**⁷⁷, where it was stated that,

"The requirement under the principle of strict compliance is not equivalent to the test of exact literal compliance in all circumstances and in respect of all documents. To some extent, therefore, the banker must exercise his own judgment whether the

⁷⁵ Issacs Michael, Michael Barnett, 'International Trade Finance - Letters of Credit, UCP 600 and Examination of Documents', J L B L R, Issue 12 (2007), Sweet and Maxwell and Contributors

⁷⁶ Commentary on UCP 600, Article-by-Article Analysis by the UCP 600 Drafting Group, page 62

⁷⁷ (1999) 1 All ER (Comm) 801

requirement is satisfied by the documents presented to him.”

For many years, there has been a considerable debate over how similar documents tendered must be compared to requirements in credits. Especially article 13(a) of the UCP 500 created clumsy uncertainties as it did not contain clear directions to overcome issues that may arise as a result thereof . The article says,

“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”⁷⁸.

The inconsistency mentioned in the above article, does not explain what type of consistency level is expected. On the face of the wording of the article, one can assume that the UCP 500 had expected the compliance level to be literal, because a margin of inconsistency can interrupt the consistency expected. As there was no any reference to minor inconsistency to be discarded, it can be assumed that the UCP 500 did not allow any discrepancy that can threaten the consistency level expected, irrespective of how trivial the discrepancy was. In contrast, the UCP 600 has been able, to some extent, to depict the required level of compliance. For examples, introducing of the term of ‘complying presentation and guidance provided in the ISBP 745.

2.3.3.3 Discouraging further investigations

As described in the Drafting Group’s comment, the review of data in documents need not be in the investigative form. It only requires ministerial review, which preclude the banker from exercising his own knowledge and expertise. However this view was questionable as it contradicts with the principle of natural justice. Banks are expected to stick with the presentation and not to exercise their knowledge to ascertain the truth. In **Bisker Vs Nations Bank NA**⁷⁹, it was held that, the bank’s refusal of accepting a photo copy of a bank note with an original signature which was presented as the 2nd attempt was lawful.

In this case, the Appellant (Bisker) entered into an agreement with Beer Distributing Company (BDC) to sell his interest in American-Potomac Distributing Company (AP). Bisker received a promissory note from BDC which was guaranteed by Stanley S. Bender. In return, Bisker received an Irrevocable Letter of Credit No. 1791 opened at Sovran National Bank, the predecessor in interest of Appellee Nations Bank. Bisker was also to receive a new promissory note in the amount of \$800,000 which was non-recourse and secured exclusively by the Letter of Credit. On or about that same

⁷⁸ Article 13(a) of the UCP 500

⁷⁹ 686 A.2d 561,565 (1996)

day, Bisker received what he believed was the original of the note, but in fact was a photocopy. The Letter of Credit, however, required by its express terms that demand for payment on the credit must be accompanied by, *inter alia*, "1. Original of the promissory note executed May 22nd, 1987, (the Promissory Note')."

When payment on the final instalment of the note was not made as promised, Bisker, demanded payment on the Letter of Credit by Nations Bank and the demand was refused, asserting that the promissory note accompanying the demand was not the original note but instead a duplicate photocopy. Bender, the original signatory, re-signed the copy of the note just above his previous signature. Bisker resubmitted the Letter of Credit along with the re-executed note, but NationsBank again refused the demand stating: "Original of the promissory note executed on May 22, 1987, not presented."

Bisker filed a lawsuit in Superior Court alleging breach of contract and breach of the implied covenants of good faith and fair dealing by Nations Bank. However, the court held that, as the Appellant has cited no decision where a variance of this size between the required original and a copy of the very instrument for which the Letter of Credit was secured has been deemed as a compliance with a letter of credit. Therefore, it was stated that the bank has properly rejected the presentment.

Given the above circumstances, the mere ministerial review of data in documents would always be sufficient and the greater amount of scrutiny is still required to determine to whether the documents are noncompliant. In that respect, it still is notable that, UCP 600 has not gone an inch beyond where it was at under the UCP 500.

However, it is salient to mention that, if the indication in the documents do not totally conform to the requirements under the letter of credit or if there is any indication of fraud or that they are not telling the truth, the bank may withhold payment or at least carry out further investigations. Indeed, the bank will be held responsible for its negligence if it transpired that the bank has ignored anything which can serve as a red flag despite the apparent good order of documents.⁸⁰

2.3.4 Documents need not to be identical

As often reiterated by the ICC, the revised version in the form of the UCP 600 was brought in to reduce the number of rejections of documents by banks and a Task Force of the Banking Commission of the ICC produced detailed standardised guidance for checking documents in the International Standard Banking Practice for

⁸⁰ Ebenezer Adodo, "A presentee bank's duty when examining a tender of documents under the uniform custom and practice for documentary credits 600", (2009) 24(11) JIBR 566, 578 available at www.lexine

the Examination of Documents under Documentary Credits (ISBP), which was approved on October 30, 2002. The ISBP articulated general principles, such as the fact that documents need not be identical, but should not be inconsistent, and provided specific guidance on matters such as the necessity of a signature on a particular document.

In order to maintain the general aim of ICC, which is the reduction of the number of rejections, it has allowed the use of non-identical documents. Reference to international standard banking practice enlarges on what could pass as documents meeting the requirements of the credit.

Article 14 (d) of UCP 600 says;

“Data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit.”

This article is the equivalent to the most part of article 21 of the UCP 500. The ICC drafting group points out the reason behind this in their publication of Commentary on UCP 600 as,

“the essential concept contained in UCP 500 that data be not inconsistent with any other stipulated document has been changed to reflect that the data in a document, when read in context in the documentary credit, the document itself and international banking practice, does not need to be identical, but must not conflict with data in the same document, any other stipulated documents or the documentary credit..... , over the years, the approach by banks to documents that may deemed to be inconsistent with one another has been proved, in many cases, to be subject to misuse to a misinterpretation of the rule. When inconsistencies encompassed issues including simple typing and grammatical errors, banks frequently cited a significant number of discrepancies. However, calling many of these discrepancies was often unwanted⁸¹”.

Further, the drafting group states that they believe that the standards introduced in above sub-article would result in a reduction of discrepancies found in documents.

In the light of above provisions, it is important to find out what the International Standard Banking Practice adds to collaborate with the ICC drafting group’s position.

“Documents presented under a credit must not appear to be inconsistent with each other. The requirement is not that the data content be identical, merely that the documents not be inconsistent⁸².”

⁸¹ ICC publication, Commentary on UCP 600, ICC publication, (Publication Number 680E, 2007) pages 63 & 64.

⁸² *ibid*

2.3.5 Inconsistent documents contained in the presentation to be treated as non-Compliant

Article 14(d) of the UCP 600 eliminates the narrow interpretation⁸³ of the rule that provided cover for the inconsistent details in documents. The current position is that, although the documents appear to be not identical, if the data in the document are consistent with requirement in credit, it would satisfy the provisions provided by the UCP 600 and International Standard Banking Practice.

In other words, it indicates that when the contents of the documents do not contradict the conditions in the Letter of credit, the bank is expected to take up documents as compliant. The only requirement to be satisfied is that the content of the seller's documents "need not be identical, but must not conflict⁸⁴" with the data required by the letter of credit.

It is apparent that, this rule reduces the complexity presented by the strict compliance rule. It can be assumed that this article would help to minimise different approaches taken by examiners when discrepancies are contained in the content of documents. Discrepancies in contents are considered as the most vulnerable areas that lead to rejection of payment. Consequently, the application of this rule has relaxed the strict nature of documents examination standards.

Given this scenario, the bankers have received a greater degree of discretionary powers which would help to cut down high levels of document discrepancies and rejections⁸⁵. This clause, primarily serves to instruct document examiners against rejecting documents simply because of not being identical to each other or to the terms of the credit.

2.3.6 Banker to be an Expert?

With the previous versions of UCPs, the only test that the banks had to carry out was that, the particular document is consistent itself with the credits. In that aspect, the banker's role was rather easier as a bank could rely on the fact that the document in question does or does not match with the requirement of credits. However, Banks

⁸³ Article 13(a) of the UCP 500

⁸⁴ Article 14(d) of the UCP 500

⁸⁵ Roberto Bergami, 'Will the UCP 600 Provide Solutions to Letter of Credit Transactions?' (June, 2007), Vol. 3, No. 2, International Review of Business Research Papers, at 41-53.

are now required to use their expertise and knowledge to decide at what stage the data in the documents go inconsistent from consistent. In these circumstances, banks have more discretionary power in deciding the margins that make the documents comply with the terms of the credit. However, this discretionary power can drag banks into more legal battles as there is no guidance on limitations for using such powers. Therefore, in different jurisdictions, the powers vested on banks to decide whether the documents are compliant may be interpreted in different degrees.

It appears that the most of the legal experts are in favour of those changes and the lack of decided case under the UCP 600 on this aspect has made it difficult to evaluate whether the ICC has achieved its intended objectives.

The position described in sub-article (d), further applies in article 14 (e) of the UCP 600 that makes a banker's duty more flexible thereby allowing the goods in all documents except the commercial invoice, can be described in general terms and thus, it will not become contrary to the requirements in the credit.

2.3.7 Non stipulated documents in the credit that make the data inconsistent

The last part of the article 13 (a) of UCP 500, states that,

“Documents not stipulated in the Credit will not be examined by banks. If they receive such documents, they shall return them to the presenter or pass them on without responsibility⁸⁶”.

As compared to the above article, the same approach has been repeated in article 14 (g) of the UCP 600.

“A document presented but not required by the credit will be disregarded and may be returned to the presenter⁸⁷”.

The general presumption is that, a bank cannot refuse to pay to the beneficiary on the basis of documents presented which were not required under the terms of credits. As provided by the above provisions in both the UCP 500 and 600, the documents not required by credit will be disregarded and will be returned to the presenter. The reason behind this particular clause is explained by the Drafting group of the UCP as,

⁸⁶ Article 13(a) of the UCP 500

⁸⁷ Article 14(g) of the UCP 600

“Under the UCP 500, banks would return the additional documents to the beneficiary and were caught up in unnecessary correspondence as to why that course of action was taken when the UCP allowed banks to forward without responsibility.”

However, the current situation can raise some issues which the UCP 600 has failed to solve.

- a) If the non-stipulated document contradicts the details contained in required documents by credits? For an example: if the non-required document indicates that the goods shipped origin from another country contrary to credit which requires the country of origin to be where Seller resides.
- b) If the required document are inconsistent with the credit and thus, the non-required document completes compliance as a supplement.
- c) If the non-stipulated document indicates that the beneficiary is guilty of fraud as to the underlying transaction.

In all these scenarios, the UCP 600 is silent and it restricts the banks from using their own findings. However, it is vital to stress that, in all three of the above scenarios, in the interest of justice, a bank should be allowed to exercise its detective powers although most legal experts believe the opposite.

2.4 Reasonable Care Vs Complying Presentation

Under the provisions of article 13 (a), the bank was obliged to examine the documents with reasonable care. The phrase of “reasonable care” has been removed in the UCP 600 and it has been suppressed by the requirement of “complying presentation⁸⁸”.

The ICC drafting group explains, that

Sub article 14(a) of the UCP 600 differs from article 13 of the UCP 500, in that, as a result of the use of the definition of ‘complying presentation’. It requires that a presentation to comply with the terms and conditions stipulated in the credit, includes complying with the terms of UCP 600 indicated in the documentary credit, which in turn includes being in accord with international standard banking practice. The requirement to use ‘reasonable care’ has been removed and has been suppressed by these more comprehensive and precise requirements⁸⁹.

⁸⁸ Article 14 (a) of UCP 600, 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.

⁸⁹ ICC Publication, Commentary on UCP 600, (Publication Number 680E, 2007) page 62.

The complying presentation is described in Article 2 of UCP as,

“a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice⁹⁰”.

Under the concept of the ‘complying presentation’, the banks are required to refer the provisions of the ISBP 745 when carrying out the documents examination and the ISBP provides guidance on what will make a document is discrepant. The guidance provided in the ISBP relating to examination of documents will be scrutinized in Chapter 3.

2.4.1 Not to use reasonable care?

As a result of the above provisions, when examining the documents, one can argue that, the obligation of the bank to use reasonable care has been limited. Although, the phrase of ‘reasonable care’ has not been included in the UCP 600, it cannot be denied the fact that, banks are still required to be reasonably diligence when the examination is done.

Reasonable care can be described as, the degree of care which requires exercising in particular situation by the bank to handle letters credit transactions. This can be done by the reference to the facts of the case and the expertise of the document checker. It is clear that a higher level of skill and in-depth knowledge are required to be exercised by the document checkers. The “reasonable care” under the UCP came into contention in the above mentioned decided case of **Gian Singh Vs Banque de l’Indochine**⁹¹, where it was stated that, the checking of the appearance of documents, whether they are correct on their face, could satisfy the requirement of exercising reasonable care.

The court explains how the reasonable care is exercised,

“The duty of the issuing bank is to examine the documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit. The express provision to this effect in Article 1 of the Uniform Customs and Practice for documentary credits does no more than re-state the duty of the bank at common law. In business transactions financed by documentary credits, bank must be able to act promptly on presentation of the documents. In the ordinary case, visual inspection of the actual document presented is all that is called for. The bank is under no duty to take any further steps to investigate the

⁹⁰ Article 2 of the UCP 600

⁹¹ (1974) 2 Lloyd’s Rep 1.

genuineness of a signature which, on the face of it, purports to be the signature of the person named or described in the letter of credit⁹².”

According to the judgment made above, it is clear that, exercising of ‘reasonable care’ when examining the documents comes as an obligation not only from the rules of the UCP, but also as a requirement of Common law. Although, article 2 of the UCP 600 refers to a ‘complying presentation’ by reference to, inter alia, its accord with International Standard Banking Practice, the predominant international banking practice in turn arguably has its own duties of exercising reasonable care with respect to documentary examinations. Regardless of what has been stated in the UCP 600, examiners are required to follow the standard practice and to treat parties fairly. In view of that, it can be said that the application of ‘reasonable care’ is inevitable when the examinations are carried out and a slight deviation from using ‘reasonable care’ may result banks being liable for breaching their contractual obligations towards the parties to letters of credit. In conclusion, it can be said that, requirement of exercising ‘reasonable care’ is still remain as the same under the current rule.

2.4.2 Examiners’ duty is more scrutinized under the current rule?

When there is a question arisen over the conduct of the bank at the examination, the bank is required to provide necessary evidence to prove that it has exercised ‘reasonable care’. However, the mere fact that the bank acted with ‘reasonable care’ in accepting a document which normally would not furnish valid ground for bank to justify the wrong decision made at the examination. In **Basse and Selve v Bank of Australasia**⁹³, it was stated that, it was for the buyer to prove lack of care on the part of the bank. In this case the plaintiffs ordered a German bank to open a documentary credit in favour of one Oppenheimer, of Sydney, from whom the plaintiffs purchased a consignment of cobalt ore. The German bank ordered the defendants to advise the credit to Oppenheimer and to add their confirmation. One of the documents called for in the documentary credit was a certificate of quality by Dr. Helms. Oppenheimer tendered a certificate which, on its face, complied with the requirements of the credit and obtained payment from the defendants. The defendants, on their part, tendered the documents to the German bank who accepted them and reimbursed. It was later discovered that Oppenheimer shipped worthless goods which were different from the sample examined by Dr. Helms. The plaintiffs brought an action claiming payment back from the defendant. Dismissing the action, the court held that it was not the duty of the defendants "to verify the genuineness of the documents." Neither was it

⁹² *ibid*

⁹³ [1904] 20 TLR 431 (CA)

their duty to inquire from the shipping company if the goods had in fact been put on board the ship. It follows that whether the goods shipped comply with their description in the documents or not is immaterial. As long as the documents are regular on their face, it is not the duty of the banker to examine whether the goods are truthfully described in the documents.

The removal of 'reasonable care' has handed much greater responsibility to the bank that they should strictly stick to each and every requirement stipulated in credits when they scrutinize the documents tendered. Therefore, one can argue that, strict adherence to "complying presentation" theory has demanded much stricter approach when checking the document.

On the other hand, a bank will be held negligent if it ignores anything that can serve as a red flag despite the apparent good order of the documents. Although, the UCP 600 removed the provision according to which a bank had to act with reasonable care, there is no reason to think that the bank is no more under such an obligation, which is in fact a common law requirement.

2.4.3 Strict rule to be applied.

On a consideration of the above mentioned provisions, it is clear that under the complying presentation rule, the bank can make the payment only if the documents submitted fulfil the requirement of complying presentation. There is no any other elements which can substitute this requirement.

The main issue arising out of the comparison between the requirement of reasonable care under the UCP 500 and the complying presentation rule under the UCP 600 is that, in a case of a misspelling or typing error in the document, if the bank is to follow the complying presentation rule, the bank is bound to reject the document, if it does not conflict with the provisions of International Standards of Banking Practice. This precludes the bank from accepting the document with trivial discrepancies, irrespective of the fact that how much damage such discrepancy can cause to the whole transaction. This is the situation where the drafters of the UCP 600 intended to deal with. In such a case, it is clear on the one hand that although, the UCP 600 was brought into operation to minimize the level of rejection on payment, on the other hand it still expects strict adherence to the compliance rule.

Another example is when there is an ambiguity in the credit instruction despite of the fact that documents tendered are in the correct order. Adopting the complying presentation rule can easily lead to the rejection of documents while under the requirement to exercise reasonable care there would have been the possibility of accepting such documents as compliant. Lord Diplock in the decision made in

Commercial Banking Company of New York v Jalsard Private Limited⁹⁴, stated that,

"When the bank has received unclear instructions from the applicant, the bank does not violate any terms of the credit if it construe unclear instruction using reasonable sense. It does not matter the fact that, it may be under closer consideration deemed as an incomplete construction of the instruction which may have more preferred other meanings⁹⁵."

As mentioned in this case, banks can construct grounds to proceed with credit using their sense reasonably. It is not clear that, under the Complying presentation rule, the banks have such liberty to act on their own initiative beyond the clumsy instructions in the credit. Normally, under these circumstances, Banks would want to go ahead with the credit, especially, when the seller is one of their faithful customers. However, applying complying presentation standards mean that the bank would not want to risk their own judgment. They will be reluctant to make payment by accepting ambiguous instructions even under the assurance of "payment under reserve" or "payment against an indemnity".

Under the rule of complying presentation, the UCP 600 has failed to clarify the above issues although providing such clarification and/or authority would have kept refusals of payment or delays in processing to a minimum.

2.4.4 Examination by a third party?

The other contentious issue, calling of delegating document examination to an external party. It can be a person or an institute who has vast knowledge of international trade. This will relieve the bank from examination duties and it can solely relying upon the decision made by an expert. Since the expert concentrates only on examination of documents, the examination process can become more productive. However, it is necessary to remember the very object of a letter of credit – which is to provide a near fool–proof method of placing money in its beneficiary's hands when he complies with the terms of the credit⁹⁶. In the case of **Axxess, Inc. v. Rhode Island Hospital Trust National Bank**, it was stated that,

"The independence of the letter of credit from the underlying commercial transaction facilitates payment under the credit upon a mere facial examination of the

⁹⁴ (1973) A. C. 279

⁹⁵ 1973) A. C. 279 at 286

⁹⁶ Axxess, Inc. v. Rhode Island Hospital Trust National Bank, 1991 WL 146869 (D.Mass.), at 2.

documents; it thus makes the letter of credit a unique commercial device which assures prompt payment”.

On the hand, for many years, the uniqueness of letters of credit has been remaining due to the fact that, it is the banker’s duty to make the final decision. Taking away of banker’s duty of examination would harm this uniqueness. In the worst case scenario, the idea of having a third party can horribly go wrong because it can end up with adding another party to litigation process.

In addition, this process will be costly and time consumptive. It will not always be possible to find on expert in a particular trade field. In the light of that, it can be concluded that, handing the document examination process to third party may not be the wisest solution suggested.

2.4.5 ISBP to substitute ‘reasonable care’

Under the terms of the UCP 600, the phrase of ‘reasonable care’ which have a broad meaning have been substituted by the set of guidelines provided in the International Standard Banking Practice otherwise referred to as ISBP.

In the UCP 500, there was a reference⁹⁷ to the ISBP but by the time of the publication of the UCP 500, the said guidelines had not been introduced.

In fact, the ISBP was approved by the International Chamber of Commerce in the year 2002 which was 5 years after the introduction of the UCP 500. Therefore, during most of the applicable period of the UCP 500’ the ISBP did not play a vital role. However, it was intended to be a companion guide to the Uniform Customs and Practice (UCP) 500 which was still in operation by the time of launching the ISBP⁹⁸.

When the UCP 600 was brought into operation by the ICC, simultaneously, the ISBP was updated to align with the main rules. It was again revised in 2013 and the current version is in full operation as the ISBP 745⁹⁹.

⁹⁸ Article 13(a): 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.

⁹⁹ A Guide to International Standard Banking Practice (ISBP 745) available online at <http://www.mjhayward.co.uk/2015/08/12/a-guide-to-international-standard-banking-practice-isbp-745-2>, accessed on 2nd March 2015

The purpose of publishing the ISBP has been described as¹⁰⁰ providing guidance on:-

- a) alleviating and reducing discrepancy rates and improving liquidity flows
- b) using virgules (?) and commas, handling of copy transport documents, corrections and alterations to documents
- c) the language of credits, mathematical calculations, differentiating between originals and copies
- d) the important content to be included
- e) preparation of documents

However, despite the above mentioned aims, it is important to examine whether the guidelines issued by the ISBP are capable of replacing the requirement of “reasonable care” in the UCP which had a broad meaning. As mentioned above, the complying presentation requirement shall be completed when the presentation is regular on their face on the basis of the standards provided by the ISBP¹⁰¹. Therefore, the ISBP guidelines should be flaw proof to enable accomplishment of this task.

On a careful consideration of these guidelines, it can be identified that, some of the sections in the ISBP do not appear to meet the required standards. For example, the paragraph in the ISBP relating to Typographical errors and/or misspellings in the name or the address in the documents submitted to the Bank says, *Misspellings and/or typing errors that do not affect the meaning of a word or the sentence in which it occurs, do not make a document discrepant*¹⁰². However, it is not easy to find out the meaning, when it comes to a name of a person or a place. Especially, the name in question may not familiar to the examiner and may be a foreign name. For the sake of argument, if we take two names such as London and Mumbai, in an instance where the examiner is based in the UK. If the word London was misspelled as Londen, he will be able to understand despite the mistake and infer the meaning of the word as London. However, if the word Mumbai was misspelled as Munbai, the examiner in the UK may not be 100% confident that the two words give the same meaning. It may be assumed by the examiner that there may be a different port of destination called Munbai. Therefore, the solution provided by the ISBP does not provide a clear formula for an issue such as this.

In the light of the above, it is clear that the ISBP has failed to provide flaw free guidelines for document examination and as the UCP 600 has been aligned with the

¹⁰⁰ David Meynell, formerly at Deutsche Bank, has his own consultancy, TradeLC Advisory, and was on the drafting group panel, available at <http://www.tfreview.com/news/legal-regulatory/icc-publishes-guides-urbpo-and-isbp-745>, accessed on 25th March 2015

¹⁰¹ Article 2 of the UCP 600.

¹⁰² Paragraph 23 of the ISBP 745

ISBP, it can be said that the UCP 600 has failed to provide a clear answer to certain issues relating to document examination standards.

2.4.6 Conclusion

In conclusion, the observation made by this chapter shows the need of having precise and comprehensive rule on the standard required to measure the complying level. The rules of the current version of the UCP does not provide precise answer for this issue. In addition, the guidance of the ISBP is not comprehensive enough to cover the various issues arisen under examination of documents. The foundation laid by the ISBP must be acknowledged, but still it is far from being well developed. Therefore, the next version of the ICC must take actions to define the guidance clearly. A comprehensive set of guidance would help to reduce the level of document rejections.

If the tendered documents are ambiguous, the tender is in principle a bad tender. However, as stated in **Hing Yip Hing Fat**¹⁰³ case, when examining the tendered documents, the banks are not expected carry out examinations to find every little mistakes. The whole process should be focused on properly reading and understanding the contents of the documents.

However, when the UCP 600 requires relying upon the guidelines provided in International Standard Banking Practice (ISBP) such as guidelines in respect of misspelling in article 24, it would restrict a bank from exercising its own understanding and expertise. Therefore, it is clear that, under the UCP 600, the law relating to examination of documents remains the same as in previous versions although it has been described by many scholars that the UCP 600 has provided much leniency in the applicability of the strict compliance rule.

¹⁰³ (1991) 2 H.K.L.R. 35

Chapter 3

Discrepancy in the documents presented

3.1 Introduction

In all letters of credit transactions, as the first step, the Buyer is required to fill in an application form giving instructions to the bank to draft the credit in accordance with legal requirements and the bank's policies. However, due to fact that the whole process is conducted by human intervention, there can often be instances which creates typographical errors or misspellings. Similarly the same situation can apply to the documents issued by the seller or any other parties who are a part of the transaction and are required to submit documents to the bank in order to proceed with the payment. Such type of omission or mistake which may result as a typographical error or misspelling can be fatal to the transaction, despite the fact that the discrepancy may be a minor one.

On perusal of the case law that has arisen as a result of this issue three main reasons can be identified where a document can be made discrepant.

1. Typographical errors and misspelling of names or an address
2. Misdescription of the goods in commercial invoices
3. Incomplete and unclear terms in the credit

This chapter will discuss about the discrepancies in the presentation under the above four categories to find out the current law applicable, its flaws and concerns. By doing so, it is expected to address the issues surrounding the current rules, in order to frame better rules if required.

3.2 Typographical errors and misspellings of names or addresses

In respect of the issue of a misspelled name or an address, it must be noted that the UCP itself does define a typing error or misspelling as a discrepancy in a document mentioned in the credit. However, as mentioned before, the UCP 600 requires the bank to rely upon the provisions of the International Standard Banking Practice 2013 Revised Edition (ISBP) as a useful guideline when determining whether the document in question is regular on its face or not. The paragraph 23 of the ISBP provides guidelines to decide on, what may constitute a typographical error. According to the paragraph 23 of the ISBP 2013 revised edition;

'Misspellings and/or typing errors that do not affect the meaning of a word or the sentence in which it occurs, do not make a document discrepant. For example, a description of the merchandise as "mashine" instead of "machine", "fountan pen" instead of "fountain pen" or "modle" instead of "model" would not make the document discrepant. However, a description as "model 123" instead of "model 321" would not be regarded as a typing error and would be discrepant¹⁰⁴.'

Until the publication of the ISBP, it was considered that the determination whether an alleged misspelling or the typing error would constitute a discrepancy should be by a Court. As a result of this, various interpretations with regard to this matter were used and introduced by Courts in their judgements all over the world. Given those circumstances, different standards and methods became applicable in various parts of the world in regard to the type of errors or misspellings that could constitute a discrepancy. This situation created conflicts among legal systems as there were differing decisions by different Courts on similar types of mistakes or typing errors.

Since the publication of the ISBP it has been intended to bring universally accepted standards that would be applicable to the determination of the instances where mistakes and errors in documents would constitute a discrepancy. However, on a perusal of the relevant paragraphs in the ISBP, it appears that their formulation has not been greatly influenced by the decided cases which can be considered as the most resourceful source.

¹⁰⁴ Article 23 of the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP 745) 2013 Revision.

In addition, the provisions provided by the UCP do not provide a clear and definitive solution for this issue. The ISBP requires the bank to ascertain whether the alleged discrepancy has changed the meaning of the word. In practice 'finding whether the meaning has been changed' is not practical in every instance. Especially when it comes to a name or an address. For example, the name Smith spelled as Smithh cannot be seen as a material meaning changer as the name Smith is a very common name. However, if a name like Soran being an uncommon name is misspelled, it would be difficult to reach a decision as to whether it is a material discrepancy as the current rules of the ISBP do not sufficiently cover such a situation. As another example, if London is misspelled as Londen, it may not be seen as a material meaning changer as it is a universally known city. However, if the Ukrainian city of Ilychevsk is misspelled it will be difficult to come to a decision under the applicable ISBP rule and decide whether the misspelled name means the same city or another city. Therefore, the application of the provisions provided in the ISBP is in most cases possible only when the misspelled word is familiar to the document examiner. If the document examiner is based in London and is required to decide whether the name of a Chinese city in a document contains a material discrepancy he may not be able to come to a definite conclusion purely based on the provisions provided in the ISBP.

The introduction of the UCP as a set of rules has not limited the Courts in adopting other standards¹⁰⁵ to decide whether the documents have duly been complied with or not. In **Dessaleng Beyene and Jean M. Hanson Vs Irving Trust Company**¹⁰⁶ despite having authority provided in the UCP 500, the Court introduced three additional standards to consider when determining whether a material discrepancy arises in a document as a result of a misspelling or an error in that document. They are;

- i. Whether the misspelling is obvious? If the bank finds the alleged typographical error as an obvious mistake, the bank should accept the document.
- ii. Whether or not the misspelling is insignificant? If it is apparent that the alleged error is not obvious and it could not possibly have undesirable and/or adverse effects on the parties to the credit transaction, then the dishonour of payment should not be justified.
- iii. Apart from above mentioned two standards, in all other instances the literal compliance of the contents of the document should be applied.

The above first standard has some essence of paragraph 23 of the ISBP but the second standard has not been provided for either in the ISBP or the UCP 600. The reason that the Courts are inclined to adopt alternative standards as against what has been provided in both the UCP600 and the ISBP implies that, both the UCP600 and

¹⁰⁵ For example; the UCP never recognized principles of Strict compliance or substantial compliance and thus, courts in different jurisdictions tend to adopt those rules when determining whether the documents are in compliance or not

¹⁰⁶ (1984) 596 F. Supp. 438 (New York).

the ISBP have failed to provide a comprehensive guidance to banks and other parties relating to the practise that should be adopted in ascertaining discrepancies in documents.

On the other hand, irrespective of what has set out in the ISBP or UCP 600, in practice, the issues that the Courts have to resolve can be differ from one to another. Therefore, this sub-chapter is dedicated to discuss and analyse the case law which covers the issues related to misspelling and typographical errors in the documents presented. In addition, this chapter will contain an analysis of cases, which goes back to the pre ISBP era, in order to find out whether the decisions made with regard to discrepancy of documents could have created a different outcome, if those decisions were subjected to the guidance provided in the ISBP. Therefore, in addition to the above mentioned objectives, this exercise will also strive to ascertain -

- a) Whether the ISBP together with the UCP 600 can provide one optimal standard to avoid the inconsistencies among decisions which can arise out of a similar type of issues relating to discrepancies in documents tendered.
- b) Whether the ISBP has been able to cover the whole scope which comes under the misspellings or typographical errors in the documents submitted.
- c) To formulate proposals to improve the applicability and productivity of the current rules.

As stated previously it is clear that the Courts have applied various standards in the decision making process to the issues related with the misspellings and the typographical errors in the documents presented rather than merely relying on the provisions of the UCP. Based on the details which are to be discussed below, it is sought to find an alternative so as to augment the current rules in order to enable a wider implementing applicability. Therefore, this subchapter will be focused on finding an optimal examination standard for discrepancies in the name or address of a submitted documents for payment. At the end, the essential elements from the case law will be discussed and sought to be applied with a view to reframing the current rule.

3.2.1 Mirror compliance standard

Under this standard, there was no room for minor discrepancies in the content of the submitted documents and therefore, any deviation of the details required by the credit agreement would result the presentation being rejected as non-complying. On perusal of the provisions provided in the previous versions of the UCP, it can be said that UCP 600's predecessors had tended to be more favourable to mirror compliance standards. For example, article 13(a) of the UCP 500 required the documents to be complied on their face against what is required by the credit. In addition to that, it is further required to be bound by the rules provided in the ISBP. Therefore, the previous rule implied that, the documents presented must not be inconsistent with

the requirements in the credit¹⁰⁷ and any spelling mistake or error should not change the meaning of the original word intended to be written¹⁰⁸.

It is often described that the mirror compliance rule represents Lord Summer's statement that "there is no room for documents which are almost the same or which will do as well", which was stated in **Equitable Trust Company of New York V Dawson Partners Ltd**¹⁰⁹. This rigorous adherence to the mirror compliance standard was well demonstrated in **Hanil Bank v. Perseroan Terbatas Bank Negara Indonesia**¹¹⁰, where an Indonesian manufacturer of car radios, PT. Kodeco Electronics Indonesia (Kodeco), negotiated with Sung Jin Electronics Co., Ltd. (Sung Jin), a Korean electronic parts supplier, to purchase automobile radio parts. Kodeco's purchase was financed by a letter of credit issued by defendant Indonesian bank, PT. Bank Negara Indonesia (Persero) (BNI), in the amount of \$170,955. The seller, Sung Jin, was the named beneficiary of the letter of credit. After shipping the radio parts to Kodeco in Indonesia, Sung Jin presented the letter and accompanying documents for payment to plaintiff, Hanil Bank (Hanil), a Korean bank that served as the negotiating bank. Hanil Bank paid Sung Jin \$157,493-the amount of the sight draft. Then the plaintiff Hanil forwarded the letter of credit documents to defendant BNI in Indonesia and instructed BNI to remit \$157,493 due it under the letter of credit in United States dollars to its Citibank account in New York. However, BNI refused payment, on the ground of, *inter alia*, the name of Sung Jing had been listed in the letter of credit as the beneficiary and in contrast, the name of Sung Jun had been listed under the name of beneficiary in the documents submitted. As a result of BNI's failure to pay, Hanil filed an action against BNI in New York.

At the hearing, the Court found that, the Hanil Bank had not claimed that, "Sun Jun" would obviously be identified as a misspelling of "Sun Jin". Taking a different view, the Hanil Bank in their claim stated that, as provided by the compliance rule, BNI was precluded from stopping payment as the alleged error could not mislead the issuing bank. At the same time, the Hanil Bank contended that, the Bank Negara should have been aware of the fact that Sun Jin was the beneficiary intended by the credit instead of Sun Jun, as the correct name was rightly stated in the application for credit compiled in Bank Negara's own file.

¹⁰⁷ Article 13 of the UCP

¹⁰⁸ Paragraph 25 of the ISBP 645

¹⁰⁹ (1927) Lloyd's Law Report 49

¹¹⁰ (2000) No. 96 Civ. 3201, 41 U.C.C. Rep. Serv. 2d 618

However, the Court took a different view and referred to article 13(a) of the UCP 500¹¹¹ instead. Eventually, it was held that the banks are only expected to rely upon the documents presented by the beneficiary and to be satisfied with the fact that they meet the requirements stated in the credit. Accordingly, Bank Negara had correctly declined the payment to the Hanil bank as it had falsely identified the name of the right beneficiary.

In this case, the court has acknowledged the first standard introduced in **Beyene v Irving Trust Company**¹¹², which is “finding of the obviousness of the misspelling’ and found that there was insufficient evidence to establish that the misspelling was clearly obvious. Interestingly, the court declined to adopt the second standard¹¹³ introduced in the Beyene case and instead, applied the provisions stipulated in the UCP 500.

Under the article 14 of the UCP 600, the requirement is that the bank to examine the documents to determine whether on the basis of the documents alone that they, on their face, appear to be constituting a complying presentation and that it does not conflict with data in that document or any other stipulated document or the credit. In this respect, even under the UCP 600, the outcome of the Hanil bank case cited earlier would have remained as the same. This clearly shows that the examination of documents presented must be carried out in respect of the document itself and the bank is not required to go beyond this and take further steps to establish something which is not stated in the credit.

In **Hyosung Corp. v. China Everbright Bank**¹¹⁴, the Court despite relying upon the provisions of the UCP 500 and the principle laid in *Beyene v Irving Trust Company*, adapted the principle as stated in ISBP to determine whether the document submitted does constitute a discrepancy or not. In this matter the dispute over the rejected letter of credit which contained the manufacturer’s name as Kumco Chemical Co Ltd and in contrast to the presented Packing bill/weight bill contained the name of Kumho Chemicals Inc. As a result of it the issuing bank refused to make the payment on the ground of, *inter alia*, inconsistency of manufacturer’s name stated in various documents submitted under the credit agreement.

The Court held that the inclusion of ‘Inc’ to the manufacturer’s name could have led to another meaning, which is completely different than Co. The Court relied upon

¹¹¹ Where it says Art. “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.**

¹¹² (1985) 762F.2d 4, C.A.2 (N.Y.)

¹¹³ “whether or not the mistake was inconsequential”

¹¹⁴ (2003) Min Jing ZhongZi Bo.069; Fujian High People’s Court [China]

principle provided in the ISBP¹¹⁵ and stated that issuing bank has not erred in law in deciding that the Bank was entitled to reject the document as it falls under the purview of article 13(a) of the UCP 500.

Neither the UCP nor the ISBP does not provide the cover for the concept of calculating the commercial significance of an alleged discrepancy to decide whether it is material or not. However, if the alleged discrepancy is commercially insignificant as far as the performance of the sales contract, can a bank be still entitled to reject the document in question? In **United Bank Ltd v Banque Nationale de Paris**¹¹⁶, similar circumstances were highlighted and the Court decided that the bank should only rely upon the discrepancy irrespective the fact how significant it is to the contract or not.

In the above case the letter of credit was opened in favour of a company called 'Pan Associated Ltd'. The High Court of Singapore upheld a bank's decision to reject documents stating the beneficiary's name as "Pan Associated Pte Ltd" as opposed to "Pan Associated Ltd" as stipulated in the terms of the credit. This was despite the existence of evidence that the Registrar of Companies would not, except with the consent of the Minister, register two companies with these similar names and therefore, the difference was commercially insignificant.

However, the Court rejected the Pan Associated Ltd's claim and held that, any discrepancy, other than obvious typographical errors will entitle either the negotiating or the issuing bank to reject the documents presented by the beneficiary. It was further decided that the matching of the documents presented with the letter of credit should be literal and exact to avoid the turning down of claim for payment.

In conclusion, the mirror compliance rule has been superseded by the complying presentation rule which has been introduced by the UCP 600. Therefore, to some degree the requirement of mirror compliance rule can be considered to be outdated.

3.2.2 Compliance under the UCP 600

After the introduction of the UCP 600, among the reported cases relating to document examination standards, the English case of **Bulgrain & Co Limited V Shinhan Bank**¹¹⁷ stands out as the most significant case decided under the provision provided in article 14 of the UCP 600.

¹¹⁵ Article 23 - "whether the alleged misspelled word can make another meaning"

¹¹⁶ (1992) 2 SLR 64

¹¹⁷ (2013) EWHC2498(QB)

Shinhan Bank of Korea was sued in an action brought by a Bulgarian claimant under a letter of credit issued in its favour. The British High Court considered a number of interesting and subtle issues as regards to,

1. What may constitute a material documentary discrepancy?
2. A compliant notice of rejection under the UCP 600.

As mentioned earlier, the judgment made a significant landmark as, inter alia, it represented the first decision of a British Court which recognised that, where an ‘&’ was present in the name of the beneficiary either in the commercial invoice or in the letter of credit itself but not in both of them, the absence of an ‘&’ in one of them may constitute a material documentary discrepancy for the purpose of Article 16(a) of UCP 600¹¹⁸.

It further recognised that such type of discrepancy entitles the issuing bank to reject the documents presented by the seller to receive payment under the letter of credit. As this case is one of the most significant cases reported after introduction of the UCP 600 in regard to discrepancies in the documents presented, it is important to evaluate the basic facts in the case, which correspond with the provision provided in the UCP and ISBP.

The Claimant sellers entered a contract to sell a cargo of wheat bran pellets to buyers in China. Pursuant to the contract, the buyers procured the issue of a Letter of Credit by the Defendant, Shinhan Bank (“the Bank”), under which the Claimant was the beneficiary. The Letter of Credit provided for payment against the presentation of certain documents, including a signed commercial invoice. At the presentation for the payment, The Bank rejected the presentation of documents made by the Claimant on the basis of two alleged discrepancies. The first discrepancy was that the name of the beneficiary in the commercial invoice submitted by the Claimant was stated as “*Bulgrains & Co Limited*”, not “*Bulgrains Co Limited*”. The second discrepancy was that the commercial invoice did not conform with the description in the LC, in that the commercial invoice described the goods as “*Bulgarian wheat grain pellets*”.

In regard to the issue relating to the alleged discrepancy, the claimant's contention was that there was no material discrepancy with respect to the name of the beneficiary on the grounds that-

¹¹⁸ ‘When a nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank determines that a presentation **does not comply, it may refuse to honour or negotiate**’.

- (i) the ‘&’ had only been omitted from the name of the beneficiary in the letter of credit itself due to the fact that, even as per the admission of Shinhan Bank, the ampersand ‘&’ symbol cannot be transmitted by SWIFT¹¹⁹ which was the system used by Shinhan Bank to issue and send the letter of credit.
- (ii) the correct address of the company and the director’s name as given in the commercial invoice had ensured that there could be no doubt as to the entity identified in the commercial invoice.

Shinhan Bank’s defence was based on the argument of that, the only exception to the doctrine of strict compliance may be where the discrepancy is insignificant or trivial such that it cannot be regarded as material. It was suggested that the test to be applied is best summarized in the textbook *Jack: Documentary Credits*¹²⁰ which states the position thus;

“It is suggested that the correct approach is that a document containing an error with name or similar should be rejected unless the nature of the error is such that it is unmistakably typographical and the document could not reasonably be referring to a person or organization different from the ones only at the context in which the name appears in the document, but not judge it against the facts of the underlying transaction”

Shinhan Bank further responded that, had the name of the beneficiary been stated in the letter of credit as ‘Bulgrains and Co Ltd’ rather than ‘Bulgrains Co Ltd’ the bank would have accepted the name as ‘Bulgrains & Co Ltd’ in the commercial invoice as compliant with the terms of the letter of credit.

The Judge agreed and, following the approach adopted by the Singapore Courts in **United Bank Ltd v. Banque National de Paris**¹²¹, concluded that any discrepancy other than obviously typographical errors will entitle the negotiating or issuing bank to reject the documents. When it comes to errors in the name of the beneficiary, the only way that a bank can be certain of the position is by making a search at the relevant company registry – which is plainly more than is required of a bank when reviewing the documents.

The Judge therefore concluded that the addition of the ampersand between “*Bulgrains*” and “*Co Limited*” was a material discrepancy, thus giving the Bank the right to reject the documents. The judge was further of the view that, even if there was no facility to insert an ampersand in the SWIFT system, the word ‘and’ could

¹¹⁹ SWIFT’s messaging services are used by banks in communicating with their branches and the other financial bodies.

¹²⁰ Jack Raymond, Ali Malek, David Quest, ‘Documentary Credits’, (4th edition, Tottel Publishing, London 2009)

¹²¹ [1992] 2 SLR 64

have been used. It should have been used in the letter of credit because the name of the claimant in the Cyrillic alphabet included the single letter which meant 'and' in English and the word therefore was properly part of the claimant's name.

On perusal of the above judgements, it is clear that the law relating to missing words in the documents submitted remains as the same as the previous versions of the UCP. The law still allows only the unmistakably typographical errors to be recognised as discrepancies which are not material.

Hence, the decision made in this case signifies that, data in the submitted document does not need to be identical but however it should not be inconsistent with data required by the credit. This is a confirmation of the provisions as provided in paragraph 26 of the ISBP 745¹²².

Although, the decision made in this case established that the document was discrepant, the judgment itself acknowledged the fact that data in the document should necessarily be identical with the details mentioned in the credit as long as they do not conflict with each other.

Therefore, this judgment becomes more significant as it deviates from the strict nature of the compliance standards required, which were associated with the previous versions of the UCP 600. This is a confirmation of leniency shown against the strict compliance standards, by establishing that the UCP 600 along with the ISBP 745 does not require the data in the submitted document to be identical.

3.2.3 Whether the misspelling is obvious?

If the misspelling and/or error in the name of the person or the company name is found to be an obvious mistake, the Courts are expected to decide whether such mistake is fatal or not. However, the ISBP current and previous editions do not recognize the requirement to decide whether the mistake is obvious or not.

It is considered as a common norm, that any mistake or error in the name which is found not to be obvious should be considered as fatal. This is evident from the judgment made in **United Bank Ltd v Banque Nationalende Paris**¹²³, where it was stated that, any discrepancy, other than obvious typographical errors will entitle either the negotiating or the issuing bank to reject the documents presented by the beneficiary.

¹²² The document must not appear to be inconsistent with each other. There is no requirement for documents to identical but must not be inconsistent.

¹²³ (1992) 2 SLR 64

The “obvious” factor as a measurement in document examination was further discussed in the United States’ Court’s decision made in **Dessaleng Beyene and Jean M. Hanson Vs Irving Trust Company**¹²⁴, which is regarded as the benchmark authority for the issues related to document examination. The Court has laid down clear and precise guidelines as to at what stage a misspelling can constitute a discrepancy.

In this case, the seller had sued the confirming bank on its refusal to honour payment under the credit. According to the terms of the letter of credit, it was required that, the one person called ‘Mohammed Sofan’ to be named as the recipient of the goods in the bill of lading. However, the bill of lading which was presented to the bank contained the applicant’s name as ‘Mohammed Soran’ instead of ‘Mohammed Sofan’.

In its judgment the Court was of the view, literal compliance is required¹²⁵ not to impose an extra burden on the bank to accept the discrepant document and it would not jeopardize the bank’s right to indemnity from its customer. Based on following reason among others¹²⁶, the Court found that the misspelling was a material discrepancy which entitled the bank to refuse the credit.

The Court was of the view that, although it clearly appears to be an obvious typographical error, there was not enough evidence to establish that the name intended by the bill of lading was unmistakably clear. For example, either it was not obvious like ‘Smith’ when misspelled as ‘Smithh’ or the beneficiary in this case had not provided enough evidence to show that in the Middle East the name of ‘Soran’ would obviously be recognized as a genuinely misspelled surname of ‘Sofan’.

