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DOCUMENTARY LETTERS OF CREDIT AND RELATED RULES UNDER INTERNATIONAL TRADE LAW: A CASE FOR ACTION

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DEDICATED TO:

MY FAMILY,

SPECIALLY OUR BELOVED "**AHMAD**",

WHO IS OUT OF SIGHT,

BUT ALWAYS REMEMBERED IN OUR HEARTS.

ACKNOWLEDGEMENTS

IN THE NAME OF GOD, MOST GRACIOUS, MOST MERCIFUL.

PRAISE BE TO GOD, THE CHERISHER AND SUSTAINER OF THE WORLDS;

MOST GRACIOUS, MOST MERCIFUL;

MASTER OF THE DAY OF JUDGMENT.

THEE DO WE WORSHIP, AND

THINE AID WE SEEK.

SHOW US THE STRAIGHT WAY.

I would like to express my thanks to my supervisor Professor T. Prosser for his help and friendship. I also express my gratitute to the Bureau of International Legal Services (BILS) , members of my family, particularly my wife and children for their moral and financial supports. Finally, I wish to thank Dr. W.H. Balekjian who has given me his full support, generously, in the last few years and whose friendship is a valueless asset for me.

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ABBREVIATIONS

ADP	Automatic/automated Data Processing
BGs	Banking Guarantees
BL	Bill of lading
CA	Court of Appeal
CISG	The UN (Vienna) Convention on Contracts for the International Sale of Goods
COGSA	The Carriage of Goods by Sea Act
Col. L. R.	Columbia Law Review
ECE	Economic Commission for Europe
EDI	Electronic Data Interchange
EFT	Electronic Fund Transfer
Geo. Wash. J. Int'l L. & Econ.	George Washington Journal of International Law and Economics
HL	House of Lords
HLR	Harvard Law Review
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ILM	International Legal Materials
JBL	Journal of Business Law
KB	King's Bench
LCs	Letters of Credit
LMCLQ	Lloyd's Maritime Commercial Law Quarterly
LH	Letter of Hypothecation
LT	Letter of Trust
LQR	Law Quarterly Review
MI	Mareva Injunction
PFD	Proposed Final Draft (for revision of Article 5 of the UCC)

QB	Queen's Bench
SLCs	Standby Letters of Credit
SWIFT	Society for Worldwide Interbank Financial Telecommunication
UCC	Uniform Commercial Code
UCP	Uniform Customs and Practices for Documentary Credits
UK	The United Kingdom
UL	Uniform Law
UN	United Nations
UNCA	Uniform Rules for Communication Agreement
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	The International Institute of Rome for the Unification of Private Law (United Nations)
URCG	Uniform Rules for Contract Guarantees
USA	The United States of America
WG	Working Group

SUMMARY

Letters of credit (LCs) as instruments of payment play an important role in international trade, namely, for bankers as trusted mediators to fill the gap between buyers/ applicants and sellers/ beneficiaries by arranging payments against documents of title (bills of lading). Rules and provisions related to such a system at the international level have always been a focus of attention and have fascinated legal scholars. The present thesis follows a similar concern; its central theme is the present system of law related to LCs at the international level; relevant questions addressed are: **(1)** what is the present system of law related to LCs?; **(2)** would such a system be adequate to provide a uniform law concerning LCs?; and **(3)** if not, what would be a possible replacement for it?

The thesis is based on UCP 500 and common law (English, American (particularly Article 5 of the UCC), and Scots law) and considers the relevant questions in four Parts (12 Chapters) in the following order:

1. Part One (three Chapters) studies LCs and the current situation; in that respect, after an introduction (background, rationale and framework of the present research study) a general background about the history and different sources on standards and rules of LCs is presented (**Chapter I**). More details follow concerning LCs' structure (definition, function, and operation) and principles operative in such a system (principle of strict compliance and doctrine of autonomy) (**Chapter II**). Standby letters of credit (SLCs) and their history, structure, their similarities and differences from LCs and bank guarantees (BGs) are considered in **Chapter III**. It is concluded that the present system of LCs is a mixture of international customary (UCP 500) and national laws.

2. Part Two focuses on the international side of the system (UCP 500). Two chapters (**IV and V**) try to establish the level of effectiveness of the existing international sources of law regarding the needs of international commercial communities, at present. In that respect, **Chapter IV** is devoted to the UCP, its structure and related issues which affect applicants, beneficiaries, and bankers in

their dealings within the system. A similar approach is followed in **Chapter V** in a comparison between UCP 500 and Article 5 of the UCC in the United States. The results make obvious that the UCP did not and does not address many issues relevant to LCs.

3. Part Three (Chapters VI-VIII) considers legal issues related to LCs from a common law perspective. In order to achieve this goal bankers' rights and duties/ undertakings in relation to the applicants (the principle of strict compliance, its concept and exceptions) and the beneficiaries (doctrine of autonomy, its concept, connection with a sale and a carriage contracts, and exceptions (particularly fraud and its relevant issues) are discussed (**Chapters VI and VII**). In the same line the bank's right of security under LCs and relevant issues are considered in **Chapter VIII**. It is concluded that many issues related to LCs are left to be decided under national rather than international law, and that harms the credibility of the system from an international law point of view.

4. Part Four (Chapters IX-XII) mainly deals with the future of the letters of credit system. In that regard **Chapter IX** deals with electronic data interchange (EDI) and relevant issues such as definition, related projects, advantages and disadvantages compared with paper-based documents, and with such legal issues as the role of documents in international trade and their impact on the UCP 500. **Chapter X**, follows a similar purpose by studying UNCITRAL's activities concerning a draft convention on SLCs and BGs, in order to establish the effect of that project over the present LCs' system. Then, issues connected to the possibility of the unification of the law of LCs, namely, current conditions in the world of commerce, meaning of unification and its practical interest, methods and techniques for the unification of law at the international level and obstacles to it, are considered.

The next issue for consideration is international legislation and issues related to such an option as a substitute for international customary law **(Section A, Chapter XI)**. In that respect and after considering different available techniques (supranational legislation, convention and model law) in a comparison between international conventions and international customs, reasons for and against each one of them are discussed. In **Section B of Chapter XI**, another reference is made

to the UCP, its legal nature and shortcomings as an international source of law connected to LCs.

Lastly, **Chapter XII** deals with conclusions based on the results of points presented throughout the thesis. It is concluded that for greater certainty, credibility, and reliability on the law of LCs at the international level, the present system (a mixture of international customs and national law) should be replaced by a new system (a mixture of international convention and national law) in order to respond better to the present and future needs of international commercial communities.

PART ONE

LETTERS OF CREDIT:

THE CURRENT SITUATION

CHAPTER I

INTRODUCTION AND GENERAL BACKGROUND

SECTION A: INTRODUCTION

1. BACKGROUND OF THE RESEARCH

1.1. Importance of documentary letters of credit

Modes of payments have always been a matter of importance in sale contracts. Payments are effected in cash, by bills of exchange, promissory notes, cheques, and not least by letters of credit (LCs). Documentary LCs[1] defined also as **"the life blood of international commerce"**,[2] have played an important role as an effective instrument for payment of the purchase price of goods in both international and domestic sale contracts. They serve equally as security for performance by parties to the contract;[3] and their use has become more common and convenient among businessmen after the Second World War[4] as a result of improvements in the credit system, particularly within the last three decades.[5]

1.2. Emergence of rules on letters of credit: The current situation and issues related to it

The present form of LCs has been in use since the first half of the 19th century. While the origins of LCs go back to the 12th century, issues related to them (legal as well as customary and practical aspects) have not been discussed for the purpose of a possible unification of national rules and standards until 1933.[6]

In that year the first **Uniform Customs and Practice for Documentary Credits (UCP)** was published by the International Chamber of Commerce (ICC) in

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[1] They are also called **"bankers' commercial letters of credit"**.