As mentioned previously, the Court recognised “the obvious” factor as the main deciding factor over the issues with discrepant documents. In terms of the principle in this, if it is apparently clear that the typographical mistake is obvious, then the bank should not be entitled to reject the document.

However, based on the example given in the judgment, it is clear that the measuring of obviousness is not an easy task when the parties to the letter of credit are comprised of different nationalities. As ‘Smith’ is acknowledged as a common name among the banks in the USA, it can be argued that, in the Middle-East ‘Smith’ will not be considered as a common name. On the hand, in each and every case, the bank

¹²⁴ (1984) 596 F. Supp. 438 (New York).

¹²⁵ (1984) 596 F. Supp. 438 (New York) page 6, where KEARSE, Circuit Judge stated; ‘The issuing bank, or a bank that acts as confirming bank for the issuer, takes on an absolute duty to pay the amount of the credit to the beneficiary, so long as the beneficiary complies with the terms of the letter. In order to protect the issuing or confirming bank, this absolute duty does not arise unless the terms of the letter have been complied with strictly. Literal compliance is generally “essential so as not to impose an obligation upon the bank that it did not undertake and so as not to jeopardize the bank’s right to indemnity from its customer.” Voest-Alpine International Corp. v. Chase Manhattan Bank, 707 F.2d at 683; see H. Harfield, Letters of Credit 57-59 (1979).’

¹²⁶ (1984) 596 F. Supp. 438 (New York). The court found another reason, to conclude the identified error was inconsequential to the performance of the contract.

cannot expect the seller to produce additional documents to prove the name in dispute as an obvious mistake. Therefore, the approach¹²⁷ taken in the ISBP provides more precise standards than relying only upon the ‘obvious’ factor. However, the “obvious” factor cannot be discarded as it can be made applicable to any discrepant words which are familiar to the document examiner.

The other concern is that, if this issue was to be decided in the Middle East, Sofan instead of Soran could have been identified as an obvious mistake. Therefore, making decisions on misspelled names, solely based on the “obvious factor” cannot be accepted as a viable method. As stated earlier names more familiar in Western countries cannot be considered equally familiar for instance in the South- East Asia or the Middle East. On the other hand, it is not often possible for banks to have experts specialized in each and every foreign language.

However, despite the application of different standards, if the current principles provided in the UCP 600 and the 2013 revised edition of the ISBP, were applied to the decision making process of this case, the outcome would probably have remained the same, as the discrepancy in the name affects the meaning of the word.

In addition to that, article 14(j) of the UCP 600 lays down clear requirements for what should be contained in transport documents presented. The latter part of the article says,

‘when the address and contact details of the applicant appear as part of the consignee or notify party details on a transport document subject to article....., they must be stated in the credit’.

Given the above situations, it is clear that the name mentioned in the documents must be precise with the credit if the name related to consignee and/or the notify party. Therefore, even under the current rules the name of ‘Mohammed Soran’ and ‘Mohammed Sofan’ would probably have been identified as two different persons.

If it is to consider the ‘obviousness’ as deciding factor of an inquiry into a discrepant name or a word, the particular name or the word must be used in common vocabulary of region where the examiner is based in. Otherwise, the validity of the ‘obviousness’ as deciding factor becomes useless. The only possible opportunity to consistently apply the above rule is where the discrepant part of the name is derived from a common word such as Company, Limited, Bank or Associate. These types of words are used in common vocabulary all around the world and well established in all forms of dictionaries.

Similar to the above mentioned situation, in **Hing Yip Hing Fat Company Limited V Daiwa Bank Limited**¹²⁸, the Court took the view that the discrepancy arises due to an obvious typographical mistake would not constitute the document as non-

¹²⁷ ISBP745 when the alleged typing error or misspelling do not affect the meaning of the word intended that would not make a document discrepant.

¹²⁸(1991) 2 H.K.L.R. 35

compliant. In this case, the bill of lading had been drawn to a company called "Cheergoal Industrial Limited instead of "Cheergoal Industries Limited" which was the beneficiary to the letter of credit. In addition to that, the advice issued by the Daiwa bank contained the same discrepancy naming the beneficiary as "Cheergoal Industrial Ltd" with the mention of the same address. In its decision, the Court stated that, using the word of "Industrial" was an obvious typographical error and such a discrepancy would not enable the bank to say that the document discrepant.

Further, giving reasons with regard to defining of the strict compliance rule the honourable judge of this case drew the attention to the law text by Gutteridge titled "The Law of Bankers Commercial Credits"¹²⁹: where it states that "the strict compliance rule should not be applicable to the dotting of i's and crossing of t's or any obviously understandable typographical errors in the credit or the documents". The judge further said that, "due to the difficulties found in using two different languages by parties, it is impossible to be inflexible. Each case should be scrutinized on its merits irrespective of the fact that it will impose an extra burden on the banker"¹³⁰.

The Court further explained the grounds considered, when it comes to identifying the merits of each and every case which are unique to one to another. According to its explanation

- 1) when the parties to the credit represent two different countries which are not familiar with English, minor mistakes can be happened as the documents are made in English.
- 2) the Bank knew whom to speak to and they were in the possession of beneficiary's business card, which indicated the right address. The bank had already phoned the manager of the beneficiary's company and informed that they will wait until it receives a written advice.
- 3) the bank had further repeated the same mistake in the advice sent citing all the discrepancies.

Based on above circumstances, the judge further stated that, "I incline to accept Gutteridge's words mentioned above and believes they make good sense. By stating so, I believe the conclusion I have arrived here does not violate the compliance standards mentioned by Lord Summer." He further added that, "I believe that I have applied common sense approach when the decision was made". It is clear that, in this occasion, the Court has extracted the essence of **Beyene v Irving Trust Company**, standards which says, "*whether or not the misspelling was obvious*", in determining the outcome.

¹²⁹ H C Gutteridge & Maurice Megrah, "The Law of Bankers Commercial Credits (7th edition, Europa Publication, London, 1984), page 120

¹³⁰ (1991) 2 HKLR 35, High Court, 1991

This approach, that the Court has taken, derives from the commercial and practical aspects of the case rather than considering the technical elements. The main principle which the Court had looked at was to find out whether the bank had been misled by the obvious typographical error in the document¹³¹.

However, there are negative signs in respect of the above decision as seen in other decisions which can threaten the uniformity of rulings in similar matters under different circumstances. The principles based in the above decision has been questioned by Feliks W H Chan¹³², on the basis that -

1. In all occasions it cannot be assumed that each and every typographical error is trivial.
2. It is not the Banks's duty check how much material the information in question.

Both the words "industrial" and "industries" actually exist in the vocabulary and in some cases these two are the only words which can distinguish two companies, which have similar first names. In a situation where the Company Act in a particular country allows two different companies to exist under the same name by having the last few letters changed in each of the names, the mistake made in the credit with regard to the name can be fatal irrespective how trivial the spellings mistake was. Considering these circumstances, the universal applicability of the judgment in above mentioned Daiwa Bank Ltd case, can be in question as it would not support the fundamental principles of complying presentation under those changed circumstances.

On the other hand, the use of circumstantial evidence such as the bank clerk's awareness of the different use of name has not been clearly recognised in either the provisions of the ISBP or the UCP. Therefore, the extent which a Court can rely on circumstantial evidence can vary from one legal system to another as it totally depends upon the practice and the customs used in the particular legal system.

As the strict compliance rule is most pivotal in document examination, the necessity for having further search for substantial evidence can raise some serious concerns. This creates a dilemma as to whether in every case, the rejection should be entered after considering all the evidence available to the bank or instead, simply to follow the complying presentation rules. However, such practice is not supported either the UCP 600 or the ISBP.

¹³¹ King Tak Fung, 'Leading Court Cases on Letters of Credit' (ICC publication, May 2004) pages 87& 88

¹³² Feliks W H Chan 'Documentary Compliance Under UCP: a Fault Finding Mission or a Mere Guessing Exercise'. Published in 'Shipping and Logistics Law: Principles and Practice in Hong Kong, 2002 Hong Kong University Press

If the current rules are applied to the circumstances mentioned in the above case, it is not clear whether such typographical error can fall under the phrase “the alleged error should not change the meaning of the word” as provided in paragraph 23 of the ISBP. The words “industries” and “industrial” are words in existence in the real world and both have perceptible differences when it comes to defining their meanings. Therefore, the level of flexibility which a Court can adopt could have been discussed, if it was to decide on the basis of the rules provided in the ISBP¹³³. Therefore, it is difficult to assume that there would have been a similar outcome if the current rules were applied to this case.

Even if it is found that there is an error in the presented documents which does not seem an obvious mistake, the bank is still expected to consider whether such mistake in the document can mislead the bank. It is salient to note that if the bank was not misled by an error in the document, it should be assumed that the presentation is duly complied with.

In **E & H Partners Limited v. Broadway National Bank**¹³⁴, the seller went to court against the issuing bank on wrongful refusal to honour of a letter of credit. The issuing bank relied upon the defence that there was among other things, a discrepancy in the beneficiary’s cover letter demanding payment in which the seller referred to a wrong letter of credit number, namely “1547424”. The banks further alleged the required letter of credit number was “1537424”.

In view of the discrepancy in the number mentioned in the credit, the Court applied the principle adopted in the above mentioned **Hing Yip Hing Fat Co** decision to find out whether there was any possibility that the alleged discrepancy can provide a misleading information. However, the Court stated that, there was no evidence had been placed to establish that the bank had been misled by the discrepancy. It was further said that the alleged mistaken was obvious and therefore the document in question should be found to be compliant.

In conclusion, it has transpired that, the principle of “obviousness” can only be applicable to the cases where the alleged error or mistake is related to a common word or a place. The “obvious factor” cannot be applied to a person’s name or company names that are not in the common vocabulary. Apart from that, the “obviousness” depends on the document checker’s knowledge of language in which the presented document is written in. Therefore, the application of the “obvious

¹³³ ISBP 745: when the alleged typing error or misspelling do not affect the meaning of the word intended that would not make a document discrepant.

¹³⁴ 39 F.Supp.2d 275, S.D.N.Y., 1998.

factor” can vary from region to region or language to language. Finally, even if there is a mistake which does not seem as an obvious one, a Court will still expect a bank to be over cautious before the rejection. In this regard, banks are expected to decide whether such information in the mistake can mislead them to a situation which can cause detrimental effects to the parties involved in the credit.

3.2.4 Whether misspelling was insignificant?

As mentioned above, the errors and/or mistakes in a document presented does not automatically constitute the document discrepant. The banks are expected to measure how significant such error is for the performance of the credit. Insignificant errors can be discarded. It is assumed that the banks are expected take the commercial aspects of the credit into consideration, when deciding on the impact of an error or a mistake. This aspect is however practiced as a custom since the UCP does not provide any guidance or authority to the bank to follow such practice

Given the above scenario, this subchapter will discuss about the importance the principle of ‘inconsequentiality’ as a measure of deciding whether the discrepant name or word is material or not. In order to do so, this subchapter will analyse the case law with a view to answer the following:-

- a) Can a misspelled name of notify party or a name of a port the bill of lading be considered as insignificant to the performance of the credit?
- b) Whether the wrong spelled a cover letter and/or a name of a company with missing words like “Ltd”, “Pvt” makes the document non-complying?
- c) The significant changes brought by the ISBP with regard to a wrong delivery address given in a document.

The above mentioned case of **Beyene v Irving Trust Company**, also discussed the importance of having the right document with the correct name of the recipient to have an assured delivery. In this case where the recipient name was wrongly spelled as ‘Sofan’ instead of ‘Soran’, the court stated that,

“Soran’ cannot be identified as the name which was insignificant to the document and wrongly spelled name was of the person to whom expected to be served with notices of the arrival of the goods. Therefore, misspelling of the recipient’s name in the credit could have led to a situation, where the goods would have been delivered to a wrong person. In the light of these circumstances, the bank has acted rightly by refusing to accept the document since if the bank was to discard the spelling mistake in the bill of lading submitted resulting in the goods being delivered to a wrong person, it would easily have lost the right to reimbursement of the credit from the issuing bank.

It is also important to consider as what would have been the outcome, if the documents submitted contain discrepancies such as -

- a) Missing words in the documents submitted in contrast to what is stated in the credit
- b) Additional words included against what is required in the credit
- c) Extra digits added or one or few digits missing from figures stated in the document submitted compared to what has been stated in the credit.

In the case of **Bank of Cochin Ltd. v. Manufacturers Hanover Trust**¹³⁵, the issuing bank suing the confirming bank alleged that the confirming bank has wrongfully honoured of the letter of credit despite having major discrepancies in the presented document to the bank. There were two major discrepancies which the issuing bank relied upon in their claim. Namely,

1. The documents submitted contradicted the company's name mentioned in the credit as St. Lucia Enterprises against St. Lucia Enterprises Ltd.
2. The document cabled by the St. Lucia Enterprises Limited to the insurance company showed a wrong insurance cover-note bearing the numbers of 4291 instead 429711.119.

In reality, neither of the documents submitted to the confirming bank was genuine in all aspects nor had the goods ever been shipped to the buyer. It was revealed that the fraudulent seller had vanished and therefore Court was required, *inter alia*, to decide who should be accountable for the scam first.

The Court by applying the standard adopted in **Beyene Vs Irving Trust Co**, which applied the principle “whether or not the misspelling was insignificant” to both the mistakes mentioned in the pleadings, decided that,

- i) It cannot be said that there is significant difference between St. Lucia Enterprises and St. Lucia Enterprise Ltd. However there was no evidence show that the intended party was paid. This signals an attempt to fraud by using two different names. However, the discrepancy in this instance appears to be insignificant.
- ii) The requirement of tendering a proper insurance cover-note was aimed to serve the insurance company confirming the shipment. The failure of providing the required cover-note in the right format was not inconsequential as such a mistake could have ended up tempting the insurance company to refuse the payment on the insurance policy.

¹³⁵ 612 F.Supp. 1533, D.C.N.Y.,1985

Under the guidance provided by ISBP, compared, the above two mistakes would probably have made the presentation non-compliant as both could clearly change the meaning of the words which were clearly mentioned in the credit as it appears, and can be assumed that the UCP 600 and the ISBP have left no room for the application of “inconsequential factor”. This is confirmed by the provisions in Sub-article 14 (d) of the UCP 600 where it only allows the accepting of non-identical documents as long as they do not conflict with the data contained therein. Therefore, the contents in the documents need to be accurate and it cannot be assumed that any discrepancy in data contained in documents can be treated as inconsequential.

The wrongly numbered insurance cover note would also constitute the document discrepant as paragraph 23 of the 2013 ISBP 745 revised edition requires numbers to be accurate and to be in the correct order.

In contrast to the decision made in the above case, a different view was taken in the judgment entered by a USA Court in 1998 that has been cited earlier, prior to the UCP 600 and ISBP coming into operation. The importance of the principles mentioned above in paragraph 23 of the ISBP 745, can further be taken into discussion with the said contrasting view taken in the above cited case of **E & H Partners v. Broadway National Bank**.

In this case, the seller sued the bank for wrongful refusal to honour of a letter of credit. The bank relied upon the defence, that there was, among other things, a discrepancy in the beneficiary’s cover letter made demanding payment. In that letter, the seller had erred in referring the letter of credit number as “1547424”. The correct designated number was “1537424”.

The Court made a historic decision by stating that “there is a possibility of allowing variances to the strict requirement on compliance. In order to accept the variance, the alleged misspellings should not create a situation where the bank can be misled’.

The Court has taken the view that the bank should have considered the commercial impact of the document, when deciding the compliance. The judge has stated, that “the reason behind of having a strict compliance requirement is to protect the document examining bank from being compelled to assess impact of an alleged discrepancy’.

The Court further stated that any substantial documents that are useful for decision making process and error in those documents would not necessarily make a reason which bank should refuse the entire presentation. The desecration of the bank can exercised on errors in supporting documents.

As the Bank conceded the fact that it was not confused by the wrongly numbered document, the court stated that the alleged error was insignificant to declare the document as non-compliant.

The other discrepancy involved in this case was that the requirement of 30 days notice required to be served on the buyer to collect upon the credit. The bank claimed that it was not able to find the postal address of the buyer pointing out the erroneous zip-code number contained in the credit. The wrongly numbered 10001 was contained in the credit instead of 10010. Therefore, the bank alleged that, though they sent the notice to the buyer, because of the wrong zip-code in the address, the purported notice had gone missing.

As an answer to the alleged discrepancy which the bank claimed, the beneficiary produced an affidavit by a retired letter distributor, who had over 30 years of experience, stating that ‘ he has no doubt” as per his experience, the purported notice would have been delivered to the buyer’s address despite having the erroneous zip-code. His had further stated that the entire process of finding the correct zip-code would normally not cause any significant delays in delivering the letter.

In the judgment, the Court was satisfied with the evidence provided by the buyer and declared that the bank has failed to convince the court that letter had been delivered to a wrong address. In addition to that, the bank had not shown its intention to have terms for such method of delivery or clear evidence as imperative requirements in the letter of credit.

Based on the conclusion which the Court has arrived at, it is clear that, the banks are expected only to look into the imperative terms mentioned in the credit and the rest should be discarded as they are inconsequential.

Even, in cases where the alleged discrepancies are related to the number mentioned in the credit, it is clear that, the bank is expected to consider whether such discrepancy can lead to a position where the bank can be misled by it. This is the theory the Court had adopted in the above mentioned case of **Hing Yip Hing Fat Co Ltd** to find out whether there was any possibility of having a situation where the bank could have been misled by the alleged mistake. Therefore, it is clear that, the theory of “whether the bank can be misled by the alleged error or mistake” is an important deciding factor in the decision making process on discrepancies in the document presented. The issue of “inconsequentiality” will come into operation after deciding whether the alleged mistake can lead the bank to be misled. However, the provisions provided in the ISBP do not direct banks to consider the measure of ‘whether the bank has been misled by the alleged discrepancy’. The measure of “whether the alleged discrepancy can change the meaning of the word” does not exactly render the same meaning. In view of this situation, it must be noted that, the ICC should have considered the merit of the concept of ‘whether the bank has been misled by the alleged discrepancy’ to be included in when drafting the ISBP.

Hence, irrespective of the areas missing in the ISBP, it is important to note that current rules and regulations in relation to the misspelled numbers are straightforward, as the ISBP requires the numbers mentioned in the credit to be precise and be in the correct order. This has at least helped to bring a certainty into the law related to such issues. It is clear that the approach taken in the ISBP regarding the numbers mentioned in the credit has been more favourable to fundamental principles in the strict compliance rule.

Given the above circumstances, if the previously cited case of **E & H Partners V. Broadway National Bank** was to be decided under the provision provided by the ISBP¹³⁶, it is most likely that the typing error/misspelling contained in the credit would have clearly constituted the document discrepant and it would have been a justifiable refusal by the bank as such mistake could obviously change the meaning of the word.

According to the rules of the UCP 600, the use of the wrong zip-code in the letter sent to the buyer would have constituted a discrepancy, as that would '*on its face*'¹³⁷ make the document non-compliant. However, such types of mistakes are occurred in daily basis and, as witnessed in the above case, such an error would not cause any harm since it would not be ending up with non-delivery or any significant delays.

However, it is not clear that, in a situation where sufficient evidence is available to show that no detriment would have been caused against the terms of the performance of the sale contract, the Court should still be bound by the strictness embedded in words '*on their face*'. If this issue is answered in the affirmative, it signifies that, the phrase '*on their face*' provided in the UCP 600 still directs Courts to adhere to the strict essence of the compliance rule.

However, there is one exception which can be found to the phrase '*on their face*' within the UCP 600 itself. The UCP 600 version has introduced a feature to combat issues that have arisen out of the buyer's address that can be contained in any document mentioned in the credit.

According to the Article 14(j), except the address and contact details of the applicant which appear as part of the consignee or notify party details on a transport document, any other the addresses are not required be tallied with the address mentioned in the credit. However, both the address are needed to be located in the

¹³⁶ Paragraph 23 of the ISBP 745

¹³⁷ Article 14 (a) of the UCP 600. And also article 14(d) which says 'the details in the document must not conflict with, data in the credit or any other stipulated document.'

same county. In the light of the terms provided in Article 14(j), the wrong zip-code mentioned in the above case cannot be disputed as a discrepancy since both addresses are situated in the United States. Therefore, the dishonour would not have been justifiable. This means that, Article 14(j) contradicts what is required in Articles 14(a) and 14(e) of the UCP 600. In the light of this, it is clear that the contrast provisions provided in Article 14(j) of the UCP 600 tend to relax the strictness required in the examination of documents.

Prior to the introduction of Article 14(j), it was totally up to Courts to decide whether the wrongly spelled name of a place contained in a document can constitute a discrepancy or not. The Courts have applied various theories when determining, at what stage such error can make the document discrepant. According to the different views taken by the Courts over similar issues it suggests that, the “inconsequentiality factor” will be depended on to ascertain the role that the misspelled document plays in the credit.

In order to find out the significance of an error in a document submitted against the performance of the sales contract, banks may need to carry additional searches. One can argue that, the UCP 600 does not encourage banks to follow such procedure. However, the deviation from the mirror compliance standards may provide a window for the bank to be a little bit investigative. Especially to carry out searches on geographical areas if an address mentioned in a document is deemed to be discrepant. There are some instances where Courts have acknowledged the importance of such procedures.

For example, in **Pasir Gudang E.O.S.B. v. The Bank of New York**¹³⁸ the Court, against customary precedence, allowed the bank to make decisions on additional information found by further investigations. In this case, the letter of credit had been erroneously issued with a misspelled port of destination. In the credit, the name of ‘Ilyichevsk’ was appeared at one place and at another place the name of ‘Ilychevsk’ was appeared. In the credit it was mentioned that the port was situated in Ukraine. When the bill of lading was issued the discrepant name was misspelled again and stated the location as ‘Ilychevsk’ and there was no indication about the country of the location. When the documents were presented to the Bank of New York, the presentation was rejected citing the discrepancy in the location. Then the seller went to Court claiming *inter alia* that the bank has unlawfully rejected the presentation.

On behalf of Pasir, it was contended that, the alleged discrepancy was a genuine mistake and that all the misspelled words were meaning the same destination. In support of his plea, he produced the court a result of an internet search of geographical location which showed the similarity of the names used for the intended port of destination.

¹³⁸ 603531/99 - (NY Sup. Ct. 1999)

Similarly, the Bank also produced the Court a set of internet searches of geographic websites which displayed different location under the names similar to the ones that contained in the credit and shipping documents. According to the bank's submission, there were 2 locations in the territory of Ukraine and there were three sites located in three other neighbouring countries¹³⁹ under the name of 'Ilichevsk'.

The bank strongly argued that if the bank was to accept the documents in dispute, there would definitely have been a risk of having the cargo being delivered to a completely different port, which was not intended in credit.

The Court affirmed the position taken by the Bank and stated that, the discrepancies contained in the submitted documents justify the refusal of payment on basis of that the Bank was not required to confine only to the details placed before them when the details in the credit and the shipping documents were contained with 3 different locations.

The Court has probably made the right decision as it is critically important that the shipment to be delivered at the right destination. It must be noted, for example, if the bill of lading was contained with one of two names mentioned in the credit, it could have made bank's position weaker as it will be difficult for the bank to argue that bill of lading was discrepant because the New York Bank had erred in mentioning the correct name in the credit¹⁴⁰.

As provided in Article 20 (iii) of the UCP 600¹⁴¹, the bill of lading should mention the port of loading to the port of destination as provided in the credit. In addition, Articles 84¹⁴² and 85¹⁴³ of the ISBP require clear and precise indication of the port of loading

¹³⁹ Kazakhstan, Uzbekistan and Azerbaijan

¹⁴⁰ Fung King Tak, 'Leading Court Cases on Letters of Credit' (ICC publication 658, May 2004) page

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¹⁴¹ A bill of lading, however named, must appear to; indicate shipment **from** the port of loading **to** the port of discharge stated in the credit. If the bill of lading does not indicate the port of loading stated in the credit as the port of loading, or if it contains the indication "intended" or similar qualification in relation to the port of loading, **an on board notation indicating the port of loading as stated in the credit, the date of shipment and the name of the vessel is required.** This provision applies even when loading on board or shipment on a named vessel is indicated by pre-printed wording on the bill of lading.

¹⁴² While the named port of loading, as required by the credit, should appear in the port of loading field within the bill of lading, it may instead be stated in the field headed "Place of receipt" or the like, if it is clear that the goods were transported from that place of receipt by vessel, and provided there is an on board notation evidencing that the goods were loaded on that vessel at the port stated under "Place of receipt" or like term.

¹⁴³ While the named port of discharge, as required by the credit, should appear in the port of discharge field within the bill of lading, it may be stated in the field headed "Place of final destination" or the like if it is clear that the goods were to be transported to that place of final destination by vessel, and provided there is a notation evidencing that the port of discharge is that stated under "Place of final destination" or like term

and the port of discharge under the right columns of the bill of lading as required by the credit. Therefore, the current position related to port of destination confirms the requirement of meticulously following of the words in the credit instructions.

In addition to that, the ISBP goes further to establish the certainty factor over the above issue of port of destination by introducing two new provisions which can guide banks to have clear guidelines when carrying out the compliance check on the port of destination. Those provisions allow bank to be satisfied on compliance when-

1. If a Container Yard (CY) or Container Freight Station (CFS) is stated as the place of receipt and that place is the same as the stated port of loading (e.g. Place of Receipt: Hong Kong CY; Port of Loading: Hong Kong), these places are deemed to be the same¹⁴⁴.
2. If a credit gives a geographical area or range of ports of loading and/or discharge (e.g. "Any European Port"), the bill of lading must indicate the actual port of loading and/or discharge, which must be within the geographical area or range quoted¹⁴⁵.

On perusal of the above mentioned provisions provided in the ISBP, it is clear that a great effort has been taken to standardize an important area of documents checking. It has given bankers and parties to the credit clear guidelines which could help to eradicate a main issue related to noncompliance of document.

There are more examples which show the factor of inconsequentiality is dependant on circumstances of the particular case. Especially the elements that make the discrepancy inconsequential may be unique to the respective case and may not be adaptable to another situation. However, for the purpose of discarding a discrepancy, the rest of the information contained in the document in question must be regular with the requirement of the credit.

For example, in **Voest-Alpine Trading v. Bank of China**¹⁴⁶, the seller sued the Bank of China for unlawful dishonour of credit, where the bank claimed that, the name of the port of destination had wrongly been spelled. The "certificate of origin" presented to the bank spelled the port of destination as "Zhangjiagng" instead of Zhangjiagang. An "a" was missing from the right form of spellings. The similar mistake was made again in the letter of credit without noticing. In addition to that, there was an error in

¹⁴⁴ Paragraph 86 of the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP) - ICC document 470/951rev4-

¹⁴⁵ Paragraph 87 of the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP) - ICC document 470/951rev4-

¹⁴⁶ 167 F. Supp. 2d 940 (S.D. Tex. 2000)

the beneficiary's certificate with spelling of "Zhanjiagng," which had missed the letters of g & a.

At the hearing, the Court was informed that China does not have a port called either "Zhangjiagng" or "Zhanjiagng". The evidence were produced before the court to show that the combination of letters of "Gng" is not included in Romanized Chinese. It was further stated that, the phrase of "gang" gives the meaning of "port" in Chinese.

Apart from that, the other relevant details mentioned the presentation was correct. At the same time, the content of the documents shows a rational link to the transaction. In the light of above evidence available, the Court decided that the misspelling contained in the bill of lading as to the name of the port of destination did not constitute the document discrepant to dishonour the letter of credit as it transpired that the remaining documents had established a rational linkage to the transaction¹⁴⁷ and therefore the alleged mistake should be considered as insignificant.

This is a contrasting view to that taken in the decision made in the case of **Pasir Gudang E.O.S.B.**, where the Court held that such type of discrepancy¹⁴⁸ justifies the dishonour as it was not inconsequential to the credit agreement. However, the disputed document was a transport document in the Pasir case where the Voest-Alpine case involved documents which were not transport documents. In that event it can be assumed that the decision made in the Voest-Alpine case has taken a different view as the document in dispute was less significant to the commercial aspect of the credit.

Essentially, in the Voest-Alpine case the Court has adopted a common-sense approach which expects the bank to ascertain "whether, on their face, the entire set of documents in the presentation has an obvious relationship to the sales transaction¹⁴⁹. The court has refused to accept the nit-picking approach to examine the documents. This has let banks to ignore the insignificant discrepancies by taking

¹⁴⁷ 167 F. Supp. 2d 940 (S.D. Tex. 2000) at 949.

¹⁴⁸ A mistake in the spellings of the Port of Destination – Court held that the banks are not expected go beyond the documents presented to them and mere compliance 'on their face' is sufficient and wrongly named port of destination could have resulted in goods have been delivered to a different destination.

¹⁴⁹ Kyle Roane, *Hanil Bank v PT. Bank Negara Indonesia (PERSERO): 'Continuing the quandary of documentary compliance under International Letters of Credit'* (2004), 41 *Houston Law Review* 1053. Available at <www.lexisniexis.com>, accessed on 3rd July 2015

all the content in the presentation together to ascertain whether the entire content bears an obvious relationship to the sales transaction¹⁵⁰.

As it appears, the UCP 600 allow banks to carry out the examination sensibly and the idea of taking all the documents together as a whole to build up an obvious relationship to the sales transaction was initiated by the UCP 500, where its Articles 13(a) and 14(b) required the examiner to evaluate all documents to find out whether they are complying with the terms of credit. A similar approach with different words has been embedded into the UCP 600 with regard to the requirement of compliance. The phrase of complying presentation with reference to the ISBP has shown a green light to the principle adopted in the case of **Voest-Alpine Trading**. For example the guidance provided in the ISBP gives the examiner to adopt different methods rather than rejecting documents on mere facial appearance.

For another example, Article 14(d) of the UCP 600, states that,

“data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical, but must not conflict with data in that document, any other stipulated document or the credit”¹⁵¹.

Accordingly, the idea of refusing a document at the first sight is no longer has value under the current version. If the required word is missing in a document, the void left by in the therein can be filled by another relevant document.

Similarly, it is said that the banking sector involved with the letters of credit, have expressed their admiration towards the common sense approach adopted by the Court in the above mentioned case and it is considered that the **Hanil Bank** and **Beyene** approach is overly formalistic¹⁵². In this regard, it is significant that the UCP 600 has taken a step forward towards reaching one of its aims, which is to minimise the amount of rejections.

The other important issue related to the concept of “inconsequentiality” is that, whether the Court can declare an error as inconsequential by overruling the provision provided in paragraph 23 of the ISBP. For example, the ISBP requires the discrepant word to have the original meaning despite the fact that it has been spelled wrongly. However, when the mistake becomes obvious and still changes the meaning of the word on the face of it, will the Court still be obliged to be bound by what is stated in paragraph 23 of the ISBP?.

¹⁵⁰ Bruce S. Nathan, ‘Letters of Credit: Another Case When the LC Issuing Bank Must Pay Despite Discrepancies’, available at <https://www.questia.com/magazine/1G1-82094264/letters-of-credit-another-case-when-the-lc-issuing>, accessed on 7th July 2015

¹⁵¹ Article 14(d) of the UCP 600

¹⁵² Kyle Roane, Hanil Bank v PT. Bank Negara Indonesia (PERSERO): ‘Continuing the quandary of documentary compliance under International Letters of Credit’ (2004), 41 Houston Law Review 1053. Available at www.lexisniexis.com, accessed on 14th August 2015

The appropriate answer to the above seems to be the judgment made in **South Korean Hyosung v. China Everbright Bank (China, 2003)**¹⁵³, where the issuing bank refused to honour the payment on the grounds that, among other discrepancies, the issuer's name in the presented document has been wrongly spelled as Bnak instead of Bank.

However, the Court refused to acknowledge the case of the issuing bank and stated that as provided by the provisions of the ISBP, the alleged typing error should not be treated as a discrepancy on the ground that the error is deemed to be an obvious mistake. It was further stated that, according to facts contained in the case, it is clear that the "bank" has wrongfully been typed as "bnak" which can be categorized as a typical typographical error¹⁵⁴.

It is also important to find out what would be the outcome, if the documents submitted contain discrepancies such as-

- a) Any alteration in the name which has not been authenticated by an authorised person.
- b) If the parties have failed to notify the bank about any alteration made.

In order to answer those issues, a judgment given by a Hong Kong Court under the UCP 500 can be taken into discussion as it covers most of the areas in question.

In the case of **NEC Hong Kong Ltd v. Commercial Bank of China**¹⁵⁵ the beneficiary (NEC Ltd) went to court against the Commercial Bank of China claiming that the bank has wrongfully refused to honour the payment under the letter of credit. As provided in the credit, an agent called "Fortune System" had been named as the collector of the goods from the Port. The documents presented to the bank for examination included cargo receipts issued and signed by the authorised persons of the Fortune System. In preparing the documents for presentation, the seller noticed that in some cargo receipts, the letter of credit numbers have been switched and therefore they related to the wrong batch of goods. Fortune System authorized the seller to make 'Fortune Co' company rubber stamp and correct the errors. An employee of the seller then made the amendments applying a small round 'Fortune System' "rubber stamps" to the top of the cargo receipts. In the cargo receipts, a signature of a person called "D. Wong" appeared and under his signature there was a line which said "GENERAL MANAGER". However the bank refused to accept the documents alleging that there were discrepancies, including that in the rectangular

¹⁵³ (2003) Min Jing Zhong Zi Bo. 069; Fujian High People's Court [China] (Extracted from 'Annual Survey of Letter of Credit Law & Practice Handbook', 2006 by James E. Byrne and Christopher S. Byrnes, The Institute of International Banking Law & Practice, at 445).

¹⁵⁴ The decision made by court was purely based on the paragraph 25 of the ISBP204 & now the Paragraph 23 of its 2013 revised edition

¹⁵⁵ (2006) HKLRD 645 (HCCL 60/2000)

signature chops at the bottom of the cargo receipt, the letter of 's' at the end of the word 'systems' had been tippexed out and therefore, the signature chop was consistent with the heading of the cargo receipts of 'Fortune System'. The bank at the trial contended that the presentation of the documents was discrepant as the 's' correction had to be authenticated by an independent signature and the seller should have informed the bank that one of its employees corrected the letter of credit numbers. Further, the bank expected the seller to inform about such type of alteration and provide evidence that it was authorized to do so. Failure to inform the bank by the seller can amount to the bank being misled as the documents can amount to a fraud.

The dispute was mainly focused upon the word of "SYSTEM" in the rubber stamped areas, because it was visible that at every occasion they had used the word called "SYSTEMS". The bank in their defence stated that these alterations to the documents were made without authentication and therefore the presentation should be treated as non-complying.

On behalf of the seller, it was contended that, the authentication for the correction was made by the signature within the rectangular signature chop of "D Wong", who was the authorized signatory to sign on behalf of the "Fortune System" and it served as a sufficient authentication. The deletion of "s" did not require separate authentication. It was further contended that there was no requirement that provides a reason for the bank to be notified about the amendments and to show it had the authority received by the seller to do so¹⁵⁶.

In its judgment, the Court held that the presentation of the document was not discrepant. Firstly the existence of 's' at the end of the word 'system' was an immaterial error. It was further reaffirmed that the doctrine of strict compliance did not extend to the dotting of "i's" and crossing of "t's", or to obvious typographical errors either in the credit or in the document¹⁵⁷.

Hence, the decision made in this case has discarded the fundamental principle adopted in the case of **Bank of Cochin Ltd**¹⁵⁸. Irrespective of acknowledging the fact that a different name has appeared as the recipient of the goods and they may have been collected by a different person who is not authorized by the seller, the Court had simply relied upon the principle that the mistake in the name is inconsequential. In that aspect, the Court has allowed a minor deviation in the name of the recipient which could also led the way to fraudulent conducts.

¹⁵⁶ Considered the case of United City Merchants (investments) Ltd & Another V Royal Bank of Canada & Vitrorefuerzos SA & Another. (1983) AC 168

¹⁵⁷ Application of Hing Yip Fat Co Ltd V Daiwa Bank (1991) 2 HKLR

¹⁵⁸ (1985) 612 F.Supp. 1533

On the other hand, it is clear that the Court has again exercised the common sense approach not letting credit to be failed due to minor mistake in the name. In that sense, it can be pointed out that the Court has agreed with the decision made in **Voest Alpine**, which stated that the mistake could have been cured by examining the title of the cargo receipts which bore the correct name of the company.

In summary the discussion on case law shows that, the concept of “inconsequentiality” depends on circumstances, which are unique to each case. Therefore, the implication on measuring the ‘inconsequentiality’ cannot be considered as a universally adoptable standard. Despite that, it is noticeable, under this concept of “inconsequentiality”, that the measures that the Court has looked into is, “whether the bank can be misled by the error in the document”. Therefore, if the bank could have not been misled by an error in the document, that discrepancy can be categorised as inconsequential. In light of above, the fact that, **‘whether the bank can be misled by the wrong information created by the discrepancy’** plays in important part in the determination process.

In addition, there was enough evidence that Courts have been reluctant to adopt standards stipulated in the UCP, despite the incorporation of them into letters of credit. It seems that Courts prefer to consider the practical aspects of the cases in addition to using the guidance provided in the UCP. The irony of such practice is that the law on these issues can become unclear, because the common sense approach can supersede the provisions provided in the UCP.

3.2.5 Several documents to be read together to find out a link to the transaction.

When the inconsequentiality is determined by the bank at the document examination stage, the decision should be based on solid evidence which demonstrates a reasonable argument. The reasoning which the bank uses to arrive at such decision must be supported with logical explanations. Otherwise, the discarding of a discrepancy on the ground of ‘inconsequentiality’ can haunt the bank for accepting a discrepant document. Therefore, one way of dealing with the concept of ‘inconsequentiality’ is to find a logical linkage between the document in question and the rest of documents and/or performance of the sales contract.

As long as the document in question fulfils the requirements of the letter of credit, the additional content may be inconsequential to the performance of the sale contract. Any discrepancy in the additional content may be discarded unless they on their face contradict with the main content. For example, in a spelling mistake in a name of a

person or company contained in a document that is required by the credit for the purpose of the description of goods to be shipped, the error itself should not nullify the legality of the document as its purpose was to describe the list of goods and not to mention the name of the party involved. In other words, it can be considered as compliant if the discrepancy in a submitted document can be cured by another document which bears a logical link with each other and the sales transaction.

This situation was discussed in the above mentioned case of **Voest-Alpine Trading USA Co. v. Bank of China**¹⁵⁹, where the Bank of China was sued for unlawful refusal of payment under the credit by the beneficiary namely Voest-Alpine. However, in the credit, the name of the beneficiary was, among other typographical errors, mentioned as “Voest-Alpine USA Trading Corp.” instead of the correct version of “Voest-Alpine Trading USA Corp”.

The Bank of China refused to honour the request to make the payment on the grounds of *inter alia* that the name mentioned in the credit under the column of beneficiary is different from the name listed in other documents. In addition to that, the bank further alleged that the number mentioned in the seller’s fax as the credit number was different from the actual and the final destination of consignment has not been mentioned correctly in the Certificate of origin.

Considering the commercial aspect of the case, the bank referred the documents in question to waiver. However, when the consignment was ready for shipping, the market price had fallen dramatically as a result of it, the buyer refused to waive the discrepancies.

The Supreme Court of Texas in the USA, where the case was heard, postulated a method which the bank could use to act upon receiving the documents for examination. This method was mostly based on views expressed by Professor James E. Byrne, who gave evidence in the case as an expert witness in International credit and the UCP. Relying upon his testimony given in the case, the Court identified three possible standards which the bank could adopt in determining whether the document is duly compliant or not. They were -

1. Mirror image compliance standard - the Court found this as being very problematic since it precludes the bank from using common sense when reviewing the tendered documents. The Court pointed out the following conclusions made in the judgement in **Banco General R.S.A. v. Citibank**

¹⁵⁹ 167 F. Supp. 2d 940, S.D. Tex., 2000

International¹⁶⁰ which sets out that: “the nature of the discrepancy is irrelevant despite the fact that it is technical or not” and in the judgement in **Alaska Textile Co. v. Chase Manhattan Bank**¹⁶¹ stated that “if the documents presented reflect as nearly the same which is required by the credit, then they should not be accepted”

2. Strict compliance standard that can lead to the rejection of documents as the bank will be at risk if it accepts a marginally discrepant document.
3. Strict compliance standard, which can be applied without over reliance on any legal precedent. The only element which the bank has to be interested is that the potential harm can be caused the buyer if the discrepant documents are accepted.

In the decision making process, the Court considered the use of the second and the third standards mentioned above in addition to the first. The Court was inclined to employ a determination procedure which can balance the interests of all the parties involved, ensuring such process will remain under the purview of the law related to letters of credit transactions. However, the Court believed that the 2nd and 3rd standards mentioned above should not be promoted as they can undermine the important elements of the independence doctrine since they can force banks to extend their examination beyond face of what they have been presented with.

In addition, the Court further looked into the provisions provided in the UCP and stated that the UCP has been enriched itself and it offers a flexible and fitting standards accompanying opinions issued by the ICC. The opinion issued by the ICC in this regard reads as;

*“the term “consistency” between the letter of credit and the documents presented to the issuing bank to mean that “the whole of the documents must obviously relate to the same transaction, that is to say, that each should bear a relation (link) with the others on its face ...”*¹⁶².

On the wording offered above by the ICC, it is clear that, the Banking Commission has not intended notion that “the document presented must mirror requirement of the credit and therefore, the Court was strongly of the view that: “a common sense should prevail on a case-by-case approach, which permits to discard the trivial

¹⁶⁰ 97 F.3d 480, 483 (11th Cir.1996)

¹⁶¹ 982 F.2d 813, In 816 (2d Cir.1992)

¹⁶² International Chamber Of Commerce, Banking Commission, Publication No. 371, Decisions (1975–1979) Of The ICC Banking Commission R. 12 (1980)

deviations. A picture perfect correspondence between the documents and the terms of the credit is almost impossible to expect.

The view which the Court has taken in this case with regard to the different numbers in the document is very similar to the decision made in **E & H Partners v. Broadway National Bank**¹⁶³, where it was found that a discrepant number mentioned in a presented document did not make the tender nonconforming. However, the reasons given by the respective Courts in arriving at such a decision were different to each other. In the *E & H Partners* case the Court applied a sensible approach to find out the possibility of bank being misled by the alleged mistake, while in the Voest-Alpine case, the Court sought to establish a logical link between the discrepant document and the rest of the presented documents.

The judgments of both the Voest-Alpine case and the Hanil Bank case were entered in the same month of the same year and thus, two contrast views had been expressed on a similar type of legal issue.

In the Hanil bank case, the Court refused to accept the principle of looking into a rational linkage between the documents and decided that the wrongly spelled beneficiary's name constituted a discrepancy, which justified the dishonour. The circumstances of this case is more similar to the Voest-Alpine case, where the different legal principles applied.

3.2.6 Discussion & recommendations

The ISBP to be a necessary companion to the UCP

In summary, the issue of non-compliance of the beneficiary's name or address in the presented document have generated similar type of conclusions in various cases mentioned above. Even though, the Court decisions in all cases appear to be fairly similar it is noticeable that different standards have been made applicable in determining the issues related to each case.

In **Bank of Cochin Ltd** case the Court sought to look for possible detrimental impact caused by the mistake, referring the principles laid down in **Beyene v Irving Trust Company** and in **Hanil Bank** case in which the decision was made in accordance with the provisions provided in the UCP by adopting the mirror compliance standard. In **South Korean Hyosung Corp** case the Court looked for the possibility of whether

¹⁶³ 39 F.Supp.2d 275, S.D.N.Y., 1998.

the alleged discrepancy could change the meaning intended by the credit as provided under the paragraph 23 of the ISBP 745

Based on the facts stated in the judgment given in the Hanil bank case, it is clear that, the Court has heavily relied upon case law despite considering the principles stipulated in the UCP. The reliance on case rather than on the UCP rules, which, Kyle Roan's opinion, obstructs rather than facilitates determinations of documentary compliance based on standard banking practices¹⁶⁴. The UCP has been formed with standardized customs and practice used by banks for centuries and the rules in the UCP has been enriched best documents examination practice among banks. However, when a court makes a decision discarding the clauses of the UCP, the purpose of having incorporated the rules of the UCP becomes futile. In this regard the UCP 600 has failed to provide clear directions as to-

- a) whether the Court should rely on the principle of '*documents should appear on their face to constitute a complying presentation*' as provided by Article 14(a) of the UCP 600
- b) whether the discrepancy could affect the meaning of the word as provided by Article 23 of the ISBP
- c) the extent to which the Court can rely upon case law when the UCP has been incorporated into the letter of credit.

According to the UCP, the Court can look for;

*"the complying presentation which is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice"*¹⁶⁵.

If the main purpose of bringing the ISBP was to regularise the document checking process, it should have given clear authority to be the main source which aid the document examination process under the rules of the UCP. Any credit contract entered under the UCP will be subject to documents checking in accordance with the rules provided in the ISBP regardless of the location, type of financial institution or any trade custom or practices.

Time for further research?

In addition, neither the UCP 600 nor the ISBP provide a platform to call for expert testimony to decide whether the misspelling of the beneficiary's name or the address

¹⁶⁴ Kyle Roane, Hanil Bank v PT. Bank Negara Indonesia (PERSERO): 'Continuing the quandary of documentary compliance under International Letters of Credit' (2004), 41 Houston Law Review 1053. Available at <www.lexisniexis.com>

¹⁶⁵ Article 2 of the UCP 600.

in a document can constitute a discrepancy or not. This issue is not confined only to document examination and remains as a lacuna to be filled in future versions of the UCP. Especially, in the case of **Hanil Bank**, where the parties to the letter of credit originate from Korea and Indonesia, the decision making process could have been made much easier, if expert's testimony was used as a guidance over the issue of the discrepant name.

Admittedly, seeking of expert advice would be costly and time consuming. More often it will be difficult to find the right expert to be consulted for the right issue. On the one hand, it cannot often be expected that a banker in the USA would be aware of a Chinese or Indian name which is contained in the letter of credit. The involvement of a third party into the document examination process could therefore be controversial and such may not be welcomed by the International Chamber of Commerce. However, if permitting the use of expert testimony would help to cut down the level of document rejections it may be worth considering the introducing of a set of guidelines which may facilitate such objective. In order to draft such guidelines the following details would be helpful -

- i) when the parties enter into the letter of credit contract, they must agree upon independent experts in the relevant field to be called upon, if there is an issue as to non-compliance.
- ii) in the document checking process, the bank should carry out three different types of searches, if there is a doubt over a name or a place mentioned in the letter of credit. For example, search on the internet, reference to maps and seeking expert advice.
- iii) the searches should not exceed one hour out of the time allocated for examination of documents and the searches carried out must be duly recorded.
- iv) in the event of the bank not being satisfied with the compliance, the searches carried out by the bank should be mentioned in the refusal notice along with the time spent on them.

However, there may be criticism on the above suggestions since they can be costly and time consuming. One can further argue that, it is not the duty of the bank to carry out further investigation and the purpose of letters of credit is to rely only upon the documents which have been available for examination. For example, in a recently decided case of **Abani Trading Pte Ltd v BNP Paribas**¹⁶⁶, the Court took the similar view as above and it was held that, while citing on the principle of autonomy, the issuing banks are not required to look beyond the documents presented under the letter of credit, and are generally not obliged to make further investigations into the underlying contract.

¹⁶⁶ (2014) Lloyd's Rep. Plus 87. HIGH COURT OF SINGAPORE.

However, the wording in paragraph 23 of the ISBP implies the requirement for further research by asking the bank to look for the meaning of the word or sentence in question. Similarly, paragraphs 86 and 87 of the ISBP require the banks to do further researches on the geographical location of the Port of destination if it had been misspelled or omitted. In the light of the above, the changes made to the UCP and ISBP imply that, the ICC has taken a step forward in favour of banks holding additional searches and therefore, for the purpose of making the examination of document process more accurate and precise, the above mentioned suggestions cannot simply be discarded on the mere fact that such searches would be costly and time consuming.

The UCP as a law over the examination of documents?

The analysis above clearly indicates the reluctance of the Courts to apply the provisions provided in the UCP as guidance. It is often said, that the guidance provided by the UCP is for the bankers and not for the Court and that the Courts are not obliged to make decisions based on the provisions provided in the UCP. In addition, the case laws given above regarding the adaptation of the rules provided in the UCP indicate that in different instances the Courts have interpreted the UCP rules differently. Therefore, it is clear that, in most cases, the Courts have elaborated and applied their own judicially created standards. As results of this there have been so many different standards in circulation and none of them provide a precise, clear and comprehensive standard to ensure uniformity in interpreting the Articles in the UCP.

According to Professor Ross Buckley, “originally, the UCP was neither designed nor intended to be used as a law. It was prepared as a set of standard terms to be incorporated by reference into letters of credit by those parties who chose to do so¹⁶⁷.” This statement had also been confirmed by the UCP 500, in its preface stating that, the UCP is not legislation but a compilation of rules made by bankers for their own industry. Similarly, the UCP 600 holds the same position by stating that the UCP 600 are rules that apply to documentary credits.

In ideal circumstances, the Courts are supposed to decide whether the parties have followed the rules provided by the UCP, when the parties have incorporated its rules into their trade contract. However, it has not been the case in every instance, as evident from the case study shown above.

In that aspect, the UCP 600 has failed to go beyond the status which the UCP 500 had and a similar type of status remains under the UCP 600, which does not have the force of law. This has led to a situation where the Courts have pronounced

¹⁶⁷ Available at <http://www.lawteacher.net/free-law-essays/finance-law/letter-of-credit.php#ixzz3Poxp9EPy>, accessed on 5th December 2015

decisions with different outcomes on similar types of legal issues. The threat caused to the certainty factor by not deciding cases on the evaluation of “whether the documents submitted satisfy the requirements provided in the UCP”, could have been reduced, when the UCP 600 was brought into operation. The failure to provide necessary powers to rules in the UCP 600 therefore still remains as a main concern.

Hence, it can be suggested that it would be appropriate that future versions of the UCP should provide a necessary solution for such issue. It could be done by introducing a phrase such as -

“if the parties have incorporated the rules of the UCP into the contract, any issue arising out of the documentary credit should be decided in accordance with the provisions provided by the UCP. The adaptation of any other legal principle is permitted only in an event where the UCP is silent on such issue.”

This may give a firm recognition to the rules of the UCP as an universal system that can be implemented all over the world instead of allowing one Court to decide a case under the UCP while another chooses a completely different method.

Finding the meaning of a name or an address.

It is questionable how practical it is to find the meaning of a word or sentence which is in question. The foundation laid by the UCP 500 and the improvements made by the UCP 600 provide that the ISBP is the main source to be used as guidance when there is an issue with a discrepant document.

As mentioned previously, paragraph 23 of the ISBP requires the word or sentence to hold the same meaning even if they have been spelt contrary to the credit. However, finding the meaning of a word or sentence can successfully be carried out only in the event where the misspelled word or sentence bears a meaning of a word which is commonly used in vocabulary such as for example the words company, limited, bank, New York, London..etc. These types of words are commonly recognised and if they had been misspelled, it can easily be recognisable as an obvious mistake.

On the other hand when it comes to a name or an address, it is impossible to find out the exact meaning which was expected in the letter of credit. For example, when Smith is spelt as Smithh, it can be recognised as obvious because it has not changed the original meaning. However, if it was presented in a country where English is not the main language, it may be found that the additional letter of ‘t’ has changed the meaning of the name. Similarly, if Soran is spelt as Sorran and then it was presented to a Bank in Saudi Arabia, it may be found as an obvious mistake as that name is commonly used in that region. But, if it was up to a bank in the USA to decide, it may have been declared as a discrepancy. The search for the meaning of a misspelled name or a place is almost an impossibility when the questioned name or the place originated from a place with which the bank is unfamiliar with. Therefore, it is clear that paragraph 23 of the ISBP does not necessarily provide a proper guidance in respect of issues related to misspelled names or places.

An alternative to paragraph 23 of the ISBP?

As the UCP requires the banks to rely upon the ISBP as the main source which can be used as guidance in the document checking process, paragraph 23 has become the most important authority which covers the issues related to misspellings or errors. During the pre ISBP era, various standards applied and tested in addition to using the provisions provided by the UCP. Even in the current environment, it is clear that the Courts are still applying their own methods despite referring to the ISBP. Does this mean that the Courts do not necessarily trust paragraph 23 of ISBP? and if so, will there be a requirement for an amendment to paragraph 23?

The best way to find the answers for the above is to evaluate the case analysis carried out in this subchapter.

The obvious factor proved to be that it is not possible to apply one common standard in each and every case. The case study showed that the misspellings in a person's or company name in two instances were found not obvious, while an opposite view was taken in three other cases. This contrast in the decisions were mainly due to the fact that the 'obviousness' can vary from one region to another depending on language and practice. Therefore, it confirms that the 'obvious factor' **alone** cannot provide the right solution.

Decision making on whether the error or the misspelling is inconsequential or not can be tricky as it can expose a bank to legal liabilities. Therefore Banks are usually reluctant to accept a disputed document, despite the error appearing to be inconsequential as far as the performance of the letter of credit contract is concerned. The above analysis showed that a misspelled name of the recipients of notice or wrongly spelled port's name in a bill of lading were considered as material and significant and therefore they were declared as nonconforming. In addition a wrongly numbered insurance cover note and a misspelled company name typed without "ltd" were found to be significant and therefore they were found as non-compliant. In contrast, the error of having a wrong zip-code in a letter was found insignificant and complying. However, given the fact that it will add extra onus on the bank to decide on the importance of the error for the performance of contract, the inconsequential factor cannot be identified as the most viable alternative to paragraph 23 of the ISBP.

However, as a plus point it should be pointed out that the common sense approach "whether the documents in the presentation bears a logical link to each other" now collaborate with Article 14 of the UCP 600 which requires that the documents of the presentation to be compliant as a whole and not individually. This can be described as the most rational and fair concept, which would ultimately lead to a situation where more consistent Court decision are made to reduce the numbers of refusals.

Article 13(a) of the UCP 500 was in a form which required compliance to be similar to mirror compliance standards. The requirements were straightforward and if a name or an address was misspelled in a presented document, the most probable outcome was the refusal of payment for non-compliance. However, the ICC has moved towards leniency as against the mirror compliance standards by introducing more practical aspects to Article 14 of the UCP 600. Therefore, it is inevitable to assume that the standards like “mirror compliance” will not play a major part in the future.

The introduction of complying presentation by Article 14 (a) of the UCP 600 has not helped to root out the ambiguousness in respect of complying standards. The main visible difference therein was that greater scrutiny was given to the ISBP over the issues of non-compliance. However, the case law analysis carried out above has proved that paragraph 23 of the ISBP 745, which states, “*the misspellings and typing errors do not constitute a discrepancy only if they do not affect the meaning of the word or the sentence in which they occur*”, does not provide a viable authority, which can address issues that have arisen in a majority of cases.

It must be noted that, in the guise of the above mentioned standards, there was a main hidden element which did not come to the limelight. The fact “whether the bank can be misled by the alleged discrepancy” is an important concept to look at as the end outcome is focused on performing the letter of credit agreement irrespective of discrepancies, which do not seriously affect the entire sales transaction. For example, if the discrepancy was found to be obvious, the next question one has to ask is “has the bank not been misled by such error?” Similarly, if the discrepancy was found to be a meaning changer, such error can be recognised as misleading information. In summary, despite applying various standards, if the bank can be confident that they are not proceeding to accept the document due to misleading information which contradicts what is stated in the credit, it would be unlikely that the bank would be attracting prosecution for wrongful dishonour.

Therefore, for the sake of simplicity and adaptability, it is suggested to modify paragraph 23 of the ISBP as;

*“the misspellings and typing errors do not constitute a discrepancy only if they are found as **an obvious mistake** and do not affect the meaning of the word or the sentence in which they occur which can lead to **misleading information**”.*

This suggested article can promote the best banking practice that can be applicable to the process when the banks are required to examine the documents presented.

3.3 Discrepant dates in the document presented.

3.3.1 Introduction

One digit difference in a date contained in a presented document can become fatal and such will lead to a rejection of letters of credit. In addition to the misspellings already analysed previously and according to article 14(d) of the UCP, any details in the submitted documents which do not conform the letter of credit would make the document discrepant.

With regard to the discrepant dates contained in a document presented, subsection (d) of article 14 of the UCP 600 can be applicable which says that,

“data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit”.

Given the above circumstances, any discrepant date can make the document discrepant since the changing of a digit can make the data in the document non-compliant.

However, the approach taken by the courts to the above article varies. In some cases the courts have tended to apply strict adherence to the rule, while in other cases, the impact that such discrepancy can cause has been taken into consideration when determining how much the discrepant data can conflict with the requirements provided in the letter of credit.

Therefore, in this subchapter, the above mentioned two scenarios will be analysed to see how the courts have reacted where the beneficiary has submitted a document dated or referring to a date inconsistent with that required by the letter of credit. By doing so, there will be a discussion on the interpretation of the above rule in order to find out an optimal standard that can eliminate the confusion involved in the rule.

3.3.2. Data should not to be conflicted

In most cases the courts have interpreted the rule in a strict manner and considered the incorrect dates contained in the document as discrepant. For example, In **Voest-Alpine Inte. Corpo. V Chase Manhattan Bank**¹⁶⁸, the seller bought an action claiming to recover the amounts which were due to him by the bank under two letters of credit. The letters of credit were issued by the Bank of Baroda at the request of the buyer and they were confirmed by the Chase Manhattan Bank. Under the terms

¹⁶⁸ F.2d 680, C.A.N.Y. (1983). 370

of the letter of credit, it was required that the documents to be presented by the beneficiary to the bank which comprised with among other things;

- a) The bills of lading which mention the shipment date on or before the 31st of January 1981.
- b) Certificates of inspection issued by the qualified inspectors along with the date the shipment was effected.
- c) A certificate issued by an independent inspector confirming the weight of the goods.

When the document were presented, it appeared that, that the bill of lading had been issued on 31st of January 1981 and indicated that the goods have been loaded on board on that date. However, the weight certificates and the certificates of inspection contained different dates. In these two documents it was mentioned that the loading was effected somewhere between 2nd of February and 6th of February 1981. Accordingly, the bank refused to accept the documents and to honour the payment based on the grounds of non-compliance.

At the hearing, the court had to look into the provisions provided in article 7 of the UCP 290 (1974 Revision)¹⁶⁹, which reads that,

'the documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in accordance with the terms and conditions of the credit'.

In its judgment, the court stated that, the fact that, the loading of goods has actually been effected on the right date and what has been mentioned in bills of lading was not relevant since the other documents which were also required by the terms of the credit, contradicts the date mentioned in the bill of lading. Under these circumstances, the court held that the bank was entitled to declare the presented documents as non-compliant and to refuse the payment.

Under the current rule, the use of 'data not be conflicted' would, instead of the phrase of 'data to be consistent with'¹⁷⁰ not bring a different outcome to the case if it was to be decided under rules of the UCP 600.

3.3.3. The impact of a discrepancy into the consideration.

¹⁶⁹ The corresponding article of Article 14(d) of the UCP 600

¹⁷⁰ Article 13 A of the UCP 500- 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.

In some cases, the courts have shown a lenient approach to the issue of discrepant dates in the documents. For example, In **Breathless Associates v. First Savings & Loan Association**¹⁷¹, the court' approach made an attempt to deviate from the strict compliance approach. In order to do so, the court looked into the fact of the purpose of the requirement of having a strict compliance approach. In this case, the disputed letter of credit had been issued on a condition that the payment was expected to be made upon the presentation of a promissory note which had been dated 28th of April 1983. Hence, when the said note was presented for examination, the bank noticed it has been dated as 29th of April 1983. Accordingly, the bank refuse to make the payment citing the non-compliance.

When this matter came to court, Sander DJ stated that, it is prudent to approach this issue contemplating the purpose of imposing a rigid compliance requirement. Accordingly, it was stated that, this requirement has two purposes that are;

- a) to impose obligations on the issuing bank to carry out the examination of documents to assure the applicant that the seller will not be paid unless and until he has performed his part under the terms of the letter of credit. For example, meeting the deadline of boarding the vessel with goods.
- b) The only exception for above is a visible and/or possible defective performance or fraud which a beneficiary had played a role.

On the basis of above two grounds, a court should answer the issue by finding what may be reasonable to assume from the face of the documents.

The judge differentiated the facts of this case from the case of Voest-Alpine Inte. Corpo. V Chase Manhattan Bank and stated that the requirement laid down in the terms of the letter of credit of the Voest-Alpine case required shipment to be completed on a particular date. However, the different date shown in the documents implies the possible delay in shipping. Therefore, the requirement of effecting the shipment has played a big role as far as the performance of the underlying contract is concerned. In the light of this, the different date which appeared in the documents has implied a non-conformity of the requirements of the credit.

In contrast to above, in the current case, the execution date of the promissory note has no importance to the performance of the beneficiary. The discrepancy contained in the document could have resulted due to the nature of the transaction and the date of the execution was not an important term to the both parties. Making referring to this approach, the court stated that, the promissory note in question has complied with the terms of the letter of credit.

¹⁷¹ 654 F.Supp. 832, N.D.Tex.,1986.

However, Sander DJ emphasized that, the approach taken in this case should not be interpreted as imposing a burden of requiring additional inquiries by the issuing bank and such necessity of having an inquiry only arises when a discrepancy exists.

Essentially, it clear that the court has adopted a different standard to what had been used before. Under this approach, if the document presented bears reasonable representation of the requirement of the credit, it should not invite for a dishonour. The only exception to this is the situation where the discrepancy reflects a defective performance by the beneficiary or it signals possible signs of a fraud which the beneficiary has involved with.

However, if the court decided to stick with provisions provided in Article 7 of the UCP 290 (1974 Revision)¹⁷², which required the documents presented to be consistent with each other, the decision could have been made other way around and even under the current rule, the judgment could have been entered in favour of the bank.

3.3.4 Conclusion

In terms of the court decisions mentioned above, justifying of the dishonour should be based on the fact as to how important the alleged discrepancy against requirements contained in the terms of the letter of credit are. The opinion on a discrepancy should be based on the fact as to what kind of detriment can be caused by such issue.

However, the above implication does not support the provisions provided in the UCP 600. Article 14(d) of the UCP does support the approach applied by the court. Therefore, it can be noted that applicability of paragraph 23 of the ISBP over this issue would help to resolve the question in a more practical way. Especially, with the changes, which have been suggested in the previous subchapter to the paragraph 23 of the ISBP, the applicability of the principle laid down in the Breathless Associate case is much more practical.

However, if the matter is to be resolved under article 14(d) of the UCP 600, the principle adopted in the Breathless Associate case could not have been facilitated, irrespective of the fact as to how reasonable was the position taken by the court. On a positive note, the applicability of the provision of article 14(d) could be helpful to reduce any uncertainty surrounded under this rule. This will also helpful to reduce the amount of inconsistent court rulings irrespective of the nature of the discrepancies.

3.4 Misdescription of goods in commercial invoices

¹⁷² Similar to article 13A of the UCP 500.

3.4.1 The current legal background

In letters of credit transactions, the commercial invoices related to the goods, that have been shipped, play an important role, when it comes to the presentation of documents to the bank for payment. These invoices normally mandatory requirement in every sale of goods transaction and therefore, it is important to get the details of the content in correct order to avoid unnecessary delays or rejection of payments.

It is reported that, for the last twenty years, the insertion of incorrect descriptions of goods in the commercial invoices has become one of the most common reasons that would result in the rejection of payment¹⁷³. Under these circumstances, it can be assumed that, the high level of reported rejections of documents have resulted due to;

- 1) The lack of precise guidance available over the rules and regulations related to the drafting stages of description in the commercial invoices.
- 2) Possible shortcomings in the law which govern such issues where the banks interpret the law differently when making decisions at the examination.

The rules related to the description of goods in commercial invoices are comprised in Article 18(c) of the UCP 600 which states that,

“the description of goods, services or performance in a commercial invoice must correspond with that appearing in the credit”¹⁷⁴.

The corresponding article in the UCP 500 also implied the similar type of meaning to article 18(c) of the UCP 600¹⁷⁵. There had been calls for the rules to be changed in the pre UCP 600 era as it was not sufficient enough to minimise the level of rejection based on non-compliance due to the error in the description of goods of the commercial invoices.

The drafting committee of the UCP 600 explains why they did not consider bringing changes to the rule as;

“applying the standard of ‘correspond with’ in this instance has now become established under International Standard Banking Practice. Therefore, the Drafting

¹⁷³ ‘The Report on the Use of Export Letters of Credit’ (2001/2002) SITPRO’s Letter of Credit Report, 11th of April 2003, at 13.

¹⁷⁴ Article 18(c) of the UCP 600

¹⁷⁵ Article 27(c) of the UCP 500.

committee saw no reason to change the current interpretation or construction of this sub-article¹⁷⁶.”

The reasons given by the ICC does not give a satisfactory answer as it is transpired that drastic action should have been taken to eradicate the shortcomings in the law related to the description of goods in invoices, given the fact that, by the year 2003, it had been identified as one of the main cause that leads to the rejection of payment¹⁷⁷. It must be noted that, as it is evident, the so called “established standard” has not helped whatsoever to reduce the complicatedness of the rule.

Since, the ISBP has been referred by the UCP 600 as a guidance to use when making decisions on examination of documents, the relevant paragraphs related to the description of goods provide the provisions similar to what has been written in the UCP.

However, in spite of looking for inconsistency contained in the documents submitted, paragraph 64 of the ISBP goes with the term which is similar to article 18(c) of the UCP 600. The paragraph 64 of the ISBP 745 says that,

“The description of the goods in the invoice must correspond with the description in the credit. There is no requirement for a mirror image. For example, details of the goods may be stated in a number of areas within the invoice which, when collated together, represents a description of the goods corresponding to that in the credit¹⁷⁸”.

It is clear that, the above paragraph 64 of the ISBP has eliminated the rigorous elements required by the strict compliance rule. In addition to above, paragraph 65 of the ISBP provides further guidance on description of the goods to be contained in invoices by stating;

“The goods description in an invoice must reflect what goods have been actually shipped. For example, where there are two types of goods shown in the credit, such as 10 trucks and 5 tractors, an invoice that reflects only shipment of 4 trucks would be acceptable provided the credit does not prohibit partial shipment. An invoice showing the entire goods description as stated in the credit, then stating what has actually been shipped, is also acceptable”.

In general terms as relevant to every type of documents, the paragraph 26 of the ISBP says,

¹⁷⁶ Commentary on UCP 600, ICC publication, by the UCP drafting group (2007) page 78

¹⁷⁷ SITPRO, Report on the Use of Export Letters of Credit 2001/2002, SITPRO's Letter of Credit Report, 11th April 2003, at 13

¹⁷⁸ Paragraph 64 of the ISBP745

“Documents presented under a credit must not appear to be inconsistent with each other. The requirement is not that the data content be identical, merely that the documents not be inconsistent”¹⁷⁹.

As mentioned earlier, the previous editions of the UCP contained the same type of provision in line with article 18(c) of the UCP 600 and the paragraph 64 of the ISBP 745 also takes the same view as what stated is in the UCP, However, as cited before, the ICC published inaugural version of the ISBP in 2003 and therefore until the only guidelines the courts had was article 37(c) of the UCP 500. Finally, it is clear that both the UCP and the ISBP do not require banks to expect the description of the goods to be exactly the same as compared to the requirements stipulated in the credit and thus the data contained in the invoice must tally with the letter of credit. Roberto Bergami explains this situation as ‘the structure of the content in the invoice is immaterial and however they must be complying with the credit’¹⁸⁰.

Since, the ICC have, when drafting the UCP 600, not attempted to make any significant changes to the rule provided by the UCP500, this subchapter will strive to;

1. Find out whether the ICC have failed to make a positive impact on the issue of deviation in the description of goods in invoices?
2. Find out the areas that need to be changed in the current rule in order to be fit for the purpose
3. Extract positive elements from other authorities such as, English Law and the Case law to draft a much improved provision.

3.4.2. Alternatives beyond the UCP

The English law approach has traditionally confined to the elements of “strict compliance rule”. This approach has not been restricted only to the contracts within a documentary credit but also to the contractual obligations between the applicant and

¹⁷⁹ Paragraph 26 of the ISBP 745

¹⁸⁰ Bergami Roberto “UCP 600: Letter of Credit Rules Revised”, School of Applied Economics, Institute for Community Engagement and Policy Alternatives, Victoria University, available at <http://www.melbournecentre.com.au/Finsia_MCFS/2007/Roberto_Bergami_final.pdf>, accessed on 19th March 2015.

the issuing bank with respect to the latter's compliance with its mandate¹⁸¹. This is evident from the statement¹⁸² made by Justice Viscount Sumner, which says;

“It is common sense to assume that in such a transaction the banks which accepts the documents are entitled to claim indemnity only if they have complied with the conditions they were expected fulfil when examining the documents, The bank's branch abroad, which does not know about the content of the underlying contract makes payment. As they are not aware of the nature of the underlying contract, they cannot decide themselves what will do well enough and what will not. If it does as it is told, it is safe; if it declines to do anything else, it is safe; if it departs from the conditions laid down, it acts at its own risk”.

Under the various editions of the UCP, British courts have dealt with many cases derived from different issues. In most cases, either the Sellers had failed to submit the precise details required under the credit or the Buyers had failed to mention in the credit about the required details, which were needed to be contained in the invoice. These types of issues can easily be avoided by a negotiation between the buyer and the seller before submitting documents for examination. In addition, the Buyer can request extra details to be added in the credit at the time of negotiating their import-export contract as to the precise nature of the details that are required by the buyer and the details that are to be submitted by the seller¹⁸³. It is not possible for banks to assume as to what documents the parties are concerned most. However, where a letter of credit is clear on the nature of documents, the relevant bank must abide by the stipulation¹⁸⁴.

When going through the case law, it is clear that, the elements of “strict compliance” has continued to haunt most decisions made by Courts on the issue of the details in the commercial invoice neglecting the fact that, the credits had been subject to the UCP. It is very rare to find a decision which has gone otherwise. It may be due to the fact that, the invoice plays a crucial role in the transaction. This raises questions as to why the UCP 600 did not attempt make the rule much stricter. According to most of the decisions, the principle is very clear. It is the duty of the issuing bank only to make payment against documents that is complying strictly with the terms of the credit¹⁸⁵. It is also important to mention that, the English law has always been

¹⁸¹ Benjamin's Sale of Goods, 9th Edition, Chapter 23 - Documentary Credits, Meaning of Compliance, at 23-101

¹⁸² Equitable Trust Co of New York v Dawson Partners Ltd, [1927] 27 Lloyd's Rep 49

¹⁸³ Leo D'Arcy, Carole Murray, Barbara Cleave, Schmitthoff's: The Law and Practice of International Trade, (10th edition, Sweet & Maxwell, London, 2000), Chapter 7, at 7-001

¹⁸⁴ Charles Chatterjee, 'Letters of credit transactions and discrepant documents: an analysis of the judicial guidelines developed by the English courts', Journal Of International Banking Law, (Oxford, December 1996) P.510-517, V.11, N.12

¹⁸⁵ Glencore International AG v Bank of China [1996] 1 Lloyd's Rep. 135 at 152, and also Chailease Finance Corp v Crédit Agricole Indosuez [2000] 1 Lloyd's Rep. 348 at.358; Credit Agricole Indosuez v

reluctant to accept that the rule of “strict compliance” is an absolutist pedantry requirement¹⁸⁶. There are a few decisions recorded where the substantial compliance rules have been applied over the issue of the description in the credit. In general, to some extent, Courts have expected, the banker to exercise his own judgment to find out whether the requirement mentioned in the credit is satisfied by the documents presented to him¹⁸⁷.

In order to understand the circumstance which make data in the description discrepant, it is important to analyse the case law which provide clear indications about the principles used when solving the issues. For the purpose of better understanding, the following case study will be divided into three parts given the nature of the issues involved. At the end there will be an evaluation of the issues discussed in this subchapter to find out whether the current rule is sufficient enough to solve the question on description of goods in commercial invoices and whether it is necessary to bring amendments to the current provisions. Finally, there will be a further attempt to frame a more comprehensive provision which can cater to any sort of problem if it is deemed to be needed

3.4.3. Can the Similar trade terms do the business?

The terms which are commonly recognised only in trade may not be accepted by the banks as a substitution to the original term which has been provided in the credit. Banks are not expected to play a role of a trade specialist at the process of document examination. Therefore, it is clear that there is no room for the similar trade terms that might be well understood between the parties in trade, hence not being mentioned in the credit¹⁸⁸.

The landmark case with regard to the “similar trade terms” was **Rayner (JH) & Co Ltd v Hambro's Bank Ltd**¹⁸⁹, where the credit required the invoice and the bill of lading to contain the name of “COROMANDEL GROUNDNUTS”, which was referred to in the subject matter of the transaction. In addition to that, it was further required

Generale Bank [2000] 1 Lloyd's Rep. 123 at 127. As cited in Michael G Bridge 'Benjamin's Sale of Goods', (9th Edition, Sweet & Maxwell, London, 2014) Chapter 23 - Documentary Credits, Meaning of Compliance, at 23-101

¹⁸⁶ Michael G Bridge, 'Benjamin's Sale of Goods', (9th Edition, Sweet & Maxwell, London, 2014) Chapter 23 - Documentary Credits, Meaning of Compliance, at 23-101

¹⁸⁷ Banque de l'Indochine v JH Rayner Ltd [1983] Q.B. 711 at 721, Parker J: “Lord Sumner's statement cannot be taken on board as it requires meticulous fulfilment of exact wording in all cases. There is a possibility of allowing slight margins”.

¹⁸⁸ Courtaulds North America v. North Carolina Bank (1975) 528 F.2d 802, C.A.N.C.

¹⁸⁹ [1943] KB 37

to be mentioned in the invoice that the “Coromandel groundnuts” are the ‘one mostly available in London’.

Although the invoice presented by the beneficiary rightly contained the words of “Coromandel groundnuts” , the accompanied bills of lading mentioned the words of “machine-shelled groundnut kernels” along with a note stating that, the country of origin as British India. In the bill of lading, there was a margin note, which included the letters “CRS”. However, when the documents were presented to the confirming bank, the payment was rejected on non-compliance with terms of the credit.

Being aggrieved by the bank’s decision, the beneficiary brought a law suit against the bank’s wrongful failure to honour the credit, citing the grounds of;

- a) CRS was an abbreviation for Coromandel;
- b) a sale of “Coromandel groundnuts” was understood by all London groundnut traders to be meant as groundnut kernels that have been shelled by machines
- c) the bills of lading for such kernels normally referred to “groundnut kernels”.

However, the beneficiary’s plea was not accepted and in the judgment, it was declared by the Court of Appeal as the documents were discrepant. It was further stated that, the understanding among the groundnut dealers cannot be taken into consideration as it is almost impossible to assume that the bank could have had such knowledge. Even if it is deemed that, the bank was aware of the use of such similar term, it cannot be expected of them to use them unless it was mentioned in the credit by the applicant. The required level of compliance does not depend on the knowledge that relevant people in a particular branch of a bank may happen to possess¹⁹⁰. The knowledge possessed by one branch may not be sufficient as various banks and branches can be involved in one credit.

It is also important to understand the current situation relating to abbreviation as provided by the ISBP. The paragraph 24 of the ISBP¹⁹¹ allows generally accepted abbreviation to be used in the credits. However, the letters of “CRS” cannot fall under the category of “generally accepted abbreviation” as it is a term which only the parties involved in groundnuts business are familiar with. This shows that, under the ISBP, the use of abbreviation must be straightforward and it should be limited to the terms which are mostly used in common

¹⁹⁰ United Bank Ltd v Banque National de Paris [1992] 2 S.L.R. 64 at 74-75.

¹⁹¹ The use of generally accepted abbreviations, for example “Ltd.” instead of “Limited”, “Int’l” instead of “International”, “Co.” instead of “Company”, “kgs” or “kos.” instead of “kilos”, “Ind” instead of “Industry”, “mfr” for “manufacturer” or “mt” instead of “metric tons” - or vice versa - does not make a document discrepant.

Although, the circumstances of the above case referred to an error in the bill of lading, the similar rules could have been applied if the alleged error was in the commercial invoice. The law applicable to discrepancy in the invoice when a similar type of issue has arisen as mentioned above was discussed in the judgment made in **Soproma SpA v Marine & Animal By-Products Corp**¹⁹², where a lawsuit was arisen over the sale of Chilean fish full meal. However, in this case while the commercial invoice providing the correct details, a supporting document, namely analysis certificate stated different details which were contrary to requirement in the credit. The contract described the goods as "CHILEAN FISH FULL MEAL, STEAM-DRIED, MINIMUM 70% PROTEIN", which was the description required in the letter of credit. The invoice provided by the seller described the goods as "CHILEAN FISH FULL MEAL, 70% PROTEIN". However, there was another document in the submission which was in error and described the goods as "CHILEAN FISHMEAL MINIMUM 67% PROTEIN". This situation created a dilemma as to, whether an additional document can nullify the merits of a duly complied commercial invoice. At the first instance, the arbitrators found that "Chilean fishmeal" was complying under the terms of the letter of credit which required the goods to be described as "Chilean fish full meal" on the basis of their findings and their own knowledge of the trade. It was stated that, commercially there was no difference of fishmeal from Chile, whether it was a full meal or not and anyone in the same trade would not expect the documents to give a more specific description other than "fishmeal".

In the Arbitration, it was acknowledged that the similar trade terms exist for the subject matter and therefore, the alleged discrepancy does not make the document non-complaint. However, in the judgment, the Court of Appeal took a different view discarding similarity of the terms confirmed by the Arbitrators. Alternatively the Court looked for the importance of the 'analysis report' and its capability to nullify the significance of the commercial invoice. Accordingly, the court stated that, it has made no finding as to the effect of any of those inconsistencies. The court was of the view that the only documents which need to be tendered were the invoice and the bills of lading. Therefore, quite apart from the shipper's invoice, the other document is probably irrelevant, though it may well have afforded the buyers with a well-justified reason for doubting the true protein content of the goods. Finally the court held that, the two documents relied upon by the buyers in their rejection, namely, the shippers' certificate of quality and the certificate of analysis were not important shipping documents to be tendered under the terms of the credit and therefore, buyer's rejection for payment was unreasonable.

In the light of above, it is clear that, similar trade terms do not have any validity under the current legal environment and the invoice must duly comply with the terms stated in the letter of credit. The complexity of letting similar trade terms to be used could attract more causes for litigation. On a perusal of case law, so far, no phrase can be

¹⁹² [1966] 1 Lloyd's Rep. 367

found, which says that, a similar trade terms used in the invoice can substitute a description stated in the credit and such substitution can make a positive effect on the compliance rule. This was further confirmed by the judgment made in the case of **Courtaulds North America v. North Carolina Nat. Bank**¹⁹³, which stated that, “the similar trade terms, which might be well understood by the trading parties, will not be tolerated in the goods description of the commercial invoice”.

As there were no changes from the UCP 500 to the 600 over the rule related to the description in the invoice, the only significant fact which the future version of the UCP to take into consideration is, whether the UCP can let similar trade terms to be used in the invoices as substitutions for the original words used in the credit. However, it seems highly unlikely as it could make the rule very complicated.

3.4.4 Omissions in the description

The omission of words in description of goods against what required by the credit can make the document non-compliant. However, this has not been the case at every instance. There are number of cases which the courts have allowed documents to be accepted, despite having lack of details in the description. As mentioned before, throughout the life span of the UCP, it has been maintained level of the requirement for compliance over the description in the invoices to be as ‘corresponding’. It has not imposed tougher requirement like ‘details to be identical’. In most of the cases, the irregular details of the goods in invoices have led the presentation to be rejected. However, the requirement of details to be ‘corresponding’ with the credit has not given a clear-cut measure for the rule to be precise over the issue of omission of words in the commercial invoices. This part of the exercise will examine the practicality of the word ‘corresponding’ under the terms of the omissions in the description.

The courts have often been reluctant to renounce interpretation of rules related to omission of words deviating from the strict compliance rule. It has always maintained standards described in **Equitable Trust Company of New York v. Dawson Partners, Ltd**¹⁹⁴. It is transpired that, the most of the decisions have rightly been made to provide a cover for buyers and especially the bankers who know nothing about the goods other than the documents. The fine example for this is the Judgment made in **Courtaulds North America v. North Carolina Nat. Bank**¹⁹⁵, where the terms of the credit required the commercial invoice to be contained the words of “100% ACRYLIC YARN” as the goods that have been shipped. However,

¹⁹³ (1975) 528 F.2d 802, C.A.N.C

¹⁹⁴ (1927) 27 Ll.L.Rep. 49, at 52

¹⁹⁵ (1975) 528 F.2d 802, C.A.N.C.

the presented invoice stated them as, "IMPORTED ACRYLIC YARN" and the payment was refused as a direct consequence. When the action was brought to the court on unlawful refusal to pay, it was decided that the issuing bank has acted lawfully in its refusal to accept the invoice, which was not confirmed the requirement stated in the credit. The court stated that,

"the words contained in the terms of the credit require each invoice must, on its face, cover 100% acrylic yarn. Any deviation will not be tolerated in the trade. There is no any substitution and any equivalent"¹⁹⁶.

According to the plea of the beneficiary, the court inquired that, whether an additional document could provide a cover to fill the void left in the commercial invoice. "Cartons marked: -100% Acrylic" was correctly mentioned in the packing list which was presented with the invoice. However, the court did not see it as a way that could remedy the discrepancy. The Court emphasised that under the UCP, there is a clear distinction that lies between "invoice" and the "remaining documents" and the importance of an invoice cannot be compared with a supporting document. The court reiterated that, "it is a well-recognised practice and/or a custom in the banking sector to treat any document marked as invoice with a clear distinction from other documents"¹⁹⁷. Given the facts stated above, the court stated that issuing bank has correctly rejected the documents which did not conform the requirements of the credit

In **Oei and M.J.F.M. Kools v. Citibank International**¹⁹⁸, the Buyer sued the Bank for wrongful honour of the letter of credit and named the issuing bank and the confirming bank as defendants.

According to the terms of the credit, it was required four copies of commercial invoices to be contained the description of the goods as "LEVI JEANS 501-0191, NEW, ORIGINALS, MADE IN USA". However, when the documents were presented to the bank, in the commercial invoice, the description of the goods missed the word of JEANS. Hence, the main invoice appeared to be contained word of JEANS which was mistakenly printed right over the word of LEVI. The copies of the invoice, which were presented along with it, did not mention the word of JEANS. Despite, having one word missing in the description, the bank cleared the payment relying upon the main invoice submitted.

The court did not agree with the position taken by the banks and stated that the description of the goods in the invoice must mirror the description required by the

¹⁹⁶ 528 F.2d 802, C.A.N.C. 1975, at 806.

¹⁹⁷ 528 F.2d 802, C.A.N.C. 1975, at 806.

¹⁹⁸ (1997) 492, S.D.N.Y

letter of credit. The court stated that, the discrepancy in the description was significant because, one of the fundamental characters of the documentary credit transaction is to ensure receipt of the exact goods which the buyer has ordered. Therefore it is utmost important to have the description of the goods which mirror the exact picture of the goods that have been ordered.

As far as the facts in the case are concerned, leaving out of the word of “JEANS” may compel the bank to assume that the incorrect goods have been shipped¹⁹⁹ and accordingly the court decided that the Banks have acted unlawfully.

The decision made in this case shows the value of having the commercial invoices which have mirrored the exact wordings stipulated in the credit. It is also important to note that, when the terms of the credit requires the parties to produce copies of a document, these copies must mirror the original document. Failure to adhere that precedent may lead to situation where the entire presentation will be rejected.

According to the decision mentioned above, when the invoice lacks a word which describes goods such as its name, it would constitute the document discrepant. When the credit requires the name of the product which has been shipped to be mentioned in the invoice, the seller should make sure that the invoice consists the right description. If the name of the goods contains more than one word, each and every word should be duly included as the description in the invoice.

It is widely expected the parties to be obliged with each and every terms in the credit and any deviation from them is not allowed unless it has specifically mentioned in the credit. The parties must be vigilant to follow the words of the credit and where an expression being used which make details lack against what required in the credit, such use should have amicably been agreed by the all parties. Especially it is the seller's responsibility that he would do well to ensure, that the letter of credit payment mechanism will be triggered by the presentation which is within his exclusive control²⁰⁰. In addition to that, any numbers related percentage, weight, length, height, capacity...etc must meet the correct amount and any slight deviation can make the invoice non-compliant.

In **Ky. Compania Naviera v. National Westminster Bank**²⁰¹, the seller, sued the bank on the grounds of refusal of payment under the credit issued by the Janata Bank on purchase of a Greek vessel called 'Lena'. The credit was confirmed by the National Westminster Bank.

¹⁹⁹ 492, S.D.N.Y., 1997, at 505

²⁰⁰ Iain Goldrein, Matt Hannaford, Paul Turner, 'Ship Sale and Purchase', (Taylor and Francis publication, June 2013), Page 295

²⁰¹ 1 Lloyd's Rep. 68 1981

The payment was available against several documents including the commercial invoice. According to the credit, the invoice should indicate the year of built as "January 1951", the weight as "about 11250 tons gross" and the net "about 5790 tons". However, the tendered invoices contained discrepancies as to the figures of a gross and net and the year of built had not been mentioned.

The letter of credit was issued under the provisions of the UCP 222 (1962 Revision), and its Article 30²⁰², which is an equivalent to Article 18(c) of the UCP 600, provided that the content of the invoice must correspond with the description provided in the credit.

It was discussed at the court whether the discrepancies as to the figures of a gross and net register of tonnage should be allowed²⁰³ as per Article 32 of UCP revision 1962, which allowed a difference in the margin of 10% per cent more or 10% less than the amount or the quantity indicated, whenever the words "about", circa or similar expressions are used. However, the court stated that, if it is not specifically mentioned in the credit, the beneficiary cannot seek immunity from any term mentioned in the credit. If the seller used an expression which is different from the words of the credit, there should have been agreement between the buyer and the sellers on such deviation. It is important that all the parties must maintain strict adherence to this principle. Departure from the principle would leave banks in some sort of uncertainty and it is important to have those uncertainties avoided for the purpose of proper operation of the credit system²⁰⁴.

In the light of the grounds given above, the court decided that the invoices make the presentation discrepant and therefore, the bank's decision of not to dishonour is justified. This decision indicates that, if the words or details have been missed in the invoice against the credit, the provisions²⁰⁵ in the UCP do not provide remedies for them. The requirements are clear. It is the obligation of the seller to provide an invoice under the terms of the credit which comply with the requirements of the UCP. When there is request to include a specific detail for an item is required in the description by the credit they must also be included in the invoice.

In much similar circumstance to the facts of the above case, it was stated In **English, Scottish and Australian Bank v Bank of South Africa**²⁰⁶, that;

²⁰² Same as article 18C of the UCP 600

²⁰³ Article 32 of UCP 222 (1962 Revision)1983 now stands for Article 39 UCP 500 revision 1993 and Article 30 of the UCP 600

²⁰⁴ (1981) 1Lloyd's Law .Rep. at 76

²⁰⁵ Article 39 UCP 500 revision 1993 and Article 30 of the UCP 600

²⁰⁶ [1922] 13Lloyd's L.Rep.21

"It is elementary to say that a person who ships in reliance on a letter of credit must do so in exact compliance with its terms. It is also elementary to say that a bank is not bound or indeed entitled to honour drafts presented to it under a letter of credit unless those drafts with accompanying documents are in strict accord with the credit as opened²⁰⁷."

It is important to mention that, there are some reported instances where the courts have shown some leniency towards the issue of omission of words in the description of the commercial invoices. However, the limitation on showing leniency depends on circumstances of the particular case. The grounds for such leniency derives out of the words used in the UCP. Therefore, it can be argued that the use of the word "correspond" instead of "identical" invite the substantial elements of the compliance rule rather than the stricter aspects.

In **Lu Hop Hong v. Bank of East Asia**²⁰⁸ a letter credit was issued for the sale of "SECOND-HAND GARDNER 8L 3 DIESEL ENGINES. The model of the engine was required to be as "GAEDNER MODEL 3 UC 3:1 REDUCTION MARINE GEARBOXES". When the seller submitted the invoice to the bank, it was revealed that the word "MODEL" under the description of the engines has been omitted. However, the issuing bank accepted presentation despite the omission and made the payment. The dispute was arisen, when the reimbursement was refused by the buyer claiming that the omission of a word in the commercial invoice has made the tender non-compliant.

The letter of credit was issued under the provisions provided by the UCP 222 (1962 Edition). The buyer claimed that the wording of Article 30 required the rule to be defined strictly and therefore, the omission in the invoice should be declared as non-compliant.

However, the court refused to interpret article 30 in strict manner and stated that the wording of the article 30 requires the description of the goods to be corresponded with the terms of the credit. In the light of above, the court stated that the omission of the word 'Model' does not make the presentation non-compliant.

In the judgment, the court described the reason behind the slight deviation from the normal practice as,

²⁰⁷ M. Adam, M Ibrahim 'The problems relating to interpretation of the strict compliance rule in letters of credits practice', available at <http://www.dradamlawoffice.com/pdf/the_problems.pdf>, accessed on 3rd May 2015

²⁰⁸ (1973) HKLR 521, FC

"it can be said that, there may be instances where an omission of a word like 'model' can become fatal. However in terms of the evidence produced, it is clear that the notation of '3UC' was a model number²⁰⁹."

Accordingly the court rejected the buyer's claim stated that the bank was right to honour the request for payment. The precedent adopted in this can be question as it requires cannot be applied each and every case as it is not the banker's duty to find out which part in the description is commercially viable. In addition, it may attract more litigations since such practise would be more complicated.

Instead using "correspond in all material particulars" when deciding the impact of an omission in the description, in **A. E. Navegacion v. Chase Manhattan Bank**²¹⁰, the court looked for the effects on such omission, which can threaten the validity of the invoice.

The seller, Astro Exito Navegacion S.A., sued the confirming bank for unlawful refusal to honour the payment under a letter of credit. The Manhattan Bank had refused to make the payment claiming that the documents submitted over the sale of a Greek vessel do not correspond with the terms of the credit.

The bank contended that, the commercial invoice presented by the seller had not been described details which were required by the credit. Among those omissions the words of "Ex Berger Pilot", which was a technical term for vessel's capacity, had been replaced by "Previous Berger Pilot" in the commercial invoice. The letter of credit was subject to article 32(c) of the UCP 290 and the court held that, the expressions "ex Berger Pilot" and "previous name Berger Pilot" indicate the same meaning.

Mr. Justice Leggatt stated that the words which the Applicant claimed as omitted were surplus to details in the description. He pruned the ancillary parts of the description and decided that the court is satisfied with the details included in the invoice which cover the purpose of having such document. The court explained that Article 32(c) of the UCP 290 suggests the details of the description must correspond with all the elements required by credit. However, the particular article does not say that the content of the invoice must be the same as the terms of the credit²¹¹.

The question is, when the credit requires some details to be included in the invoice, can the bank decide which parts of them are surplus in the description. The rule should apply to all the details required by the credit unless the parties have agreed

²⁰⁹ (1973) HKLR 521, FC, at 527, 528

²¹⁰ (1986)1 Lloyd's Law Rep. 455

²¹¹ (1986)1 Lloyd's L Rep. 455, at 458

otherwise. It should not be imposed extra burdens on the banks which are not experts in the trade which involved shipping various types of goods.