[2] Kerr, L.J. in R.D. Harbottle (Merchantile) Ltd. v. National Westminster Bank Ltd. [1978] Q.B. 146, p. 155 [emphasis added].

[3] Standby letters of credit; see Article 1 of the UCP 500.

[4] Kozolchyk, Boris, "Letter of Credit", 9 International Encyclopedia of Comparative Law, Chapter 5, 1979, p. 1 [hereinafter referred to as Kozolchyk].

[5] See introduction to the UCP 290 (1974), UCP 400 (1983), and UCP 500 (1993).

[6] For a relevant discussion concerning the history of LCs see Section B.1 of the present chapter below.

Paris.[7] Its provisions, dealing mostly with the customs and practices related to LCs in international trade,[8] and some, but not all, issues of documentary credits,[9] were later revised five times[10] ; the revision of the UCP 500, published by the ICC in the Spring of 1993, came into effect on January 1, 1994.

Regarding, however, the legal issues concerning LCs,[11] there are no uniform rules applicable in international trade. Related issues have been treated under respective national laws. As a result, at present, a mixture of international commercial customs (UCP)[12] and national rules apply to the documentary credit system in international commercial transactions.

1.2.1. The current situation of the letters of credit system

Many cases relevant to LCs have been considered by English courts, and the situation is no different in the USA, as far as common law is concerned. In Europe cases have been examined in the light of civil law systems. In such a state of diversity of law a question arises: **is the present system satisfactory in promoting reliability and legal certainty as well as coping with disputes?** If yes, why are there so many disputes related to LCs? Are the roots of the problems related to the system in general, or is the main reason for the existence of numerous

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[7] The ICC was founded in 1919; Eberth, Rolf, "The Uniform Customs and Practice for Documentary Credits", (updated by Professor EP Ellinger), (Kee, Ho Peng, "Singapore Conferences on International Business Law, Current Problems of International Trade Financing", Butterworths, 1990, 2nd Edition [hereinafter referred to as Singapore Conferences 1990], pp. 3-20, p. 5 [hereinafter referred to as Eberth, Singapore Conferences 1990].

[8] For more details about UCP 500 see Chapter IV (below); and regarding its position as an international source of law see Chapter XI, Section B.

[9] In that respect look at discussions in Chapter V, Section B.2 and particularly Section B in Chapter VII and Chapter VIII (below).

[10] In 1951, 1962, 1974, 1983, and 1993; Davidson, Paul J., "The UCP and the need for amendment in the light of technological advances", Singapore Conferences 1990, supra (f.n. 7), pp. 21-36 [hereinafter referred to as Davidson, Singapore Conferences 1990].

[11] See below Chapters VI-VIII for legal issues relating to LCs from an English law point of view.

[12] As to the UCP and its nature see below Chapter XI, Section B.

cases to be sought in the law of LCs in a narrow sense, namely, the legal aspects of LCs as separate from custom and practice? It may be that the law is not clear for contracting parties and for defining mutual rights and obligations.

The practical issues related to the current system are dealt with by the ICC which, to some extent, has succeeded in unifying a part of customary standards applicable to LCs in international trade under the UCP. The UCP, however, covers some but not all issues related to LCs; as such it leaves certain questions unanswered and may lead to uncertainty between the interested parties.

Regarding the merits of the respective national laws of states, the main objection to them is that issues of an international character are considered by national law while dealing with legal questions attached to an international instrument; efforts by states have been based on national rather than international interests.[13] This situation may generate different views about one and the same issue related to LCs. It may be hence argued that the cause of uncertainty and the lack of clarity may be due to the absence of a **"uniform law"**, that is, in the form of an international commercial **"legislative"** text governing LCs in international trade. If the UCP promotes or provides for a common understanding and therewith uniformity in business transactions between trading states, as to commercial custom and practices affecting LCs, an international commercial "legislative" text may provide for needed uniformity as far as the transnational legal issues of LCs are concerned.

1.2.2. What are the current transnational legal issues concerning LCs?

Generally speaking, there are three parties in a documentary credit operation, namely, **(1)** the applicant for the credit (the buyer or bank's customer), **(2)** the bank (namely the issuing bank or the intermediary bank), and **(3)** the beneficiary of the credit (the seller).[14] These parties to the credit have different interests, and

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[13] For further details see below Section B, Chapter X and Section A.3, Chapter XI.

[14] By including the terms **"on its own behalf"** in Article 2 of UCP 500 it seems the situation is prepared for a "two party" letter of credit transaction; for further details see Dolan, John F., **"Weakening the letters of credit**

for the protection of their respective interests in practice different principles and techniques are used to control the balance of interests and to coordinate them within the system. For instance, the **"doctrine of autonomy"** provides a good assurance for the seller as the beneficiary of the credit, namely, if documents required under a letter of credit are tendered by the beneficiary, the bank must pay to him the amount of the credit; however, in the case of fraud committed by the beneficiary or if it is proved that he was aware of such an action committed by a third party, the bank is released from such an undertaking.[15] On the other hand, to preserve the right of the applicant for the credit, another principle, namely the **"principle of strict compliance"**, is applied. In such a situation, the bank undertakes to keep the balance between the parties, namely, the applicant and the beneficiary for the credit, by acting as a reasonable and reliable person to prevent misunderstanding and possible abuse of the system.[16] Moreover, for safeguarding their interests under the system, banks use different techniques such as taking documents as pledge for recovering their money from the applicant for the credit.[17] These points and others related to them have been the subject of consideration in many cases in the U.K.

As issues related to the above points and modes are not normatively clarified by legal rules at an international level, reasons for misunderstanding may exist or one of the parties to a credit arrangement may be tempted to abuse the system and change the balance of interests and claims in his favour. The national law of a state, with English or Scots law as an example, may provide some rules about legal issues related to LCs, but would it be sufficient to enable a prediction that issues of LCs

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product; The new Uniform Customs and Practice for Documentary Credits", International Business Law Journal, No. 2, 1994, pp. 149-177 [hereinafter referred to as Dolan]; see also Ellinger, E.P., "The Uniform Customs and Practice for Documentary Credits- the 1993 Revision", LMCLQ, part 3, August 1994, p. 377 [hereinafter referred to as Ellinger's article 1994].

[15] For more details about the "doctrine of autonomy" and its exception(s), see below Chapter VII.

[16] See below Chapter VI for details relating to the principle of strict compliance.

[17] See Chapter VIII (below).

shall be treated in the same way at an international level? If the answer is no, what could be done to achieve uniformity or at least ban non-uniformity regarding the legal aspects of transnational documentary credits? Different legal systems reflect similar positions, e.g., with respect to fraud committed by the beneficiary of the credit; but also differences between them may exist. For instance, is there any limitation to the meaning of fraud committed by the seller as far as the transaction is concerned? Does the beneficiary's fraud cover the sale contract or is the fraud only related to the credit contract?[18]

1.3. What is meant by "Uniform Law"?

A first step to promote the law of LCs towards unification could be in the form of international commercial legislation anchored in a convention.[19] It could cover only legal issues related to the documentary credit system. Concerning UCP, its contents could be supplemented and integrated as the base of the new **uniform law (UL)**; or, alternatively, it could be considered better to leave matters as they are as at present. The first method may be preferable if all issues of LCs, either in the form of legal rules or customary practice, are codified in one instrument; and with it the creditability and reliability of UCP would be increased since its legal position would be changed from that of customary standards to a legislative form.[20] By contrast, it would lose, to some extent, its flexibility; this is an important point which should not be ignored.