Since, the rule in the UCP 600 related to omission in description of the invoice remains the same as its predecessors the only significant facts which the future version of the UCP to take into consideration is that;

- a) Can the UCP let the banks to identify the most important elements in description
- b) Can the bank discard any omission in the details which are surplus in the description

However, such drastic changes seem highly unlikely as it could make the bankers responsibilities on examination of documents very complicated.

3.4.5 Additional words in the description.

The commercial invoice normally contains a description of the goods or services or performance that corresponds with the description in the credit and sometimes, it can contain additional words, which are not mentioned in the credit. The general presumption is that, the presence of additional details related to the goods that have been shipped do not necessarily make the document discrepant. The UCP does not impose a limit on the description in the invoice to be confined to what has been stated in the credit.

The limit which the additional words are allowed in the description ends when those extra words can change the meaning of the goods that have been shipped. In other words, noncompliance can occur, when the substance of the additional words renders a lack of correspondence within the description indicating a different meaning against what is required by the credit. For example, a bank may tend to reject the invoice which says "second-hand" when the credit does not mention such words under the description of goods. The next question is, for example, when the credit requires the description in the invoice to be "men's T-shirts", if the invoice included an additional word within the brackets "(Medium)" could that be described as discrepant? As it has been mentioned before, drawing a line as to the factors which may/may not constitute a discrepancy is almost impossible.

Nevertheless, the following case study is cited with a view to find out whether the UCP 600 has missed any important elements that can bring more certainty over the issue of additional words in the invoice which may lead to a discrepancy.

The landmark case for this is **Glencore International AG v Bank of China**²¹², where a dispute arose between Glencore international AG as the seller and Shan He Trading Company Limited, as the buyers over the sale of aluminium ingots. The payment was agreed to be made by way of an irrevocable letter of credit against presentation of various documents such as the invoice, a list with packing and weight details and a certificate of origin. The letters of credit were opened under the UCP 500 by the Bank of China which was the defendant in the case. The terms included *inter alia*, a specific clause requiring the origin of goods to be Western, excluding India and Egypt. The contract of sale contained provisions for arbitration under the rules of the London Metal Exchange ('LME') and English law. Both letters of credit contained identical terms. When the documents were presented for payment, the amended invoice contained the origin of the goods as 'any Western brand'.

The negotiating bank in London with documents submitted by Glencore, tendered them to the Bank of China requesting reimbursement in accordance with the terms of the letters of credit. However, the Bank of China rejected the documents citing, among other discrepancies,

1. The presented copies of the invoices described the origin of the goods that had been shipped as "any Western brand - Indonesia (Inalum Brand)' contrary to the letter of credit, which required them to be as 'any Western brand'.
2. Copies of the packing list did not disclose or identify the goods shipped adequately or at all

Apart from that, the Bank of China also pointed out that, the buyer has rejected the goods on the ground that they were not in conformity with their contract.

In determining whether the Bank of China has acted lawfully in its rejection of the document, the Court of Appeal held that:

"the origin mentioned in the letter of credit as any Western brand bears a very broad general meaning; the inclusion of "Indonesia (Inalum brand)' does not alert the bank to concern with. It was clear that on the face of the document, the words "Indonesia (Inalum brand) had been used to provide a precise description of the goods. It is evident that, this precise description of the brand fall within the general description mentioned in the credit²¹³".

Accordingly, the Court of Appeal held that, the alleged description in the invoice did correspond with the requirement stipulated in the letter of credit. This level of compliance would satisfy the criterion in Article 37(c) of UCP 500²¹⁴. Therefore, it was held that the additional details provided in commercial invoice would not cause

²¹² (1996) 1 Lloyd's Rep 135

²¹³ (1996) 1 Lloyd's Report 135

²¹⁴ Equivalent to Article 18(C) of the UCP 600

any detrimental effects and they are in compliance with the requirement mentioned in the credit.

It is important to note that, at the Commercial Court, against which the appeal was made, it was stated that the inclusion of “Indonesia (Inalum Brand)” may have implicated a special trade meaning which the bank has no knowledge at all, and in the light of that, the bank was entitled to reject the document.

However, the Court of Appeal’s decision consider the additional words in the sense of broad general way can be seen flawed. Neither the UCP 500 nor the UCP 600 require the banks to have knowledge to understand that there trade terms in the aluminium trade. The Court of Appeal’s reasoning for its conclusion was that, the extra usage of words have been used to describe the precise trade brand which comes under general meaning contained in the credit. This additional words under any possible reading standards aimed to indicate that goods do not fall under the general description²¹⁵.

The Court of Appeal further explains that, it felt deprived by considering otherwise and referred to a publication²¹⁶ by the ICC, which discusses the UCP rules in regard to the description of goods in commercial invoices. The publication says;

“Certain National Committees recommended that the word “correspond” be replaced with “identical” in respect to the description of the goods appearing in the commercial invoice versus that of the credit. The Working Group felt that the word “identical” was too restrictive and would place an undue burden on all the parties to the documentary credit and increase the number of discrepant invoices presented. At times additional information is supplied in the description of the merchandise appearing in the commercial invoice, those additional information may not be considered detrimental or inconsistent with the requirements in the credit and therefore it is acceptable²¹⁷”.

However, the view taken by the Court of Appeal’s contradicts Donaldson J’s explanation made in **M Golodetz & Co Inc v Czarnikow-Rionda Co Inc**²¹⁸ which states that, the test is whether documents are ‘properly read and understood’, call for no further inquiry and it casts no doubts at all upon the fact that the goods were

²¹⁵ (1996) 1 Lloyd’s Report 135 at 119, 120

²¹⁶ Charles Del Busto, ‘UCP 500 & 400 compared’, (ICC Publication, July 1993), page 100 in the context of article 37

²¹⁷ (1996) 1 Lloyd’s 135 at 120

²¹⁸ (1979) 1 Lloyd’s Report 450

shipped²¹⁹. Therefore, the court ruling in the Glencore case does not bear a profound insight into the real issues.

It was not the bank's duty to do further investigations to find out whether the additional words do not contradict what is required in the credit. This fundamental principle was well established and it is evident by the decision made in **Hanson Vs Hamel and Horley Limited**²²⁰ where it was stated that, "when the documents are handled by banks; they have to accept or reject them promptly and it should not be left for prolonged inquiry".

It must be noted that, one can argue that decision made in Glencore case would indicate that the court had been considering the substantial compliance standards. However someone can disagree by saying that the Court has deviated from the precise requirement provided by the UCP. Has this led to situation where the terms of the UCP was not precise enough? If it was the case, why did the ICC not attempt to amend the rule?

On the other hand, the ICC may have expected the rule to remain simple. That is why it has been described, in the documentary credit mechanism, that the Seller should follow the exact words of the letter of credit, and the description of goods on the invoice must correspond to that in the Credit²²¹.

Apart from above case, in **Melli Bank Iran v. Barclays Bank**²²², it was discussed about the stages where an additional word can make a document discrepant under the English Law. The confirming sued issuing bank against unlawful refusal to reimburse the money which had been paid to the beneficiary under a letter of credit issued on a sale of 100 Chevrolet Trucks. The Issuing Bank in their defence claimed that the documents presented were discrepant.

According to the confirming bank, the payment was authorized as the invoice produced confirmed the shipment of 100 Chevrolet Trucks. However, the description provided in the invoice indicated words of 100 'Chevrolet Trucks in new condition'.

When making the decision, the court stated that, the usage of '100 Chevrolet Trucks in new condition' does not mean the same as '100 Chevrolet Trucks' and therefore, the strict requirement provided in the UCP has not been satisfied.

The court further stated that, the expression of '100 Chevrolet Trucks in new condition' may have special meaning in the trade field and however, from the

²¹⁹ Gutteridge and Megrah, *The Law of Bankers' Commercial Credits* (7th edition, Europa Publishers, London, 1984) at pp. 118–123 under the heading 'Compliance of documents'

²²⁰ (1922) 2AC 36

²²¹ As mentioned in the above cited *Ky Compania Naviera* (1981) 1 Lloyd's Rep. 68

²²² (1951) 2 Lloyd's Law Rep. 367

banker's point of view, the description of 'in new condition' does not mean the same as 'new'.

In conflicting with what has stated in above mentioned Glencore case, in **Sunlight Distribution, Inc. v. Bank of Communications**²²³, it was decided that, it is not the bankers' duty to reconcile discrepancies when determining whether the documents is compliant. In this case, the bank has refused to honour the payment due to inter alia, the discrepancy contained between the description of goods in the invoice and in the credit. The court was of the view that the bank is not required to go further beyond what they have presented with to examine the additional words would fall under the same meaning intended in the credit. It was also stated that the strict compliance rule should be applied when the description contains the words which give technical meanings which another party cannot understand.

3.4.6. Discussion & Recommendations

i) Flexible approach

As the UCP requires the description in the commercial invoice to be "corresponding" with the credit, it may mistakenly be understood that, literal compliance rule has been encouraged. However, most of the time, it was not the case in terms of the case studies carried out above. As there were no changes to the rule related to the description in the invoice from the UCP 500 to 600, both authorities have not provided any particular flexibility to adopt the literal compliance approach²²⁴. When the banks apply the strict compliance rule over the description and due to the strictness of the standards applied, there may be so many discrepancies to uncover. This may have led to the high volume of rejections which have been reported during the last ten years. If the rule is to be relaxed, it may reduce the amount of rejections. However, it is not easy to find a word that can replace "corresponding" in a more lenient way. If it is to be changed, the word which can replace "corresponding" should be able to strike a balance between literal compliance and the strict compliance. Moreover, it should not attract further litigation.

Until any future changes to be implemented to the rule, the advice to the Seller is simple. Irrespective of the word "corresponding", the invoice must be copied the

²²³ (1995) WL 46636, S.D.N.Y.

²²⁴ Bergami Roberto, "UCP 600: Letter of Credit Rules Revised", School of Applied Economics, Institute for Community Engagement and Policy Alternatives, Victoria University, available at http://www.melbournecentre.com.au/Finsia_MCFS/2007/Roberto_Bergami_final.pdf, accessed on 8th November 2015

description provided in the credit. Even a slight deviation in the invoice from the credit, according to the current legal environment, may constitute a discrepancy which would result in a refusal to honour the payment.

In that aspect, this is one area that the UCP has failed to address one of its main aims which is to reduce the amount of the documents rejection level.

ii) **No changes from the UCP 500 to 600**

As discussed above, the wording of the provisions of the UCP regulating the description of goods in the commercial invoices has not changed from the UCP 500 to 600. However, the introduction of the ISBP has brought some significant aspects to the rule. The most important aspect of the ISBP is that it does not require the compliance of “mirror image”²²⁵.

As per the paragraph 64 of the ISBP, the reasoning given in above **Oei and M.J.F.M. Kools** and **Sunlight Distribution** are not correct, which described the mirror image as a must²²⁶.

Due to the inflexible nature of article 18(c) of the UCP, as per the case study above, the courts have developed their own standards to interpret the law related to the description in the commercial invoice. In some cases, the courts were holding the view that, it is mandatory to follow words in the credit closely when describing them in the commercial invoice²²⁷.

In Courtaulds North America case²²⁸, the court held that, no similar trade terms are permitted although they may be well understood by the trades. It was further stated that, any discrepancy in the invoice cannot be supplemented by any supporting document. This show the vital part plays by the invoice in letters of credit.

According to the paragraph 69 of the ISBP, with regard to the trade terms, if they are mentioned in the credit, accordingly it must be reflected in the invoice too. This may be interpreted in the sense that, the similar trade terms in the description can only be accepted if those words have also been used in the credit. Given this scenario, the ISBP has attempted to clear out one major concern that remained in the description in the commercial invoices.

²²⁵ Paragraph 64 of the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP), ICC document 470/951rev4

²²⁶ Paragraph 64 of the ISBP, There is no requirement for a mirror image. For example, details of the goods may be stated in a number of areas within the invoice which, when collated together, represents a description of the goods corresponding to that in the credit

²²⁷ Bank Melli Iran, Courtaulds North America Inc., Kydon Compania Naviera S.A. and Sunlight Distribution Inc.

²²⁸ Courtaulds North America, Inc. v. North Carolina Nat. Bank, 528 F.2d 802 (4th Cir. 1975)

Apart from that, according to current provisions in the UCP, the courts have reiterated that, the banks are only expected check wording of the invoice to find out whether they matches with the description of goods in the credit. It is only needed to compare the tendered documents and the credit, they cannot be expected to be aware of the details which are unique to the particular trade which the letter of credit was subject to²²⁹. Accordingly, it is not expected that the banks accept technical terms which are mutually replaceable or understandable in the trade.

However, in contrast to most of the cases mentioned above, there were examples that the courts did not apply strict rules on examination of the invoices. Especially in **Lu Hop Hong** case²³⁰, it was stated that, omission of words not material to description required and therefore, the invoice was not non-compliant.

As per the above situation, it is clear that, the ICC has not given much attention to consider the materiality of the discrepant word/s against what has been stated in the credit. It is important to note that, the materiality will depend on the circumstances around each and every case. Therefore, it is not easy to impose rules on materiality as it may make grounds for further litigations, if the banks are to interpret them on their own terms.

iii) A cure for the issues

In order to eliminate the issues over the description in the invoice, the proactive adaptation of the rules is very important. At the stages of drafting the credit, checking papers and accepting the credit, the seller should take every step to maintain the expression needed for the description very simple. The basic information of identification will be sufficient to make the details less complicated. The best way to deal with this issue is that when the invoices are issued, the issuer should copy the description provided in the credit. As mentioned earlier, a tiny deviations in the wording of the goods description on the court's point of view it could have constituted sufficient grounds for justifying the refusal of the presentation. A trivial deviation can be fatal and would cause detrimental effects to beneficiary and also it may affect the bank which accepted discrepant invoice with good faith.

If the ICC is considering a change in the current rule related to the description in the commercial invoice, they must do so by imposing a firm framework for invoices

²²⁹ Courtaulds North America, Inc. v. North Carolina Nat. Bank. 528 F.2d 802 (4th Cir. 1975)

²³⁰ [1973] HKLR 521, FC.

which are a major part of the letters of credit²³¹. It can be suggested that, when drafting the letters of credit, each should have a column which is specific for the description of the credit. In that column, the description should be plain, clear and simple. As the parties have agreed upon the terms of the credit, when drafting the invoice, parties must be directed to include what has only been included in the column aforementioned. This may not cure the problem one hundred percent but however, if the parties have, either by the UCP or ISBP, been informed and/or educated, the general understanding among the parties may lead to a reduction of the refusal level over the issues related to the description in the commercial invoice.

In addition to that, parties must be encouraged either by the UCP or ISBP, to include a note like “errors and omissions excepted”²³² in the invoice, which allow banks to discard the discrepancies which it deems to be not material. Especially where, all the details required are fulfilled and hence some additional words included.

Finally, it is clear that, as the description in the commercial invoice is very important to letter of credit transactions, the ICC has shown less eagerness in relaxing the current rule. Other than, educating the parties to the credit about the importance of sticking with the details mentioned in the credit, a lenient approach from the ICC appears to be highly unlikely.

²³¹ Leo D’Arcy, Carole Murray, Barbara Cleave, ‘Schmitthoff’s: The Law and Practice of International Trade, (10th edition, Sweet & Maxwell, London, 2000), Chapter 7, at 7-002

²³² “errors and omissions ” extracted from Leo D’Arcy, Carole Murray, Barbara Cleave, ‘Schmitthoff’s: The Law and Practice of International Trade’, (10th edition, Sweet & Maxwell, London, 2000),Chapter 7, at 7-003

3.5 Incomplete and unclear terms in the credit

3.5.1 Introduction

The UCP 500 and its predecessors contained two articles in their respective versions relating to the rule governing issues of incomplete or unclear credit instructions. It was intended to provide instructions on accurate completion of details in letters of credit and minimising the insertion of excessive and insignificant details.

Article 5 of the UCP 500 which provided instructions to issue and/or amend letters of credit says,

A. Instructions for the issuance of a Credit, the Credit itself, instructions for an amendment thereto, and the amendment itself, must be complete and precise.

In order to guard against confusion and misunderstanding, banks should discourage any attempt:

i. to include excessive detail in the Credit or in any amendment thereto;

ii. to give instructions to issue, advise or confirm a Credit by reference to a Credit previously issued (similar Credit) where such previous Credit has been subject to accepted amendment(s), and/or unaccepted amendment(s).

B. All instructions for the issuance of a Credit and the Credit itself and, where applicable, all instructions for an amendment thereto and the amendment itself, must state precisely the document(s) against which payment, acceptance or negotiation is to be made.

In addition to that, article 12 of the UCP 500 provided guidance to the Banks on how to respond when they receive incomplete or unclear Instructions by the letter of credit. Article 12 says.

“If incomplete or unclear instructions are received to advise, confirm or amend a Credit, the bank requested to act on such instructions may give preliminary notification to the Beneficiary for information only and without responsibility. This preliminary notification should state clearly that the notification is provided for information only and without the responsibility of the Advising Bank. In any event, the Advising Bank must inform the Issuing Bank of the action taken and request it to provide the necessary information.

The Issuing Bank must provide the necessary information without delay. The Credit will be advised, confirmed or amended, only when complete and clear instructions have been received and if the Advising Bank is then prepared to act on the instructions.”

However, when the UCP 600 was published, the above two articles had been deleted from its content. As a result of that, now there is no provision in the UCP 600 which covers the principle laid down in articles 5 and 12 of the UCP 500 and after all, the ISBP does not seem to be providing any cover for them either.

Due to the lack of cover, it has become the courts' duty to clarify the rule related to this issue and the standards developed by courts are varying from one to another. There are many instances that can be found in case law where the judgments have been entered against either the Bank or the Beneficiary.

The ICC may not have considered it as an area, which needs much attention and thus, it is apparently clear that, it is still remaining as one of the main reasons, which the documents presented to bank can get rejected. It is not needed to highlight the fact that, the submission of documents for examination on an incorrectly issued letter of credit can easily be vulnerable to rejection.

The incomplete or unclear terms and/or credit instruction can occur when,

- a) the Applicant to the letter of credit includes an unclear term by mistake in the letter of credit application
- b) the Bank changes a term in the letter of credit by mistake
- c) the beneficiary fails to identify any terms entered by mistake when he reviews the drafted terms of the letter of credit.

Normally, prior to accepting the terms issued under the credit, the beneficiary is given an opportunity to review the credit terms and to bring any amendment, if necessary.

However, it is impossible to expect one hundred percent accuracy or attention to detail from the beneficiary at all times. In the light of that, there will still be cases ending up with rejection of payment on the grounds of unclear credit instructions or terms.

Irrespective of the fact that, there is no cover from either the UCP 600 or the ISBP, when an issue has arisen on such background, the court will have to look into the provisions provided in previous versions of the UCP and the case law.

It may be argued that, instead of having a clear rule on incomplete or unclear terms in the credit, the UCP 600, indirectly, provides enough cover to above issue. However, it is questionable that the cover provided by the other articles of the UCP 600 do have the same effect. Therefore, this subchapter will be aimed at finding out the following-

- a) has the omission of the provision related to incomplete and unclear terms created a vacuum in the UCP
- b) can the law related to the above issue survive with the case law available for reference
- c) is there a necessity of introducing similar type of rules, which the UCP 600's predecessors had, in any future version to the UCP.

d) If there is such necessity, how the rule should be shaped to be.

In order to find out the answers for the above questions, it is vital to examine the stages that can make the terms in the credit incomplete and unclear. Basically, the incompleteness or unclearness can be caused by a mistake committed by a party bound by the terms stipulated in the letter of credit. However, the responsibility of making such mistake can often lie with either the banks or the seller. The buyer can be immune to being held responsible as failure to provide necessary details to execute the letter of credit does not damage his financial expectations. If there was a deliberate attempt by the buyer to put the whole transaction process in jeopardy, it can be dealt by way of either a fraud or a liable case.

The incompleteness or unclearness in the terms of credit can occur by either inserting such terms or failing to spot any mistake which can make the term ambiguous. Normally, it is expected that, the party who fails to perform his obligations should be held responsible for such act. In that context, the seller, issuing bank or confirming bank can be found liable.

3.5.2 The seller should be attentive to the details in the letter of credit.

When the credit terms are drafted, the seller as the beneficiary is expected to pay full attention to make sure that the terms in the letter of credit are clear and complete. However, the involvement of the human factor in both drafting and reviewing stages of the terms can often be prone to mistakes or negligence. Especially, when there are technical terms involved which only the parties in the particular trade are familiar with, it cannot be expected that the bank should be aware of the knowledge that either the seller or the buyer have.

In **Tradax Petroleum American Inc v Coral Petroleum Inc**²³³, the seller failed to spot the mistake committed by the buyer in the letter of credit, which described the technical name of the subject matter of the sale. Coral Petroleum who was the buyer mistakenly instructed in the letter of credit, the oil to be shipped as 'WTNM SO or SR which is the designated name for sour oil. However, the original negotiation was to provide sweet oil and when the Issuing bank sent the letter of credit to the Tradax Petroleum for the approval, it failed to spot the mistake committed by the Coral Petroleum. After all, the Tradax Petroleum shipped 31000 barrels of sweet oil to the Coral Petroleum.

²³³ 878 F.2d 830, C.A.5 (Tex.),1989

At the trial, the Tradax asserted that it is inequitable to make Tradax assume the risk of non-payment, since Tradax tried to shift that risk by requiring Coral to provide a letter of credit. However, the court disagreed with this assertion on two main reasons. The court stated that, in the first place, it does not agree that equitable considerations are relevant here. "The right to enforce express terms, without reference to the equities, has long been recognized in letters of credit law, and it is essential to the proper functioning of letters of credit device."²³⁴ Second, we do not believe that a beneficiary under a letter of credit can shift all of the risk to the issuing bank simply by purporting to enter into a letter of credit transaction. The beneficiary always assumes the risk that it will not be able to collect money from the bank, if it does not present documents in precise compliance with the letter of credit's requirements. This is the very reason that the beneficiary is given the opportunity to examine and either accept or reject the letter of credit.

Due to lack of relevant case law, the court relied on J.F. Dolan's words that says;

"Due to the strict nature of the compliance requirements, usually beneficiary is required to be certain about the drafted terms of the credit as to whether he can fulfil the requirements demanded. This gives the opportunity for parties to check whether the terms are made in accordance with the underlying contract. It is very important for the beneficiary to review the terms before he perform under the sales contract"²³⁵.

Accordingly, the burden to spot the mistakes in the credit shifts away from banks especially where the incompleteness or unclearness arises out of technical terms which the banks are not familiar with. Banks are acting upon the instructions given by the customer and it is the duty of the customer to make sure that the correct instructions are provided to the bank for drafting the credit.

In the light of above, the court held that the bank has acted lawfully to refuse the payment especially when the impossibility had been created due to a technical term which was included under the review of the parties to the credit.

The similar circumstances to above case were discussed in **Mutual Export Corporation v. Westpac Banking Corporation**²³⁶, where the forms for drafting the letter of credit mentioned the expiry date of the credit as "45 days after the later of the last possible day on which Kumul Express or Lakatoi Express²³⁷ charter may terminate".

²³⁴ Harfield, Code, Customs, and Conscience in Letter-of-Credit Law, 4 U.C.C. L.J. 7, 14 (1971-72).

²³⁵ (1989) 878 F.2d 830, C.A.5

²³⁶ (1993) 983 F.2d 420, C.A.2

²³⁷ Two container vessels owned by the Japanese and hired from Mutual Export Corporation for transportation between Australia and Papua New Guinea

In June, 1985, Reefer decided to sell one of its subsidiaries called Refrigerated in two transactions, with one half of its capital stock to go to a group led by managers of Refrigerated, and the second half to a quasi-governmental New Guinea agency. As a condition of the sale and to guarantee Refrigerated's obligations under the charter parties, Refrigerated was to receive a standby letter of credit from Westpac for the benefit of Mutual in the sum of \$500,000 and it would secure approximately one month's payment on the charter parties of the Lakatoi and Kumul. Sometime around June 26, 1985, Reefer's counsel sent Westpac a draft form of the letter of credit. The draft letter was in the amount of \$500,000, to be drawn on by Mutual in the event of a default on the charter parties, and contained the clause of: "**This letter of credit expires on [45 days after the later of the last possible day on which Kumul Express or Lakatoi Express charter may terminate].**" The brackets surrounding the termination date were in the original.

Upon the request made bank agreed open a standby letter of credit upon the instruction provided in the draft form by the beneficiary or all the parties who had consented mutually.

When the approval by the parties was made, the draft was modified and the original termination date was crossed out and a handwritten date was added as 30th of June 1986. No one objected to the change made and the terms was approved without any hindrance.

Mutual made an attempt to draw on the letter of credit on the 3rd of October 1989 and the bank rejected the payment on the ground that the credit had expired. Being aggrieved by the refusal of payment Mutual sued the bank claiming that the termination letter contained in the letter of credit was wrong and the bank should be held responsible for the inclusion of a wrong date.

When the judgment was entered, the court stated that "the law relating these types of disputes is very straightforward. Mutual being the beneficiary must have inspected the entire letter of credit prior to agreeing. Therefore negligence against the bank cannot be claimed"

It was further stated that, "Mutual had enough time to review the terms of the credit and thus failed to request the bank to change the expiry date or even to seek an extension. The court concluded that, there is no room for Mutual shift burden of irresponsibility to anyone else and if the court let it to be happened that will become inconsistent with the law and purpose of letters of credit.

The decision made in this case is very much similar to the above mentioned *Coral Petroleum Incorporation case* and in both cases the courts were of the views that, the ambiguous credit terms were due to the beneficiary's negligence and therefore his inability to comply strictly with the letter of credit was his own fault. The only

notable difference between these two cases was that, contrary to the Coral Petroleum matter in this case the changes to credit terms occurred while the bank drafted the credit.

3.5.3 Confirming bank's failure to spot the deficiency.

Often it is considered that the beneficiary is liable for not spotting the mistakes in the letter of credit when it is presented to him for approval. However the banks can be held responsible for not complying with the instructions received by the beneficiary asking for amendments. When both the confirming bank and the beneficiary failed to spot the mistake at initial stages and when the credit was presented for payment, if the confirming bank makes the payment without spotting such mistake, a subsequent claim for money from the issuing bank can be rejected on the grounds of accepting a discrepant document.

The classic example for that is **Hanil Bank v. PT. Bank Negara**²³⁸ where the issuing bank issued a letter of credit with the misspelled name of the beneficiary as "Sung Jin Electronics Co. Ltd.", instead of the correct name of "Sung Jun Electronic Co., Ltd.". Similar to above mentioned two cases, the beneficiary did not make any attempt to get it amended of the letter of credit to change the name into the correct form.

Irrespective of having such discrepancy in the name of the beneficiary, the Sung Jun was able to negotiate with the Hanil Bank and receive the payment. However, when the Hanil bank submitted the documents to the Bank Negara Indonesia, the latter refused to pay on the ground of, inter alia, the discrepant name of the beneficiary in the presented document.

The court was of the view that there was any wrongdoing from the bank's side when the ambiguity was occurred at the issuing stage of the credit. Therefore, the court, while referring the judgment made in *Mutual Export* decided that the Bank Negara Indonesia has lawfully refused to honour the payment on the basis that the documents does not provide a true reflect of the beneficiary's name.

On perusal of the details in the case, it is clear that the Hanil bank was not the one which made the error in giving wrong instructions to the issuing bank and hence, it has been held liable for accepting the documents with a wrong name.

The normal assumption is that the bank will not be held liable or responsible for the form, sufficiency, accuracy, genuineness, falsification or legal effect of a

²³⁸ 2000 WL 254007 (S.D.N.Y.), 2000

document²³⁹. When the unclear or incomplete instructions are received from either the buyer or the seller, it is the bank's responsibility to maintain distance from such ambiguity. If the bank fails to act with due care upon receiving ambiguous instructions, the terms entered in the credit can be interpreted in many ways contrary to what was really intended. For example, in the previously referred **E & H Partners v. Broadway National Bank**, it was held that, "if ambiguity exists, the words are taken as strongly against the issuer as a reasonable reading will justify"²⁴⁰.

In many cases, it was often decided against the issuing bank when there was an ambiguity issue involved in the terms of the credit. In **Automation Source Corp. v. Korea Exchange Bank**²⁴¹, it was stated that, 'the court would be obliged to make judgment against the bank in every instance in which there was ambiguity, regardless of the implausibility of the beneficiary's construction of the letter of credit's terms'. According to Dolan, the courts construe the ambiguous credit against the drafter and some construe it against the issuer.

In the above mentioned, **E & H Partners v. Broadway National**, the letter of credit was issued with terms which were not clear and could give different interpretations. As direct result of it, the court decided that the bank has not acted with due diligence and awarded the judgment in favour of the beneficiary.

In the disputed letter of credit, a term contained requirement of submitting a notification letter which was written to the buyer by the seller saying "any invoice(s) to be drawn". The term like "any invoices" was very clumsy that can be interpreted in many ways. As a result of it, the presented a letter by the beneficiary referring to "invoices billing over \$500,000,000".

At the presentation of the documents to the bank for honour, the issuing bank rejected the above letter stating that it does not comply with the requirement mentioned in the letter of credit.

The court disagreed with the issuing bank and stated that, "parallel to the strict compliance rule, letter of credit must be contained with precise and clear terms"²⁴² and as the beneficiary is expected comply strictly with the terms of the letter of credit, he must be aware of the exact requirements need to be fulfilled.

²³⁹ Richard King, 'Gutteridge and Megrah's Law of Bankers' Commercial Credits', (8th edition, Routledge publishers, United Kingdom, 2001) edition, chapter 7, 7-01

²⁴⁰ This is a confirmation of what stated in *United States Steel Corp. v. The Chase Manhattan Bank, N.A.*, 1984, WL 598.

²⁴¹ 249 A.D.2d 1 (1998), 670 N.Y.S.2d 847

²⁴² As held in *Marino Industries Corp. v. Chase Manhattan Bank, N.A.* 686 F.2d 112, C.A.N.Y., 1982, at 115

Accordingly, it was declared that the presented notification letter had been complying with the credit terms. The court emphasised that, it is not intending to endorse a replacement for the strict compliance standard by substituting the “reasonableness”.

The use of “any invoice(s) to be drawn” in the terms of the credit makes itself ambiguous and therefore it was contrary to the provisions provided in Article 5(a) of the UCP 500.

It is important to look into instances, where the bank was able to get away from being liable for a term in a letter of credit which the bank has drafted. In **Ocean Rig ASA v. Safra National Bank**²⁴³, the court referred several instances where the issuing bank cannot be held liable.

- a) Errors which do not require reviewing as bank officer can exercise his discretion.
- b) Exercising his discretion is deemed to be insignificant as far as the underlying commercial transaction is concerned.

In this case, there was a dispute over a document rejected by the bank due to the validation of signatures. According to terms of the credit three people’s signatures were required from the beneficiaries’ as a part of his obligation. The term in the credit further required those signatures to be notarized by a Public Notary in Oslo, Norway. It also required them to be legalized by way of Apostille²⁴⁴, or by the Embassy or Consulate of the USA situated in Oslo, Norway²⁴⁵.

However, the beneficiary misunderstood and interpreted these requirement in a different manner which he asserted that the clause in the credit requires the signatures to be legalized by either of parties mentioned in the credit.

In contrast, the bank expected the signatures to be legalised by two parties mentioned in the credit.

The beneficiary complied in accordance with his own understanding of the terms and submitted the document with signatures which had been legalized only by the Apostille. However, the bank did not agree with the beneficiary’s interpretation and rejected the document for non-compliance.

²⁴³ 72 F.Supp.2d 193, S.D.N.Y., 1999.

²⁴⁴ The **Apostille Treaty**- an international treaty promulgated by the Hague Conference on Private International Law. Used for the purpose of document certification.

²⁴⁵ 72 F.Supp.2d 193, S.D.N.Y., 1999.

The court found that, the ambiguousness in the terms weighed favouring the beneficiary and thus, acknowledge the fact that, if the bank's construction of the terms was accepted, the outcome could have been interpreted differently.

The court looked into previous court cases and found that, the parameters for the tolerance level of such ambiguous construction of a term remains meaningless differences where the errors do not allow the bank officer who reviews the credit to exercise his discretion.

In addition, the court cited the standards adopted in **Venizelos, S. A. v. Chase Manhattan Bank**²⁴⁶ where it was decided against the issuing bank over an ambiguous letter of credit. When deciding in this Venizelos case, the court explained that within the strict compliance standard, a letter of credit "is reasonably capable of constructing terms which will make it enforceable. Between two different interpretations, the interpretation which gives meaningless or impossible effect should be rejected".

In addition to legal issues, it was further found that, there was no possibility of getting legalized by the U.S.A Consulate as it was not available under an U.N. treaty to which the both Norway and U.S.A had signed

As a result of above findings, the court stated that the issuing bank has acted unlawfully by constructing credit terms which were impossible to execute.

3.5.4 Conclusion

General overview

The case laws analysis carried out in this subchapter shows that letters of credit with unclear or incomplete terms can lead to a fatal outcome where misspelled name, wrong description of a merchandise, wrong date, adding completely different details or following wrong direction when it comes to submit the documents to execute the payments. As a consequence of this, one of the parties may end up losing money which is duly due to him.

In order to eliminate this travesty, as a general practice, when drafting the credit, all the parties should closely work together to minimise the ambiguousness in the terms of the credit.

²⁴⁶ 425 F.2d 461, C.A.N.Y. 1970, at 465.

It is important to note that, as of today, neither the UCP nor the ISBP provide cover over the issues of incomplete and unclear terms in the credit. On the other hand, the case law, make the current situation worse, and do not provide one clear standard, which can be applied over the issues related to ambiguousness in the terms of the credit.

For example, in the Coral Petroleum and Mutual Export Corporation matters the courts were of the view that it is the duty of the beneficiary to review the terms prior to finalizing them. In Hanil bank case, the court penalized the confirming bank for accepting a discrepant document despite it transpiring that the alleged discrepancy occurred due to the ambiguousness of the credit terms over which the confirming bank did not have any sort of control.

In the E H Partners case, the court took a different view by stating that, as the beneficiary is expected to comply strictly with the terms of the credit, the parties should know clearly what expected requirements are. Given the circumstances, if the discrepancy arises due to the ambiguousness in the terms of the credit, the words will be taken against the issuing bank since any reasonable reading could justify. Finally, in the case of Ocean Rig ASA, it was stated that, even in the strict compliance requirement, there is a room for the letter of credit to create a construction that can give a sensible meaning and valid despite the fact that terms in the credit are unclear.

Given the above circumstances, if there is an issue over a document presented due to the ambiguousness of the terms of the credit, the liability may, in most cases, float between the beneficiary and the issuing bank.

General approach to address the issues

The incompleteness or unclearness in the terms of the credit can occur mainly in two ways.

- a) The general errors such as spelling mistakes, discrepant dates.
- b) The discrepancy between the sales contract and the terms of the credit.

Based on the nature of the discrepancy, the liability for committing such error can be decided.

Most of general errors occur due to the mistakes committed either by the beneficiary or the issuing bank and therefore, any of the above two can be held responsible for not fulfilling their part. For examples, if the bank makes a mistake against details provided in instructions, the bank will be liable for such mistake and if the beneficiary

fails to spot the discrepancy or provides wrong details for drafting the credit, the beneficiary will be liable for his mistakes.

On the second category of errors, the issuing bank plays a minor role as it acts on the instructions given by the applicant to the credit. Therefore, it is the duty of the parties to the underlying sales contract to provide correct instructions and review them before it is finalized. Similarly, the banks are not familiar with trade terms which are unique to the particular trade and therefore, the intervention by the bank when drafting the trade terms in the credit can be minimal. When the ambiguous or impossible credit terms have formed with complicated technical or trade terms, the case should be decided against the beneficiary.

As per the misunderstandings that can occur due to the lack of clarity and/or ambiguousness in the credit terms, the beneficiary of the credit should, before finalizing the credit, be presented with a form in which can be entered the desirable changes to the terms, when reviewing the entire provisions in the credit.

Apart from that, as the beneficiary is strictly required to comply with the terms of the credit, it is the duty of the issuing bank to provide clear, precise and unambiguous terms in the credit and failure to adhere to that requirement can result in the issuing bank being liable for not framing clear and precise details in the credit.

Chapter 4

Decision making and communication within the time limit

4.1 Introduction

After the shipment of goods, the buyer tenders the documents required by the credit to the bank to receive the money for the transaction. The bank then examines the documents to ascertain that the documents are in compliance with the terms of the credit. The examination process may take time depending on the complexity of the case²⁴⁷. However, the UCP has imposed a time limit on banks for examination of documents to restrict excessive consummation of time to complete this process. This time limit for examination has evolved gradually from the UCP's previous versions to what we have today.

The limitation on time scale for examination of documents is mainly aimed at protecting the interest of the parties involved. This limitation imposed by the UCP assures the seller that he will be informed within a specific period of time whether his documents tender is accepted or not.

Receiving the decision of the bank within an allocated time frame is very important to the seller as it confirms-

1. Receipt of the payment for the goods that he has shipped.
2. The decision will be made before the expiration of credit.
3. The bank will be precluded from refusing the payment, if the decision is not made within the given time limit.

In the light of the above mentioned importance of receiving the bank's decision within the time limit, this chapter will discuss the law relating to the issues involved with 'time limits' provided by the UCP to examine the tendered document. This will be an

²⁴⁷ Peter Ellinger, 'The Uniform Customs and Practice for Documentary Credits – the 1993 revision', Lloyd's Maritime and Commercial Law Quarterly, page 391, where it says applicable time period will depend on complexity and bulkiness of the documents that are required to be examined.

exercise which analyses the methods used in determining the time frame for examination of documents, the options available for the bank within the time limit, the consequences of failure to comply with the rules related to the time limit, the content to be included in the final notice and how to return the documents to the beneficiary. The outcome of this will be used to make recommendations in the last chapter.

4.2 Time limit for examination of documents

4.2.1 Introduction

Prior to the publication of the UCP 600, the time limit for examination of the documents, decision making and communicating the final decision to the beneficiary was confined to a reasonable time not exceeding the 7 banking days. However, the UCP 600 has been amended in respect of this limitation and now a bank has maximum of 5 banking days to complete the above mentioned process. In order to find out whether the current limitation is beneficial for the purpose of minimising the level of litigations arising out of the rule relating the time limit, this subchapter will discuss about the positives and negatives of the previous rule compared to the current.

4.2.2 Reasonable time

In order to avoid any adverse effects to the parties involved in credit, a quick decision by the bank in regard to the documents tendered is required. Unnecessary delay by the bank to make its decision may cause adverse effects on the negotiability of the shipping documents, particularly, when multiple re-sales are envisaged²⁴⁸. A quick decision is also important as far as the beneficiary is concerned, if he wishes to see an alternative transaction process when his submission to the bank is rejected²⁴⁹. Prior to the UCP 500, there was no upper limit for the allowed time scale on examination of documents. 'Reasonable time' was the only yardstick available to measure the time scale.

It must be noted that, the question of 'reasonable time' is more often associated with the cases where the beneficiary tenders documents for examination to the bank, when the life of the credit will soon expire. In that scenario, the beneficiary seeks immediate and/or earliest notice from the bank as to whether the documents that are

²⁴⁸ Paul Todd, 'Bill of Lading and Bankers' Documentary Credits', (4th edition, Routledge publishers, United Kingdom, 2007) page 238, 9.13 and 9.14

²⁴⁹ Ibid

complying with the terms of credit. It can be argued that it is the responsibility of the beneficiary to tender the documents for examination allowing enough time to the bank to examine them. However, according to most of the reported cases, it has transpired that, the submission of documents well prior to the expiration of credit is not always possible. This may occur due to various reasons such as, *inter alia*, late negotiations of terms of the sales contract or delayed shipment due to a natural disaster. It was reported that, at the time of the discussion for bringing a revised version to the UCP in 1983, there was an attempt²⁵⁰ to define the meaning of 'reasonable time' for document examination. However, the quest to find a definite answer was not successful as it was suggested by various parties that, 'the reasonable' time should be somewhere between 3 to 30 days. As a result of it, the UCP 400 did not contain any guidance as to what a 'reasonable time' should be to examine the documents submitted²⁵¹.

Eventually, the interpretation of 'reasonable time' became a duty of the Courts when such issues arose. As a consequence of this various standards were adopted in determining as to what was a 'reasonable time'²⁵². For example, in **Banker's Trust Company Vs State Bank of India**²⁵³, it was decided that the 'reasonable time should be less than 8 days from the submission of documents for examination. In this case, the plaintiff had issued an irrevocable letter of credit, which was confirmed by the defendant. On perusal of 967 pages of submitted documents, the plaintiff discovered some discrepancies and notified the applicant to the credit within 3 days of submission. An additional 72 hours elapsed during the time that the applicant of the credit was allowed to re-examine the documents. As a result of it, the notice of rejection was given to the defendant by the plaintiff after the 8th day of submission. The defendant was of the view that, the notice of rejection by the plaintiff was not given within a 'reasonable time' as provided by the UCP. However, the plaintiff was in contention that the 'reasonable time' includes the time which the plaintiff consulted the applicant of the credit.

When this matter came to the Court of first instance, it was decided that, the period of 8 working days has exceeded the reasonable time period provided by the UCP 400²⁵⁴. This was affirmed by the Court of Appeal and held that, a reasonable time for

²⁵⁰ S.K Chatterjee, 'Persisting controversy as to "reasonable time" under the documentary credit mechanism: an overview of the 1993 UCP for Documentary Credits', J.I.B.L. 1994, 9(6), 235-240 available at West Law; The survey conducted by the International Chamber of Commerce in the course of the preparation of the 1983 Revision of the UCP suggested a preference for five to six days as the reasonable time (accessed on 9th January 2016)

²⁵¹ Article 16C of the UCP 400, 'the issuing bank shall have a reasonable time in which to examine the documents and to determine whether to take up or refuse the documents.'

²⁵² Carole Murray, David Holloway and Darren Timson-Hunt, Schmitthoff's The Law and Practice of International Trade, (12th edition, Sweet & Maxwell, London, 2012), page 201

²⁵³ (1991) 2 Lloyd's Report 443, CA

²⁵⁴ (1991) 1 Lloyd's Report 587

the bank to examine the documents cannot be extended to a further period that the applicant was allowed to carry out their own examinations. Therefore, it was decided that the issuing bank exceeded the reasonable time in between presentation and rejection²⁵⁵.

It was presumed that the length of the 'reasonable time' is depending on the circumstances of each case which can vary one to another. According to Ellinger, 'the transactions were not all the same and it was always considered that a longer period may be appropriate where the credit is for a very substantial amount, or documents are either numerous or unusually complex, or in a foreign language²⁵⁶. Therefore, the factors to be considered over deciding the length of a 'reasonable time' is mainly involved with the complexity of the tendered documents, their language and possible objections to payment by the buyer on the grounds of a suspected or actual fraud by the seller²⁵⁷.

4.2.3 Seven days Rule under the UCP 500

In the light of the above discussions and case law referred to, by the time of the 1993 revision, the ICC was able to draw a line stating that, a 'reasonable time' should not exceed the maximum of seven banking days. The Article 13(b) of the UCP 500 says that-

"The Issuing Bank, the Confirming Bank, if any, or a Nominated Bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly"

This clarified what was missing in previous revisions by stating that the limitation of not exceeding the stipulated 7 days for document examination should be applied to the "Issuing Bank, the Confirming Bank, if any, or a Nominated Bank". This means that any bank involved in the processing of the Credit can claim time up to seven days and thus, this does not cause a multiplication of the seven-day time limit.

However, according to Professor Charles Chatterjee, 'the seven days limitation was introduced to the UCP 500 by referring to the practice of banks in the western world, without appreciating the fact that the seven day period of time might not be sufficient

²⁵⁵ (1991) 2 Lloyd's Report 443 at 449

²⁵⁶ Peter Ellinger, 'Reasonable time for Examination of Documents', (1985) J.B.L 406, 407-408.

²⁵⁷ Leo D'Archy, Carole Murray and Barbara Cleave, Schmitthoff's Export Trade The Law and Practice of International Trade, (10th Edition, Sweet & Maxwell, London, 2000), page 176, 11-009

for banks in developing countries in which banks are not adequately automated, or where staff may not be adequately trained or experienced²⁵⁸.

Therefore, the practicality of limiting the time allowed for examination to 7 days may not be viable for all cases where the circumstances of the cases require attention to various factors, which can be different one to another.

On the bright side, the introduction of a standard time scale created a situation, where the beneficiary is assured that his tender has duly been accepted as complied if he does not receive notice of rejection within 7 days of documents submission. The banks cannot come after the beneficiary, if they fail to spot and notice a discrepancy in the tender after the 7th day of submission. Therefore, under the UCP 500, if the Confirming or Issuing Bank fails to reject documents within the 7 day period given, it was always deemed that the documents are duly accepted. However, the nominated banks were immune from such constructive acceptance as they are not involved in the document confirming process. Therefore, the nominated banks were under no obligation to bear responsibility if the examination exceeds seven banking days.

If the credit requires that the documents be presented to another branch of the bank other than the one which issued the credit, the 7 days limit does not extend due to the fact that extra time may be required for the above two branches to communicate with each other.

However, even after the change made to the UCP 500 by limiting the reasonable time period up to 7 banking days the main issue of whether a bank can wait until the 7th day from submission of documents to give notice to the beneficiary when such type of period was not actually needed to carry out the examination was not answered. This mainly affected tenders made with credits which had less than 7 days for expiration of their lives.

In practice, it has been reported that the banks are usually presented with documents which contain at least one discrepancy upon initial tender. According to evidence given by the experts in the case of the above mentioned **Bankers Trust Co. v. State Bank of India**, the discrepancies are discovered in nearly one-half of all documentary presentations tendered under Letters of Credits in England²⁵⁹. Thus, in a vast majority of cases, the discrepancies can be remedied, by either obtaining corrected and confirmed documents or receiving the approval from the applicant for waiving the discrepancies. These remedial options have been available for many

²⁵⁸ Charles Chatterjee, *Legal Aspects of Trade Finance*, (Taylor & Francis publication, London, November 2006), page 67

²⁵⁹ Paul Todd, *Discrepancies between Bills of Lading and Letters of Credit*, Letter of Credit update (Government Information Services, USA) (199) pp 14-19

years and they have become a part of documentary credit practice²⁶⁰. However, given the above circumstances, it could have been questioned the fact that, the imposing of a limit on the examination period could have led the banks to reject the document more often rather than taking action to remedy the discrepancy citing that the 7 days limitation was not sufficient enough to carry out a full examination and/or asking for a waiver from the Buyer. In that situation where the credits had sufficient life spans it would have been better if they were allowed to go beyond the 7 days period for examination, if the bank has asked the beneficiary to cure the defect or the buyer to waive the discrepancy if such actions take more than 7 days. Banks act with good faith to facilitate the payment for the goods that have been shipped and the rejection of such payment due to a rigid time scale, when the cure for the cause of rejection is easily available would not do justice to any party involved.

4.2.4 Seven days limit V. Reasonable time.

Introduction of the 7 day limit, in addition to keeping 'reasonable time' in the same Article created more controversy over the issue as to whether a 'reasonable time' can be equal to 7 days or less. In the majority of cases, banks may not have to spend seven days to complete the documents examination. This initiated another dilemma for Courts to decide whether the reasonable time is exactly equal to 7 days or is within the 7 day period depending on the nature of the documents tendered.

As discussed earlier, Article 16(c)²⁶¹ of the UCP 400 (1983 revision) provided that the issuing bank would have a "reasonable time" to examine the documents. At that time, "reasonable time" was diversely construed by the Courts and was generally considered too vague and became the subject of controversy²⁶². In the above mentioned **Bankers Trust V State Bank of India** case, "reasonable time" was defined as flexible depending on-

- a) the complexity of the transaction
- b) the number and complexity of the documents tendered
- c) whether the review is being conducted by a major bank in a financial centre or a smaller bank in a place where such transactions are less common.

²⁶⁰ S.K Chatterjee, Persisting controversy as to "reasonable time" under the documentary credit mechanism: an overview of the 1993 UCP for Documentary Credits J.I.B.L. 1994, 9(6), 235-240 available at West Law UK, accessed on 9th November 2015

²⁶¹ The issuing bank shall have a reasonable time in which to examine the documents and to determine as above whether to take up or refuse the documents.

²⁶² S.K Chatterjee, Persisting controversy as to "reasonable time" under the documentary credit mechanism: an overview of the 1993 UCP for Documentary Credits J.I.B.L. 1994, 9(6), 235-240 available at West Law UK, accessed on 9th November 2015) and Benjamin's Sale of Goods, (4th edition, Sweet & Maxell, London, 1992) section 23-116

The limitation on the examination period to 7 days was designed to facilitate the above mentioned 3 scenarios. However, it was questionable, when the phrase 'reasonable time' remained in the same Article in addition to the 7 day limit. This shows that, the UCP 500 had failed in providing clear definitive guidelines as to the time period allowed to examine the documents.

Similar to Article 16c of the UCP 400, the interpretation of the 7 day rule was subject to controversies²⁶³. Initially it was assumed that the banks should spend as much time as required for examination of the documents closer to the end of the reasonable time which stands for 7 working days. In contrast it was also suggested that under the UCP 500, the reasonable time stands for 7 banking days and therefore, there is no room for flexibility in interpreting it. Thus, it was also suggested that banks have only a reasonable time to carry out necessary examinations and the time line of seven days is merely the maximum possible reasonable time available only in cases with utmost complexity²⁶⁴.

This was explained in **DBJJ Inc v National City Bank**²⁶⁵ where it was stated that the bank's right to spend a maximum 7 day period cannot be reconciled with the intent of the UCP 500. According to Court, the drafters of the UCP 500 did not expect Banks to spend the maximum time available irrespective of how complex the examination is²⁶⁶. According to the ICC publication, *"The seven-day limit, as stipulated in UCP 500 sub-Article 13(b) was agreed upon as a compromise. However, just because a bank now has a limit not to exceed seven days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents does not mean that it is prudent, reasonable, or even proper for a bank to take all of that time to examine the documents and determine whether to accept or refuse such documents"*²⁶⁷.

The above mentioned intention of the ICC was tested in Courts in many cases, as the wording of Article 13 (b) of the UCP created an uncertainty over the issue of allowable time for documents examination. In **NEC Hong Kong Ltd v Industrial and Commercial Bank of China**²⁶⁸, the bank took 5 days to reject the documents and the petitioner claimed that taking 5 days does fall under 'reasonable time' despite the 7 day period provided by the UCP 500. It was further claimed that reasonable time

²⁶³ Carole Murray, David Holloway and Darren Timson-Hunt, 'Schmitthoff's The Law and Practice of International Trade', (12th edition, Sweet & Maxwell, London, 2012), page 201

²⁶⁴ E P Ellinger, 'The Uniform Customs and Practice for Documentary Credits – the 1993 Revision', Lloyd's Maritime and Commercial Law Quarterly, February 2004

²⁶⁵ 123 Cal. App. 4 th 530, at 540 (2004)

²⁶⁶ 'UCP 500 & 400 Compared' Commission on Banking Technique and Practice, Published by the International Chamber of Commerce, Publication No. 511 at p. 40.

²⁶⁷ *ibid*

²⁶⁸ HKLRD 645 (2006)

means without any delay but not later than 7 banking days and therefore, the bank has not given notice of rejection within a reasonable time²⁶⁹. However, the Court held that, the petitioner is prevented by seeking such relief as the preclusion rule²⁷⁰ applies only to a breach of Article 14 itself. Thus, the only timing issue that can trigger the preclusion effect of Article 14 of the UCP 500 was a breach of Article 14 (1) (d) and therefore the petitioner's claim under Article 13(b) does not hold a valid cause of action.

The issue of what prevails between 'reasonable time' and the '7 day rule' was further discussed in **Banco General Runinahui SA vs Citibank International**²⁷¹ where the Seller sued the bank *inter alia* for estoppel.

In this case, the initial presentment of documents to Citibank was made one day before the presentment deadline and the Citibank advised the seller that the documents were nonconforming by telephone two days after the submission. The District Court found that Citibank had not examined those documents within a "reasonable time" and had not notified the seller about the discrepancies "without delay."

In their appeal, the Appellants were relying upon the facts that, the district Court has failed to consider whether the Citibank has acted "within a reasonable time" when the summary judgment was entered. In addition, it was claimed that, the complaint of "without delay" was not originally presented before the District Court on summary judgment, but instead it was introduced into the case *sua sponte*²⁷² by the Court without the benefit of briefing from the parties, affidavits directed to these issues, or other development of the record²⁷³. In the light of that, the Appellants were of the view that the summary judgment entered in favour of the beneficiary was inappropriate.

The beneficiary relied upon Article 16 of the UCP 400 which provides;

²⁶⁹ Article 14D. i. of the UCP 500, If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents. Such notice shall be given to the bank from which it received the documents, or to the Beneficiary, if it received the documents directly from him.

²⁷⁰ According to article 16 F of the UCP 600, 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.

²⁷¹ 97 F. 3d 480 (11 Cir 96)

²⁷² In law, *sua sponte* - Latin term which means "on its own motion" . in other words an act of authority taken without formal prompting from another party.

²⁷³ Foot note 15 at <<http://caselaw.findlaw.com/us-11th-circuit/1019974.html>> accessed on 8th December 2015

- i. The issuing bank shall have a reasonable time in which to examine the documents and to determine . whether to take up or to refuse the documents.
- ii. If the issuing bank decides to refuse the documents, it must give notice to that effect without delay by telecommunication or, if that is not possible, by other expeditious means.
- iii. If the issuing bank fails to act in accordance with the [above] provisions the issuing bank shall be precluded from claiming that the documents are not in accordance with the terms and conditions of the credit.

The Court explained that, “in the letter-of-credit context, what can constitute ‘a reasonable time’ should be determined by examining the behaviour of those in the business of examining documents, that are mostly banks,”²⁷⁴, and requires an analysis of the “nature, purpose, and circumstances of each case.”²⁷⁵

However in this case, the Court found that although the Citibank had not reviewed the documents within a “reasonable time,” it appears that the District Court had not taken any steps to examine banking behaviour. The only point that the District Court focused upon was, whether the beneficiary had been left with enough time to cure any discrepancies mentioned in the refusal notice. This had reduced the entire inquiry to a question of the document presentment deadline.

Further into the precise details of the case, the Court noticed that the beneficiary submitted documents to Citibank on July 21, 1992, which was one day prior to the document presentment date, and in return, the Citibank notified the beneficiary’s freight forwarding agent that the submitted documents were discrepant on July 23, 1992, one day after the expiration of the document presentment date.

The Court stated that, the “reasonable time” requirement cannot be interpreted, as it was done by the District Court that described it as “early enough to allow the beneficiary to cure and represent the documents before the presentment deadline.” The mere fact that the presentment period expired before the completion of Citibank’s review and notification process does not compel any conclusion about whether Citibank spent a reasonable amount of time examining the documents²⁷⁶. The Court clearly stated that, if a rule which requires, in all circumstances, notice to the beneficiary of discrepancies before the passing of the document presentment

²⁷⁴ Alaska Textile company Vs. Chase Manhattan Bank, N.A, 982 F.2d at 823 (1982)

²⁷⁵ 97 F. 3d 480 (11 Cir 96)

²⁷⁶ the “reasonable time” requirement does not imply that banks must examine a presentation out of order or hurry a decision based upon particular needs or desires of a beneficiary. Foot note 16 at <http://caselaw.findlaw.com/us-11th-circuit/1019974.html>. Accessed on 8th December 2015

date, would conflict with Article 16(c) of the UCP 400 by stripping banks of their “reasonable time” to review documents²⁷⁷.

According to the decision of the Court, it has been interpreted that “reasonable time” under the UCP 400 means at least three business days²⁷⁸ and, it also disagrees with the provision provided in Article 13b of the UCP 500 which affords banks seven banking days to review documents and give notice of any discrepancies. In conclusion, as Citibank has reviewed the documents and also notified the beneficiary via telephone about the discrepancies within two days, it was decided that, the District Court had erred in finding Citibank estopped from dishonouring the beneficiary’s nonconforming presentment.

The interpretation of ‘reasonable time’ was further discussed in **Integrated Measurement SYS Vs International Commercial Bank of China**²⁷⁹, where it was stated that, if a bank waits until expiration date of the letter of credit to give the rejection notice, it may seem that the bank’s conduct is creating a situation where the beneficiary has been precluded from curing the defects stated in the refusal notice.

In this case, the International Bank had 10 days to examine the documents before the expiration date of the letter of credit which seems as more than enough for such examination. The purpose of having such a rule like ‘reasonable time’ is that the bank is required to notify the beneficiary ‘without delay’²⁸⁰, in order to provide ample time to cure the defects before the expiration date of the credit. The only exception to this rule would be the situation where the beneficiary has waited until the last few day of the date of expiration of the letter of credit to submit the documents to the bank²⁸¹.

In **DBJJJ Inc v National City Bank**²⁸², the beneficiary sued the advising bank for *inter alia* unlawful rejection to honour on two letters of credit and delay in giving refusal notices.

The beneficiary of the case presented documents to the advising bank for examination on Monday the 26th of November (for first letter of credit) which was due

²⁷⁷ Available at <http://caselaw.findlaw.com/us-11th-circuit/1019974.html> accessed on 8th December 2015

²⁷⁸ See also, *Occidental Fire & Casualty Co. v. Continental Bank, N.A.*, 918 F.2d 1312, 1318 & n. 3 (7th Cir.1990), (as mentioned in the above judgment)

²⁷⁹ 757 F.Supp. 938 (1991)

²⁸⁰ Article 16 of the UCP 400.

²⁸¹ **Occidental Fire Casualty Company of North Carolina Vs Continental Bank NA**, 918 F.2d at 1318 n. 3 (7th Cir.1990), where it was stated that, ‘Certainly, the issuing bank is not required to drop everything — including other letter of credit draw submissions — just because a beneficiary has decided to delay submitting a draw until less than a week before the letter of credit expires.’

²⁸² 123 Cal. App. 4 th 530, at 540 (2004)

to be expired on the same day. The letter of credit had been issued on the 19th of October 2001 for the amount of \$123,000. On the 30th of October 2001, Bank acknowledged the receipt of the documents and the bank reviewed the documents on that same day. The bank had prepared a "Negotiation Worksheet," a form document with blank spaces to be filled in by the document examiner. On examination, the Negotiation Worksheet contained three discrepancies identified between the documents and the terms of the credit.

On the 3rd of December 2001, the Bank sent the Buyer a letter identifying the discrepancies and seeking a waiver. On the 11th of December 2001 the buyer informed the bank that they are refusing the request for the waiver and being informed as such, the bank gave refusal notices to the seller on that same day.

The second letter of credit was issued on the 23rd of October 2001, which was to be expired on the 14th of December 2001. The documents were presented to the bank on the 6th of December 2001 and the very next day the bank identified four discrepancies between the presented documents and the terms of the letter of credit.

The bank sent a letter to the buyer mentioning the discrepancies and seeking for a waiver. The letter contained the words of 'Please contact us immediately with your waiver of discrepancies or other instructions'. The buyer took time until the 20th of December 2001 to inform the bank that, they are refusing the request for waiver. On the same day, Bank notified the seller that the presentation has been rejected due to the discrepancies in the documents.

The seller went to Court against the bank's decision and at first instance a summary judgment was entered against the seller. Being aggrieved by the decision, the seller appealed and the bank contended that it had acted legally within the given period of 7 days. It further relied upon the fact that, in practice, a bank uses seven banking days to provide notice whenever a bank seeks a waiver from the applicant.

However, the Court refused the bank's explanation by stating that the Bank's interpretation is inconsistent with the UCP 500 on the grounds that, it diminishes the effects of the "reasonable time" concept. The Appeal Court further explained that, Article 13(b) provides for a "reasonable time, not to exceed seven banking days" and it does not, as the Bank's argument suggests, provide for a time period of "seven banking days." By giving no meaning to the phrase "reasonable time," the Bank's argument is inconsistent with the plain language of Article 13(b)²⁸³.

The Court further stated that, a 'reasonable time' is not extended to accommodate an issuer's procuring a waiver from the applicant". "Examiners must be aware of the fact that the seven-day period is not a safe harbour²⁸⁴. The time within which the bank should give notice is the lesser of a reasonable time or seven business days.

In the judgment, the Court concluded that the fact has to be acknowledged that there

²⁸³ Available at http://caselaw.findlaw.com/ca-court-of-appeal/1009710.html#footnote_5, accessed on 8th December 2015.

²⁸⁴ *ibid*

was a lack of precision in the language of Article 14 of the UCP 500, which raised an ambiguity. However, it cannot accept the Bank's view which says that the UCP 500 intended to fundamentally alter the rule of preclusion. It is clear that the time spent on examining the documents decides when the issuing bank is required to notify the beneficiary about the discrepant documents. If the issuing bank fails to examine the documents within a "reasonable time, not exceeding seven banking days" it cannot notify the beneficiary "without delay" as required by Article 14(d)(i)²⁸⁵. Article 14(d)(i) incorporates the time period specified in Article 13(b). A violation of Article 13(b) results in a violation of Article 14(d)(i), which, in turn, triggers preclusion under Article 14(e)²⁸⁶. As a result of it, the Court decided to enter judgment in favour of the seller by quashing the summary judgment made against him in the Court of first instance.

The above decision indicates the complexity that existed within the provisions of the UCP 500 which relate to the time period that a bank can spend on examining documents. This great uncertainty over the issue led the ICC to consider less complex rules when drafting the UCP 600 revision.

However, the limitation on the upper limit of the allowed time period to examine the documents helped to bring a universally accepted standard to the process. It is further deemed that limitation of time had strengthened the hands of the beneficiary under the UCP 500, compared to its predecessors. The parties were assured that, if banks exceed the 7 days period and do not give notices on time that documents are defective, then the banks are bound to honour the payments.

From the observations made in this subchapter, the conclusion can be drawn is that, keeping two contrast elements in the same rule as to the allowed time period for examination of documents had led to a situation where a high volume of court cases had been reported. This situation implies the requirement of having one clear guidance for the allowed time period which makes the rule simpler.

4.2.5 Bank to notify all the discrepancies within the time limit.

In the matter of giving notices by the bank, Article 16 (d) ii of the UCP 500 states that,

²⁸⁵If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, **without delay** but no later than the close of the seventh banking day following the day of receipt of the documents. Such notice shall be given to the bank from which it received the documents, or to the Beneficiary, if it received the documents directly from him.

²⁸⁶ Available at http://caselaw.findlaw.com/ca-court-of-appeal/1009710.html#footnote_5, accessed on 8th December 2015

“Such notice must state **all** discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.”

The word of ‘**all**’ is a replacement for its corresponding Article of the UCP 400 which required ‘**the discrepancies to be stated**’ and therefore, if a bank fails to state all the discrepancies within the given 7 days period it will preclude them from citing new discrepancies even in a situation where bank has given notice of rejection 2 or 3 days prior to expiration of 7 days²⁸⁷. In other words, if a bank, which fails to state all the discrepancies which it expects to claim subsequently, it is deemed that the bank has failed to comply with as required by Article 14 of the UCP 500. This shows that banks have only one opportunity to identify all the discrepancies that they are going to rely upon. This seems to be a viable clause that can help to reduce the amount of rejection of payment as-

- a) it gives an assurance to the beneficiary that there will not be any other ground to be raised for rejections in the future.
- b) If the beneficiary cures the identified discrepancies within the time limit, nothing can stop him receiving the payment.

However, under this rule, there may be some instances where the confirming bank finds it difficult to reimburse money from the issuing bank. If the confirming bank fails to mention a discrepancy in the notice of refusal even before the given time limit, a subsequent finding of a new discrepancy may stop the bank from reimbursing. For example, the confirming bank upon receiving the documents from the seller sends notice of refusal within 4 days. However, the seller cures (and/or receive the approval for a waiver) the discrepancies stated in the refusal letter and receives the payment from the confirming bank on the 7th day of submission of documents. In the meantime, the confirming bank finds another fatal error contained in one submitted document within the 5th day of submission and as per Article 16 (d) ii of the UCP 500, the confirming bank was barred from raising that discrepancy resulting it could prevent the bank from reimbursing from the issuing bank.

The corresponding Article 16 C of the UCP 600 states that-

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:

²⁸⁷ Mohd Hwaidi and Brian Harris, ‘The mechanics of refusal in documentary letter of credits: an analysis of the procedures introduced by article 16 UCP 600’, *Journal of International Banking Law and Regulation*, published in 2013, available at www.westlaw.co.uk, Accessed on 18th December 2015

- i. that the bank is refusing to honour or negotiate;
- ii. *each discrepancy* in respect of which the bank refuses to honour or negotiate.

The words of 'all discrepancies' have been replaced with the word of 'each discrepancy' and it does not make much different to the effect of the rule. Thus, this rule reassures the beneficiary that nothing can stop him getting paid if the notices were issued in his favour.

4.2.6 Acting upon utmost good faith.

If the banks relied only on the 7 day rule (5 days rule in the UCP 600), instead of reasonable time, a bank with a perverse incentive can delay the examination of documents until near the 7th day maximum period to give notice to the seller. During such unreasonable delay, the credit can be expired and/or the time limit for the beneficiary to rectify the errors in the documents may be elapsed. This can cause a great injustice to the beneficiary who has duly shipped the goods and therefore, compelling a bank to examine the documents in reasonable time rather than letting them use a maximum of 7 days would help to ensure that the accountability of letters of credit is maintained, and can satisfy all the relevant parties.

On the other hand, if the bank refers a deficiency in the submission to the buyer asking for a waiver, the consummation of time by the Buyer to give his answers, does not provide a reason for the bank to delay its decision. In a situation which the credit is about to be expired, such referral by the bank may tempt the Buyer to delay in providing a response. The deficiencies that can easily be subject to a waiver may not be authorized by the Buyer within the time period for document examination since it may seem as a safer option for him to wait until expiration of credit. This may be ended up with the buyer getting an unfair advantage and the payment to the seller being refused on a perfectly executed sales transaction.

In the light of the above, it is clear that, imposing a fixed time scale for document examination without any flexibility may not contribute to guarantee a smooth process of credit transactions. Especially, when the defects in the documents are easily curable or be subject to a waiver. It seems that the UCP has failed to address this issue, despite the ICC striving to minimise the level of rejection of payment for credit.

4.2.7 Five days Rule under the UCP 600.

Article 14b of the UCP 500 restricts the reasonable time limit from 7 banking days to 5 banking days. As mentioned above, Article 13 b of the UCP 500 allowed banks to have a reasonable time not exceeding 7 banking days, which created a dilemma over interpretation. Article 14 b of the UCP 600 states that-

*‘ 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** 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.**’*

When this is analysed, it transpires that 3 major changes have been made to the previous version of the UCP that covered the rule over time limit for document examination-

1. The words ‘reasonable time’ have been removed and the allowed time period has been reduced to 5 banking days from 7.
2. There is an additional part which makes provision that the maximum 5 day period will not be curtailed any other reasons such as expiry date of the credit or waiting until last day to make presentation.
3. The UCP 600 has excluded the words ‘without delay’ which was provided in Article 16 (d) of the UCP 500 as a banker’s duty to decide whether the documents are in compliance or not²⁸⁸.

According to the ICC, the cutting down of examination days from a maximum of 7 days to 5 is explained as, ‘the period of five banking days following the day of presentation was determined following consultation with ICC national committees, when they were asked to vote for the applicable number of days, taking into consideration that agreement had already been reached to remove a reference to ‘reasonable time’²⁸⁹.

Removal of reasonable time.

According to the drafters of the UCP 600, the reasons for removing of ‘reasonable time’ is explained as “it created a lack of a standard application of the concept globally. In fact, it was still the case during the revision process that a number of banks considered a reasonable time to be the full of seven banking days following the day of receipt of the documents. Therefore, the majority of ICC national committees voted for the removal of the reference to the ‘reasonable time’²⁹⁰”.

When the removal of ‘reasonable time’ was suggested, the controversy over the phrase was widely analysed. The main issues of having such phrase was²⁹¹;

²⁸⁸ This provision should be read with article 16 d of the UCP 600, where it is missing the words of ‘without any delay’ as compared to article 16 of the UCP 400 and article 16d of the UCP 500.

²⁸⁹ ‘Commentary on UCP 600’, ICC Publication (2007) page 63

²⁹⁰ ‘Commentary on UCP 600’, ICC Publication (2007) page 62 and 63

²⁹¹ Charles Debattista, “The New UCP 600--Changes to the Tender of the Seller's Shipping Documents under Letters of Credit”, *Journal of Business Law* [2007] 329, 338, available at

- a) Banks tend to assume that they have seven banking days to examine and issue the notice neglecting the fact that in many cases, examination and the issue of notices do not require that much time.
- b) There were many reported cases that, in one jurisdictions, different interpretation were made to the phrase of 'reasonable time' depending on the circumstances of the case.
- c) The elements that can be applicable to measure the reasonable time would vary from one bank to another depending on the examiners knowledge, experience and other facilities available such as the latest technology.

Referring to the above three scenarios, it was explained that these types of uncertainty surrounding the question as to how many days short of seven constituted a 'reasonable time' led to an overwhelming majority of ICC National Committees to recommend the deletion of this phrase and to give each bank involved in the letter of credit chain a fixed maximum number of days in which to examine the documents²⁹².

Evidently, it is clear that, the removal of reasonable time was borne out due to an abundant desire of the UCP 600 Drafting Group to address the controversies which had widely arisen under the UCP 500²⁹³. However, it is debatable that the time scale which the UCP 600 provides to examine the documents can help to reduce the complexity of the process. It is more likely that, under the UCP 600, the beneficiary could lose out any advantage which was available to him under the UCP 500 as Article 14 (b) imposes a rigid time scale instead of having lenient expression of a reasonable time. This can play well into the banks' hand leading them to use the maximum time available.

"Maximum" of five banking days

The position taken above by the drafting committee of the UCP 600 to remove the words 'reasonable time' may seem as profound and thus, it has not taken steps to prevent banks presuming that, now they have time until the 5th day from submission of documents to give notice to the beneficiary. The words '**maximum 5 days**' should not necessarily make a case for the bank that it should give the notice to the beneficiary at the earliest possible opportunity. In that aspect mere removal of the

<<http://eprints.soton.ac.uk/id/eprint/47533>>

²⁹² *ibidem*

²⁹³ Carole Murray, David Holloway and 'Darren Timson-Hunt, Schmitthoff's The Law and Practice of International Trade', (12th edition, Sweet & Maxwell, London, 2012), page 201 and E P Ellinger, The Uniform Customs and Practice for Documentary Credits – the 1993 Revision, Lloyd's Maritime and Commercial Law Quarterly, page 391

'reasonable time' would not make the ICC's stance viable. This implies that the banks can still take as much as time they need within the maximum 5 banking days period irrespective of the fact that the examination could have been finished within one or two days.

It can also be argued that, the word '**maximum**' can be matched with the words '**reasonable time**'. On the face of it, it is clear that the word 'maximum' has shown some leniency towards the bank when determining the time period that a bank should spend on examining. According to the Oxford dictionary, the word 'maximum' means the greatest amount and consequentially, it may seem that banks have the entire time of five days to examine the documents. In contrast, the words 'reasonable time' restricts the banks from using the maximum time permitted to be spent on documents examination. Apparently, the banks get more liberty to spend time on documents examination rather than the time they actually need. Consequently, the mere removal of 'reasonable time' from the UCP does not seriously make the ICC's vision of bringing a universal standard of application to the rule viable. It is inevitable to assume, that the interpretation of the word 'maximum' as provided by the UCP 600 does not seem as a clear and less complicated answer to what was in the corresponding Article of the UCP 500.

In contrast it can also be assumed that banks cannot simply stay until the 5th day of submission to communicate their decision unless they have reasonable grounds to do so. The word of 'maximum' could alert the banks that they can wait until the 5th day only in cases where the examination needs thorough researches. For example, the expression of "the bank shall have a maximum of five banking days" instead of using " the bank shall have five days" implies that the drafters of the UCP 600 did not intend that in each and every case banks do need five banking days to discharge their duty²⁹⁴.

Five days period is not be curtailed

On perusal of case law relating to time limit indicates that most legal actions had arisen due to the tender of documents when the credits were about to be expired. Considering the frequent issues that have arisen over the time limit for examination with regard to tender of documents with credit soon to be expired, it is important to find out what differences have been made by the 2nd part of Article 14 (b) in comparison to its predecessors.

²⁹⁴ Ebenezer Adodo, 'A presentee bank's duty when examining a tender of documents under the Uniform Customs and Practice for Documentary Credits 600', *Journal of International Banking Law and Regulation*,(2009), available at www.westlaw.co.uk, (accessed on 7th January 2016); where it says 'it is indeed obvious that its drafters do not intend to impose an inflexible time limit in every case of document checking, other than a five-day cap'.

Sub Article 14 (b) of the UCP 600, which is new to the UCP states that the maximum period for examination of documents is not curtailed or affected by the date of expiry of credit or the latest date for presentation of the documentary credit falling within this period. According to the UCP drafting group, “ banks process presentation of the documents within the normal flow of business transactions and are not responsible for expediting examination because the documentary credit is about to expire. It is the responsibility of the beneficiary to ensure that the documents are presented in sufficient time so that if there are correctable discrepancies, it may have the time to correct these and re-present the documents”²⁹⁵.

This part has been brought into the UCP to tackle the most probable difficulty that arises frequently by submitting documents to the bank by the beneficiary within the last few days of the credit’s life time.

Under the previous versions of the UCPs, it was assumed that the banks were in some way legally obliged to examine such late submissions in a short period of time²⁹⁶, despite the fact that the set of documents submitted are bulky and if it was deemed that the possibility of completing the examination within the limited time frame is very little. This obligation of banks to examine the documents prior to expiration of the credit had not been imposed by the UCP in its all revisions. However, until the publication of the UCP 600, there was no such a provision which provided that the examination process by the bank should not be affected by the fact that, the lifespan of the credit is about to be expired. There were many reported case where it was described a ‘reasonable time’ means 2 or 3 days. In **Banker’s Trust Co v State Bank of India**²⁹⁷, expert evidence was adduced by the defendant to the effect that the major UK clearing banks generally aim at accepting or rejecting the documents within three working days of their receipt. In addition, the Court of Appeal in **DBJJJ Inc v National City Bank**²⁹⁸ stated that, ‘article 13(b) provides for a “reasonable time, not to exceed seven banking days” and it does not, as the Bank’s argument suggests, provide for a time period of “seven banking days.” By giving no meaning to the phrase “reasonable time,” the Bank’s argument is inconsistent with the plain language of Article 13(b)²⁹⁹. For example, under the Seven days limit, if the beneficiary makes the tender 3 days before the expiration of credit, given the fact that ‘reasonable time³⁰⁰’ involved, the bank could have been obliged to make the decision within the next 3 days from submission, when the tender is not comprised with a bulk of the documents. As provided in the above mentioned DBJJJ Inc case, the calculation of the reasonable time is dependant on how complicated the tendered

²⁹⁵ Commentary on UCP 600 – ICC publication (2007), page 63

²⁹⁶ Especially under the UCP 400 where bank has a ‘reasonable time’ to examine the documents.

²⁹⁷ (1991) 1Lloyd’s Law Report 443 at 594

²⁹⁸ 123 Cal. App. 4 th 530, at 540 (2004

²⁹⁹ *ibid*

³⁰⁰ Article 13 (b) of the UCP 500.

documents are and how many documents are available to be examined³⁰¹ and therefore, in this example the bank may be compelled to complete the determination within 3 days. The banks were not entitled to rely on the fact that it has an extra 4 days to complete the examination as the UCP have provided the 7 days period for examination and communicating its decision. Hence, if the bank failed to communicate its decision prior to expiration of the credit, it could have been declared as a violation of Article 14 (b)³⁰² of the UCP 500.

According to new terms in Article 14 (b) of the UCP 600, that assumption may no longer be valid. Now, even after an extreme late submission, the bank's duty to carry out examination remains as the same and thus, it does not lap with the letter credit's life time. For example, if the beneficiary submitted the documents to the bank on the expiry date of credit which contained a bulk of papers, neither the size of such tender nor date of submission stops the bank from carrying out the examination process. However, Banks are not legally obliged to make instant decisions due to a short life span of the credit. Under this rule, banks are required to perform as normal in the examination process and if they fail in doing so, that would make the preclusion rule applicable as mentioned in Article 16 (f)³⁰³ of the UCP 600.

Apparently, the new clause in Article 14 (b) of the UCP 600 diminishes the safer environment which was available to a beneficiary under the previous regime unless the word of 'maximum' is not interpreted as similar to 'reasonable time'. Otherwise, this will badly affect the cases where submissions are made 2, 3 days before the expiration of credit.

For example, if the tender was made 4 days prior to the expiration of credit, under the UCP 600, the wording of the 2nd part of Article 16 (b) may make the bank assume that it is not obliged to make the decision until the 5th day from the submission despite credit will be expired on the 4th day from the tender of documents. Ultimately, this will end up in the beneficiary not getting paid for the goods shipped to the buyer despite tendering of documents four days prior to the expiration of the credit. This situation will diminish the reasonable expectation of the beneficiary as well as the aim of the drafter of the UCP 600 which was to strike a balance of rights between all the parties involved in the credit.

Obviously, the banks are very keen to keep their loyal customers satisfied and strive hard to provide the best customer service. However, when the transactions are worth millions of pounds Sterling, banks may be reluctant to make quick decisions

³⁰¹ DBJJJ Inc v National City Bank, 123 Cal. App. 4 th 530, at 540 (2004)

³⁰² Upon receipt of the documents the Issuing Bank and /or Confirming Bank, if any, or a Nominated Bank acting on their behalf, must determine on the basis of the documents alone whether or not they appear on their face to be in compliance with the terms and conditions of the Credit.

³⁰³ 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.

considering the problems associated with reimbursing or being liable for damages to the buyer. Therefore, banks may tend to carry out the examination unscrupulously to evade the complication of reimbursing by using the vagueness between the two parts of the Article 14 (b) of the UCP 600. This considerably reduces the reasonable utility value of letters of credit even where the defects in tender are easily curable.

4.2.8 Measuring the actual time required for examination.

The UCP has failed to introduce a mechanism as to how the actual examination period required can be decided. There was a plethora of evidence that the time for documents examination can vary from one to another. Basically, the actual time required for documents examination can be decided upon either the complexity of the documents tendered or the length of the documents that are available to be examined. In **Seaconsar Far East Ltd v Bank Markazi Jomhuri Islami Iran**³⁰⁴, it was stated that the time period required for examination of documents is decided on the amount of documents required to be examined by the letter of credit, details to be contained in the documents and how clearly those details have been spelt out. For example, in the above discussed **DBJJJ Inc v National City Bank**³⁰⁵, it was stated that, when there are few documents to be examined, the reasonable time would be less than 7 days³⁰⁶.

However, in some cases the time required for examination may take additional time depending on the complexity of the case. For example, in **Pasir Gudang E.O.S.B. v. The Bank of New York**³⁰⁷ the bank was required to investigate about three possible ports of destination which were located in totally different areas. In this case, the letter of credit contained two different names which had been misspelled although they were intended to be meant the same. The port of destination had been misspelled as 'Ilyichevsk' at one place and at another place as 'Ilychevsk'. Though the credit indicated the port of destination is located in Ukraine, the bill of lading did not bear the name of the country.

At the hearing of the case which was brought on the grounds of an unfair refusal to accept the document, the Bank of New York, in their defence, submitted to the Court a set of internet searches of geographic websites which showed different locations under the same name which are located in three different countries.

³⁰⁴ [1999] 1 Lloyd's Rep. 36, at 41

³⁰⁵ 123 Cal. App. 4 th 530, at 540 (2004)

³⁰⁶ 123 Cal. App. 4 th 530, at 540 (2004)

³⁰⁷ 603531/99 - (NY Sup. Ct. 1999)

The bank strongly argued that if the bank was to accept the documents in dispute, there would definitely have been a risk of having the cargo being delivered to a completely different port which was not intended in the credit.

The Court affirmed the position taken by the Bank and stated that the discrepancies contained in the submitted documents justify the bank decision to reject the bill of lading as it was not expected the bank to rely merely on papers presented when the discrepancies are visible.

The Court has probably made the right decision as it is critically important make sure that the goods are delivered to the designated location under the credit. However, if the bank decided to refer the documents in question to be cured, it would have taken a considerable amount of time for the beneficiary to provide the corrected documents. In the meantime, the time limit available for examination would have been elapsed. If there was flexibility in the time limit available for examination, the bank could have chosen the option of offering the beneficiary the right to cure the defect.

This leads to the question that, when the documents in question are referred either to cure defect or to waive the discrepancy, the banks should be allowed to spend more time in making their final decision. If banks are given more time considering the two curable aspects, there will be an opportunity to minimise the level of rejections. Banks will be keen to keep their loyal customers satisfied and therefore, they would want to clear the payment after receiving the confirmation from either the buyer or cured documents from the beneficiary. Therefore, it can be suggested that, when the documents are referred for cures or waiver, the formal time limit should not stand against the bank. Especially, when the credit has a long life span, it would not be unfair for banks to taking an additional period to redress the issue. Imposing of time limits is mainly focused on protecting the interest of the beneficiary and, making extra effort by the bank to pay the beneficiary will not cause any prejudice to either party. However, if the banks rely upon their own judgments, without making any effort to refer the document either for a waiver or cure, exceeding of the formal time limit provided in the UCP, cannot be justified.

Beyond the UCP, under the general principles of law, all the parties are contractually obliged to perform their part with due diligence unless parties have specifically excluded such expectation by written terms in the contract. Under these circumstances, the bank can simply not discard the duty of care and due diligence. Therefore, under the credit agreement, the banks are obliged to carry out a reasonably competent and diligent examination on documents received by the beneficiary. As a consequence, if a bank takes an excessive number of days against what is actually required, it may fall under a breach of contract in respect of which the bank can be liable for damages to the beneficiary.

4.3 Approaching the applicant for a waiver

4.3.1 Introduction

The bank, when it deals with the discrepancies, has an option of seeking waivers of discrepancies from the buyer. The practice of seeking waivers of discrepancies had been adopted by banks long before the UCP was promulgated, as a common and perhaps universal banking practice. In most of the cases, the applicants agree to waive the discrepancies, if the doubts on documents are created by minor technical discrepancies. In 1993, this practice was introduced by the ICC into the revised version of the UCP 500. The main elements of this Article has remained the same in the UCP 600. According to Article 14(c) of the UCP 500, when the Issuing Bank identifies that the documents are not in compliance with the terms and conditions of the Credit, "it may in its sole judgment approach the Applicant for a waiver of the discrepancies".

The corresponding Article of the UCP 600 takes a similar approach as its predecessor and makes provision under Article 16 (b). This article says that-

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

According to the UCP drafting committee, the Article 14 of the UCP 500 was one of the Articles that prompted the most queries to the ICC Banking Commission³⁰⁸. As a result of it, the ICC published a paper titled 'Examination of Documents, Waiver of Discrepancies and notice under UCP 500' in the year of 2002. This paper contained the explanation for the queries received and the content of the document was later used by the ICC for the purpose of reframing and/or building Article 16(b) of the UCP 600.

³⁰⁸ Commentary on UCP 600, article by article analysis by the UCP 600 Drafting group, (2007) page 72

According to the ICC, the option of approaching the Buyer for a waiver is available only to the issuing bank³⁰⁹. The reason behind this is that, the issuing bank holds the direct contact with the buyer³¹⁰. In most cases, the issuing bank, being the buyer's bank, has fast and easy access to the buyer and understands the interests of its customer. In some cases, either the confirming bank or the seller may request the issuing bank to approach the buyer for a waiver. Hence, it is important to note that such request made by the beneficiary of the letter of credit and/or confirming bank and/or nominated bank, does not make the issuing bank obligated to do so³¹¹. As it constitutes a discretionary act of the issuing bank no party can bring an action against the issuing bank for not exercising the request for waiver³¹².

This option has created a platform to increase the productivity level of making decisions on honouring the payment, whereas over 50% of the demands for payment under letters of credit are discrepant³¹³ at the initial tender. This also reduces the level of rejections of documents on the ground of minor discrepancies which can be discarded by the buyer without any major concern. On the other hand, this minimises the risk of the bank being sued by the buyer for unlawful acceptance of discrepant documents. Therefore, this concept promotes fairness among all parties and it can help banks to keep their loyal customers satisfied, rather than refusing multimillion worth of transactions merely relying on irreverent discrepancies in the presentations.

4.3.2 The Buyer should not be made a consultant

However, it must be noted that in terms of this Article, the option for waiver does not seem to extend to a position where the bank can substitute its customer's judgement concerning either to accept or reject the documents. The buyer should not be asked to provide opinions on outcome of the examination. In other words, the bank should not allow its customer to review the documents seeking additional discrepancies beyond those identified by the bank. This means, that the buyer is expected to do a mere consulting role rather acting as a document checker. This assures that that the

³⁰⁹ Commentary on UCP 600, article by article analysis by the UCP 600 Drafting group, (2007) page 72

³¹⁰ Commentary on UCP 600, article by article analysis by the UCP 600 Drafting group, (2007) page 72

³¹¹ Commentary on UCP 600, article by article analysis by the UCP 600 Drafting group, (2007) page 72

³¹² There is no rule in the UCP that requires the issuing bank to seek a waiver of the discrepancies from the applicant. Commentary on UCP 600, article by article analysis by the UCP 600 Drafting group, page 72

³¹³ King Tak Fung, 'Leading Court Cases on Letters of Credit' published by the ICC in May 2004

bank has the ultimate say when it comes to the decision on compliance and prevents an environment where the parties are dragged into unnecessary correspondence.

It is important to make sure that the issuing bank makes an independent determination on the paper submitted as to the apparent facial conformity when compared with the terms provided in the letter of credit. Therefore, the approach made by the issuing bank should not allow the applicant to examine the documents. In many instances, issuing banks, disregarding the above fact, send documents to the buyer for checking. This may be due to the fact that banks wish to reduce the workload and to get away from potential legal challenges from the buyer if the issuing bank has failed to identify certain discrepancies³¹⁴. Hence, this practice should not be encouraged as it may lead to the bank being deprived of its right of rejection.

At first instance, the issuing bank should identify the discrepancies and then it should approach the buyer for a waiver. This is evident from the wording of the judgment in **Bankers Trust Co v State Bank of India**³¹⁵ where it was made clear that releasing documents to the applicant should be made only for the purpose of facilitating the him to make decisions on whether he can be agreed to waive the discrepancies that have already been identified by the bank³¹⁶. The reasons behind such requirement is to make sure that there may be a motive of unwillingness on the part of the buyer to pay the seller. On the other hand, if the seller is in possession of convincing evidence to established that the bank has sent the document to the applicant to identify the discrepancies prior to making the final decision, it may lead to a situation where Courts may tend to award the judgment in favour of the seller discarding the discrepancies contained in the presentation.

In addition, it is not mandatory for the issuing bank to rely on the decision made by the buyer on a waiver request. The issuing bank may decide not to follow the buyer's decision, even if the buyer has decided to waive off the discrepancy³¹⁷. However, if the issuing bank decides to ignore the buyer's decision, it must give a logical explanation for its conduct. This position was affirmed by the judgment made in **Bombay Industries Inc. v. Bank of New York**³¹⁸ where it was stated that when a

³¹⁴ King Tak Fung, 'Leading Court Cases on Letters of Credit' published by the ICC in May 2004 at 84

³¹⁵ (1991) 2 Lloyd's Law Rep. 443

³¹⁶ King Tak Fung, 'Leading Court Cases on Letters of Credit', ICC publication, published in May 2004 at 84-85,

³¹⁷ Discrepant Documents, Waiver and Notice, An ICC Banking Commission Recommendation, Commission on Banking Technique and Practice, published by the ICC on 9th April 2002, available at <<http://www.iccmex.mx/uploads/banca/posturas/Examination-of-Documents-Waiver-of-Discrepancies-and-Notice-under-UCP-500.pdf>> (accessed on 10th January 2016)>: where is says, The mere fact that an applicant waives the discrepancies does not obligate the issuing bank to waive the discrepancies, whether or not the issuing bank requested such waiver..

³¹⁸ 233 A.D 2d 146, 649NYS 2d 784(App. Div 1996)

bank ignores, without justification, the buyer's waiver acceptance, it may violate the seller's anticipation that the bank would operate neutrally..

4.3.3 Notices to be given 'without delay'

Under the UCP 500, there had been a conflict between two sub-sections over the issue of approaching the applicant for a waiver. Article 14(b) of the UCP 500 provided that, a bank "may refuse" the documents if they are inconsistent with the terms of the letter of credit. In addition, the banks were required to give notice of refusal to the beneficiary 'without delay'³¹⁹. At the same time, Article 14(c) stated that 'a bank may approach the applicant for a waiver of the discrepancies'. However, the requirement of giving refusal notices 'without delay' could have prevented a bank from exercising its discretion to approach the applicant for a waiver. In other words, when a bank reaches the applicant for a waiver, it could be identified as a violation of the "without delay" rule. For example, the bank approaches the buyer seeking for waiver of a discrepancy and waits until it receives the buyer's decision. Ultimately, the buyer decides to refuse the waiver of the discrepancy. After receiving the buyer's decision the bank issues the refusal notice to the seller before the expiration of 5 days. Under this situation, it is not clear, whether the seller can sue the bank for not issuing the refusal notice within a reasonable time³²⁰. Therefore, banks may be reluctant to use the waiver rule since it can place an extra burden to the decision making process within the allowed limited time period. For example, when a decision is made not to make a waiver request, such decision would not incur any financial losses to the issuing bank as they are not legally bound to do so in the first place. As a result of this, it can be assumed that the implementation rule for application of waiver procedure by the issuing bank became less attractive under the regime of the UCP 500. It can be assumed that, the above mentioned situation therefore made banks less interested in implementing the waiver rule.

However, under the UCP 600, the ICC has corrected the above mentioned flaw by removing the phrase of 'without delay' in regard to giving of notice of refusal to the beneficiary³²¹. This reduces the application of the preclusion rule against the bank for

³¹⁹ Art. 14(d)(i) - If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents.....

³²⁰ Under article 14 (b) of the UCP, the time that the bank can spend on examination of document is limited maximum of 5 days and waiting until the 5th may not be justifiable, even if the waiver request had been made.

³²¹ Article 16 d of the UCP 600 - 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.**

taking time to give notices prior to the expiration of 5 working days from the submission of documents for examination. Therefore, under the current rules banks are encouraged to exercise their discretion in deciding whether to approach the applicant for a waiver or not. The positive outcome of this is very clear as more the requests that are made by banks for waiver mean a lesser amount of rejections.

The only negative side of the current rule is that, the bank in collusion with a perverse minded buyer can wait until the 5th day to issue the refusal notice, if the lifespan of the letter of credit is about to be expired. The removal of the phrase of 'giving notice without delay' can therefore work against the interests of the seller. In order to avoid such a situation, it is important to make it obligatory for a bank to inform the seller about any waiver request made, as soon as it approaches the buyer.

4.3.4 Waiver within time limit.

Banks would never volunteer to honour a presentation which is not conforming with the terms of the credit. Normally, banks may identify the discrepancies in a presentation and agree to accept the documents as complying if they receive a confirmation from the applicant of the credit to waive off such discrepancies. Therefore, identifying discrepancies in a presentation and refusing the documents as non-compliant are two separate acts to be done by the banks.