1.4. The role of English law in developments toward a uniform law for LCs

What would or could be the contribution of English law and practice to the process of unification? As the legal issues of LCs in the present thesis are considered in the light of English law, its impact on promoting new uniform law may

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[18] In respect of fraud and its relevant issues see Chapter VII, Section B (below).

[19] See below Chapter XI.

[20] On this point see below Section A.3, Chapter XI.

be considered. What contributions could English law provide for achieving a uniformity for the law of LCs, and what possible obstacles may arise when envisaging uniformity? In addition to English law, American and Scots law, if relevant, are considered when dealing with points related to the above questions. The thesis may refer to arbitrate awards dealing with LCs, but it does not discuss them as part of its main contents.

2. RATIONALE OF THE STUDY

The letters of credit system, its rules and standards in international trade, legal issues related to them, and the future of the system, as indicated above, are issues that the present research study examines. The purpose of the study is simply to find whether there is any possibility to have a system more satisfactory than the present system? If there is such a possibility, to what extent could a new system provide a certain and reliable system for all parties to LCs?

3. THE FRAMEWORK OF RESEARCH

To answer these questions Part one (in three Chapters) sets out a general background relating to the history, standards and rules, and mechanism of the documentary letters of credit (LCs and SLCs). Moreover, legal as well as other issues related to LCs are considered in the second and third Parts of the study (Chapters IV-VIII). In that respect, UCP 500 and its differences with Article 5 of the Uniform Commercial Code (UCC) in the United States of America are the main issues considered. In addition, points related to legal issues, in connection with principle of strict compliance, doctrine of autonomy, and bank's right of security, are further issues while the present thesis considers from the angle of English law.

As to the future of the documentary credits system beside issues connected to Automatic Data Processing (ADP) or Electronic Data Interchange (EDI), the main subject of discussion is the possibility for having the first international legislative instrument in the form of a **convention** for LCs. These issues and points related to them are considered in Part four (Chapters IX-XI). In order to benefit the view of experts on the above point a letter was sent to banks located in the UK (Barclay's

Bank, Lloyd's Bank, Midland Bank, National Westminister Bank, The Royal Bank of Scotland, Bank of Scotland, and Bank Melli Iran (London branch)), international and national organisations (UNCITRAL (New York, Vienna and Geneva), UNIDROIT (Rome), ICC (Paris and London), Glasgow Chamber of Commerce, The British Institute of International and Comparative Law, The American Law Institute), legal scholars and lawyers (whose residance are in the UK, the USA, France, Italy and Canada) in 1995, and received replies are considered in due course. Lastly, in Chapter XII of Part four of the present study, the extent to which an international legislative instrument, compared with the present mixture system of international commercial custom and related national law, could provide better rules and standards for all interested parties to a letter of credit arrangement.

As an introduction to the discussion of legal issues related to LCs in more detail, what follows below refers to general aspects of the current system.

SECTION B: GENERAL BACKGROUND

A brief history of the documentary credit: a general background followed by the legal meaning/definition, function, operation, and application of significant principles accepted for credit arrangements.

1. HISTORY OF LETTERS OF CREDIT

1.1. From the 12th century to early 20th century

A form of letter of credit dating from 1201[21] shows that the earliest type of credit (namely the open credit)[22] was known at least to the English kings,[23] princes,

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[21] Sanborn, F.R., "Origins of the early English Maritime and Commercial Law", New York 1930, p. 374; Davis, A.G., "The law relating to commercial letters of credit", London, 3rd ed., 1963, p. 2 [hereinafter referred to as Davis].

[22] The old form of credit called "open credit" which was different from the new form of letter of credit which is known as "documentary credits"; J. Story in his book, "Commentaries on the Law of Bills of Exchange, Foreign and Inland as Administered in England and America", 2nd ed., Boston, 1860, chapter 13, para. 459, defines an open letter of credit in the following terms: "An open letter of request, whereby one person (usually a merchant or banker) requests some other person or persons to advance moneys, or give credit, to a third person, named therein, for a certain amount, and promises that he will repay the same to the person advancing the same, or accept Bills drawn upon himself, for the like amount. It is called a general letter of credit, when it is addressed to all merchants, or other persons in general, requesting such advance to a third

popes and other rulers in Europe in the 12th century. Whether they were known to English traders of the time is "extremely doubtful".[24] While Italian merchants used open letters of credit in the 14th century there is little evidence that they were well known among British traders, even as late as the 16th century.[25]

In the 17th century the operation of the letter of credit was described in these terms: "A merchant doth send his friend or servant to buy some commodities or take up money for some purpose, and doth deliver unto him an open letter, directed to another merchant, requiring him that if his friend [...] the bearer of that letter, have occasion to buy commodities or take up moneys that he will procure him the same and he will provide him the money or pay him by exchange."[26]

A text on letters of credit was published in 17th century.[27] There is no doubt that LCs became popular in the 18th century,[28] but it seems that they did not present many problems for the courts: there are no reported cases.

Although LCs were considered by Lord Mansfield in several cases,[29] no principles of law were laid down for them.[30] The earliest case was decided a

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person; and it is called a special letter of credit, when it is addressed to a particular person by name requesting him to make such advances to a third person."; see Davis, ibid., p. 1, f.n. 1; Ellinger, E.P., **"Documentary Letters of Credit"** [hereinafter referred to as Ellinger], Singapore, 1970, pp. 5-7; Kozolchyk, supra (f.n. 4), about "letter of payment" in 12th-13th century, p. 4, f.n. 4.

[23] Ellinger, ibid., p. 24.

[24] Ellinger, supra (f.n. 22), pp. 24-25.

[25] Ellinger, supra (f.n. 22), pp. 24-25.

[26] Malynes, **"Lex Mercatoria"**, London, 1622, p. 76 and pp. 104-6; see also Kozolcyk, supra (f.n. 4), about the letter of credit and its definition in 17th century, at p. 4, f.n. 5.

[27] Marius, J., **"Advice concerning Bills of Exchange"**, London, 4th ed., 1684, pp. 30-31 and p. 36 (the first edition was published in 1651); Roberts, R., **"The merchants' map of commerce"**, London, 1700; Malynes, ibid., 3rd ed., 1868; Davis, supra (f.n. 21), pp. 3-4.

[28] Jacob, G., **"Lex Mercatoria, or the merchant's companion"**, 2nd ed., London, pp. 39-40; and also from the same writer, **"A new law dictionary"**, London, 1729; Ellinger, supra (f.n. 22), p. 25; Davis, supra (f.n. 21), pp. 4-5.

[29] **Pillans v. Van Mierop** (1765)3 Burr. 1663; **Mason v. Hunt** (1779) 1 Doug. 297; **Russel v. Lanstaffe** (1780)2 Doig. 514.

century later;[31] it was then very obvious that credits were common and in general use.[32] It may be then assumed that English merchants have used them for at least 300 years.

In the USA the first case on LCs was decided earlier than the first case in England in 1841.[33] There have been some cases at that time, showing that American bankers were familiar with credit operations;[34] but 40 years later a court stated that it could not find any other authorities dealing with LCs similar in all aspects to the case before it.[35] Hence, legal issues of open LCs were not yet settled by 1886.

1.2. The modern form of documentary letters of credit

Commercial letters of credit are modern instruments.[36] There is no accurate date to show when the modern practice of documentary credits began. From its functions one can assume that the use of letters of credit started from the first half of the 19th century; this assumption can be supported by a decision made at that time.[37] It is also suggested that the first developments probably took place from the

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[30] Davis, supra (f.n. 21), pp. 5-8.

[31] **Re Agra and Masterman's Bank** (1867)2 Ch. App. 391.