In the light of above, the completion of the examination, waiver request and communication of the decision to the beneficiary within a short time line was very important. The communication was expected to reach the beneficiary without any undue delay. The importance of complying with the above requirement was mirrored in the judgment made in **Hamilton Bank v Kookmin Bank**³²², where the issuing bank, after finishing the examination process on time, couriered the dishonour notices against using a means of telecommunication (such as SWIFT) which was required by the UCP 500. Therefore, the communication of refusal was delayed. In the light of the delayed communication to the beneficiary, the Court held that the issuing bank had wrongfully dishonoured the Letter of credit by failing to comply with the provisions provided in the UCP 500.

Since, under the current rule, the above mentioned examination and the issuing of the refusal notice are required to be completed within 5 working days or less, adding the waiver request to such a tight schedule may not be very practical. Even under the previous regime of the UCP where a bank had an extra two working days to complete the whole process, there were doubts as to how a bank could complete the entire process within seven working days or less. For example, Professor Charles

³²² 44 F. Supp. 2d 653 (1999)

Debattista³²³ argued that, banks may find difficulties in complying with the time limit as-

- a) It was not clear that the UCP 500 gave banks seven banking days, rather than a reasonable time up to seven banking days.
- b) Even within the same jurisdiction, there may be various factors which might influence the fact whether a particular interval was or was not reasonable.
- c) A reasonable time could be differently interpreted in different financial centres.

Even under the current rule, the above given three issues have not been resolved entirely and therefore doubts still remain whether banks would be willing to take an extra burden by seeking a waiver. The amount a bank charges to offer the payment facility can be another deciding factor. Banks may not be motivated to take extra steps to facilitate the payment if the service charges for accommodating the letter of credit transaction do not justify the responsibility associated with it. This will not be the case in every letter of credit transaction and thus, when the bank has a tight time line together with its other busy day to day business, the bank may not look to approaching the buyer for a waiver. This situation could have been avoided if the waiver rule was made mandatory for the bank or it had been given additional time to issue the final notice. In this regard under the UCP 600 the reducing of the time period for examination and issuing of notice by two days would not help to promote more referrals for waiver. Banks do not receive extra protection against preclusion simply because they referred the discrepancies for a waiver. This does not seriously help the ICC's case by cutting down the level of rejection of documents.

Therefore, there should be a way by which banks will be encouraged to make more waiver requests. Instead of limiting the time period, the ICC should have introduced a window period of time that can go beyond 5 days, if the bank has approached the buyer for a waiver. The Bank cannot be made liable for preclusion, if it makes the best effort to make the payment to the seller. As a suggestion, the limit of 5 days should not be applicable in instances where the bank has approached the buyer for a waiver. Instead, the bank should be granted an extra 'window' period until it hears from the buyer. To avoid being sued for preclusion, the bank should simultaneously inform the seller about the referral to the buyer for a waiver. As soon as the seller is informed about approaching the buyer for a waiver, an extra few days (4 or 5) should be added to the current 5 days rule. The addition of these extra days should not be made applicable to instances where banks do not seek a waiver from the buyer and where the seller had not been informed about such request. Similarly, this process of adding extra days can be applicable to cases where banks approach the seller to cure discrepancies.

³²³ "The New UCP 600--Changes to the Tender of the Seller's Shipping Documents under Letters of Credit" [2007], J.B.L. 329, 338 available at <http://eprints.soton.ac.uk/id/eprint/47533>

However, it must be noted that, the idea of having additional period of time for examination, when the waiver request was made, has already been rejected by the English courts. In **Banker's Trust Co v State Bank of India**³²⁴, the plaintiff had to examine some 967 pages of documentation within three days and upon discovering discrepancies, it was notified to the buyer. A further 72 hours elapsed during which time the buyer was allowed to check the documents. The notice of rejection was issued to the seller some 8 days after the submission of documents. At the appeal, the Court of Appeal stated that, a 'reasonable time' for the bank to examine the documents was not be extended by a further period of time in which, the customer was allowed to conduct its own examination³²⁵.

Hence, one can argue that, the above statement made in the judgment does not encourage banks to make more waiver requests which will help to cut down the level of document rejections. Given this situation, the limited time available for banks to make decisions on documents examination does not aid the cause of approaching the buyer for a waiver³²⁶. It is inevitable to question, why a bank would take extra risk of being liable for preclusion when the application of waiver request is solely discretionary.

In the light of above circumstances, it is important to note that, the proposed additional time period should be imposed by way of a contractual term provided in the rules of the UCP. This will encourage banks to make more referrals for waiver as no bank would like to lose its customer by refusing documents that could have easily been curable.

4.3.5 Issuing bank to approach the buyer.

According to the ICC, the option of approaching the Buyer for a waiver is available only to the issuing bank³²⁷. The reason behind this is that, the issuing bank has direct contact with the buyer³²⁸. It further states that a request from the beneficiary to

³²⁴ (1991) 1Lloyd's Law Report 443

³²⁵ (1991) 1Lloyd's Law Report 443 at 449

³²⁶ The normal assumption regarding the 'limited time period' is that it is there to protect the rights of the seller as he expects quick payment for the goods he has shipped.

³²⁷ Commentary on UCP 600, article by article analysis by the UCP 600 Drafting group, (2007) page 72

³²⁸ Commentary on UCP 600, article by article analysis by the UCP 600 Drafting group, (2007) page 72

the credit and/or confirming bank and/or nominated bank to the issuing bank does not make it obligatory for the issuing bank to abide by that request³²⁹.

The fundamental principle behind letters of credit is to ensure that the seller gets paid for what has been shipped. The confirming bank (in many cases being the seller's bank) may, in its capacity, strive hard to ensure that its client's rights are protected. On the other hand, the issuing bank (being the buyer's bank) does not bear a similar type of obligation towards the seller. Especially when the parties to the letter of credit are located in two different countries, it is difficult to assume that the issuing bank would tend to take additional steps to look after the interests of the seller, who is a total stranger to it. This situation has struck an imbalance between the rights of the buyer and the seller, as the option of seeking a waiver in many instances is at the hands of the buyer's bank.

This goes to show that that the UCP 600 has not taken a positive approach to even out the imbalance created by permitting the issuing bank to decide whether to approach the buyer for a waiver or not. Making this power discretionary for the issuing bank to use, raises issues such as -

- a) If a document was found discrepant, the seller would suffer the financial and other losses.
- b) the use of the waiver option is in the hands of the bank that has a lesser interest in protecting the seller's rights.

The beneficiary to the credit makes the document submission to the confirming bank and the bank conducts the initial examination. Therefore, the confirming bank gets the initial opportunity to identify any discrepancies. Within the time limit available for examination of documents, the confirming bank should, with the consent of the seller, be able to approach the buyer for a waiver through the issuing bank. This can give the parties sufficient time to act upon the discrepancies within the time limit.

However, the approach made for a waiver should be a one-time approach as this should not create an environment that leads to endless negotiations.

4.3.6 Conclusion.

In terms of the discussion above, it has transpired that the seeking of a waiver from the buyer is the right option which can reduce the amount of rejections of documents. However, as this practice remains optional, its utilization has been covered by the dark cloud of a rigid time scale to communicate the final decision. Therefore, as suggested above, there should be an additional time allocation to issue the final notice when the request for waiver has been made.

³²⁹ Commentary on UCP 600, article by article analysis by the UCP 600 Drafting group, (2007) page 72

Apart from that, if the extra time for examination and issuing of notice is allocated, that additional time should only be allowed if the issuing bank has informed the seller about the waiver request made within the normal 5 banking days period.

Therefore, it can be suggested that an amendment to Article 16 (b) as shown below to accommodate the required changes discussed above which will help issuing banks to make more use of the waiver request -

*'When an issuing bank determines that a presentation does not comply, it may in its sole judgement approach the applicant for a waiver of the discrepancies. This does not, however, extend the period mentioned in sub-article 14 (b) **unless the seller has duly been notified by the issuing bank when the approach for waiver was made.**'*

The time period for the extra allocation of time may be decided by the facts relevant to the particular case. However, it should remain within the limit of 3 to 4 days.

In addition to above, for the purpose of minimizing the misuse of the waiver request made to the buyer (such as waiting until the expiration of the lifespan of the credit) it can be suggested to impose a time limit by the issuing bank on the buyer to communicate his decision on waiver request to the bank. For example, when an issuing bank approaches the buyer for waiver of discrepancies, the issuing bank should inform the buyer that he should make his decision within some certain time (may be within 1 or 2 days). If the buyer fails to respond within this time limit, the issuing bank should not be bound by the decision of the buyer made outside the imposed time period. The similar type of approach was implicated in the ICC publication where it says, 'in order to avoid a refusal of documents solely based on the judgment of the issuing bank, any decision made by the applicant on waiver request should be communicated to the issuing bank within the time frame established by the issuing bank³³⁰.

4.4 Preclusion rule.

4.4.1 Introduction

It is often considered that the preclusion rule in letters of credit serves as a counterweight to the doctrine of strict compliance. These rules strike a balance between the obligations of the parties to the letter of credit that require utmost due

³³⁰ Discrepant Documents, Waiver and Notice, An ICC Banking Commission Recommendation published by the Department of Policy and Business Practices of the ICC on 9th April 2002 available at <<http://www.iccmex.mx/uploads/banca/posturas/Examination-of-Documents-Waiver-of-Discrepancies-and-Notice-under-UCP-500.pdf>>, accessed on 28th February 2016

diligence. The strict adherence to these principles has led to the setting of high standards on international trade finance. In the doctrine of strict compliance, the presenter of the documents is required to comply strictly with the terms of credit and in the preclusion rule the bank is required to adhere strictly to the provisions of the UCP.

Especially, this strict adherence to the provisions of the UCP by the bank matters most when the goods that have been shipped are subject to a falling market. In a rising market, the buyer can sell the goods anywhere and can instruct the bank to pay the beneficiary irrespective of discrepancies in the documents submitted³³¹.

Article 16 of the U.C.P. 400, (the 1983 version) required the banks to examine the beneficiary's documents within a reasonable period of time and give notice of discrepancies without delay after deciding that the documents were non-compliant. This Article contained a strict estoppel provision which stated that the bank is precluded from claiming the documents are not compliant if they fail to examine the documents within a reasonable time or fails to issue notice of refusal mentioning discrepancy in the tender.

The same trend was continued in the UCP 500, which provided, that banks should examine the documents and give the refusal notice within 7 banking days, if they decide that the tender is non-compliant³³². At the same time, Article 14(e) provided the preclusion provision which stated-

“if the issuing bank and/or confirming bank, if any, fails to act in accordance with the provisions of this Article and/or fails to hold the documents at the disposal of, or return them to the presenter, the Issuing Bank and/or Confirming Bank, if any, shall be precluded from claiming that the documents are not in compliance with the terms and conditions of the credit.”

The Preclusion rule can be applied against the document examination by the bank under three circumstances-

- i) Bank's failure to give notice on refusal of documents submitted for the examination.
- ii) Bank's failure to give notice on Return of documents to the presenter.
- iii) Bank's failure to return the documents with due diligence

4.4.2 Rejection of the presentation

As mentioned earlier, Courts have predominantly treated the procedure for rejection of payment stipulated by the UCP rules with the level complying requirement as

³³¹ John F. Dolan, 'Weakening the letter of credit product: the new Uniform Customs and Practice for Documentary Credits', *International Business Law Journal* (1994) page 6

³³² Article 13 and 14 of the UCP 500.

similar to the doctrine of strict compliance. Any notices that have not followed the procedure for rejection which is provided in the UCP is treated as faulty³³³.

Banks refuse to honour the payment or negotiate against the non-compliant submission by giving single notice to the Seller. Normally, banks give refusal of payment notices on non-compliant presentation when-

- a) they decide not to approach the buyer for waiver or the seller for cure
- b) the buyer has informed the bank their disagreement to waive the discrepancies
- c) the bank decides not to waive even if the applicant would³³⁴

According to the UCP, the banks are strictly required to follow the procedure related to rejection, giving notice and returning the documents submitted by the seller³³⁵. Any failure to adhere to these procedures would result in treating documents have duly been accepted by the bank

Article 16(c) of the UCP 600 provides provisions setting out the requirements regarding the contents of the rejection notice stating that-

“ 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

Failure to follow the above provisions could preclude the bank from claiming that the documents are non-compliant and it will subsequently lead to a situation where the

³³³ Ellinger E.P., The UCP-500: Considering a New Revision, 2006 Annual Survey of Letter of Credit Law & Practice Handbook, edited by James E.Byrne and Christopher S.Byrnes, The Institute of International Banking Law & Practice, Inc, at 109.

³³⁴ As the rule of seeking for a waiver does not make the bank obligatory to follow at every instance. In that aspect, it can be assumed that it is only the bank's discretion whether seek a waiver or accept the agreement by the applicant to waive the discrepancies.

³³⁵ Article 16F of the UCP 600

bank is obliged to honour the payment despite the discrepancies in the tender. In addition to that, on perusal of the above Article, there are two main elements, which the bank is required to take into serious consideration when dealing with Refusal Notices and Return Notices. They are,

- a) A single notice to be issued stating refusal to honour the payment
- b) The documents to be returned to the beneficiary promptly.

4.4.3 A Single notice stating refusal to honour

In terms of this Article, firstly, the Refusal Notice must contain a statement saying whether the Bank is refusing to honour or negotiate. Secondly, it must specifically mention each of the discrepancies which led the bank to arrive at the decision to reject. Thirdly, the Notice must state reasons why the bank considers them as discrepancies³³⁶. In terms of these requirements, if a bank fails to list each discrepancy in the notice, they will not receive another opportunity to supplement or amend the earlier notice³³⁷. For these circumstances, the preclusion provisions can be applicable as provided by Article 16(c). Therefore, it is absolutely vital for the bank to list all the discrepancies that they found as they will not be able introduce additional discrepancies as grounds for rejection.

The strictness of this obligation of listing all discrepancies in a single notice is affirmed by the wording of the ICC's drafting group which states; "it is not sufficient to list one discrepancy or to give a partial list, if more than one discrepancy is found in the documents. The list must be complete and be specific as to the reason each is considered to be a discrepancy³³⁸."

First of all, the Notice must clearly state that they are refusing the presentation and therefore they reject the honouring of payment. The wording in the Notice in this regard has to be clear and precise. There should not be any room for clumsiness. Any unclear term used for refusal may end up resulting in the bank being responsible for not issuing a proper refusal notice. For example, in **Bankers Trust Co v State Bank of India**³³⁹, the bank sent the rejection notice by telex saying,

"The purpose of this telex is to alert you that we do not find documents value USD 10,335,536 as being in compliance with letter of credit terms. Full details of discrepancies will follow by a separate telex".

³³⁶ Commentary on UCP 600 by ICC's drafting committee, (ICC Publication 2007), page 73

³³⁷ King Tak Fung, 'Leading Court Cases on Letters of Credit' (ICC Publication 658 May 2004) at 85

³³⁸ Commentary on UCP 600 by ICC's drafting committee, (ICC Publication 2007), page 73

³³⁹ [1991] 2 Lloyd's Rep. 443 CA (England).

In the judgment, the Court found that the Notice in question-

- a) did not say in clear words whether the bank is refusing the honour or will negotiate
- b) has not listed all the discrepancies that are grounds for rejection.

Based on the above two reasons, the Court held that the bank does not have subsequent opportunities to remedy the deficiency in the first notice. Accordingly, it was decided that, the Bank has failed to give a proper refusal notice and therefore, it is precluded from refusing to honour the payment irrespective of the discrepancies contained in the tender³⁴⁰.

This case was decided under the regime of the UCP 400, which did not say that the bank must give a single notice of refusal³⁴¹. The decision made here shows that, the Court has identified the importance of issuing a single notice of refusal as against what has been written in the UCP. Strangely, the ICC had again failed to adopt the essence of the above judgment and there were no expressed terms in the UCP 500 stating that the bank can issue only one notice. Under the UCP 500, the provisions relating to the issuing of the Refusal Notice was almost similar to its corresponding Article of the previous version and it says that-

“If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents³⁴².”

On a reading of the above mentioned article, there was a possibility of arguing that the bank can give as much notices as it wants within the specific time period³⁴³. In **Voest-Alpine Trading USA Corp. v Bank of China**³⁴⁴, there was a discussion at the hearing over whether the bank can give notices more than once within the allowed time period. This case was decided under the UCP 500 and thus the Court did not specifically deny the bank’s right to issue an additional refusal notice. The Court observed that the bank’s notice of dishonour was deficient, irrespective of the fact that, the presentation to the bank contained several discrepancies. As a result of it, the Court ordered the bank to pay the beneficiary on basis that the notice issued

³⁴⁰ [1991] 2 Lloyd’s Rep. 443 CA (England).

³⁴¹ Article 16 D of the UCP 400, “if the issuing bank decides to refuse the documents, it must give notice to that effect without delay by telecommunication or if that is not possible by other expeditious means.

³⁴² Article 14 D(i) of the UCP 500.

³⁴³ Under the UCP 400, it was ‘a reasonable time’ that can lead up to unknown amount of days depending on the case’s circumstances and under the UCP 500, it was ‘a reasonable time up to 7 banking days’.

³⁴⁴ (S.D. Tex. 2000), 167 F. Supp. 2d 940

by the bank did not specifically mention that they are rejecting the presentation and they are refusing the payment. The bank's omission was clearly visible by the words contained in the notice which stated that, it will contact the buyer to explore whether the buyer would be willing to waive the discrepancies in the documents. The vague nature of this statement led the Court to assume that the bank was open to the possibility that the bank would accept the documents after receiving a waiver of discrepancies by the applicant. In addition to the first notice, the bank had sent out a second rejection notice to the beneficiary, which fell outside the time period that the banks are allowed to examine the document.

Given the above two judgements, it is clear that the Courts have refused to accept the methods of issuing multiple refusal notices. The Courts have clearly rejected what has been written in the UCP 400 and 500. The provisions provided in both the UCP 400 and the UCP 500 in respect of the issuing of refusal notices cannot be considered to be clear and precise and could create more controversies rather than eliminate the relevant issues. This situation led the drafters of the UCP 600 to understand the importance of giving a single notice of refusal to the Seller.

The advantage of giving a single refusal notice is that the beneficiary of the credit gets to know the outcome of his presentation to the bank within the 5 day period, so that he can take the necessary and timely steps to cure the deficiency or find an alternative payment method. On the other hand, when the beneficiary receives a refusal notice giving reasons why the bank has reached such a conclusion he will know that no further reasons will be given by the bank at a subsequent stage. Especially, when he is preparing to address the issues raised by the first refusal notice. In addition, this single notice rule makes banks more productive and accurate. As there is no additional opportunity to cite the discrepancies, banks are compelled to carry out their duty with due diligence in order to avoid any legal repercussions. This will increase the banks' professionalism and reliability.

The negative side of this is that, the correspondence entered into prior to the final decision communicated by the bank to the beneficiary can often be misunderstood as the final notice. There can be various types of correspondence between the parties during the period between the submission of documents to the bank and the issuing of the final notice. For example, if the bank informs the beneficiary that "it would contact the buyer to explore whether the applicant would be willing to waive the discrepancies in the documents"³⁴⁵, that notice can be misunderstood as the final notice given by the bank. A subsequent proper refusal notice can be rejected as the bank can be considered as already having given one notice. Therefore, it can be suggested that there should be a universally standardised format for the Refusal Notice. One unique form of refusal notice, which can, on the face of it, be easily

³⁴⁵ As happened in *Voest-Alpine Trading USA Corp. v Bank of China* 167 F. Supp. 2d 940 (S.D. Tex. 2000), *aff'd*, 288 F.3d 262 (5th Cir. 2002)

recognizable as the notice that communicates the bank's final decision would be a remedy for the single notice dilemma.

In addition, it is required, that in issuing a single notice, the words contained in the notice should clearly express the intention of the bank to the beneficiary. . Therefore, the words used in the refusal notice has to be precise and clear. Incomplete or unclear words or sentences can be interpreted differently against what the bank has intended. For example, in most cases, the documents are examined by the Issuing bank and they issue the notice to the confirming bank and the seller who are in a different country and who use a different language and more often the banks issue the Refusal Notices in the English language, which may not be the native language of the issuer. In such instances, the usage of a foreign language not native to the recipient in the Refusal Notice may create a situation where the meaning of the notice is construed differently. .For example, if the Refusal Notice states that "we are unsatisfied with your documents submission to reach a decision on making payment" instead of stating directly that "we decline your request for payment due to the discrepancies in the documents submitted", due to the ambiguous nature of the words that have been used, a mere reading of the banker's words may not bring a clear understanding of the banker's decision. It could appear to someone that the bank is still trying to make the payment after clearing some doubts over the documents in the tender. Therefore, it is very important to use precise and unambiguous words when the bank informs its decision to the documents presenter.

Therefore, the logical conclusion is that it is necessary to have a universally accepted standard for refusal notices in order to minimise any uncertainty that may be created by the wordings used in the Refusal Notice. On a careful evaluation, it transpires that, the Refusal Notice and Documents Return notice are the most important documents that can be used for litigation against the bank. Similarly, they can be the documents, which the bank's defence entirely relies upon. Therefore, it is absolutely vital to have the right formula for each Notice issued by the bank. It is a necessity that banks have proper guidance on this subject. In the light of that, it can be suggested that a future version of the UCP should contain a universally applicable format for refusal notices that can come as an annex to the main document. This format for Refusal Notice and Return Notice must be made compulsory for use, if the parties have incorporated the UCP into their Letter of credit transactions. This notice should contain, among other things, a box to be ticked which says-

Payment on the letter of credit is approved?	Yes	No
--	-----	----

In addition, there will be columns to state each discrepancy and the reasoning for the bank's findings. The full content of the suggested format for the refusal notice will be discussed in detail at the conclusion of this thesis.

It is important to note that, having such a universally adoptable format can make the Bankers' job easy. On the other hand, it will give a clear insight to the bank's document examination process and the credibility of their work. Similarly, the documents presenter is also receiving the decision of the bank which is clear and short.

Finally, it is further suggested that, Article 16(c) of the UCP 600, should be amended as follows to allow the above mentioned changes to be included-

" 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 **as provided in the annex (A)** to that effect to the presenter".

Failure to use the right format provided in the UCP for Refusal Notice and Return Notice should make the bank liable for preclusion.

4.4.4 Documents to be returned promptly

As mentioned before, Banks are expected to return documents to the presenter as soon as the presentation is rejected. This requirement is a mandatory provision, which makes any failure by the bank to comply resulting in making the bank liable for preclusion. In addition to that, there are more requirements to be followed by the banks under the requirement of the return of documents. First of all, the bank must state in the Refusal Notice what they are going to do with the refused documents and/or how they will dispose of them. In terms of the provisions provided in the UCP, the Refusal Notice must state³⁴⁶;

- a) whether 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 the instructions previously received from the presenter.

The option (b) and (d) have newly been introduced to the UCP 600 as a remedy to the previous shortcoming often responsible for litigation over the Return Notice issued on documents found to be discrepant³⁴⁷. As mentioned earlier, the issuing bank is not under obligation to accept a waiver that is received from the applicant. The situation explained in option (b) normally arises, when the issuing bank receives

³⁴⁶ Article 16C (iii) (c) of the UCP 600

³⁴⁷ Article 16C (iii) (b) and (d) of the UCP 600

the instructions from the presenter to handle the documents differently in between the period that the waiver request has been made to the buyer and its acceptance. In that event, now, it gives the option for the issuing bank to handle documents in accordance with the instruction received from the presenter depending on whether the waiver or instructions are received first³⁴⁸. For example, when the presenter is informed by the bank that the description of goods in the invoice does not match with the requirements in the letter of credit by a slight margin, the presenter can ask the bank to take into consideration a supporting document submitted which will prove the right goods have been shipped. This method was widely used under the regime of the UCP 500 though its wording did not reflect such banking practice. Therefore, the UCP 600 has now duly recognised that practice, which was already commonly used by the banks³⁴⁹.

Therefore, it is absolutely vital to have the document return details in the Refusal Notice at the earliest opportunity as it gives space to the presenter to act immediately. King Tak Fung, in his book published in 2004 describes the rationale behind having such rejection notice requirements as -

- a) when the bank decides to reject the documents and sends a proper rejection notice promptly, the beneficiary can dispose of or correct the documents without any delay³⁵⁰
- b) the beneficiary can know the exact grounds, which the bank has rejected the documents, that leaves them to decide whether the grounds mentioned in the notice are acceptable or unjustified³⁵¹
- c) the details at the locations of documents are kept is necessary so that the seller or the negotiating bank, being the owner of the rejected documents, can dispose of the documents accordingly³⁵²

Given the above circumstances, it is absolutely important for the bank to issue a proper refusal notice promptly to evade the infringement of the seller's or the negotiating bank's interests. Similarly, failure to adhere to the correct procedure could preclude the bank from claiming that the documents are discrepant³⁵³. However, the UCP 600 does not say that the documents should be returned to the presenter at the earliest opportunity and instead it says that - 'the bank after

³⁴⁸ Commentary on UCP 600, ICC Publication 2007, page 73.

³⁴⁹ Commentary on UCP 600, ICC Publication 2007, page 73.

³⁵⁰ King Tak Fung, 'Leading Court Cases on Letters of Credit' (ICC Publication 658, May 2004) at 91

³⁵¹ King Tak Fung, 'Leading Court Cases on Letters of Credit' (ICC Publication 658, May 2004) at 91

³⁵² King Tak Fung, 'Leading Court Cases on Letters of Credit' (ICC Publication 658, May 2004) at 114

³⁵³ Article 16(f) of the UCP 600

providing the notice under Article 16(iii) (a) and (b), return documents to the presenter at any time³⁵⁴.

The concept of giving notice promptly and other provisions of Article 16 (c) of the UCP 600 were scrutinized in the British Court decision of **Fortis Bank S.A. /N.V. and Stemcor UK Limited v Indian Overseas Bank**³⁵⁵. This case is considered as the most relevant case that tested the wording of Article 16 of the UCP 600. This case relates to the procedure to be followed, when dealing with the non-compliant presentation under the English Law and the UCP 600.

As discussed, Article 16 of the UCP 600 requires notice to be contained whether the credit was authorized/ negotiated, discrepancies if rejected, reasons for refusal and other related issues. The other important requirement is that the notice must state the way the bank deals with the documents submitted to the bank. The two options that a bank can utilise with the documents were tested in this case. The two options were-

- i) The bank is holding the document pending further instructions from the presenter
- ii) The bank is returning the documents to the presenter

In addition, it was further discussed about the requirement of "reasonable promptness" and the consequences of failing to serve the correct notice in accordance with Article 16 of the UCP 600.

In this case, the applicant of the credit requested Indian Overseas Bank to issue letters of credit in favour of the beneficiary (Stemcor UK Limited), , in connection with sales contracts between Stemcor and a third party.

All the letters of credit were issued subject to the UCP 600. Each letter of credit contained a request from the Indian Overseas Bank to Fortis Bank to advise the beneficiary and it was further stated that the Fortis bank "may add" its confirmation to that Letter of credit and the Letter of credit may be "confirmed at the request and cost of beneficiary".

After the submission of the documents by the beneficiary, the Fortis bank confirmed, negotiated and honoured the letters of credit presented and forwarded the documents to the Indian Overseas Bank for reimbursement.

However, the Indian Overseas bank rejected the majority of documents presented by Fortis Bank and refused to authorise the reimbursement to Fortis. The Indian Overseas Bank pointed out discrepancies in the documents submitted and issued the Return Notices and a Hold Notice to Fortis. After receiving the notices, there was some correspondence between the Indian Overseas Bank and Fortis in regard to discrepancies in the submission. Eventually, after 89 to 104 days, the Indian

³⁵⁴ Article 16(e) of the UCP 600

³⁵⁵ [2011] EWCA Civ 58

Overseas Bank returned all the documents to the Fortis Bank. The hold documents were returned 34 days after receipt by the Indian Overseas Bank.

Given the circumstances, the Court was required to decide whether the Indian Overseas Bank had complied with Article 16 of the UCP 600 in regard to return notices and hold documents. In addition, as a consequence of the Indian Overseas Bank's action, whether the bank was precluded from claiming that the documents submitted are discrepant.

The Fortis bank asserted that Article 16 of the UCP requires the documents to be returned to the presenter following a discrepant presentation. When a return notice is issued by the bank or it is holding the documents on the instructions of the presenter Article 16 (c) (iii) should be interpreted as the bank taking an undertaking to act in accordance with notices issued.

In addition, the language of Article 16 of the UCP should be interpreted as the bank should return the documents with reasonable promptness when the return notice is issued or request is made by the presenter to return the documents following the issue of hold documents. Therefore, the time period that Indian Overseas Bank took to return the documents was not reasonable.

Given the above circumstances, the preclusion provisions should be applied to the Indian Overseas Bank as per Article 16 (f) of the UCP 600.

The Indian Overseas Bank's defence, whilst claiming it was not under obligation to honour the reimbursement request, argued that, the wording of Article 16 of the UCP 600 does not express any requirement of returning documents and therefore, the Forties bank's claim cannot be considered as the correct interpretation of the Article in question. Furthermore, it was claimed that the rules of English law cannot be applicable in interpreting and constructing terms as parties have incorporated the UCP into the contract.

In its judgment, the Court took a purposive approach to interpret Article 16 of the UCP 600 and decided to construe the wording to reflect the best practice and reasonable expectations of experienced market practitioners. By doing so, the Court emphasised that, the "Commentary on UCP 600" by the drafting Group of the ICC should be considered as a mere discussion of the terms of UCP 600 and it does not hold any evidential value in construing the terms of the UCP. It was further decided that there is an implicit requirement in Article 16 in respect of Return Notice and/or the Hold Notice. Therefore, the Indian Overseas Bank was under obligation to return the discrepant documents to the presenter following the issue of a Return Notice. The same principle would apply to the situation where the Indian Overseas Bank received the request to return the documents from the presenter following the issue of the Hold Notice.

In considering the defendant's averments the Court explored the practical aspects of

the procedure provided in the UCP 600. The evidence of banking practice gave significant input to the understanding of the banks over this issue and provided direction as to how the Court should dispose of this dilemma. In this regard Fortis bank provided important evidence from seasoned bankers' on the current practice over the Return Notice and the Hold Notice after a non-compliant presentation of documents³⁵⁶.

According to their evidence, it transpired that, the bank after deciding the submission was non-compliant, issues notice to the presenter and then, the presenter may, and often will, request to hand back the documents. After receiving such request, the bank returns the documents immediately or within two days at the latest.

The Court stated that, the requirement provided in Article 16(c) of UCP 600 to mention in the return notice that the bank "is" returning the documents, does not necessarily mean that the bank is actually in the process of returning the documents along with the return notice. There is room to return the documents after issuing the Return Notice.

Similarly, when a Return Notice has been issued and upon receipt of it, if the presenter request not to return the documents³⁵⁷, the bank should maintain its obligation in the Return Notice and return the documents to the presenter.

The Court did not specifically mention how long a "reasonable promptness" would be. It stated that, the time period by which discrepant documents must be returned by the Bank to the presenter depends on the particular circumstances facing the Bank. Hamblen J stated that, "in the absence of special extenuating circumstances, a bank which failed to dispatch the documents within three banking days would have failed to act within reasonable promptness"³⁵⁸.

Given the facts in this case, the Court held that the unreasonable delay by the Indian Overseas Bank to return the documents to the presenter triggers failure to comply with the provisions provided in Article 16 and therefore, it is precluded from refusing to honour the reimbursement request. It was further held that, if the bank had a valid reason not to follow the requirement of "reasonable promptness", it should inform the presenter with due diligence.

However, the determination of "reasonable promptness" in the return of documents is not a straightforward matter. At the hearing of the case, it transpired that there is no international banking practice which can provide standards in determining the amount of time banks can spend before it should return the documents to the presenter. In this case it was stated in the experts' evidence, that the "reasonable

³⁵⁶ The expert evidence given by Gary Collyer, who was the technical adviser to the ICC Banking Commission and the Chairman of the ICC Drafting Group that spearheaded the deliberations which resulted in the promulgation of the UCP 600 and Roger Jones, the Chairman of the UK delegation to the ICC Banking Commission.

³⁵⁷ When the presenter disputes the decision on non-compliance.

³⁵⁸ Fortis Bank [2011] EWHC 538 (Comm) at [35].

promptness” should be one to two banking days³⁵⁹.

However, the position taken by the Court contradicts with Article 16(e) of the UCP 600 which says that the bank "may, after providing notice required by sub-article (c) (iii) (a) or (b), return the documents to the presenter at any time". This provision provides the bank an option to return the documents at any time to the presenter where a waiver from the applicant or instructions from the presenter are not received³⁶⁰. It is abundantly clear that, “reasonable promptness” and “at any time” do not have the same meaning.

The Court interpreted the current position as provided by the UCP 600 as-

“... the obligation to return the documents with reasonable promptness must be considered in the context where UCP 600 set five banking day limit for the paying bank to decide whether to accept or reject the documents....a more onerous task that the bank making arrangements to return the documents and in the light of the commercial importance of getting the documents back to the presenter³⁶¹.”

In summary, this case clearly provides guidance on the procedure that the bank should follow with the discrepant documents. Especially about what is implied in the wording of Article 16 in respect of the Return Notice and the Hold Notice. This clarifies the consequences of failing to adhere with the provisions of the said Article that can result the preclusion.

Given the above deliberation by the Court, it is clear that there are two ways of applying the preclusion rule in rejecting the document presentation. The principles laid down in Article 14(e) of the UCP 500 and the current Article 16 of the UCP 600 precludes the documents examining bank from claiming that the documents are non-compliant if it fails to hold the documents at the disposal of or return them to the presenter. Return Documents or returning Hold Notice at the request of the presenter, are in existence as a mandatory obligation that should be followed by the bank soon after issuing the documents rejection notice.

However, on a thorough examination, it can be seen that Article 16(F) of the UCP 600, which is supposed to be superseded by Article 14(e)³⁶² of the UCP 500 lacks the important essence that the Court described in the above judgement³⁶³. In other

³⁵⁹ Fortis Bank SA/NV, Stemcor UK Ltd v Indian Overseas Bank [2011] EWCA (Civ) 58 at [33].

³⁶⁰ Mohd Hwaidi, Brian Harris, Journal of International Banking Law and Regulation 2013, ‘The mechanics of refusal in documentary letter of credits: an analysis of the procedures introduced by article 16 UCP 600’, available at www.westlaw.co.uk page 6, (accessed on 28th February 2016)

³⁶¹ Fortis Bank [2011] EWHC 538 (Comm) at [34].

³⁶² Article 14(e) of the UCP 500: If the Issuing Bank or Confirming bank, If any, fails to act in accordance with provisions of this article and/or fails to hold the documents at the disposal of, or return them to the presenter, the issuing bank and/or confirming bank, if any, shall be precluded from claiming that the documents are not in compliance with the terms and conditions of the credit.

³⁶³ Ebenezer Adodo, Journal of International Banking Law and Regulation 2012, Case Comment, Letters of credit: Existence of a duty to return documents listed in a rejection notice, Journal of International Banking Law & Regulation (Issue 11), pp. 455-461. Published by Thomson Reuters (Professionals)/Sweet & Maxwell UK Ltd,(20012)

words, Article 16(f) of the UCP 600 does not make its position clear. Dr. Adodo says, *"Nevertheless, there are many possible explanations for the omission other than an intention on the part of the new regime to break with the past; for example, it might have been intended to serve cosmetic purposes, i.e. to streamline and modernise the overall structure of the sub-article. In that sense, in the absence of an express contrary provision in the code, one must presume art.16(f) to be substantively identical with, and not making a radical departure from, the erstwhile art.14(e)"*³⁶⁴.

It is difficult to understand the rationale behind the silence of the UCP 600 over the duty of returning the documents and the allowed time for returning them. The ICC's opinion on this is also vague, which states "the expectation, although not obligatory, is that banks will give prior notice of the date they will return the documents rather than arbitrary action"³⁶⁵.

Therefore, it can be suggested that, when such issues arise over the return of documents, the Court should look beyond the provisions provided in the UCP. It has been suggested, that such a duty arises independently³⁶⁶ of the UCP as the document presenter does have proprietary and possessory rights under the relevant applicable law³⁶⁷ and it can be assumed that the "*lex situs*"³⁶⁸ is applied when action arises over this issue³⁶⁹.

The other issue is that the preclusion rule provided in Article 16(f) may not be applicable when the bank acts in accordance with Article 16(c) (iii) (a), (b) or (d) while having no instructions from the Presenter. In that event, although the Presenter of the documents has rights to have the possession of rejected documents, if he fails to give appropriate response to the bank as to what should be done with the documents, any failure to return the documents should not trigger the preclusion rule³⁷⁰. Under normal circumstances, this issue will not lead to a lawsuit. However,

³⁶⁴ Ebenezer Adodo, Journal of International Banking Law and Regulation 2012, Case Comment, Letters of credit: Existence of a duty to return documents listed in a rejection notice Journal of International Banking Law & Regulation (Issue 11), pp. 455-461. Published by Thomson Reuters (Professionals)/Sweet & Maxwell UK Ltd, (2012)

³⁶⁵ Commentary on UCP 600, ICC Drafting Group, (ICC Publication 2007), Page 74

³⁶⁶ In *Kuwait Airways v Iraq Airways* (Nos 4 & 5) [2002] UKHL 19; [2002] 2 A.C. 883, it was stated that, if a foreign made law was in breach of clearly established International Law, then an English court should not recognize it. To do otherwise would be contrary to public policy.

³⁶⁷ Mohd Hwaidi, Brian Harris, Journal of International Banking Law and Regulation 2013, The mechanics of refusal in documentary letter of credits: an analysis of the procedures introduced by article 16 UCP 600, page 6, available at www.westlaw.co.uk, (accessed on 28th February 2016)

³⁶⁸ The law prevailing at the place at which the documents are presented / Latin word for law governing over the transfer of title to the property which is dependent upon and varies with the location of the property for the purposes of the conflict of laws.

³⁶⁹ Mohd Hwaidi, Brian Harris, Journal of International Banking Law and Regulation 2013, The mechanics of refusal in documentary letter of credits: an analysis of the procedures introduced by article 16 UCP 600, page 6, available at www.westlaw.co.uk, (accessed on 28th February 2016)

³⁷⁰ Mohd Hwaidi, Brian Harris, Journal of International Banking Law and Regulation 2013, The

when the credit is expired while the documents are held at the bank, the presenter who did not give precise instructions as to the disposal of documents may decide to take legal action against the bank for non-compliance. In addition, the bank's deliberate withholding of documents either in collusion with the buyer or any other party may cause detriment to the presenter due to lack of clarity in the provisions provided in Article 16. Therefore, there should be a provision which would compel the bank to return the documents within 2 to 3 days after giving Return Notice to the presenter. In any event, if the presenter fails to provide clear instructions on the return of documents, the bank should be made obligatory to return them to the presenter with reasonable promptness.

Overall, it is clear that the conclusion reached in the above mentioned Fortis bank case has taken the right approach. When the bank issues a return notice and fails to return the documents within a reasonable time, the beneficiary to the credit may lose out on the opportunity to deal with the documents or cure the alleged discrepancies before the expiration of the credit. It may also incur additional demurrage or storage costs. In order to eliminate this shortcoming the future version of the UCP must adopt the important essence from the judgment of the Fortis bank case.

Chapter 5

Banks' rights to reject facially complying documents under the fraud rule

When the examination of the documents is carried out, the banks are required to abide by the principle of "Autonomy of the credit". Apart from other obligations, which we discussed in previous chapters, this principle adds authority to the topic that the banks should not look beyond the documents that they have been presented with when making the decisions. The UCP, from its inception, recognized this principle as one of the fundamental ingredients which safeguards the viability of the payment method. Under this chapter, the principle of Autonomy of credit will be scrutinized with reference to the provisions of the UCP 600, aiming to address issues surrounding the theory of its application to letters of credit

5.1 Principle of Autonomy

mechanics of refusal in documentary letter of credits: an analysis of the procedures introduced by article 16 UCP 600, page 6, available at www.westlaw.co.uk, (accessed on 28th February 2016)

This principle is considered as one of the key elements which is applicable to all Letters of credit³⁷¹. It is also referred as the “Independence Rule” and it makes a banker’s responsibilities on examination of documents totally independent from the underlying sales contract³⁷². In other words, any argument regarding the performance of the sales contract is irrelevant to the bank and if the bank is presented with the right documents, the payment should be made to the beneficiary regardless of a dispute over sales terms.

Article 4 of the UCP 600 defines this principle as;

*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 its relationships with the issuing bank or the beneficiary. A beneficiary can in no case avail itself of the contractual relationships existing between 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.***

According to the above provisions, the obligations of the bank to examine, negotiate, honour or refuse are not subject to claims or any defences by the Seller or any other party.

In addition to that, Article 5 of the UCP 600 states that,

“Banks deal with documents and not with goods, services or performance to which the documents may relate.”

In terms of the above, the issuing bank is obliged to honour the credit upon receiving documents that make a complying presentation, irrespective of any non-fulfilment of the underlying contract.

This concept is widely regarded as a key element that protects the rights of the seller and promotes the efficiency in international trade³⁷³. Apart from that, it protects the rights of the bank guiding them not to go beyond what they have been presented

³⁷¹ Carole Murray, David Holloway and Daren Timson-Hunt, ‘Schmitoff’s Law and Practice of International Trade’, (12th Edition, Sweet & Maxwell, London 2012), page 194

³⁷² Hamzeh Malas & Sons v British Imex Industries Ltd (1958) 2 Q.B 120, Uzinterimpex JSC v Standard Bank Plc (2008) Int. Com. L.R. 07/15

³⁷³ JJ Ortego & E H Krinick ‘Letters of Credit: Benefits and Drawbacks of the Independence Principle’ (1998) Banking Law Journal 487; Chatterjee C & Lefcovitch A ‘The Principle of Autonomy of Letters of Credit is Sacrosanct in Nature’ (2003) Journal of International Banking Regulation 72.

with³⁷⁴. This concept is also described as “pay first, argue later”³⁷⁵ and considered as the ‘cornerstone of the commercial vitality of the letters of credit’³⁷⁶. Given above, it can be assumed that, the rationale behind this concept is to give a guarantee to the seller that, the undertaking by the issuing bank will not be influenced by or interfered with any issues arising out of the underlying sales contract³⁷⁷.

However, it has to be cautious, when relying upon this concept, because, it may minimise the significance of letters of credit as a method of payment, if it supersedes every dispute arising under the underlying contract. It is often questioned, whether it is sufficient enough to rely only on documents regardless of the commitment laid in the commercial contract. On the hand, the strict adherence to the rule is also often criticised as the ‘Autonomy Principle’ may pave the way to promote false calls, abuse and fraud³⁷⁸.

5.2 The importance of the Autonomy Principle

Assurance

This establishes the strength of letters of credit that defuses the risk of being substituted by any obligation of the underlying contract. Assurance is made that the beneficiary receives payment and the issuing bank is reimbursed against any claim or dispute over the performance of the commercial contract. Similarly, the buyer cannot either prevent or delay payment to the beneficiary or the issuing bank claiming a dispute over the underlying contract. The only remedy available for the buyer is that, he can bring a subsequent legal action against the seller for damages or non-performance of commercial obligations³⁷⁹.

Life within the documents

³⁷⁴ Article 5 of the UCP 600

³⁷⁵ Eakin v Continental Illinois National Bank & Trust Co. (1989) 875 F.2d 114 at 116

³⁷⁶ Ward Petroleum Corporation v Federal Deposit Insurance Corporation. (1990) 903 F.2d 1299

³⁷⁷ J F Dolan ‘Tethering the Fraud Inquiry in Letter of Credit Law’ (2006) Banking and Finance Law Review 449

³⁷⁸ H Stewart ‘It is Insufficient to Rely on Documents’ (2002) Journal of Money Laundering Control 225

³⁷⁹ R Sappideen ‘International Commercial Letters of Credit: Balancing the Rights of Buyers and Sellers in Insolvency’ (2006) Journal of Business Law 146

Irrespective of the commercial aspect of the whole transaction, the bank is required only to be concerned with documents submitted by the beneficiary³⁸⁰. The Issuing bank's obligation is to examine the documents and decide whether to pay the beneficiary or not³⁸¹. If the issuing bank duly fulfils that obligation, it is assured to be reimbursed by the buyer.

No room for repetition

The confirming bank or negotiating bank is assured that they are not at risk of being reimbursed by the issuing bank. The Issuing bank cannot interfere with subsequent claims when the confirming bank or negotiating bank have already made the payment to the beneficiary³⁸². In addition, this supports the beneficiary to carry on with its normal business transaction as there is no risk of being asked to pay back the money that he received from the bank. However, it must be noted that, there can be a lawsuit over the commercial contract and then the beneficiary may be liable to pay damages to the seller though such events do arise out of the purview of the letter of credit which facilitated the whole transaction as the method of payment.

5.3 Exceptions to the Principle of Autonomy

Although the principle of autonomy plays a vital and dominant role within the letters of credit system, it does not mean that the whole concept is not prone to controversy. The procedure followed on exercising the autonomy rule is not immune from litigation. There are many instances where injunctions³⁸³ are sought from the Courts preventing banks honouring the credit to the beneficiary. Especially, in a case of fraud, the Court has to decide whether to grant an injunction or not in order to prevent an innocent party being a victim. In that event, in addition to the main grievance of being a victim of a fraud, the Court has to consider public policies, statutes, the public interest and other parties' rights³⁸⁴.

³⁸⁰ Y Demir-Araz 'International Trade, Maritime Fraud and Documentary Credits' (2002) *International Trade Law & Regulation* 129

³⁸¹ C Hare 'Not so Black and White: The Limits of the Autonomy Principle' (2004) *The Cambridge Law Journal* 288

³⁸² M Yafrich 'Third Party's Attachment on Letter of Credit Proceeds' (2001) *Journal of Business Law* 159 and Rendell RS 'Fraud and Injunctive Relief' (1990-1991) *Brooklyn Law Review* 113.

³⁸³ This application is sometimes made ex parte (without notice) and upon affidavit evidence. For the guidelines when an injunction can be issued under English Law; refer to the House of Lord's decision in *American Cyanamid Co v Ethicon* [1975] AC 396, where it was stated that, the court should first consider whether, if the plaintiff were to succeed at trial in establishing his right to a permanent injunction, he would be adequately compensated by an award of damages for the loss he would have sustained as a result of the defendant's continuing to do what was sought to be enjoined between the time of the application and the time of the trial. If damages in the measure recoverable would be an adequate remedy and the defendant would be in a financial position to pay them, no interim injunction should normally be granted.

³⁸⁴ R L F Garcia, *Autonomy principle of the letter of credit*, *Mexican Law Review* (2009), 69

However, use of such exception must carefully be implemented. For example in **Bank of Nova Scotia v Angelica-Whitewear Limited**³⁸⁵ it was stated that,

“The potential scope of the fraud exception must not be a means of creating serious uncertainty and lack of confidence in the operation of letter of credit transactions; at the same time the application of the principle of autonomy must not serve to encourage or facilitate fraud in such transactions”.

It is also important to note that there are no clear standards that can draw a line between the fraud rule and the principle of autonomy. It is not well established when, where and under what conditions the fraud exception should be applied. Therefore it has become one of the most controversial and confused areas in the law relating to letters of credit³⁸⁶.

In addition to the above, there are few other grounds that can be considered as exceptions to the autonomy principle³⁸⁷. For examples, illegality³⁸⁸ of the transaction, nullity³⁸⁹, unconscionable conduct³⁹⁰, interim court relief can be pointed out.

However, it must be noted that, the above exceptions have a limited applicability and so far, there is no threat by them to be adopted as an exception to the Doctrine of Autonomy credit. Therefore, further discussion on exception to the autonomy principle will be limited to the fraud exception.

³⁸⁵ (1987)D.L.R 161- 168 (Can)

³⁸⁶ Fraud in the transaction, Enjoining Letters of credit during Iran Revolution, 93 HLRV L. REV 992,995 (1980) quoted in The Development of the Fraud Rule in Letter of Credit Law by Ross P. Buckley and Xiang Gao available at;

[https://www.law.upenn.edu/journals/jil/articles/volume23/issue4/BuckleyGao23U.Pa.J.Int'lEcon.L.663\(2002\).pdf](https://www.law.upenn.edu/journals/jil/articles/volume23/issue4/BuckleyGao23U.Pa.J.Int'lEcon.L.663(2002).pdf), accessed on 4th April 2016

³⁸⁷ Nelson Enonchong, The Autonomy Principle of Letters of Credit: An Illegality Exception?' (2006) Lloyd's Maritime and Commercial Law Quarterly 404

³⁸⁸ Nelson Enonchong, The Autonomy Principle of Letters of Credit: An Illegality Exception?' (2006) Lloyd's Maritime and Commercial Law Quarterly 404

³⁸⁹ R Hooley, (2002) 'FRAUD AND LETTERS OF CREDIT: IS THERE A NULLITY EXCEPTION?', *The Cambridge Law Journal*, 61(2), pp. 239–294. Despite the absence of fraud on the part of the beneficiary of a letter of credit, is the issuing or confirming bank entitled to refuse to pay the beneficiary on the ground that a tendered document is a “nullity” in the sense that it was forged by a third party or has been executed without the authority of the person by whom it purports to be issued, also Roy Goode and to some extent EP Ellinger have recognized the exception or implied the expression that does not deny the existence of the exception. RM Goode, *Commercial Law* (Penguin 2004) 996 and P Ellinger 'Documentary Credits' in Benjamin Sale of Goods (Sweet & Maxwell 2004).

³⁹⁰ In *Montrod Ltd v Grundkotter* [2001] EWCA Civ 1954, [2002] CLC 499. Potter J, while rejecting the nullity exception raised an alternative ground. The Court of Appeal observed that it is possible that the beneficiary, though not actively implicated in the fraud of a third party, but may be culpable for the fraud because he acted recklessly, in haste or somehow was at fault.

5.4 The Fraud exception

Fraud exception penetrates the heart of letters of credit, as it directs banks to carry out examinations beyond the documents and if necessary, stop the payment to the beneficiary on the grounds of fraud. Neither the UCP nor any other set of rules recognise this rule as an effective force. Therefore, this exception is considered as one area where controversies and confusions remain.³⁹¹ However, despite the non-recognition, the fraud rule has become a major element of the letters of credit process.

This exception first came into the limelight when the United States' lawsuit of **Sztejn v J Henry Schroder Banking Corporation**³⁹² was decided. In this case, the parties agreed to make the sales, proceeding under a letter of credit. Sztejn who was the plaintiff brought bristles from the Transea Traders Limited which was located in India. The credit was issued by the Henry Schroder Bank upon the request made by Sztejn. The terms of the credit required the beneficiary to present an invoice and a bill of lading. Transea loaded 50 cases of materials on board and obtained the bill of lading. Then they presented it along with other documents to the confirming bank and eventually, they were passed on to Henry Schroder bank for examination. In the meantime, before the payment was made, Sztejn filed an action in Courts seeking injunctive relief preventing the issuing bank from making payment to the beneficiary on the grounds that the seller had shipped cases of cow hair and worthless material instead of bristles with the intent of defrauding. In reply, the confirming bank refused the claim made by Sztejn stating that, the bank's obligation lies only with the presented documents and on the face of them, the presented documents comply with the requirements stipulated in the letter of credit.

However, the Court dismissed the bank's claim stating that Transea was acting to defraud the plaintiff which collaborated with the evidence that they have shipped absolutely worthless rubbish. Further, it was stated that the Confirming bank was not an innocent holder of the draft for value and thus it was preparing to make the payment to the Transea. Accordingly, the Court concluded that a fraud has been committed in the transaction and ruled in favour of Sztejn. While delivering the judgment, justice Shientag laid down the importance of the principle of autonomy in the law relating to letters of credit as follows :-

³⁹¹ Fraud in the transaction, Enjoining Letters of credit during Iran Revolution, 93 HLRV L. REV 992,995 (1980) quoted by The Development of the Fraud Rule in Letter of Credit Law by Ross P. Buckley and Xiang Gao available at;

[https://www.law.upenn.edu/journals/jil/articles/volume23/issue4/BuckleyGao23U.Pa.J.Int'lEcon.L.663\(2002\).pdf](https://www.law.upenn.edu/journals/jil/articles/volume23/issue4/BuckleyGao23U.Pa.J.Int'lEcon.L.663(2002).pdf) and at page 664

³⁹² 31 NYS 2d 631 (1941)

“the autonomy principle for the purpose preserving the efficiency factor in letters of credit as a viable method in financing the international trade’ and ‘to furnish the seller with a ready means of obtaining prompt payment for his merchandise’. It will be an unnecessary interference if a bank before honouring drafts drawn upon it was obliged or even allowed to go behind the documents, at the request of the buyer and enter into controversies between the buyer and the seller regarding the quality of the merchandise that have been shipped. If the buyer and the seller intended the bank to do this they could have so provided in the letter of credit itself, and in the absence of such a provision, the court will not demand or even permit the bank to delay paying drafts which are proper in form”

However, in his judgement justice Shientag pointed out the situations, where the fraud rule can supersede the autonomy principle.

“However, this is not a controversy between the buyer and seller concerning a mere breach of warranty regarding the quality of the merchandise and it can be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In that event, where the seller’s fraud has been drawn to the bank’s attention prior to the drafts and documents have been submitted for payment, the principle of the independence of the bank’s obligation under the letter of credit should not be extended to protect the unscrupulous seller.”

In the light of this case, it is clear that, although the bank is not required to be interested in the exact detailed performance of the sales contract, it is necessary to be assured that there are some goods represented by the documents³⁹³. This decision became a land mark authority which has been referred in many cases decided in respect of the fraud rule.

5.5 Fraud Exception and the UCP

Apart from being an important element that is associated with letters of credit in practice and under various jurisdictions, the UCP has never recognized fraud as an exception to the principle of Autonomy of the letter of credit³⁹⁴. Keeping to the UCP’s previous tradition, the UCP 600 has also opted not to include any provision that

³⁹³ Sztejn v Henry Schroder Banking Corporation 31 NYS 2d 631 (1941) 635.

³⁹⁴ Buckley RP & Gao X ‘The Development of the Fraud Rule in Letter of Credit Law: The Journey so Far and the Road Ahead’ 23 (2002) University of Pennsylvania Journal of Economic Law, page 700: The UCP is silent with respect to the issue of fraud and the fraud rule. The reason behind this lacuna is that it is not the function of the UCP to regulate issues that are the proper province of national law and national courts.

deals with the fraud exception³⁹⁵. Roy Goode explains³⁹⁶ the reluctance of the ICC to include any provision regarding the fraud exception in the UCP as follows:-

“Although the International Chamber of Commerce operates as an international organization, it is not a law making institution despite its organizational representation in world business and finance. The UCP’s rules do not bear the force of law unless, as the rules themselves expressly provided, the parties to contracts incorporating them as terms of their contracts. Therefore, UCP has been made not to deal with such matters as the effect of fraud on a beneficiary’s right to payment.”

Despite the lack of empathy to understand the importance of this exception by the ICC, the fraud rule has been playing a major role in letters of credit transactions for almost a century as custom and/or practice among banks and legal systems. However, it is understandable why the ICC opted not to consider the fraud exception as a rule because, it does not expect the UCP to be operative as a law. However, if a banking system in a country has a custom and/or practice which can stop the payment on suspicion of a fraud and these practices are continuously used by them, there should be a discussion on identifying conditions which a bank can come to the conclusion as to a fraud has been committed or not.

It must be noted that, regardless of the fact that, the UCP, does not recognised the fraud exception, there are many reported cases in respect of the issue of fraud related to letters of credit which have incorporated UCP into their contracts. For example, banks are sued for unlawfully claiming that the documents are fraudulent or refusing to reject fraudulent documents.

It must be noted that the determination of whether a fraud has been committed or was imminent should remain with a Court. Banks should not be required to hold an inquiry as to whether a fraud has been or about to be committed. In most instances a bank would probably be not competent enough to carry out such an investigation. However, when a request is made by the applicant to the credit to hold the payment or where the bank finds a document suspected to be a forgery amongst the submitted documents then the bank should be provided with guidelines which can dictate its next step.

In the light of the above, this discussion will not go so far as to suggest that the powers vested in the Courts to determine whether a fraud has been committed or is imminent should be transferred to the bank. However, there should be measures that a bank can take to minimise or deter the seller taking unfair advantage, which can

³⁹⁵ Thanuja Rodrigo, UCP 500 TO 600: A Forward Movement, page 7, available at <http://elaw.murdoch.edu.au/index.php/elawmurdoch/article/viewFile/85/48>, accessed on 4 April 2016

³⁹⁶ Roy Goode, ‘Abstract Payment Undertakings in International Transactions: Symposium New Developments in the Law of Credit Enhancement-Domestic and International’ [1996] Brooklyn Journal of International Law 1, 4.

subsequently amount to a fraud or an unfair request by the buyer to hold the payment on the ground of an alleged fraud.

Therefore, this chapter will evaluate the facts so as to conclude, when it would be reasonable to adopt the fraud exception, bearing in mind how it can impact the principle of autonomy and the letter of credit working system. Secondly, there will be an attempt to identify improved standards applicable to the fraud rule which can be acknowledged as internationally applicable guidelines on this matter. Listing of such a set of guidelines is purely aimed at preventing a bank being tested under various laws on how to act when a fraudulent document is presented or the criteria that can be used to decide whether a fraud has been committed.

In order to find answers to the above mentioned issues, this chapter will analyse and evaluate the law related to the fraud rule under English Law, the American Law and the United Nations Convention on Independent Guarantees and Standby Letters of Credit published by the United Nations Commission on International Trade Law (UNCITRAL)³⁹⁷. By this exercise it is proposed to extract the necessary ingredients from the above mentioned three authorities to list a set of standards for the law related to fraud exception.

5.6 Fraud Exception under the English Law

In the United Kingdom, the fraud exception has not been codified as a rule. However,

Courts generally tend to apply the rule where it is necessary. The traditional approaches taken by the Courts imply the reluctance of the Courts to interfere with the autonomy principle³⁹⁸. Judge Kerr in his judgement in *R D Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd*, stated,

“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 noticed, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration

³⁹⁷ The UN Convention on Independent Guarantees and Standby Letters of Credit was adopted by the General Assembly of the United Nations on 11th of December 1995 and came into operation on 1st of January 2000

³⁹⁸ *R D Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.*, 2 All E.R. 862, 870 (Q.B. 1977)

as available to them or stipulated in the contracts.... Otherwise, trust in international commerce could be irreparably damaged”.

The narrow approach taken by the British Courts and their reluctance to interfere was greatly demonstrated in the judgment in **Hamzeh Malas and Sons v British Imex Industries Limited**³⁹⁹ where the Court of Appeal explained that ‘it is clear enough that the opening of a letter of credit confirms a bargain between the banker and the seller which makes the bank obliged to honour the payment irrespective of any dispute between the parties over the performance of the sales contract. It would be wrong for the Court to involve in any case as it will become an interference against the established practice.’

However, on perusal of reported cases, it is clear that, the level of reluctance of the Court to interfere has been fading away as time passed by. For example, in **United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Limited**⁴⁰⁰, the standards of evidence required to prove a fraud were scrutinized. The principles laid down in the judgment of this case serves as a formula which can be utilised in respect of any dispute relating to fraud⁴⁰¹.

Lord Justice Ackner in his judgement, by way of obiter dicta, specified the standard of evidence as follows:

The evidence placed before the Court on fraud must be clear. The assertion or allegation of fraud would not be sufficient. It would expect plaintiff to present strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the seller and the buyer. The evidence of fraud to be clear, the Court would also expect to give opportunity to parties involved to answer the allegations. **If the Court is satisfied with the materials before it, then the buyer has made out a sufficient case of fraud.** However, the Court was cautious in imposing above position as it pointed out that it is a well-accepted fact that letters of credit and performance bonds are part of the essential machinery of international commerce and any delay in payment under such mechanism could harm the proper process in international commerce and the reputation of the International banking community.

In the light of the above mentioned view, it is clear that, due to the general non-interference approach by the Courts in the United Kingdom the plaintiff has been

³⁹⁹ [1958] 2 QB 129

⁴⁰⁰ United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd [1985] 2 Lloyd’s Law Reports 554

⁴⁰¹ Turkiye IS Bankasi AS v Bank of China [1996] 2 Lloyd’s Rep 611 .

saddled with the onerous responsibility to prove the cause of action in the case of a fraud⁴⁰².

This position is further established by the judgment made in **Edward Owen Engineering Limited V Barclays Bank International Limited**⁴⁰³ where it was stated that, 'to the general principle of independence, the only exception would be the established or obvious fraud to the knowledge of the bank'.

In addition to above, the requirement of 'clear' and 'obvious' factors to prove a fraud were well demonstrated in **Discount Records V Barclays Bank Limited**⁴⁰⁴ which became the first British case that scrutinized the principle laid down in the decision made in *Sztejn v Henry Schroder Banking Corporation*. In this case, the British buyer entered into a contract with a French company to buy 8625 discs and 825 cassettes. Accordingly, the buyer instructed the bank to open a letter of credit in favour of the seller. The seller shipped the goods and presented the documents to the bank for payment. However, when the goods arrived, the buyer noticed that, there were 92 cartons of which two were totally empty, five were filled with rubbish, some of the record boxes and cassettes were partly filled and among other deficiencies, out of 8625 records ordered only 275 were delivered in accordance with the order.

At the hearing, the buyer, referring to *Sztejn's* decision, attempted to enjoin the issuing bank from making payment to the seller on the ground that the seller has perpetrated a fraud. However, the Court disagreed with the buyer's claim and stated that, the circumstances of this case is different from *Sztejn's* case. Judge Megarry stressed that, in *Sztejn's* case, there was a motion in the formal proceedings against the claim of the buyer stating that there is no cause of action in it. This had led to the assumption that the facts stated in the complaint were accurate and true. The complaint was based on an alleged fraud, whilst the Court was dealing with a case of established fraud. On the contrary, the present case has not established fraud rather than a mere allegation of a fraud. The Court found that it is difficult to issue an interim relief as the defendant who was not concerned with that matter, had understandably adduced no evidence on the issue of fraud. Judge Megarry stated that, it is highly unlikely when the seller was not a party to the case, it could contain enough evidence to establish the fraud. As a result, the Court found that fraud had only been alleged and but not established. Furthermore, Judge Megarry added that, '**the Court would be reluctant to interfere with bankers' irrevocable credits unless a sufficiently grave cause was shown, as it would gravely impair the reliance which was placed on such credits, especially in the sphere of international banking**'.

⁴⁰² Buckley RP & Gao X 'The Development of the Fraud Rule in Letter of Credit Law: The Journey so Far and the Road Ahead' 23 (2002) University of Pennsylvania Journal of Economic Law, page 689

⁴⁰³ 1 All E.R. 976, 981 (C.A. 1977)

⁴⁰⁴ *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 Lloyd's Law Reports 447

It is questionable why the Court could not conclude there was an established fraud considering that the buyer produced 3rd party evidence which confirmed that most of the shipment constituted rubbish or empty cartons. Therefore, the rigorous requirements to establish a fraud is almost impossible to fulfil under the English law. It is also contrary to the very own English law concept of 'the Court will not allow their process to be used by a dishonest person to commit a fraud'⁴⁰⁵.

On the other hand, the position taken by the Court is quite clear as it believed that payment made by the bank to the seller did not infringe the rights of the buyer. If the payment has been made wrongly, the buyer has the right to demand damages from the bank. This situation fulfils the common law requirement where a Court will not issue interim relief unless it is clear-cut and a final remedy and the buyer has no other legal recourse⁴⁰⁶. This has led the banks to find themselves in a difficult situation as, if they have to make a decision to not pay the seller without sufficient evidence of fraud, the bank will likely be sued by the seller and on the other hand if it makes the payment, the buyer may refuse to reimburse or may sue the bank for damages⁴⁰⁷.

In **United City Merchants (Investment) Limited V Royal Bank of Canada**⁴⁰⁸, the existence of the fraud rule was acknowledged and it was discussed when and where it should be applied. In this case, the bank refused to honour the payment citing that the bill of lading had fraudulently been pre-dated by the shipping agent. However, the seller was not aware of such act and when the payment was refused. The seller sued the confirming bank for wrongful refusal to honour. When the case was heard in the House of Lords, it was held that, the fraud exception should not apply to prevent the payment to the beneficiary. The Court was reluctant to undermine principle of autonomy. In giving reasons for their decision, Lord Diplock said, parties in the letter of credit only deal with documents and not with goods or any other materials. The bank is under the contractual agreement to honour the payment when the right documents are duly presented for the examination. This process should not be stopped by the bank's understanding or knowledge of buyer's alleged claim or in fact an already committed breach of the sales contract which the documents appear on their face related to. This would give the buyer the right to treat the sales contract as rescinded and to reject the goods and/or refuse to pay the seller's purchase price. The main commercial purpose of this kind of payment system in international trade is to give the seller an assured right to be paid prior to ownership of the goods shifted

⁴⁰⁵ As Lord Diplock pointed out in ⁴⁰⁵ *United City Merchants (Investment) Limited v Royal Bank of Canada* [1983] 1 A.C. 168 at 183 F-184; The Court will interfere to stop the process being used by a dishonest person to carry out a fraud

⁴⁰⁶ Zhang Y 'Approaches to Resolving the International Documentary Letters of Credit Fraud Issue' (2011) 81

⁴⁰⁷ Zhang Y 'Approaches to Resolving the International Documentary Letters of Credit Fraud Issue' (2011) 81

⁴⁰⁸ [1979] 1 Lloyd's Law Reports 267 (QB)

away from him. Therefore, any dispute over performance of the buyer on the sales contract should not permit banks to make it a ground for non-payment or reduction/deferment of payment⁴⁰⁹.

At the same time, Lord Diplock acknowledged the emphasis on fraud exception by stating, to the general acknowledgment on Independence principle, there is one exception where the seller for the purpose of receiving money on the letter of credit fraudulently submit the confirming bank documents that contain expressly or by implication, material representations of fact that to his knowledge are false. This exception has been well established in the USA as provided by the decision made in **Sztejn v. J. Henry Schroder Banking Corporation**....., the fraud exception on the part of beneficiary expecting to avail himself of the credit is a clear application of the *maxim ex turpi causa non oritur actio*⁴¹⁰ or 'fraud unravels all'. The Court will interfere to stop the process being used by a dishonest person to carry out a fraud⁴¹¹.

At the conclusion, it was stated that, **the beneficiary's knowledge about the fraud is the key in determining either to apply the fraud exception or not**. As it was revealed that the beneficiary had no knowledge about the fraudulent act committed by the shipping agent, the exception should not be applied.

However, this tendency of the non-interfering approach has started to deviate towards the opposite⁴¹² as reported by recent court decisions. For example, in **Themehelp Limited V West**⁴¹³, the plaintiff made an agreement to buy the defendant's shares in a company called Shinecrest which manufacture stands for Televisions. The value of a share was intended to be based on profit projection prepared upon the demand from the main customers such as Sony. According to the agreement a part of the payment was payable upon the completion of the contract and the outstanding amount to be paid by subsequent instalments. The last part of the payment was intended to be paid by a performance guarantee (which, for these purposes, is the legal equivalent of a letter of credit). After making the first two instalments, the plaintiff started proceedings for rescission of the contract and damages on fraudulent misconduct by the defendants. The plaintiff claimed that the defendants fraudulently concealed the important information at the time of signing of

⁴⁰⁹ United City Merchants (Investment) Limited v Royal Bank of Canada [1983] 1 A.C. 168 at 183 (amendments were made to shorten paragraph of the judgment)

⁴¹⁰ Legal doctrine which states that a plaintiff will be unable to pursue legal remedy if it arises in connection with his own illegal act. Particularly relevant in the law of contract, tort and trusts.

⁴¹¹ United City Merchants (Investment) Limited v Royal Bank of Canada [1983] 1 A.C. 168 at 183 F-184 (amendments were made to shorten the paragraph)

⁴¹² Buckley RP & Gao X 'The Development of the Fraud Rule in Letter of Credit Law: The Journey so Far and the Road Ahead' 23 (2002) University of Pennsylvania Journal of Economic Law, page 691

⁴¹³ 4 All E.R. 215 (C.A. 1995)

the contract which was that Sony had decided to buy all future supplies from another competitor. Therefore, the plaintiff applied for an injunction restraining the sellers from giving notice to the Guarantors to enforce the guarantee. At the hearing, the Court granted the injunction stating, that the evidence produced before the Court is sufficient enough to raise an arguable case at the trial and therefore, it is reasonable enough to interfere which arises from the circumstances of the case that the sellers have acted fraudulently. Affirming the decision made, it was further stated that, the circumstances of the case was exceptional and the plaintiff had sought the relief at an early stage to restrain the beneficiary alone in proceedings to which the guarantor is not a party⁴¹⁴. It was further stated that, normally it is expected to have strong corroborative evidence over the allegation, such as cotemporary documents, particularly those emanating from the buyer and if the Court is satisfied that such evidence shows that the only realistic interference to draw is that of fraud, then the plaintiff has made a sufficient case to prove the fraud⁴¹⁵.

Conclusion

On perusal of the reported cases, it can be observed that, in a limited number of cases, where the fraud rule has applied, they were not brought to Court by the applicant to the credit. In most of the cases, the actions have been filed against either the bank's decision to refuse to honour or the beneficiary's demand for payment. It appears that the British Courts adopt a different approach when the applicant to the credit brings an action to stop the payment over an allegation of fraud. If it is needed to apply for an injunction to prevent the bank from paying the beneficiary, the evidence to be placed before the Court must be sufficient enough to establish the fraud. If the bank has stopped the payment to the beneficiary on the basis of a fraud, the bank has to justify its decision to Court with evidence that satisfy with the balance of probabilities that the beneficiary was guilty of fraud. Therefore, it can be stated that, under the English law, the application of the fraud rule is very narrow as against the Autonomy principle. In summary, under English law, to establish a fraud, the plaintiff is required to establish before the Court a **clear and obvious**⁴¹⁶ fraud which the bank must have knowledge of and a mere allegation of fraud is not sufficient enough⁴¹⁷. In addition, the **beneficiary must have knowledge of the fraud**⁴¹⁸ at the time of presenting documents to the bank for examination and otherwise, he would not be a party of the fraud. Finally to prove the

⁴¹⁴ 4 All E.R. 215 (C.A. 1995)

⁴¹⁵ 4 All E.R. 215 (C.A. 1995) (Lord Justice Waite delivered the judgment, Lord Justice Balcombe agreed, and Lord Justice Evans dissented)

⁴¹⁶ Edward Owen Engineering Ltd v Barclays Bank International Ltd. and Another [1978] All ER 986.

⁴¹⁷ Discount Records Ltd. v. Barclays Bank Ltd [1975] 1 Llyod's Law Reports 448.

⁴¹⁸ United City Merchants (Investment) Limited v Royal Bank of Canada [1983] 1 A.C. 184

fraud, the allegation must be supported with **strong corroborative evidence**⁴¹⁹, usually in the form of contemporary documents.

5.7 Fraud Exception under the UNCITRAL Convention

The United Nations Commission on International Trade Law (UNCITRAL) was established by the United Nations General Assembly in the year of 1966. It was promulgated to promote the progressive harmonization and unification of International Trade Law. In the year 1988 the UNCITRAL initiated work on a Uniform Law on International Guarantees. After seven years of work, in the year 1995 the UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit was drafted. The convention was regulated and made available for signature by the General Assembly by its Resolution in December 1995. The provisions of the UNCITRAL recognise the fact that there are exceptions to the independent principle on standby letters of credit issued under the convention.

Article 19 of the Convention provides guidance as to when the Issuer or the Guarantor can refuse the beneficiary's demand for payment.

If it is manifest and clear that;

- a) *Any document is not genuine or has been falsified*
- b) *No payment is due on the basis asserted in the demand and supporting documents*
- c) *Judging by the type and purpose of the undertaking, the demand has no conceivable basis, the guarantor/issuer, acting in good faith, has a right, as against the beneficiary, to withhold payment.*

The above mentioned term 'no conceivable basis' is explained in paragraph 2 of Article 19 as -

- a) The contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialized
- b) The Underlying obligation of the principal/applicant has been declared invalid by a Court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking
- c) The underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary
- d) Fulfilment of the underlying obligation has clearly been prevented by wilful misconduct by the beneficiary

⁴¹⁹ United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd [1985] 2 Lloyd's Law Reports 561

- e) In the case of a demand under a counter-guarantee, the beneficiary of the counter-guarantee has made payment in bad faith as guarantor/ issuer of the undertaking to which the counter-guarantee relates

The UNCITRAL has therefore been able to provide some instances where payment can be refused on the basis that it is manifestly clear that a document is not genuine and constitutes a fraud or falls within the other categories referred to above. Though this may not be comprehensive as there may be other grounds that can trigger the fraud exception, Article 19 of the UNCITRAL stands out as one of the most detailed Authorities which brings in the concept of considering possible fraud⁴²⁰ or other reason as stated therein when determining the question whether to make payment to a beneficiary. In addition, the above five scenarios that can trigger the fraud rule have been described as the most specifically elaborate instances which outline the unfair calling on undertakings⁴²¹.

The other important factor about the aforementioned definition is, it has not included terms like 'bad faith', 'abuse' and 'fraud' which can lead to numerous meanings given the fact that they can be tested in different legal systems and avoids the criminal nature such as malicious intent.

The degree of proof required

In terms of the Article 19 the main requirement is that the fraud is required to be manifest and clear. The happening should be immediate and/or be imminent. In most instances, the Convention covers documents that need to be submitted to the bank for examination. Under these provisions, the documents will be subject to checks on whether they are genuine or not. There is no expressed concern over the identity of the fraudster nor any mention as to intention of the fraudster and whether it should be proven or not. The main focus always remains with the nature of the fraud and not with the intension or identity of the fraudster.

In addition, the provisions of Article 19 do not impose on the bank the mandatory requirement to refuse payment and, it is expressed more as a right of the bank and that is a discretion that the banks therefore can utilise when the demand of payment is made. Article 19 therefore guides the banks on how to judge whether the requirements to prove a fraud have been met or not.

Irrespective of the formula provided in Article 19, there is still a risk of having various interpretation of the terms by the Courts in different contracting nations. On the bright

⁴²⁰ Xiang Gao *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* (2002) at 97.

⁴²¹ N Horn, *The UN Convention on Independent Guarantees and the Lex Mercatoria*, German Banking Law and Practice in International Perspective (1999), Chapter 11 at 200–201

side, however the risk involved has, to some extent, been reduced due to the examples giving the grounds for denying payment as provided in Article 19(2).

Conclusion.

The UNCITRAL Convention can be recognized as the first real attempt made to prevent unfair calls and the fraud. The efforts taken at the Convention to address the issues are commendable. The impact of the terms of the UNCITRAL Convention on its effectiveness is universally recognised.

Under the provisions of the UNCITRAL convention, the requirements to establish a fraud have been explained. The main requirements are that the alleged fraud should be **clear and manifest**. In contrast to the English law, the **intention of the fraudster is less important** under this rule. However, the omission of considering the intention of the fraudster may be controversial as it may lead to a situation where a genuine mistake committed by the beneficiary can be declared as a fraud. For example, the submission of a wrongly dated document or an unattested document can be declared as fraudulent even if the beneficiary had no knowledge about such mistake.

5.8 Article 5 of the Uniform Commercial code of the United States of America

The **Uniform Commercial Code** (hereinafter referred as the UCC), can be described as the most comprehensive code which covers matters related to commercial law⁴²². It is often considered as one of the most developed areas in American law. The UCC was published by the National Conference of Commissioners on Uniform State Laws in collaboration with the American Law Institute. The group of drafters is comprised of Attorneys, Judges, Legislators and Academics who represent all States in the USA.

The Uniform Commercial Code does not have legal effect unless its provisions are enacted by the individual state legislatures as a statute. At present, the UCC, either in whole or in part has been enacted, subject to legal variations, in all 50 states in the USA.

In the year 1995, Article 5 of the Uniform Custom code of USA was revised to eliminate certain weaknesses and shortcomings. It identified a weakness in the

⁴²² For example, Buckley RP & Gao X in 'The Development of the Fraud Rule in Letter of Credit Law: The Journey so Far and the Road Ahead' 23 (2002) University of Pennsylvania Journal of Economic Law, page688, footnote 50, state, 'The text of Section 5-109 also demonstrates how succinctly most of the common law restrictions on the issuance of injunctions can be expressed in codified form'.

original Article and consequently a revision was made to accommodate constant development of law of letters of credit⁴²³.

According to the Article 5 section 109 of the Uniform Commercial Code,

(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honour of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(1) the issuer shall honour the presentation, if honour is demanded by

(i) a nominated person who has given value in good faith and without notice of forgery or material fraud,

(ii) a confirmer who has honoured its confirmation in good faith,

(iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or

(iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and

(2) the issuer, acting in good faith, may honour or dishonour the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honour of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honouring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(3) all of the conditions to entitle a person to the relief under the law of this State have been met; and

(4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honour does not qualify for protection under subsection (a)(1)

According to the above, the operation of the letter of credit can be interrupted in two ways. This can happen either by the issuing bank refusing to honour the payment or the applicant of the credit going to Court seeking to prevent the payment by the bank

⁴²³ Buckley RP & Gao X 'The Development of the Fraud Rule in Letter of Credit Law: The Journey so Far and the Road Ahead' 23 (2002) University of Pennsylvania Journal of Economic Law, page 685

to the beneficiary⁴²⁴. This section defines the boundaries of the fraud stating that fraud should have arisen out of the underlying contract. In other words, fraud must be found either in the documents presented to the bank or it must have been committed by the beneficiary on the issuing bank or the seller⁴²⁵.

Measuring the materiality

Article 5 section 5-109 provides the standards that can establish a fraud. Establishment of fraud can be done by proving that a fraud has been committed and the alleged fraud should be material. However, Uniform Commercial Code does not provide a definition for 'material fraud'. Therefore, it can be assumed that, defining the materiality and its limits should be done by the Courts. This position is explained by the comment made on section 2-109 which says 'necessarily Court must decide the breadth and with of the materiality. The fraudulent factors in a document submitted for examination required to be material to the buyer and/or the alleged fraudulent aspects should have negative effect on the parties involved in the underlying contract'⁴²⁶. The process of measuring the materiality can be varied depending on the case. For example, if the contract has been made to purchase 1000 boxes of stereo headphones with necessary cables and the seller shipped 1000 boxes to the buyer, knowing that the necessary cables are missing in ten boxes. In that case, it will be a breach of the underlying contract. However, can this situation be classified as a fraud or justify an injunction?. Possibly, it would not have been recognised as a material fraud. However, if 100 boxes did not contain the necessary cables and the seller was aware of it, a fraud could have been committed. Therefore, the Courts are required to examine the nature of the underlying contract, when there is an allegation of a material fraud. It can be decided only thorough the examination of the underlying sales contract, whether a document submitted for examination is fraudulent or whether the beneficiary is responsible for the fraud. If those two components are ticked as 'yes', the fraud would be material to the underlying sales contract.

However, this concept is criticised by Dolan, where he says, 'although the law now commands American courts to look into the details of the underlying contract as a part of their inquiry into fraud, it should not be used as an open invitation to use the underlying transaction inquiry to corrode the independence of letters of credit'. He

⁴²⁴ Section 5-109(a) and (b), Official Comment 2 on Revised UCC Article 5 section 5-109

⁴²⁵ Official comment on the Revised UCC article 5, as refereed by Michelle Kelly-Louw in 'Selective Legal aspects of Bank Demand Guarantees' published by the University of South Africa (2008)

⁴²⁶ Official comment on the Revised UCC article 5, as refereed by Michelle Kelly-Louw in 'Selective Legal aspects of Bank Demand Guarantees', published by the University of South Africa (2008)

further suggests that a court should not engage in a wide ranging fraud inquiry and should limit the scope of such inquiry⁴²⁷.

Case law on materiality

The standards set out in Article 5 of the UCC were tested in **Western Surety Co v Bank of Southern Oregon**⁴²⁸, where section 5-109 came under scrutiny. In this case, Western Surety Company issued two performance bonds on behalf of Black Oak construction Company for the work they were to carry out in a school in the Washington State and another in the State of Oregon. Under the terms of the performance bond, the bank of Southern Oregon issued two letters of credit in favour of Western Surety Company. Those letters of credits were issued to be served as security for losses which the Western Surety company might incur if the Black Oak Company defaults.

Both letters of credit contained almost similar language and terms. However, they had different issuing numbers, issuing dates, expiry dates and amounts of value. The terms of the letters credit had failed to indicate the project that each was referring to. The Black Oak Company defaulted its performance on the project in Washington and as a result of it the Western Surety Company had to undertake the project. This led to payment in respect of the project to be made on the performance bonds. At the end, the Western Surety Company presented drafts under the letters of credit to the bank for payment. However, it was refused by stating that one letter of credit is related to a project in Washington and there is no connection has been established relating to the project in Washington.

Being aggrieved by the decision of the bank, the Western Surety Company immediately went to Court seeking a summary judgment against the unfair dishonour by the bank. The Court of first instance issued the summary judgement which led the bank to appeal. In their argument, the bank claimed that there is a clear cut case of material facts which imply that the beneficiary had fraudulently attempted to reimburse the letter of credit in question. However, at the appeal the Court did not agree with the bank and made the judgment in favour the beneficiary. The Court pointed out that the bank has failed to establish the fact that the letters of credit were intended to limited to a particular specific project. Applying the concept of material fraud which was laid down in section 5-109, the Court said, in terms of the relevant statute of the state of Oregon, that the issuing bank, acting in good faith can dishonour the payment on a letter of credit, **if the presentation facilitates a material fraud committed only by the beneficiary to the credit** and fraud as a solid defence against the bank's obligations under the letter of credit must narrowly

⁴²⁷ J F Dolan 'The UN Convention on International Independent Undertakings: Do States with Mature Letter-of-credit Regimes Need It?' (1998) 13 Banking and Finance Law Review 1

⁴²⁸ 257 F 3d 933 (9th Cir 2001), 44 UCC Rep Serv 2d (West) 1239

be construed. Fraud cannot be considered as a viable defence when the beneficiary has a more colourable claim for payment under the credit.

A similar application which adopted the decision in the above case was made in **New Orleans Brass LLC v Whitney National Bank**⁴²⁹ in which section 5-109 was scrutinized again. In this case New Orleans Brass LLC requested the Whitney National Bank to open a standby letter of credit in the name of the Louisiana Stadium and Exposition District providing a guarantee for rental payments. After opening the letter of credit, there was a dispute between the landlord and the tenant and as a result of it the rental payments were defaulted. The Louisiana Stadium and Exposition as the beneficiary of the letter of credit, presented documents to the bank for payment. However, New Orleans Brass opposed the payment and sought an injunction against the bank to prevent them from making payment to the beneficiary. New Orleans argument was that the documents submitted by the beneficiary contained false representations and therefore, any payment to the beneficiary would cause irreparable loss. However, the Court of first instance (Court a Qua) refused the application for an injunction and then the matter went up in appeal to the Louisiana Court of Appeal.

The Court of Appeal found no sufficient evidence for 'material fraud' according to the description which has been provided in section 5-109 of the Uniform Commercial Code and affirmed the decision made in the lower Court. The Court of Appeal used the explanations set out in the official comments on the Uniform Commercial Code to adopt the standards for material fraud. It also referred to the interpretations made in **Air Transfer Incorporation V Westates Airlines Incorporation**⁴³⁰ where it stated that, the only ground which the fraud exception can be invoked is that when the demand which has been made has no absolute basis in fact or the beneficiary's conduct has tainted whole transaction'.

In another case the Supreme Court of Ohio defined the limitation on applying the concept of materiality. In **Mid-America Tire Inc v PTZ Trading Ltd Import and Export Agents**⁴³¹, the lawsuit related to a deal extensively internationally negotiated over a sale of specific type of Michelin tyres by the beneficiary and another party from PTZ Trading Limited in Guernsey in the Channel Islands. The buyers arranged a letter of credit as the method of payment for the tyres. At the time of the negotiations on the sales contract, the agents of the buyers requested specific requirements on the quality, quantity and sales price. However, the completed agreement did not match the quality, quantity and the sales price which was agreed at initial negotiations. The tyres were not imprinted with United States Department of

⁴²⁹ 818 So. 2d 1057, 48 U.C.C. Rep. Serv. 2d. (West) 294 (La. Ct. App. 2002)

⁴³⁰ 899 F 2d 1269 (1st Cir 1990) at 1272–1273

⁴³¹ CA99-11-105. (Ohio Ct. App. Nov. 20, 2000) and available on LexisNexis 43 UCC Rep Serv 2d 964 (2000) ((2000) Ohio App LEXIS 5402, accessed on 03rd June 2016

Transportation identification numbers which made them illegal to sell in the United States. The buyers treated those as fraud and requested the seller not to ship the tyres. In addition to that, the buyers went to Court and secured a temporary injunction that prevented honouring of the letter of credit. Irrespective of the buyers' actions, the seller shipped the tyres and presented the documents to the bank for payment under the letter of credit. In the meantime, the buyers obtained a preliminary injunction to prevent the bank from honouring payment. At the hearing for a permanent injunction the Court was satisfied that the seller had submitted the documents strictly conforming to the conditions of the letter of credit and, issued a permanent injunction on the ground of fraud in the sales contract⁴³².

When this matter came up to the Court of Appeal, the decision on injunction by the lower Court was overturned by a majority of the judges. The Court of Appeal sought to interpret the term 'material fraud' as provided in the Uniform Commercial Code. The Court emphasised on the importance of narrowly limiting the application of fraud rule. The Court set out two occasions where materiality can be applicable.

- i) The wrongdoing of the beneficiary to the credit has to vitiate the entire transaction.
- ii) The demand by the beneficiary for payment under the letter of credit should not have an absolute ground in fact.

The Court found that the buyers had not provided sufficient grounds to satisfy either of the above situations and accordingly held that there was no fraud in the presentation of documents. In contrast to the view of the majority, Valen J stated, 'in my opinion, the PTZ Trading Limited has violated its obligations on good faith, diligence, reasonableness and care. If the beneficiary fails to act in accordance with those principles then it perpetrates a fraud. Accordingly, payments on the letter of credit should be enjoined.' However, this requirement that the beneficiary's violation of its obligation of 'good faith, diligence, reasonableness and care' constitutes the commitment of 'material fraud' has attracted criticism as it advocates 'an overly broad fraud exception based on a lack of good faith'⁴³³.

Being aggrieved by the decision made by the Court of Appeal, the buyer further appealed to the Supreme Court of Ohio and was able to successfully overturn the Court of Appeal decision. On the issue of 'material fraud', the Supreme Court stated that 'the Court of Appeal' has construed the 'vitiation exception' so narrowly which prevents the relief for the buyers even after fraudulent conduct by the beneficiary arises out of the underlying transaction. The Court held that **material fraud means the conduct of the beneficiary that has vitiated the entire transaction, leaving**

⁴³² According the previous version of the UCC on fraud rule, it was allowed to have an injunction on the basis of fraud in the underlying contract(for example, seller has made a material misrepresentation to the buyer)

⁴³³ Michelle Kelly-Louw, 'Selective Legal aspects of Bank Demand Guarantees' (published by the University of South Africa, 2008) page 239.

the legitimate purpose of the independence of the bank's obligation can no longer be served. Accordingly, the permanent injunction was granted.

In **Harris Trust & Savings Bank V GMAC Business Credit**⁴³⁴, the letter of credit was issued in Italy and it was confirmed to the seller in the United States by his bank. However, based on the seller's anticipatory repudiation of the underlying contract, an Italian Court issued an ex parte restraining order against payment by the issuing bank. By the time of the interim order was issued, the issuing bank and the confirming bank had accepted the beneficiary's documents presentation and had undertaken to proceed with the payment. However, there was a clause in the letter of credit which stated that a 90 days maturity period needs to be observed before the payment is made.

The confirming bank in the United States informed the beneficiary that they have stopped making the payment at maturity due to the reason that its payment would facilitate a material fraud. The bank went to Court in the United States seeking declaratory relief. The seller opposed the action taken by the confirming bank and filed a counter claim for breach of good faith and fraud by the confirming bank. However, the Court allowed the seller to proceed only with the counterclaim of wrongful dishonour.

The Court had two questions to answer,

- i) Assuming that the confirming bank is not itself asserting the fraud defence, can a foreign Court injunction justify the dishonour by the confirming bank under the law applicable to the confirmation?
- ii) If the above question is answered as 'cannot', should the foreign Court lift the injunction in recognition of its inequitable effect on the confirming bank?

In the judgment it was stated that, under the section 5-109 of the Uniform Custom Code, receipt of the fraud notice does not excuse dishonour by either the Issuing Bank or the Confirming bank. The Court further stated that, **It is necessary to seek the injunctive relief from a court of competent jurisdiction**⁴³⁵. Additionally, if the seller holds the confirming bank's accepted draft or took the confirmer's deferred payment obligation for value without notice of material fraud, the subsequent injunction issued against the Issuing bank does not prevent the confirming bank from making the payment to the beneficiary.

Conclusion

On perusal of the above cases, it is clear that the fraud exception can only be applied in a limited number of occasions where the demand for payment under the letter of credit does not have 'basis in fact'. This approach has been described as

⁴³⁴. 2002 WL 1553435, at *2-*3 (N.D. Ill. 2002)

⁴³⁵ When the shoe is on the other foot, U.S. courts generally refuse to enjoin honour by U.S. issuers of LCs confirmed by overseas banks. Example; World-Link Inc. v. HSBC Bank USA, No. 604118/1999 (N.Y. Sup. Ct. May 23, 2000)

'unduly narrow'⁴³⁶. The main breakthrough that contributed to the development of fraud exception was the above mentioned **Sztejn v J Henry Schroder Banking Corporation** case and it has helped to construct the framework for the Article 5 section 5-109 of the UCC. However the necessary components that are required for the fraud to be committed have not been clearly mentioned in the UCC. Therefore, the Courts' approach is very important when defining the materiality. This has created a situation where various standards and opinions have been applied. It is not clear whether the fraud requirement should 'taint the entire transaction'⁴³⁷ and/or whether it only has to be committed by the beneficiary.

However, the introduction of Article 5 section 5-109 of the UCC appears to provide sufficient guideline as to the determination of, whether the fraud has been committed or not. This section 5- 109 stands out as the most comprehensive authority on deciding whether a fraud has been committed or not and the core elements of it has been referred in most jurisdictions all over the world. The above discussed cases indicates that the Courts are willing to use the guidelines provided in section 5-109 when proclaiming judgments. In the majority of cases the 'materiality' has been interpreted as the standard required to establish that 'the demand for payment under the letter of credit has absolutely no basis in fact'.

The other important factor is that, under the UCC, the concept of fraud has been categorised into two components. The fraud or forgeries related to the documents submitted to the bank for examination and a fraud committed by the beneficiary which is not related to documents, but relates to the underlying sales contract are accepted as viable forms of frauds.

In comparison, under the English law it is mandatory that the fraud had been committed by an act by the beneficiary prior to the application of the fraud exception. However, under the UCC Article 5 section 109, that the main focus remains with the nature of fraud and identity of the fraudster is also significant. The section 5-109 of the UCC does not clearly state that the fraud must have been committed by the beneficiary for the application of the exception.