[32] **Banner v. Johnston** (1871)5 HL case 157; Davis, supra (f.n. 21), pp. 8-9.

[33] **Carnegie v. Morrison** (1841), 2 Metc. 381 (Mass.); Davis, supra (f.n. 21), pp. 9-10; see also Professor Karl N. Llewellyn's Commentary in Henry Harfield, **"Bank Credits and Acceptances"**, 5th ed., 1974, pp. 158-62 about the history of the letter of credit in the United States.

[34] **Russell v. Wiggin** (1842), 2 Story 213; 21 Fed. Cas. 68; **Brickhead v. Brown**, 5 Hill (N.Y.) 634 (1843), affirmed 2 Den. (N.Y.) 375 (1845).

[35] **Lafargue v. Harrison** (1886), 70 col. 380; 9 Pac. 259; Davis, supra (f.n. 21), pp. 9-10.

[36] Davis, supra (f.n. 21), at p. 10, said: *"It* is given not to the customer, but to some third person named by the customer, with whom the customer has commercial dealing, in order to carry through a particular transaction. In effect, the name and reputation of the banker are substituted for those of his customer."; McCullough, Burton V., **"LETTERS OF CREDIT"**, Matthew Bender, 1993 [hereinafter referred to as McCullough], pp. 1-18 (history of LCs).

[37] **Brickhead & Carlisle v. Brown**, supra (f.n. 34); Ellinger, supra (f.n. 22), pp. 28-35.

middle of the 19th century and later grew in Anglo-American and European trade.[38] For instance, a Finnish importer of Brazilian coffee used commercial LCs as early as 1840.[39]

A form of modern LCs can be found in a case decided in the early years of the 20th century;[40] its usage did not become general before the end of the Second World War,[41] when there was a lack of economic stability, with fluctuations of foreign exchange rates. After 1945 international trade accelerated and improvements were introduced in the capability of the system as secure for payments. Parallel to these developments, there has been a tendency to seek greater uniformity throughout the world.

2. SOURCES ON STANDARDS AND RULES OF LETTERS OF CREDIT

2.1. The Uniform Customs and Practice for Documentary Credits

Before 1933 some individual efforts were made by different countries[42] to put all aspects of the credit in a codified legal framework, but none of them had an international scope. In 1933, for the first time, by the efforts of the International Chamber of Commerce (ICC) at its 7th Congress held in Vienna, the first edition of **the Uniform Customs and Practice for Documentary Credit (UCP)** was published.[43] The ICC Congress was more successful in codifying issues related to

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[38] Kozolchyk, supra (f.n. 4), pp. 3-4.

[39] Kozolchyk, supra (f.n. 4), at p. 4, f.n. 3.

[40] Basse and Selve v. Bank of Australia (1904) 90 L.T. 618; Ellinger, supra (f.n. 22), pp. 35-6.

[41] Davis, supra (f.n. 21), p. 10.

[42] In 1920 the USA, 1923 Germany and Greece, 1924 France and Norway, 1925 Italy, Czechoslovakia, and Sweden, 1926 Argentine, 1928 Denmark, 1930 Netherlands; Ellinger, supra (f.n. 22), p. 37; Ellinger, E.P., "The Uniform Customs - their nature and the 1983 Revision", L.M.C.L.Q. 1984, pp. 578-606, at p. 578 [hereinafter referred to as the Uniform Customs].

[43] It was codified by the 7th Congress of the ICC, Brochure No. 82; it is necessary to mention that there was another attempt for international standardisation in 1929 Congress of the ICC, held in Amsterdam, but it was not

LCs than in promoting and establishing uniformity, as only certain European countries and some American banks accepted it.[44]

To achieve uniformity, to improve the capability of the UCP with regard to developments in methods of transportation and communication, the need to recognize appropriate documents, and the need to accept new types of credits such as standby letters of credit and deferred payment credits, the ICC revised the UCP provisions five times within 60 years between 1933-1993.[45]

2.2. English and Scottish law

In the United Kingdom (UK), the UCP, beside court cases relevant to LCs, is the only available source related to letters of credit.[46] There is no particular Act of Parliament regarding LCs.

2.3. American law

In the USA, the rules relating to letters of credit, beside court cases related to LCs, were codified in Article 5 of the Uniform Commercial Code (UCC).[47] It was

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successful; Ellinger, the Uniform Customs, ibid, p. 579; Eberth, Singapore Conferences 1990, supra (f.n. 7), p. 6.

[44] Eberth, Singapore Conferences 1990, supra (f.n. 7), p. 7; Davidson, Singapore Conferences 1990, supra (f.n. 10), p. 22.

[45] See ICC's Publications, Pub. No.151 (UCP 1951), Pub. No. 222 (UCP 1962), Pub. No. 290 (UCP 1974), Pub. No. 400 (UCP 1983), and Pub. No. 500 (UCP 1993); Buckley, Ross P., "The 1993 Revision of the Uniform Customs and Practice for Documentary Credits", Geo. Wash. J. Int'l L. & Econ., Vol. 28, 1995, pp. 265-313.

[46] The UK and Commonwealth banks accepted the UCP in 1962; Eberth, Singapore conferences 1990, supra (f.n. 7), p. 7; Davidson, Singapore Conferences 1990, supra (f.n. 10), at p. 22 said: "a revised version was adopted by the thirteenth congress of the ICC in Lisbon in 1951. Although this Revision extended the scope of application of the UCP in that they were now followed by banks in the USA, they remained limited in their application as the UK and Commonwealth banks were still not adherents (primarily because they felth the UCP provided for too much discretion in the banks with regard to the acceptance of shipping documents not expressly mentioned in the letter of credit). It was not until 11 years later, with a further revision of the UCP in 1962, that the British banks were induced to adhere."; Ellinger, EP, "Letter of credit", Horn, Norberth and Schmitthoff, CM, "Studies in International Economic Law, The Transactional Law of International Commercial Transactions", Kluwer, 1982, Vol. 2, pp. 241-732 [hereinafter referred to as Ellinger's paper in IEL 1982], at pp. 248-49; Editorial, "British banks accepted the ICC Uniform Customs for Commercial Credits", JBL, 1963, pp. 99-101; Megrah, Maurice, "A uniform code for documentary credit practice?", International and Comparative Law Quarterly, Vol. 8, January 1959, pp. 41-58, at pp. 52-55 (attitude of British banking) [hereinafter referred to as Megrah's paper 1959].

accepted by most of the states of the USA, but New York, Alabama, Missouri, and Arizona modified UCC before adoption.[48] In these states UCP 500 has also been applied.[49]

CONCLUSIONS

The documentary letters of credit system and its importance in international trade are so obvious as to be undeniable.[50] It is also clear that international provisions concerning the system are mainly customary in nature (UCP 500) and issues not covered by the UCP are covered by law (at national level) chosen by parties to LCs transactions. Therefore, at present the letters of credit system is a mixed system, namely, of international commercial custom and relevant national law. Would such a mixed system be adequate to provide a uniform law concerning LCs? If not, what would be a possible replacement for the present system?

With reference to the first question above, both parts of the letters of credit legal system (namely, UCP 500 and respective national law) have some limitations that undermine its efficiency as a sound platform for a movement towards preparing a unified and codified law of LCs. UCP 500 is limited to some aspects of LCs,

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[47] Other rules relate LCs are Articles 1072 to 1082 of Yugoslav Federal Code of Obligations of 1978 (its name might be changed as a result of recent events in former Yugoslavia) and Articles 367 to 377 of the new Kuwait Commercial Law that came into force on 25 February 1981; Eberth, Singapore Conferences 1990, supra (f.n. 7), pp. 5-6.

[48] Those states adopt sub-section 4 of Article 5-114; therefore, the bracket in the last sentence of sub-section 1 of Article 5-112 of the UCC should also be included; see also relevant discussion about UCC later; "Uniform Commercial Code", The American Institute, National Conference of Commissioners on Uniform States Laws, 1972 Official Text, with comments and appendix showing 1972 changes, pp. 417-43 [hereinafter referred to as UCC]; Mccullough, supra (f.n. 36), at ss 2.05[1], sub-paragraph [e] it is said: "New York, Alabama, Arizona, and Missouri have adopted a nonuniform amendment to Article 5. It reads as follows: "Unless otherwise agreed, this Article 5 does not apply to a letter of credit or a credit if by its terms or by agreement, course of dealing or usage of trade such letter of credit or credit is subject in whole or in part to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the thirteenth or by subsequent Congress of the International Chamber of Commerce.""

[49] UCP 1951 was accepted by banks in the USA; Davidson, Singapore Conferences 1990, supra (f.n. 10), p. 22; for a comparison between Article 5 of the UCC and UCP 500 see below Chapter V.

[50] See discussion concerning history of LCs under present chapter above.

namely, customs and practices; less attention is paid to legal issues, e.g., fraud and bank's right of security (reasons for such a policy by the ICC are considered later.)[51] The ICC has no plans to change its policy regarding the UCP, and the last version of its provisions (UCP 500) uphold such a view. Another point concerning the UCP, from the angle of international law, is the question of the nature of provisions, namely, whether they are customary or contractual in nature. This point assumes importance in case of a dispute in the transaction between parties to a letter of credit contract where nothing precisely refers to the application of the UCP; if the UCP is accepted as an international custom, it automatically governs LCs in the absence of any agreement regarding the applicable law of the contract. By contrast, if the provisions are contractual in nature, as accepted by the ICC in Article 1 of UCP 500,[52] a different situation emerges, namely, the UCP is not automatically accepted as the applicable law of LCs unless it is precisely agreed upon. This issue and other points concerning shortcomings of the UCP (discussed later below), generate a serious doubt as to the effective role of its provisions at an international level in respect of the question under consideration.

As to the other part of the mixed system concerning LCs, namely, national law, several points should be noticed: Firstly, it becomes clear that the only exiting codified rule at national level concerning LCs is that of Article 5 of the UCC in the USA. Article 5 is not identical to UCP 500 (their differences are considered below later).[53] It is, however, important that parties to international LCs transactions take into consideration that Article 5 of the UCC is applied in most of the states of the USA except New York, Alabama, Missouri and Arizona; parties could face, therefore, regulations different from UCP 500 if the applicable law of their contract is not the law of one of the above mentioned USA states, or nothing is indicated within

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[51] See Chapter XI, Section B.3.3 (below).

[52] See ICC Pub. No. 500 and discussion concerning legal nature of UCP 500 in Section B.2, Chapter XI (below).

[53] See Chapter V (below).

their transaction precisely in respect of the UCP. Secondly, it is obvious that, generally speaking, in most cases the national law of one country is not identical with the national law of another country with different roots, possibly with different national interests. Such a situation can be traced even in countries sharing a common legal tradition, e.g., the UK and the USA.[54] With such a diversity of national laws, it is not surprising that parties to international LCs would possibly obtain different results for similar issues in different jurisdictions. Thirdly, as already stated above, is it reasonable that the international law of LCs, as an important instrument for payment in international trade, has been shaped by national law itself engineered for safeguarding national rather than international interests?[55]

In conclusion, for reasons pointed out above and elsewhere,[56] the law of LCs at international level is not unified; the rights and obligations of parties to such transactions are far from clarified. This may itself cause confusion and uncertainty between parties to international LCs. There is, therefore, marked need and practical interest for having an international unified and codified set of standards concerning LCs. As to the second question (pointed out earlier), namely, what would be a possible replacement for the present system, it is necessary to know more about the current system before considering a solution; therefore, questions related to letters of credit system (with particular reference to standby letters of credit (SLCs)), UCP 500, Article 5 of the UCC and legal issues related to LCs (common law perspective) are discussed in Chapters II-VIII.

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[54] For examples concerning distinctions between the English and American law see relevant discussions in Chapter VI and VII (below).

[55] For more details see relevant discussion (international convention v. international customs) in Section A.3, Chapter XI (below).

[56] For instance see chapter V, Section B (Comparison between Article 5 and UCP 500) below.

CHAPTER II

LETTERS OF CREDIT:

STRUCTURE AND PRINCIPLES

SECTION A: DEFINITION, FUNCTION AND OPERATION

1. DEFINITION

What is an LC as a concept? Is it a type of contract similar to a sale contract (with two parties) or a bill of exchange (a three party contract with no rule of independence)? Or, is the credit contract as a special type of arrangement with its own specific peculiarities, namely, a three party agreement, independent from its underlying contract(s)? A general view of the character of points related to credit arrangements is given below.

1.1. UCP 500

Regarding the meaning of a credit, UCP 500 provides that "Credit(s), mean any arrangement, however named or described, whereby a bank (the "Issuing Bank") acting at the request and on the instructions of a customer (the "Applicant") or on its own behalf, **(i)** is to make a payment to or to the order of a third party (the "Beneficiary"), or is to accept and pay bills of exchange (Draft(s) drawn by the Beneficiary, or **(ii)** authorises another bank to effect such a payment, or to accept and pay such bills of exchange (Draft(s)), or **(iii)** authorises another bank to negotiate, against stipulated document(s), provided that the same terms and conditions of the Credit are complied with."[1] According to this definition a letter of credit is a type of agreement belonging to the form of contract usually concluded between three parties; however, as pointed out above, Article 2 of UCP 500, by including the terms "on its own behalf", prepared the way for two parties LCs.[2]

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[1] Article 2 of UCP 500; for a similar definition see Section 5-103 of the UCC.

[2] Ellinger, E.P., "The Uniform Customs and Practice for Documentary Credits- the 1993 Revision", LMCLQ, part 3, August 1994, p. 377 [hereinafter referred to as Ellinger's article 1994], at p. 383 says: "[...] while the 1983 definition encompassed a letter of credit only where the bank issued it on behalf of its customer (the "applicant"), the new Article 2 covers credit opened by the issuing bank on its own behalf. Such credits are, for instance, used where a bank issues a standby credit in order to back a trasnaction in which it participates as principal."; Dolan, John F., "Weakening the letters of credit product: The new Uniform Customs and Practice for Documentary Credits", International Business Law Journal, No. 2, 1994, pp. 149-177 [hereinafter referred to as Dolan], at p. 168 regarding "two party credit" said: "Bankers are properly concerned with the development of new products. That concern is evident in Article 2 of UCP 500 where the Uniform Customs for the first time sanction the two party credit, that is, they permit a credit to issue when there is no bank customer. This provision enables banks to issue their obligations as letters of

Moreover, it is a type of conditional payment, in contrast to a bill of exchange or a promissory note, namely, against document(s) which are also included as a document of title.

1.2. English law

In English law there is no comprehensive definition of the credit; nevertheless, its character has been described through court cases. For example, Scrutton, L.J., in **Guaranty Trust Co. v. Hannay & Co.**[3] explained the operation of the documentary credit.[4] Rowlatt, J., in **Urquhart Lindsay & Co. Ltd. v. The Eastern Bank Ltd.**,[5] tried to give a general definition for the LC. He said: "A credit is in general a contract for payment of money against documents of title to goods."[6]

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credit or to enhence their obligations with their own credits. The two party credit is, however something of a chimera. It looks like a letter of credit but does not operate like one; and the effect of it is to dilute the independence feature of credits that is so essential to the commercial utility of the letter of credit device."