Under English Law, it is important that the bank is aware of the beneficiary's fraudulent act and when an injunction is sought the knowledge of the bank regarding a fraud is not considered as vital by the United States' Courts⁴³⁸. In addition, under the English law, the standard of proof to establish fraud is very high in contrast to the

⁴³⁶ J G Barnes and J E Byrne 'Letters of Credit: 2000 Cases' (2001) 56 Business Lawyer 1805 at 1812

⁴³⁷ Air Transfer Incorporation V Westates Airlines Incorporation, 899 F 2d 1269 (1st Cir 1990) at 1272-1273

⁴³⁸ Roeland Bertrams, Bank Guarantees in International Trade: The Law and Practice of Independent (First Demand) Guarantees and Standby Letters of Credit in Civil Law and Common Law Jurisdictions, page 416-417, 3 edition (2004) Kluwer Law International: The Hague, The Netherlands

United States' Courts which have a more relaxed approach in this regard. For example in **United Bank Limited Et Al. v. Cambridge Sporting Goods Corp**⁴³⁹, the respondent's failure to produce a viable objection to the petitioner's claim was considered as enough evidence to allow the application for right to the proceeds, which was the subject of an irrevocable letter of credit. The respondent had not refused the genuineness of the disputed signatures on the drafts and therefore, they were considered as admitted. Accordingly, it was stated that, the petitioner as the holder of the instrument was entitled to recover on them unless the defendant establishes a viable defence. This decision shows that, unless the respondent shows a viable defence against a claim made over a fraud, the Court may tend to decide in favour of the petitioner. In addition, there are some examples where Courts have granted injunctions to prevent making payment to the beneficiary on demand made over reasons subtly suggestive of fraud. For example in **Harris Corporation v National Iranian Radio and Television**⁴⁴⁰, the National Iranian Radio and Television ("NIRT") and Bank Melli Iran appealed against a district Court order to grant a preliminary injunction in favour of the plaintiff-appellee Harris Corporation. The injunction had enjoined the National Iranian Radio from demanding the payment from Bank Meli, Bank Meli honouring the demand for payment and Bank Meli receiving payment from Continental Illinois National Bank and Trust Company under a standby letter of credit issued by Continental Bank. In making the decision, the Court of Appeal stated that, 'unlike the first line of argument presented by Harris, the issuance of a preliminary injunction based on a showing of fraud does not create unfortunate consequences for a bank that honours letters of credit in good faith and it is up to the customer to seek and obtain an injunction before a bank would be prohibited from paying on a letter of credit. Under these circumstances, it was within the district Court's discretion to find that, at a full hearing, Harris **might well be able to prove** that NIRT's demand was a fraudulent attempt to obtain the benefit of payment on the letter of credit in addition to the benefit of Harris's substantial performance.'

5.9 Identifying the general standards to define the Fraud rule

As mentioned above, the fraud rule as an exception to the Principle of Autonomy of the Credit is not recognized by the UCP. It is understandable that the UCP does not intend to provide guidance over Court procedures since by nature it remains a set of rules rather than an operating law. Therefore, defining the fraud, issuing and/or seeking interim injunctions can remain outside the scope of the UCP. However, it

⁴³⁹ 49 A.D.2d 868 (1975)

⁴⁴⁰ 691 F 2d 1344 (11th Cir 1982) at 1356

must be admitted that, there could have been discussion on the bank's right to refuse the payment on the grounds of a fraudulent submission of a document by the beneficiary. In addition to that, the discussion should be extended to areas which clarifies under which circumstances a document submitted can become fraudulent.

The principle of Autonomy of the Letter of credit should not be challenged on the grounds of any fraudulent act by the beneficiary other than the document presented for examination and it should remain within the powers of the Court. Similarly, the UCP does not need to cover the area related to fraudulent documents because the UCP's rules do not bear the force of law unless, as the rules themselves expressly provided. This suggestion takes a contrary position compared to the provision provided in the Uniform Commercial Code of the United States⁴⁴¹. This is due to the fact that the UCP is intended to cover all the jurisdictions in the world while the UCC is applicable only to one country. On the other hand the UCC operates as a law in adapted States while the UCP does not have the force of law. Therefore, providing guidance on defining fraud, issuing interim injunctions by the UCP is practically difficult since different jurisdictions have different systems of judicial proceedings. Therefore, this exercise is aimed at educating and guiding parties those are interested on how a bank can recognize and define a fraud. In addition this thesis try to list the ways which a bank should handle a fraud claim under the best practice followed worldwide. The next question is, what can be the general guidelines to cover the fraud rule. In order to aid this task, an attempt will be made to extract the necessary ingredient from the case law discussed above and other relevant authorities which were mentioned earlier.

Prior to all, it is important to recognize the important elements to be included in the proposed Article-

- i) The fraud must be clear and obvious.
- ii) It should have been already committed
- iii) The fraudulent act should be related to the document presented for examination.
- iv) The beneficiary and/or document presenter must have a knowledge of the fraud. (the fraudster's intention of committing the fraud should not be added as proving the fraudulent intention is a very difficult and complicated task).
- v) The bank must have a knowledge of the fraud
- vi) The beneficiary must be a part of the fraud.

The concept of materiality provided in the UCC, should not be considered as such a complicated term may be subject to different interpretations. Finally, it is

⁴⁴¹ Article 5 section 109 (b) of the UCC where it states as 'a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honouring a presentation or grant similar relief against the issuer or other persons.....'

presumed that the providing of guidance to the parties on fraud exception may be helpful for better understanding of the rule and it will result in cutting down litigation arising out of the acceptance a fraudulent document and/or failing or refusing to accept a fraudulent document and/or refusing the payment on a fraudulent document.

The guidelines proposed by this thesis

A) If a presentation made for examination appears, on its face, strictly complying with the terms and conditions of the letter of credit, but a required document is forged and the fraudulent document is presented with knowledge of the beneficiary and honouring the presentation would facilitate the fraudulent act committed by the beneficiary, the issuer shall not honour the demand of payment if;

- a) The fraud which has already been committed is clearly established*
- b) The fraudulent act is related to the document presented for examination.*
- c) The beneficiary and/or document presenter is aware of such fraudulent act*
- d) The beneficiary is a part of the fraud.*

B) However, the issuer shall honour the presentation if the demand is made by:⁴⁴²

- (a) a nominated person who has given value in good faith and without notice of forgery,*
- (b) a confirmer who has honoured its confirmation in good faith,*
- (c) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or*
- (d) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person*

It is expected by the abovementioned guidelines that, banks in all over world can look into them, when they are presented with a fraud claim. Due to the lack of guidance available at international stage, different methods are using by banks without any standardised formalities. This can result in adapting two or more different methods to decide fraudulent claims by banks in the same jurisdiction. It is hoped that, the abovementioned guidelines are formed to promote best practice around world. This would enhance the trustworthiness of letters of credit as viable means of payment because parties to credits are well aware under what general circumstances a fraud claim is scrutinized by any bank in the world.

⁴⁴² Extracted from Article 5- 109 Of the UCC.

Chapter 6

Conclusion and Recommendations

6.1 General overview

The research work carried out in this thesis reveals that the issues surrounding the current rules which are applicable to the operation of letters of credit. Certainly, the current version of the UCP has made an attempt to provide clear and precise rules. In order to achieve this, the ICC have cut down the amount of articles to 39 from 49 which the UCP 500 had. Similarly, the ambiguous phrases which were contained in the previous versions of the UCP have also been removed. As a result, the language used in articles seems easy to understand. In terms of the above stated aspects, it can be stated that, the UCP 600 has provided a set of comprehensive guidelines which can be used by the parties engaged in international trade.

In addition to above, the ICC expected the UCP 600 to contribute towards reducing the level of litigation arising out of the issues related to letters of credit. In order to achieve this, the ICC made drastic changes when framing the rules for the UCP 600. It is visible that there are some positive signs which were created as a result of it. For example, defining the complying presentation, and guidance on returning documents which was framed in accordance with widely spread banking practice can be pointed out. However, after considering facts discussed in this thesis, it has transpired that the ICC should have gone further when reframing the rules for the UCP 600.

It is intended by this thesis to enquire about the efficacy of the legal framework for protection of rights of the parties involved in letters of credit transactions highlighting areas of examination of documents and communication of the decision by the bank. The line of enquiry made herein implies that there was a problem of efficacy in implementing and enforcing the relevant legal framework. However, this is not to claim that, the frame work provided by the UCP 600 is ill-conceived or poorly drafted. The effort made by the ICC in revising the rules and publishing the UCP 600 should be highly appreciated. At the same time, it must also be acknowledged that the rules provided in the UCP have been drafted by the most eminent lawmakers who are experts in their particular field. It must also be noted that, most of the time, the rules provided in the UCP appear fit for the purpose. However, there is still room for improvement in certain areas. Especially, when analysing the areas where there have been issues since the introduction of the UCP's first edition it must be stated

that, the focus on eliminating the vagueness and inefficiency has been neglected for a long time. For example, documents examination standards and the necessary level of compliance have not been clearly explained and standardized. It must also be noted that the principles used in the rules of the UCP have been changed from time to time with each and every edition without any continuity. This had hindered the evolution of the legal principle within the UCP itself.

Consequently, the problem of implementation and enforcement of the rules of the UCP still remain. More significantly, the historical issues associated with the rules of the UCP cannot be eliminated unless and until drastic changes are made.

This thesis proposes the way forward for the UCP to be made conclusive and comprehensive. In addition, it makes proposals to amend the UCP 600 on the subject area discussed above. It is expected that the recommendations suggested herein and changes that have been proposed will contribute towards the minimising of the level of litigation that has arisen as a result of the respective rules of the UCP 600. In addition, the major changes suggested herein would benefit the concept of letters of credit to continue to remain in the future as a viable method of payment in international trade.

Apart from the above mentioned facts, it was intended by this thesis to discuss the practical aspects of implementing the rules of the UCP. There were discussions at some length on the areas which are prone to litigation. There was further discussion on how the parties involved in letters of credit transactions should act under the rules of the UCP to avoid unexpected legal issues. In view of that, it is envisaged that the contribution which has been made in this thesis would help to enrich the practical knowledge of how the letter of credit system operates. Therefore, it can be expected that this thesis has offered valuable tips and hints to the traders and bankers in international trade.

6.2 Main Recommendations

6.2.1 Examination of Documents

Current rule

Under the UCP 600, banks are required to examine the documents to ascertain whether the content of the documents are regular on their face with the terms of the letter of credit. The UCP requires the bank to carry out the examination of documents under the standards set out in the ISBP.

Issues

- 1.) Can the determination process of the discrepant name, address, date and description of goods only be concluded by referring to paragraph 23 of the

ISBP which provides that Misspellings and/or typing errors that do not affect the meaning of a word or the sentence in which it occurs, do not make a document discrepant?

- 2.) Has the UCP 600 provided universally accepted standards for the process of examination of documents?
- 3.) Will there be any room for improvement of the rule?
- 4.) How to reduce the rejection level of documents
- 5.) How the rule should be shaped in future version of the UCP

Flaws in the current rule.

As mentioned in the chapter 3, paragraph 23 of the ISBP requires the word or sentence to hold the same meaning, even if they have been spelt contrary to what has been written in the letter of credit. The above discussed decided cases showed that, finding of the meaning of a word or sentence can successfully be carried out only in events in which the misspelled word or sentence bear a meaning of a word which is commonly used in the vocabulary. For example words like Company, Limited, Bank, New York and London can be pointed out. In addition, the concept of the 'meaning changer' greatly depends on the knowledge of the document examiner in the questioned field.

Apart from that, when it comes to a name of a person, the challenge of deciding the 'meaning changer' becomes very difficult. The best example for that is the above discussed case of **Beyene v Irving Trust Company**⁴⁴³, where a wrongly spelt Middle-Eastern name was involved. Banks face grave difficulties when the questioned name or the place originates from a place where the bank is unfamiliar with.

Therefore, it is clear that, paragraph 23 of the ISBP does not provide a comprehensive solution for this issue and amendments should be made to the current rule to achieve better clarity and productivity.

Solution 1

Balance of Probabilities test.

Since, paragraph 23 has become the most important authority that covers the issues related to misspellings or errors in the documents, any changes to be made should go along with the said section.

As mentioned in the concluding part of Subchapter 3.1, it is suggested that an amendment be made to paragraph 23 of the ISBP as follows-

⁴⁴³ 762F.2d 4, C.A.2 (N.Y.), 1985.

*“the misspellings and typing errors do not constitute a discrepancy only if they are found as **an obvious mistake** and do not affect the meaning of the word or the sentence in which they occur which can lead to **misleading information**”.*

In addition to the requirement of ‘not affecting the meaning of the word or sentence’, another 2 elements are suggested to be included in the paragraph. Accordingly, the proposed paragraph require 3 elements to be satisfied. The reason for proposing 3 elements to be included in this paragraph is that, it gives the bank more options to consider before making the decision. Under the proposed article, banks are required to carry out the balance of probability test in line with the 3 measures provided therein. When a word or a sentence in a submitted document appears to be discrepant, the bank can carry out the ‘balance of probabilities’ test to find out whether the alleged discrepancy would make the document non-compliant. In order to carry out the test, it is suggested that banks - use a working-sheet as follows-

Balance of Probabilities test

<i>L/C requirement</i>	<i>Alleged discrepancy</i>	<i>Obvious?</i>	<i>Not affecting the meaning?</i>	<i>Not leading to misleading information?</i>
Soran	Sofan	✓	✗	✗
Cheergoal Industries	Cheergoal Industrial	✓	✗	✓

Assuming that the banker makes his judgment under the 3 categories mentioned above, if at least, two components out of three are answered in the affirmative, the bank can make the decision that the discrepancy in question is not significant to reject the presentation. In contrast, if they were answered as negative under two categories or more, the presentation would be rejected.

The component of ‘not leading to misleading information’ allows the banker to use common sense in order to adapt to circumstances which are unique to the particular case. This gives the opportunity to disregard trivial errors in the submission where they seem very obvious.

If the cases discussed above were compared and tested under this formula, it would have transpired that the outcome of such test would produce the same end-result which the Courts have reached. However, it must be noted that, the banker’s ability to use common sense would be applicable under this formula. Hence, allowing the bank to approach the issue with the common sense approach would help to reduce the level of rejection of documents.

The requirement of ‘the details of the commercial invoices to be corresponding’, would facilitate the use of the same formula when the description of the invoice is disputed. Therefore, the above suggested formula can be made applicable to issues

that arise in the commercial invoices. Similarly the same principle can be made applicable to the issues that arise due to discrepant dates in the documents.

Solution 2.

Digital Validation.

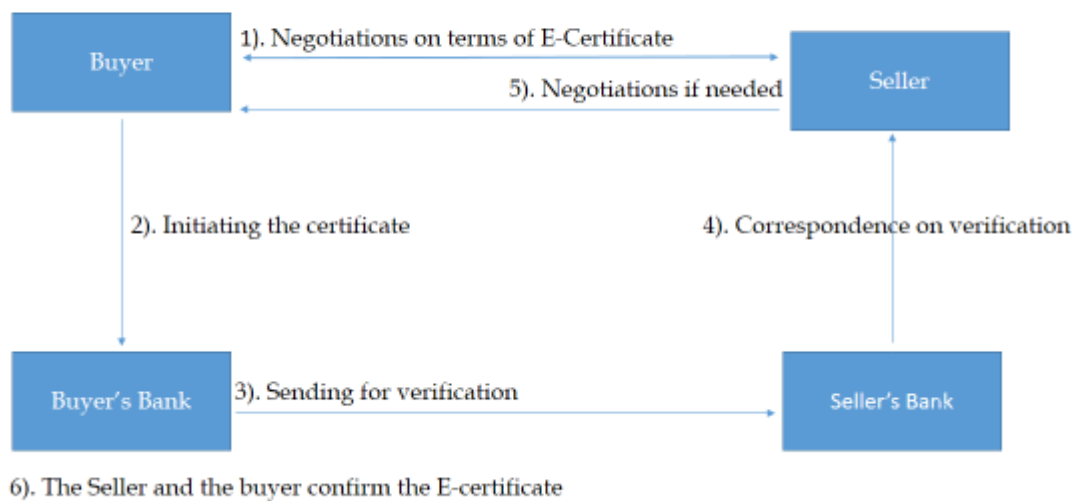
In addition to suggesting changes to amend the current rule over the examination of documents, it is important to explore the alternatives, which can be used to minimise the level of discrepancies in the documents submitted to the bank. As in chapter 3, we have understood the core elements that can make documents discrepant, it may be possible to apply a digital solution, which will help to cut down the level of discrepancies at least by 90%. This solution lies outside the scope of the UCP. However, adopting the suggested digital solution will help to sustain the credibility of letters of credit as the most preferred payment method in international trade. The initiative for this can be taken by the International Chamber Commerce for universal adaptation or even, by the Central bank of any country which expects a very productive local banking system⁴⁴⁴. The implementation process can be costly and may not be compatible with every aspect of the letter of credit process. However, the first initiative will lead to more developments that can raise the level of reliability of the service.

Under the suggested solution, when the letter of credit is drafted, the issuing bank creates an *E-certificate* contained the requirements mentioned in the letter of credit. This certificate is categorized under different columns to add necessary details. For example, under the shipment details, the recipient's name and address, and sender's name and address can be included to be compared with the bill of lading at the time of the issuing thereof. In a different column, the description of the goods can be included to be compared with commercial invoices. Likewise, there can be many columns depending on the requirements of the credit. As the focus of this part of the thesis is to reduce the level of discrepancies in the name and address of the recipient of the goods and the description in the commercial invoices, the solution offered herein will be discussed and confined only to the above mentioned issues, despite the fact that it can be adaptable and applied to any sort of document discrepancy.

⁴⁴⁴ As discussed in the chapter 3, Banks are, constantly, subject to the litigation process, that can be very costly. Therefore, developing a new system, which banks can adapt and if the solutions offered, reduces the level of litigations, the banking community will be pleased to fund such initiative.

The Process

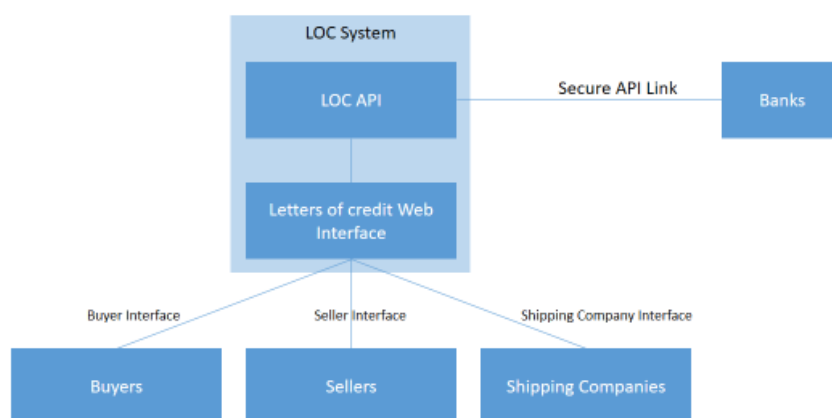
Creating the Digital Certificate



1. When the seller and the buyer negotiate on sales terms, there can be discussion about the details that should be contained in the E-certificate. After agreeing on the details, the buyer can ask the issuing bank to create the E-certificate along with the letter of credit. Basically, those details would be the same data mentioned in the letter of credit, which require to be satisfied to meet the complying presentation.
2. This E-Certificate has a unique identification number and the access to the E-Certificate is password protected, which only the seller, the buyer, the issuing bank and the confirming bank are privy to. This E-certificate is stored and maintained in a secured webserver run by the ICC and/or the Central Bank of the respective country and/or the bank which provides the Letters of credit service.
3. Upon the completion of the E-certificate, the issuing bank informs the buyer's bank (confirming bank) about the access details which should be communicated to the seller.

4. Then the confirming bank sends the login details to the seller. Each party will have a different interface⁴⁴⁵ of the web application according to the functionality which they are allowed use.
5. The seller has an opportunity to go through the content and renegotiate with the buyer, if any changes need to be made.
6. Finally, the E-certificate can be completed by adding digital signatures of the buyer and the seller. Once completed, the E-certificate cannot be amended.

System Architecture



The System is run either by the ICC and/or another party such as the Central bank of the respective country. Any bank that needs service of the application/system can subscribe to the system which will have an annual license fee. Once subscribed the bank has access to the system via a web Application Programming Interface (API)⁴⁴⁶. The API is a web development concept which is limited only to the particular web application's clients. API usually does not include web server or browser implementation details such as SAPI⁴⁴⁷s or Web browser engine.

⁴⁴⁵ In computing, an interface is a shared boundary across in which two separate components of a computer system exchange information each other. The combination of exchange can be between software, computer hardware, peripheral devices and humans. Presently, most of computer hardware devices such as touchscreens can both send and receive data through the interface, while others such as a mouse or microphone may only provide an interface to send data to a given system.

⁴⁴⁶ A web API is an application programming interface (API) for either a web server or a web browser.

⁴⁴⁷ Server Application Programming Interface (SAPI) is the direct module interface to web servers. For example, the Apache HTTP Server, Microsoft IIS, and Oracle iPlanet Web Server

The protocols for the E-Certificate can be designed by the main service provider such as the ICC. The application of the E-Certificate should be compatible with any software system. Once, a bank creates a password protected E-certificate in the main system, the seller and the buyer can view and amend the content through password protected access. The amendment of content is restricted to the time until the final confirmation is made by the parties. The notifications will be issued to all the parties about any request for amendments which can only be done prior to the final confirmation of the E-Certificate.

How it works

Once, the Letter of credit and E-certificate are confirmed, the seller can ship the goods to the buyer and obtain the necessary documents for submission. At the stage of issuing the bill of lading, the shipping company via the password provided by the seller, can validate the shipping details by running through in the system to validate the content required in the E-Certificate and the details about to be included in the bill of lading. In a more developed system, under the protocol designed, the shipping company will have access only to the shipping details part of the E-Certificate. When running this application, the system will pick up any discrepancies contained in the drafted shipping details, which are expected to be included in the bill of lading. The confirmed Bill of Lading can be issued after rectifying the errors picked up in the validation process and this system will be helpful to cut down the rate of discrepancies reported in Bills of Lading by a big margin. For example, in **Voest-Alpine Trading USA Company v. Bank of China (Texas, 2000)**⁴⁴⁸, the discrepancy contained in the port of destination which was misspelled as “Zhangjiagng” instead of Zhangjiagang could have been picked up by a digital validation in contrast to the naked-eye inspection that may not spot the difference.

Similarly, the seller can, prior to issuing the commercial invoices, run through the description of the goods and other relevant details to validate with the content of the E-Certificate to pick up any discrepancies contained in the drafts of commercial invoices. As descriptions of the goods contain so many technical terms, the digital validation system can offer a 100% discrepancies-proof invoices issuing system. For example, in **Soproma SpA v Marine & Animal By-Products Corp**⁴⁴⁹, the discrepancy contained in the description of the goods as "CHILEAN FISH FULL MEAL, 70% PROTEIN" instead of "CHILEAN FISH FULL MEAL, STEAM-DRIED, MINIMUM 70% PROTEIN", could have been picked up by the system and the error could have been adjusted in accordance with the requirement provided in the E-Certificate.

Likewise, as in the above mentioned two incidents, the E-Certificate system can also be applied to any other documents which is required by the letter of credit.

⁴⁴⁸ 167 F. Supp. 2d 940, S.D. Tex., 2000, aff'd, 288 F.3d 262, C.A.5 (Tex.), 2002.

⁴⁴⁹ [1966] 1 Lloyd's Rep. 367

This system will enhance the reliability level of the letters of credit as a method of payment. The implementation process can be costly but once implemented, there won't be excessive cost to maintain the system.

The other issue is the security of such mechanism. All the parties involved in the trade would not be happy to expose their trade details to a third party. Therefore, advance security measures need to be taken when the system is programmed. Currently, worldwide, banks are using the SWIFT⁴⁵⁰ system to communicate international transfer details to each other. The SWIFT international payment network is one of the largest financial messaging systems in the world. The ICC or any other body can collaborate with a company like SWIFT, if required, for the purpose of initiating this process.

Finally, this i process that digitalises the validation process should be added to the process of naked-eye inspections. If implemented correctly, this will help to reduce the level of documents rejections by at least 90%.

6.2.2 Decision making and Communication within the time limit.

Solution 1.

Additional time for the process

It is important to encourage banks to make more waiver requests since it will reduce the amount of refusal of documents. In order to do that, it is vital to remove the rigorous time scale which have been imposed on the banks. For example, since the banks are required to complete the examination and issuing notices within 5 banking days, banks may not consider making an extra effort to find a cure for the issue. In practical terms, if a bank took 3 days to complete the examination and found discrepancies, the bank may be reluctant to make a waiver request as the balance 2 day period may not be sufficient to contact the buyer, then explain the details of the discrepancy, and await till the buyer makes the decision and based on the buyer's decision to issue the final notice. Therefore, it has been suggested in the chapter 4 to allow banks to have a window period of time to accommodate the waiver requests.

Accordingly, it is suggested that article 16 (b) be amended as follows to accommodate the changes discussed above-

'When an issuing bank determines that a presentation does not comply, it may in its sole judgement approach the applicant for a waiver of the

⁴⁵⁰ The **Society for Worldwide Interbank Financial Telecommunication (SWIFT)** is a service provider network that facilitate financial institutions worldwide to send and receive information about financial transactions in a secure, standardized and reliable environment. SWIFT also sells software and services to financial institutions, much of it for use on the SWIFTNet Network

discrepancies. This does not, however, extend the period mentioned in sub-article 14 (b) unless the seller has duly been notified by the issuing bank when the approach for waiver was made.'

The time limit for the extra allocation may be decided in accordance with the facts relevant to the particular case. However, it should remain within the limit of 3 to 4 days. Issuing of a Notification to the seller has been suggested in order to offer transparency to the process and to deter the possibility that the bank can be made liable for preclusion, if the waiver process exceeds the five days limit. It can be assumed that there is no any viable reason for the seller to disagree with this position, since the waiver process has been designed to protect his interest.

Solution 2

Format for the Final Notice

Article 16 C Notice

<u>The Notice issued under Article 16 C of the Uniform Custom and Practice for Documentary Credit</u>	
Bank Name:	
Bank's Contact details:	
Letter of Credit Number:	
Document presenter's Name:	
Document Presenter's Address:	
Beneficiary's(s') Name:	
Beneficiary's(s') Contact details:	
Applicant's Name:	
Applicant's Contact details:	
<p>Under the provisions provided by the Article 16 C of the Uniform Custom and Practice for Documentary Credit, We,(bank) of(address) issue this Notice to (beneficiary) of (address)</p>	
A) Honour or Negotiation	
i. Does the Bank agree to honour the payment request made under the Letter of Credit Number	Yes No
ii. Reasons for the bank's decision:	
iii. List of discrepancy the bank found (if there is refusal of payment)	
<u>Discrepancy</u>	<u>Reasons</u>
1.	

2.

3.

B) Returning of Documents

- | | | |
|------|---|-----|
| i. | Is the bank holding the documents pending further instructions from the presenter:
No | Yes |
| ii. | Is the issuing bank holding the documents until it receives a waiver from the applicant and agrees to accept it:
No | Yes |
| iii. | Is the issuing bank holding the documents until it receives further instructions from the presenter prior to agreeing to accept a waiver:
No | Yes |
| iv. | If not, documents return date: | |

C. Any other comment***Bank's stamp or digital signature******Date of issue.***

On perusal of the case law related to the Refusal and Return Notices, the main concerns were with-

- a) How to differentiate the bank's initial communication from its final notices
- b) The vague nature of the language used in the final notice
- c) What will the bank do with the documents submitted for examination (either holding them or returning them)
- d) When will the bank return the documents to the presenter?

In order to find an answer for the above mentioned concerns, this thesis proposes the above mentioned format for the Refusal and Document Return Notices. This can

be attached to the future version of the UCP as a sub-schedule and should be made mandatory to issue to the presenter and/or the beneficiary when the bank has made its decision. Once the beneficiary and/or the presenter has received this notice, he knows that the final decision has arrived and then he can act accordingly.

The language of the notice is plain and clear and by ticking Yes or No, the bank can communicate its conclusive decision.

The other area of the notice is for the documents returning obligation. Under the UCP 600, there are new features to be complied as to the returning of documents and therefore, the above mentioned notice has been designed to accommodate all the requirements mentioned in article 16 c (iii) of the UCP 600. Apart from that, there is another column for the documents return date by which the bank should return the documents to the presenter if they decide not to hold them. Under this format the issues of returning of documents which arose in the above mentioned **Fortis Bank S.A./N.V. and Stemcor UK Limited v Indian Overseas Bank**⁴⁵¹ could have been avoided, before it led to litigation.

This notice can be the main document which can be subject to litigation if a party is not happy with the outcome of the examination. Therefore, the plain language used in the format would help parties to the litigation process to make their plea. In addition, this format requires all of the discrepancies to be listed in the right order and reasons given next to them and this will help Courts when decisions have to be made since all the discrepancies are easy to refer and locate.

It must be stated that, despite the fact that of having numerous ways of communication by the bank to the beneficiary about the final outcome, if the Article 16 C Notice is not issued within five banking days⁴⁵², the bank will be liable for preclusion if the letter of credit has been issued under the rules of the UCP. In other words, until the beneficiary receives the article 16 C Notice by the bank, it is assumed that he has not been informed about the final outcome of the examination. In addition to that, the failure by the bank to include any details required in the format may make the bank liable for preclusion.

In conclusion, it can be assumed that, the proposal made herein with regard to the Refusal and Document Return Notices will help to eliminate issues that have led to litigation by a significant margin

⁴⁵¹ [2011] EWCA Civ 58

⁴⁵² Unless the bank approaches the buyer for a waiver under the terms suggested in the above solution one

6.2.3 Banks' rights to reject facially complying documents under the fraud rule

Under the UCP, there is no provision that covers the Fraud exception. However, irrespective of the fact that the UCP does not recognize the fraud exception, the rule still applies to the cases where the respective letters of credit were issued subject to the provisions of the UCP. The ICC's position is clear in this regard and it does not want to act as a law making body. However, the lack of cover provided by the UCP over this issue leaves a vacuum over the issue of how a bank should act when a complaint is made regarding fraudulent document. Due to that reason, various methods are adapting by banks to decide whether to hold the payment when a suspicion is raised.

Whether, it has been provided in the UCP or not, the banks and Courts all over the world recognize the fraud rule as an exception to the Independence principle. There was no reported case, where the court had refused to apply the fraud rule citing the reason that the UCP does not recognize it. Therefore, it must be acknowledged that the Fraud Exception has become a part and parcel of the law related to letters of credit.

The discussion in this thesis suggest that there should be guidelines which can aid banks when they are required to make decision regarding frauds. This thesis argues that, banks should have standardized general guidelines as to steps they should take when they are presented with a suspicious document or fraud claim. Therefore, the content of the discussion made in chapter 5 has recognized the importance elements which can aid banks when they are required to make decision on alleged fraud.

However, it is suggested that, the application of fraud exception should be limited only to the documents submitted for the examination. The reason behind this is to leave any dispute over the performance of the underlying sales contract outside the purview of the banker's duties. In Addition, it is not suggested that banks should hold inquiries on the performance of the sales agreement and act as a Court house. The only element suggested by this thesis is the measures that can prevent making payment by the bank to the beneficiary on forged documents or preventing banks claiming documents are forged when the beneficiary has nothing to do with the alleged fraudulent act.

Proving guidelines to banks can minimize the amount of erroneous interpretation on fraud exception. For example, if there is a claim or request made by the buyer to the issuing bank to stop the payment to the seller and as long as the bank applies the rule suggested below, the request made by the buyer does not prevent the

bank from effecting the payment if it is transpired that the seller has not played any role in the fraudulent act. When a dishonest buyer alleges that the right goods had not been shipped, the suggested guidelines, if adapted, provides a safer umbrella to the seller since he knows that he will receive the payment once the right set of documents are submitted to the bank.

On the other hand, when the bank is accused for wrongful acceptance of a forged document or refusing to make the payment citing a forgery, it has a defence to adduce how they reached the disputed decision. Apart from that, this provides the opportunity for courts to evaluate the way that the bank has reached its decision.

The suggested guidelines-

A) If a presentation made for examination appears, on its face, strictly complying with the terms and conditions of the letter of credit, but a required document is forged and the fraudulent document is presented with knowledge of the beneficiary and honouring the presentation would facilitate the fraudulent act committed by the beneficiary, the issuer shall not honour the demand of payment if;

- a) The fraud which has already been committed is clearly established*
- b) The fraudulent act is related to the document presented for examination.*
- c) The beneficiary and/or document presenter is aware of such fraudulent act*
- d) The beneficiary is a part of the fraud.*

B) However, the issuer shall honour the presentation if the demand is made by:⁴⁵³

- (a) a nominated person who has given value in good faith and without notice of forgery,*
- (b) a confirmer who has honoured its confirmation in good faith,*
- (c) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or*
- (d) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person*

This guidelines gives four components to be satisfied, if the document is to be declared as forged. When there is doubt on the authenticity of the document, the bank should carry out the above mentioned test. If the test shows at least one component out of four is satisfied, the bank should stop making the payment. However, this article should not prevent an innocent beneficiary, who knew nothing

⁴⁵³ Extracted from Article 5- 109 Of the UCC.

about the fraudulent act, receiving payment from the bank. Therefore, part (B) of the article provides the exceptions where the rule cannot be applied. The part (B) suggested herein would stop unfair interpretations by banks on the fraud rule. For example, in **United City Merchants (Investment) Limited V Royal Bank of Canada**⁴⁵⁴, the beneficiary was not the party who committed fraud. However, due to the lack of guidance available to the bank, the bank neglected the fact that, the beneficiary was unaware of the fraudulent act and refused the payment on the ground of fraud. If the bank had been provided with guidelines mentioned in the above proposed article, the bank would not have refused the payment to the beneficiary.

It is believed, that the suggestion made herein, can cover the banker's role when he comes across a forged document. In addition, this gives a certainty over how and when the rule can be applied. In addition, this will prevent the excessive application of the fraud exception as it limits the circumstances where the rule can be applied.

As the suggested article provides clear guidance to the rule applicable on fraud exception, it is believed that the guidance provided by this suggested article, will lead, if adapted, to a reduction of the amount of litigation under the fraud rule.

6.3 Overall Conclusion

Letters of credit are a method of payment used to finance international business transactions. A main objective of letters of credit is to ensure that the both parties' interests are secured over the performance of the underlying sales contract. On the part of the seller, if he ships the goods and pass possession purely based on the buyer's promise to pay as agreed in the sales contract, the seller may not have an effective means of security against the buyer's default in payment. On the other hand, if the buyer makes the payment before the shipment of the goods or receiving the possession of the goods, he may not have necessary protection against default in performance by the seller. This primary objective of protecting both parties' interests in a letter of credit transaction remains pivotal to the successful utilisation as the most preferred⁴⁵⁵ means of payment in international trade.

In order to achieve the abovementioned objectives and enable the proper utilisation of letters of credit, the whole payment concept is operating on two cardinal principles, namely the Autonomy of Credit and the Doctrine of Strict Compliance. Under the principle of the autonomy of credit, bank's duty to pay is to be decided on

⁴⁵⁴ [1979] 1 Lloyd's Law Reports 267 (QB)

⁴⁵⁵ Nearly 55% in International Trade transactions are subject to Letters of Credit that values trillions each year; Source: 'Rethinking trade finance', ICC publication, October 2016, page 45, available at http://www.iccgermany.de/fileadmin/user_upload/Content/Banktechnik_und_praxis/ICC_Global_Trade_and_Finance_Survey_2016.pdf) accessed on 18th December 2016.

the letter of credit itself and duty to make payment do not in any way depend on the performance of the seller/beneficiary's obligations under the contract of sale.

When documents are presented to bank by the beneficiary for examination, the bank checks whether the documents satisfy the requirements stipulated in the terms of the credit. A minor discrepancy may tempt the bank to reject the presentation and refuse the payment⁴⁵⁶. The adherence by the bank to examine the documents strictly to ascertain whether the documents are in compliance with the terms of the credit is called the Doctrine of Strict Compliance. It has been pointed out in chapter two that, the doctrine of strict compliance seeks inflexibly to detach from 100% picture perfect compliance with the terms contained in the credit. This function primarily makes sure that the seller ships the right goods under right conditions. However, in the second chapter, it has been pointed out that the courts, at every instances, do not seek literal compliance standards. This is evident from most recent cases where the courts have shown a trend to adapt substantial compliance standards⁴⁵⁷.

In addition to that, it is argued that, the guidance provided by the UCP 600 and its predecessor with regard to the standard required for examination of documents were not sufficient enough to receive a recognition as a comprehensive set of guidance. This is clearly evident from the methods used outside⁴⁵⁸ the guidance of the UCP by courts all over the world, when defining the document examination standards. In addition to that it was argued that, the ICC has failed to identify the right direction which the documents examination standards can move forward. For example, under the UCP 500, the document examination standards required documents to be complied 'on their face' with the terms of the credit and now under the UCP 600, it is required to follow the 'complying presentation' that has been guided by the ISBP. Paragraph 23 of the ISBP 745 requires content of the document not to change the meaning of a word or a sentence against requirements stipulated in the credit. Therefore, this thesis contends that, the introduction of various methods by the ICC to documents examination standards time to time, has hindered the evolution of rules related to the documents compliance standards.

In the Third Chapter, it has been evaluated the current rule under the UCP 600 with regard to the document examination standards. It has identified the flaws of the current rule, especially the guidance provided in paragraph 23 of the ISBP 745, which says that the alleged discrepant word or sentence should not change the meaning of word intended by the credit. However, it has been disputed by this thesis the fact that relying on the concept of meaning changer would not solve the problem. Especially, when the word or sentence in question is not familiar to the documents checker who would not probably be an expert in trade or cultural usage of the language where the documents are produced. For example if the name of Smith is

⁴⁵⁶ Paul Todd, 'Discrepancies between Bills of Lading and Letters of Credit', Letters of Credit Update (Government Information Service, USA) (1999) pp. 14-19 at page 474, where it says, the original common law position is that the triviality of a defect was irrelevant.

⁴⁵⁷ *Soproma SpA V Marine & Animal By-Products Corp* (1966)1 Lloyd's Law Rep 367

⁴⁵⁸ See *Dessaleng Beyene and Jean M. Hanson Vs Irving Trust Company*, (1984) 596 F. Supp. 438 (New York). And *Voest-Alpine Trading USA Co. v. Bank of China* 167 F. Supp. 2d 940, S.D. Tex., 2000

misspelled as Smiths, it can be recognised as a non-meaning changer by an examiner in the UK and however, if it was under the examination in China, the examiner may have serious doubts as to whether Smiths means a totally different name. This situation can also work other way around and it will be difficult for an English examiner to understand one or two letters deviation in a Chinese name.

In order to address this issue, this thesis strived to find out other standards⁴⁵⁹ adopted by court and evaluated the merits on each concept in details with reference to the decided cases. Then those methods were scrutinized on adaptability at international level and practicality on utilization. After considering facts stated in the cases and experts comments regarding this subject, this thesis introduces two other components to be added to the test stipulated in paragraph 23 of the ISBP 745. The new format suggested for the said paragraph to have three component that need to be satisfied when a discrepant word or sentence is contained in the presentation.

In addition to that, it is suggested by this thesis to adapt a digital validation system, prior to issuing final documents to the bank for examination in order to obtain the payment. This area falls outside the purview of the UCP and it is suggested that such a system would be introduced locally and it would help the exporter in that particular country receive a fast payment for their exports. The system should be developed by either the banking system in the particular country or any other entity which wishes to provide the service. It is explained that if the banking system in one country adapted this system, it would help to cut down payment rejection as it would help to cut down level of discrepant documents by a larger amount.

There is another discussion in this chapter with regard to incomplete and unclear terms contained in the credit instruction and the content of the discussion has been extended to the length which discusses the liability of drafting and/or interpreting such instructions. This Sub-chapter comes to the conclusion of suggesting that, the liability should lie on the party who fails spot the ambiguity prior to finalising the terms of the credit.

Overall, chapter 3 discusses the circumstances which a misspelling or a typographical error can become material to be declared as non-complying. This discussion analyses the current provisions in the UCP, the previous position under the earlier revisions of the UCP, the case law and experts' comments in order to find out flaws in the current document examination rules. After analysing all relevant authorities, this thesis comes up with solutions which will be helpful to bankers and other interested parties to understand, interpret and implement the universally adaptable standards which are related to document examination.

Chapter Four has been dedicated to discuss the time limit available for banks to decide and communicate its decision regarding the final outcome of the examination. This thesis identifies the difficulty regarding the interpretation of the current rule which says banks have 'maximum of five banking days'. It is argued that,

⁴⁵⁹ Methods such as 'whether the misspelling is obvious', whether the 'misspelling is insignificant', whether the misspelling can be cured by taking whole document presentation as one', 'whether the misspelling can be cured by the rational linkage contained in the details of the document'

the word of 'maximum' may lead parties to think that, a bank can spend 'maximum of five banking days' for the cases only where the presentation of documents is bulky and complicated.

This chapter also suggests that, when a waiver request is made by the bank, the allowed time period to make the decision by the bank should be extended to further 3 or 4 days in order to ensure that the banks' rights are protected, when the waiver request is made. As approaching the buyer for a waiver by the bank is discretionary by virtue of the provisions in the UCP, it is argued that, banks would be reluctant approach the buyer and spend extra 2 or 3 days until hearing from him. This situation would not encourage the bank to make a waiver request, given the fact that bank has only 5 days to make its final decision. Therefore, allowing banks to have extra 3 or 4 days to approach the buyer would encourage the banks to make more waiver requests and it would help to cut down the level of rejected documents.

The second part of Chapter 4 discusses about the requirements stipulated in the UCP 600 with regard to issuing of 'final notice' and 'documents return notice'. It also discusses about the importance of returning documents to the presenter promptly. It recognizes the fact that if a bank fails comply with those three requirements, it would result them being liable for preclusion which prevents refusing payment to the beneficiary on non-compliance. The analysis in Chapter Four recognizes the failure of the UCP 600 to provide a format for the final notices. Due to this failure, currently banks use various types of notices which sometimes not up to the standards required by the UCP⁴⁶⁰. Similarly banks are not following the documents return policy correctly and due to this reason, bank are sued for non-compliance of article 16 of the UCP 600⁴⁶¹. Therefore this thesis proposes to introduce a format which can come as a sub schedule to the UCP 600. The suggested format is easy to use, the language is plain and universally adaptable. It is suggested that, if the parties are incorporating the UCP's terms into their contract, the bank should use the format suggested for their final notices. Any other notices issues prior to the final notice will be considered as initial correspondence and if a bank fails to issue the final notice in suggested format within the allowed time period, it will be precluded from claiming documents are discrepant and refusing to make the payment.

Fifth Chapter discusses about the situation where, banks are presented with documents which are complying with the terms of the credit and yet a document or documents appear to be forged. This chapter identifies the UCP's position which does not provide any cover for the issue. It is further identified that, despite the silence of the UCP over the fraud exception rule, banks and courts all over the world apply the fraud rule to letters of credit which were subject to the rules of the UCP. This thesis acknowledges the position taken by the UCP and agrees with reasoning given on non-inclusion of the fraud rule to the UCP.

⁴⁶⁰ Bankers Trust Co v State Bank of India [1991] 2 Lloyd's Rep. 443 CA (England) and Voest-Alpine Trading USA Corp. v Bank of China 167 F. Supp. 2d 940 (S.D. Tex. 2000)

⁴⁶¹ Fortis Bank S.A. /N.V. and Stemcor UK Limited v Indian Overseas Bank [2011] EWCA Civ 58

As the application of the fraud rule is a well-established practice, this thesis discusses about the important elements connected to the rule. It is intended by this thesis to identify main elements related to the fraud exception to promote the best practice which should be followed by banks when a complaint is made about a fraud. It is expected that the important component identified by this thesis will assist parties who are interested in finding the appropriate standards to apply the fraud exception. The suggested guidelines are comprised with important standards adapted by courts and other international conventions. The proposed guidelines will serve the bankers who are keen to study the international standards that are usually applied to determine whether the presentation is forged or not. In addition this thesis discusses about the circumstances where the bank should not hold inquiry into the fraud claim. It is also suggested to provide cover for innocent beneficiary to the credit who does not have any knowledge about the purported fraudulent act. It is further expected that, guidelines suggested herein will create opportunities to develop a coherent body of rules on the issue of fraud in the presentation.

Overall, this thesis has thrived to identify the challenges faced by exporters, importers and the banks in interpreting the rules contained in the UCP 600 as to the subject areas of this research. It has recognised that, different interpretations are used when defining the current rules by banks and courts. Therefore, this thesis has attempted find an optimal standard which can be used by all the parties in defining the rules provided in the UCP 600.

There is also an evaluation of changes brought to the previous rules when drafting the current rules. There is also an analysis to find out whether the exporters, importers and bankers have positively or negatively been affected by the rules of UCP 600. This thesis suggests the way they can be benefited from the UCP 600 and to make the best use of it.

In addition, there is a discussion on the areas which need to be changed in the current rules. After evaluating the case law, experts' comments and provisions of the other international conventions, it is suggested by thesis to amend some of the rules, introduce new rules in order promote best practice. This entire work seeks to make a significant contribution to the future legislative enactments and policy development in the UCP in the wake of emerging alternative transactions methods in international trade. It is expected that, the contribution made herein would help to enhance the productivity level of the UCP as a universally applicable set of rules.

This study has sought to make a contribution to the legal literature on letters of credit, international trade, export trade and import trade. This has been attempted by having a constructive debate surrounding the issues relating to letters of credit as a way of payment in international trade.

It must be acknowledged fact that, there is a considerable amount of scholarly contribution made to the law on Documentary of credit and yet there is a vacuum in

legal literature which analyses the practical aspects of judicial pronouncements, which has a theoretical significance. Therefore, this thesis has attempted to fill this void through a contribution to the literature on this subject.

Finally, it is expected by this thesis to offer practical hints for Importers, Exporters and Bankers on the matters relating to international trade transactions particularly in keeping with the rules of the UCP 600. The contribution made herein is expected to be useful to the law practitioners who are specialized in the law relating to commercial disputes and those who provide advice on matters relating to letters of credit.

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