[3] [1918]2 KB 623 (CA).

[4] Ibid., at p. 659 it is said:"The enormous volume of sales of produce by a vendor in one country to a purchaser in another has led to the creation of an equally great financial system intervening between vendor and purchaser and designed to enable commercial transactions to be carried out with the greatest money convenience to both parties. The vendor, to help the finance of his business, desires to get his purchase price as soon as possible after he has despatched the goods to his purchaser; with this object he draws a bill of exchange for the price, attaches to the draft the documents of carriage and insurance of the goods sold, and discounts the bill that is, sells the bill with documents attached to an exchange house. The vendor thus gets his money before the purchaser would, in the ordinary course, pay; the exchange house duly presents the bill for acceptance and has, until the bill is accepted, the security of a pledge of the documents attached and the goods they represents. The buyer, on the other hand, may not desire to pay the price till he has resold the goods. If the draft is drawn on him, the vendor or the exchange house may be willing to part with the documents of title till the acceptance given by the purchaser is met at maturity. But if the purchaser can arrange that a bank of high standing shall accept the draft, the exchange house may be willing to part with the documents on receiving the acceptance of the bank. The exchange house will then have the promise of the bank to pay, which, if in the form of the bill of exchange, is negotiable and can be discounted at once. The bank will have the documents of title as security for its liability on acceptance, and the purchaser can make arrangements to sell and deliver the goods. Before acceptance, the documents of title are the security, and an unaccepted bill without documents attached is not readily negotiable. After acceptance, the credit of the bank is the security."; Gutteridge, H.C., and Megrah, M., "The Law of Banker's Commercial Credit", London, 1984, 7th ed., pp. 2-3 [hereinafter referred to as Gutteridge]; G.A. Penn, A.M. Shea, and A. Arora, "The Law and Practice of International Banking", Banking Law, Vol. 2, London, Sweet & Maxwell, 1987, pp. 291-92 [hereinafter referred to as International Banking Law (Int.B.L.)].

[5] (1921) 27 Com. Cas. 124.

[6] Ibid., p. 128; Megrah, M., "The Uniform Customs and Practice for Documentary Credits, the 1962 Revision and after", Gilbert Lectures on Banking 1969, (Printed for King's College by Walter Bargery Ltd., London, S.E. 1), p. 4 [hereinafter referred to as Megrah]; see also International Banking Law, supra (f.n. 4),

As a distinction between letters of credit and bills of exchange, it has been said: "A bill of exchange must be an unconditional order, and any agreement between the parties to it that the order shall be conditional causes the document to cease to be a bill of exchange. But a commercial letter of credit may be, and often is, a conditional promise. The importation of a condition does not render the instrument any less a letter of credit. What is all important is that there shall be a promise of reimbursement by the giver of the letter. The terms attached to that promise are a matter for agreement between the parties."[7]

2. FUNCTION

The most important function of the documentary credit system is to facilitate payment against a document of title serving as a "constructive delivery" in international trade. Lord Wright in **T.D. Bailey, Son and Co. v. Ross T. Smyth & Co. Ltd.**,[8] described the function of a banker's commercial credits as: "The general course of international commerce involves the practice of raising money on the documents so as to bridge the period between shipment and the time of obtaining payment against documents." Devlin, J., in **Midland Bank Ltd. v. Seymour**,[9] said the effect of the letter of credit is that the seller/beneficiary has obtained a guarantee from a person who is solvent that, if he carries out his part of contract, he will

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p. 290, para. 13.01, in which documentary credit was described in terms as follows: "A commercial letter of credit may be said to be an undertaking by a bank to pay a sum of money to the person in whose favour the credit is issued, or to accept or purchase a bill of exchange drawn or held by that person. The bank's undertaking is usually conditional on the presentation of certain specified documents to the bank showing that the goods described in the credit have been despatched to the beneficiary."; Harfield, H., **"Bank Credits and Acceptances"**, 5th ed., 1974 [hereinafter referred to as Harfield], at pp. 3-4 said: "Credit is made up of three elements: the acceptance of a duty by an obligor; the presumed ability of the obligor to perform that duty; and the availability of social sanctions, in the form of law, to compel performance or a compensatory substitute for performance. The combination of these elements is credit and it is essential building block upon which they be classified by duration, such as short, medium or large term credit; or by function, such as commercial, customer, construction, or working capital credit; or by form, such as secured or unsecured credit; or by character of the creditor, such as trade or bank credit."

[7] Davis, A.G., **"The law relating to commercial letters of credit"**, London, 3rd ed., 1963 [hereinafter referred to as Davis], pp. 13-14.

[8] (1940)56 TLR 825, p. 828.

[9] [1955]2 Ll.L.R. 147, p. 165.

receive the purchase price. Professor Kozolchyk has described the advantage of a letter of credit in worldwide usage not only as a payment instrument, but also as a type of payment against documents of title. He said: "With the increase in international trade since the end of the First World War, it is not surprising in the light of these advantages, that commercial letter of credit gained worldwide acceptance, not only for the financing of international sales, but also as a means of payment in non-title passing transactions."[10]

3. OPERATION

A letter of credit originates in a sale contract; and the duty of arrangement rests on the buyer/applicant for the credit.[11] The operation of "opening of the credit", "communication to the beneficiary", "presentation of documents", and "acceptance and payment" involve several stages.[12] Firstly, the applicant for the credit (usually the buyer) makes a formal application (which is called "letter of request")[13] to his

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[10] Kozolchyk, Boris, **"Letter of Credit"**, 9 International Encyclopedia of Comparative Law, Chapter 5, 1979 [hereinafter referred to as Kozolchyk], p. 7 (What is the meaning of "non-title passing transactions"?); see also p. 27, sec. 45 of the same reference, where the same writer said: "The commercial letter of credit owes many of its characteristics in the Civil and Common law systems to the development of documentary sale [...]. Documentary sales are "title passing" transactions. Possession of the documents of title to the merchandise sold even though it is not the equivalent of absolute and unimpeachable ownership of the goods, is, in the case of disputes over the right to their immediate possession, decisive [...] however, commercial letters of credit are not used solely for the purpose of providing the buyer with assurance of the seller's compliance with the terms of the underlying documentary sale."; and also look at p. 25, col. 1 of above reference, in which it is said: ""Documentary" sales are such as CIF, FOB, FAS, and others."

[11] **Guaranty Trust Co. of New York v. Hannay** [1918] 2 KB 623, at p. 659; for further details see **"Guide to Documentary Credit Operations"**, ICC Publication No. 415.

[12] Kozolchyk, supra (f.n. 10), pp. 7-8; International Banking Law, supra (f.n. 53), p. 291; Ellinger, EP, **"Documentary credits and fraudulent documents"**, (Kee, Ho Peng, "Singapore Conferences on International Business Law, **Current Problems of International Trade Financing"**, Butterworths, 1990, 2nd Edition [hereinafter referred to as Singapore Conferences 1990]), pp. 139-87, at pp. 140-45 [hereinafter referred to as Ellinger's paper].

[13] Davis, supra (f.n. 7), at p. 16 describes the contention of a "letter of request" by saying that: "In this document a buyer will request the bankers to issue a letter of credit in favour of B. He will state what documents must be delivered to the bankers before they honour B's drafts. He may request that the opening of the credit be advised through the banker's agents [...]. After the terms of request, A's obligations towards the bankers are stated. These are, broadly, an undertaking to reimburse the bankers for all payments they may make under the letter of credit subsequently to be issued, to pay freight and landing charges, to pay the bankers' commission, and to allow the bankers to hold the goods, or the documents of title to them, as security for their advances, until such time as A shall reimburse the bankers what they have paid. There is of course nothing to prevent the bankers from acting upon a verbal request to issue the credit; but any bankers

bank, usually in his country, to open a letter of credit for him. That letter of request contains details of the terms of the credit contract between the bank and the applicant and plays an important role if a conflict arises between the parties. When the banker accepts the buyer's application, the contract is completed between the bank and its client.

As a second step the issuing bank approves the credit directly to the beneficiary (usually the seller), or may ask another bank, as an intermediary bank, to do this, either advising the beneficiary (as an "advising bank"), or adding its confirmation (as a "confirming bank"). At the next stage, upon receipt of the credit the beneficiary/ seller is guaranteed that if he carries out his duties under the sale contract the payment will be secured and credited to him. By tendering the proper documents the seller/ beneficiary is then entitled to obtain the purchase price. However, when the payment is made by an intermediary bank, the presented documents must be forwarded to the issuing bank to claim reimbursement.

Finally, the issuing bank passes all documents to its client. Nevertheless, if the buyer cannot repay his debt, the bank is entitled to exercise its right of sale under security measures usually granted by the client.[14]

SECTION B: PRINCIPLES APPLIED TO DOCUMENTARY CREDITS

1. THE PRINCIPLE OF STRICT COMPLIANCE

In a banker's commercial letter of credit operations it is accepted as a general rule that contracting parties are concerned with the documents, not with the goods.[15] Therefore, documents and their compliance with the terms and conditions

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who did so would be acting unwisely, for the letter of request is the document which sets out in detail the terms of the contract between A and the bankers, and in the event of subsequent disputes, it is essential that, whatever the interpretation of the terms themselves should be definite and not a matter of oral, and probably conflicting, evidence [...]."; see also Gutteridge, supra (f.n. 4), pp. 4-5.

[14] Lloyds Bank Ltd. v. Bank of America Trust & Saving Association [1938]2 KB 147; see also discussion related to the bank's right of security under letters of credit in Chapter VIII.

[15] Harfield, supra (f.n. 6), p. 71 and f.n. 1; see also Article 4 of UCP 1993 (ICC Publication No. 500); Ellinger, EP, "Letter of credit", Horn, Norberth and Schmitthoff, CM, "Studies in International Economic Law, The Transactional Law of International Commercial Transactions", Kluwer, 1982, Vol. 2, pp. 241-273 [hereinafter referred to as Ellinger's paper in IEL 1982], p. 260.

of the credit or the principal' s mandate play an important role in the credit system in accordance with the doctrine of strict compliance.

The concept of the doctrine

Article 4 of the UCP 500 provides: "In a Credit operation all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate." As a result of such a provision bank(s) undertake to examine with reasonable care and in due time all documents required under the credit agreement and presented by the beneficiary of the credit. If, however, documents do not comply with the credit's conditions, then bank(s) must consider, on the basis of the documents alone, whether they should be accepted or rejected.[16]

There are reasons, from the banker's point of view, for accepting and applying such a rule to credit transactions. First of all, a banker (the issuing bank or the correspondent bank, as the case may be) is a special agent with limited authority to act in accordance with the principal's instructions. If a bank acts outside a mandate, it loses its right of recourse against the principal. Moreover, it should be noted that a bank is dealing with banking business and finance, not goods. Secondly, a bank may not have sufficient knowledge or expertise in the usage and practice specific to a trade; even if it is capable of having expertise, it usually does not wish to engage in any other (non-banking) areas of transaction and would prefer to remain solely in banking.

This doctrine has been approved by English courts. In **Equitable Trust Company of New York v. Dawson Partners Ltd.**,[17] Lord Sumner defined it in the following terms: "It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it

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[16] Articles 13 and 14 of UCP 500; and also appendix 1 for Sections 5-109 (1)(c) & (2), 5-112 & 112 (1)(a), 5-113, and 5-114 (1) of the UCC; Sarna, L., "Letters of Credit, the law and current practice", 2nd ed., 1986, pp. 73-87 [hereinafter referred to as Sarna]; for more details concerning the principle of strict compliance see relevant discussion in Chapter VI (below).

[17] (1927) 27 Ll.L.R. 49; Kozolchyk, supra (f.n. 10), p. 71, para. 140 and p. 77, para. 147.1.

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 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."[18]

Does the above decision mean that even small and unimportant discrepancies may put an end to a credit contract? According to one writer, that is not a correct interpretation of the decision. He said: "It is not intended that any discrepancy, however, trifling, would invalidate the promise in the credit."[19] Another author has pointed out that from a practical point of view it is not possible to apply that rule in a strict and literal manner. He said: "Nevertheless there is an economic if not a physical limit to the diligence required from a bank when checking formal or apparent regularity. As stated by an experienced banker, if an absolutely perfect tender were the required standard, very few tenders would qualify."[20]

Furthermore, there are articles in the UCP 500 concerning the bank's obligation in examining documents, like Article 14.[21] There may even be situations

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[18] Ibid., p. 52 (emphasis added); Midland Bank Ltd. v. Seymour [1955] 2 Ll.L.R. 147 (Devlin J.); Kydon Compania Naviera S.A. v. National West minster Bank Ltd. (The Lena) [1981] 1 Ll.L.R. 68 (Parker, J., at p.75); Gian Singh & Co. Ltd. v. Banque de l'Indochine [1974] 1 W.L.R. 1234; Lamborn v. Lake Shore Banking and Trust Co. 196 App. Div. 504, 188 N.Y. Supp. 162, affirmed 231 N.Y. 616; Miller, J.B., "A casebook on bankers' commercial credits", p. 63 [hereinafter referred to as Miller]; Soproma S.P.A. v. Marine & Animal By Products Corp., [1966] 1 Ll.L.R. 367, at p. 387; as to the other points look at Schmitthoff, C.M., "Schmitthoff's Export Trade, The law and Practice of International Trade", 8th ed., 1986 [hereinafter referred to as Schmitthoff], pp. 343-44, particularly f.n. 41 at p. 344 (about difference between **Soproma** and the S.H. Rayner & Co. v. Hambros Bank Ltd. [1943] 1 K.B. 37, that stated McNair, J., rightly distinguished those cases from each other since the former is the subject of the UCP, but not the latter.

[19] Megrah, M., "Risk Aspects of the Irrevocable Documentary Credit", Arizona Law Review, Vol. 24, No. 2, 1982, pp. 255-66, p. 258.

[20] Kozolchyk, supra (f.n. 10), pp. 77-78 and f.n. 430.

[21] See ICC Publication No. 500 (1993).

in which the bank may seek to obtain the applicant's agreement for a waiver of the discrepancy(ies).[22] Similarly, it seems English courts have been reluctant to deal with abstract points and have tried to decide on the merits of each case and so have interpreted the principle of strict compliance in a more liberal manner. Otherwise, the principle may damage the credit operation. In **Golodetz & Co. Inc. v Czarnikow-Rionda Co. Inc. (The "GALATIA")**,[23] Donaldson, J. unreservedly accepted the view stated by Lord Sumner in **Hansson v. Hamel & Horely Ltd.**,[24] and said: "A tender of documents, properly read and understood, calls for further inquiry or are such as to invite litigation is clearly a bad tender. But the operative words are **"properly read and understood."** I fully accepted that the clause on this bill of lading makes it unusual, but properly read and understood it calls for no inquiry and it casts no doubt at all upon the fact that the goods were shipped in apparent good order and condition or upon protection which anyone is entitled to expect when taking up such a document whether as a purchaser or as a lender on the security of the bill."[25]

In **Banque de l' Indochine et Suez v. J.H. Rayner (Mincing Lane) Ltd.**,[26] Donaldson, M.R., accepted the view of Parker, J., on the linkage between presented

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[22] Article 14(c) of UCP 500 provides: "If the Issuing Bank determines that the documents appear on their face not to be in compliance with the terms and conditions of the Credit, it may be in its sole judgment approach the Applicant for a waiver of the discrepancy(ies). [...]"; Kozolchyk, supra (f.n. 10), p. 78 & f.n. 431; Ellinger, E.P., "Documentary letters of credit", Singapore, 1970 [hereinafter referred to as Ellinger], at pp. 281-82 said that in some cases demand for literal compliance, e.g., Dyer, J., in First National Bank of Lacon v. Bensley [2 f. 609, p. 614 (1880)], but general tendency in all important legal systems is to avoidance of a requirement of literal compliance.

[23] [1979]2 Ll.L.R. 450.

[24] [1922]2 A.C. 36, at p. 46 Lord Sumner stated: "When documents are to be taken up the buyer is entitled to documents which substantially confer protective rights throughout. He is not buying a litigation [...] These documents have to be handled by banks, they have to be taken or rejected promptly and without any opportunity for prolonged inquiry, they have to be such as can be re-tendered to sub-purchasers, and it is essential that they should so conform to the accustomed shipping documents as to be reasonably and readily fit to pass current in commerce."; Gutteridge, supra (f.n. 4), p. 123.

[25] **The Galatia**, supra (f.n. 23), at p. 456(1). [Emphasis added]

[26] [1983] All ER 468, [1982]2 Ll.L.R. 476, [1983]1 L.L.R. 228 (CA).

documents, and after thorough consideration stated: "There is in my judgment, a real distinction between an identification of "the goods", the subject matter of the transaction, and a description of the goods. The second sentence of art. 32(c) gives latitude in description, but not in identification [...]. But however general the description, the identification must, in my judgment be unequivocal. Linkage between documents is not, as such, necessary, provided that each directly or indirectly refers unequivocally to "the goods". This seems to me to be the proper and inevitable construction to place on art. 32(c) if the specified documents are to have any value at all."[27]

In conclusion, concerning the concept of the principle of strict compliance, the beneficiary of a credit should be aware of conditions stipulated in the credit so as to be able to tender proper and necessary documents. On the other hand, bankers should understand that only those conditions that are actually embodied in a credit are considered by the courts in relation to compliance. Nevertheless, the question is: what type of discrepancies are important to the law? This question is considered below later.[28]

2. DOCTRINE OF AUTONOMY

The doctrine of autonomy is a cornerstone in letters of credit and is defined in Article 3 of UCP 500.[29] It has been supported in many decided cases;[30] for

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[27] **Banque de l'Indochine et Suez v. J.H. Rayner (Mincing Lane) Ltd.**, [1983]1 Ll.L.R. 228 (CA), p. 233(1); Article 32(c) of UCP 290 (1974), referred in case above was similar to Article 41(c) of UCP 400 (1983) and Article 37(c) of UCP 500 (1993).

[28] See Chapter VI for more details about the principle of strict compliance.

[29] Article 3 of UCP 500 provides: "a. Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such a contract(s) is included in the credit. Consequently, the undertaking of a bank to pay, accept and pay Draft(s) or negotiate and/or to fulfil any other obligation under the Credit, is not subject to claims or defences by the Applicant resulting from his relationships with the issuing Bank or the Beneficiary.

b. A Beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the Applicant and the Issuing Bank."; it is similar to Articles 3 and 6 of UCP 400; see also appendix I for Section 5-109 (1)(a) and 5-114 (1) of the UCC.

[30] See Chapter VII; Ellinger's paper, Singapore Conferences 1990, supra (f.n. 12), p. 151; Schmitthoff, CM, **"Conflict of laws issues relating to letters of credit: An English perspective"**, Singapore Conferences

instance, in **Power Curber International Ltd. v. National Bank of Kuwait**,[31] where the plaintiff (an American Co.) brought an action against the defendant (an issuing bank placed in Kuwait) for rejecting payment of an irrevocable credit in England (since that bank had a registered address in London) the Court of Appeal gave support to the plaintiffs' argument. Lord Denning, M.R., in support of the above doctrine said: "It is vital that every bank which issues a letter of credit honour its obligations. The bank is in no way concerned with any dispute that the buyer may have with the seller. The buyer may say that the goods are not up to contract. Nevertheless the bank must honour its obligations. The buyer may say that he has a cross-claim in a large amount. Still the bank must honour its obligations. A letter of credit is like a bill of exchange given for the price of the goods. It ranks as cash and must be honoured. No set off or counterclaim is allowed to detract from it."[32]

There is an exception, however, accepted by English courts as to the doctrine of autonomy, namely, if a fraud is committed by the beneficiary or such a crime was committed by a third party but the beneficiary is aware of it. The issue of fraud and other relevant points related to the doctrine of autonomy are discussed later below.[33]

1990, supra (f.n. 12), pp. 103-114, at p. 105 (the principle of autonomy of the letters of credit) [hereinafter referred to as Schmitthoff's paper].

[31] [1981] 1 W.L.R. 1233; Schmitthoff, supra (f.n. 18), p. 341 & f.n. 25 (for referred cases).

[32] Ibid., p. 1241; the credit arrangement is also independent from the contract between the buyer and the issuing bank dealing with furnishing a credit in favour of the seller/ beneficiary. This view found support in **North American Manufacturers Export Associates, Inc. v. Chase National Bank of City of New York**, 77 F. Supp. 55 (1948), where the plaintiffs' allegation was that the presented documents, although they did not comply with the terms and conditions of the credit, were in accordance with terms which were agreed by the buyer and the defendant (the issuing bank) in an amendment of the credit. Therefore, they should be regarded as good presentation under the credit contract. Medina, J., refused to accept that contention and held that: "If the bank, in the formulation of the letter of amendment, failed to follow the instructions of its customer [...] this would not involve the bank in any responsibility to plaintiff. The letter of credit, either in its original form or as amended must control."

[33] See Section B, Chapter VII (below).

CONCLUSIONS

The letters of credit system offers a method of payment through a mediator (bank(s)) and provides a good assurance for both seller/beneficiary and buyer/applicant in an international sale transaction. LCs are used in different forms, namely, revocable credit, irrevocable credit and irrevocable/confirmed credit; the last one is the safest form of credit used in international trade including four parties (the applicant for a credit, the issuing bank, the confirming bank, and the beneficiary).[34] Moreover, it is obvious that a letter of credit is a type of conditional payment, namely, against document(s) including a document of title (bills of lading) and serving as a means of payment in non-title passing transactions.[35] This is the most important contribution of the documentary credit system in international trade.

Two important principles are operative for LCs, namely the **doctrine of autonomy** and the **principle of strict compliance**. Most questions about documentary credit operations are related to these principles. On the one hand the applicant for the credit may try to adopt a narrow interpretation of the rule of compliance, inter alia, by raising exceptions to the independent nature of LCs, and attempt to stop payment in undesirable circumstances related to the credit arrangement.[36] The beneficiary of the credit, by contrast, may invoke the doctrine of autonomy in order to safeguard his rights within the system.[37] This may in some cases develop into an ongoing argument between the parties to the credit contract, making it difficult for the bank to decide which argument is correct, particularly where the subject for dispute is a legal issue such as fraud.

The importance of the above mentioned principles for providing a reasonable balance between the applicant and the beneficiary in a credit transaction and the

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[34] See Articles 2 (meaning of credit), 6-9 (revocable, irrevocable credits) and 9(b) (irrevocable and confirmed credit) of UCP 500, in ICC Pub. No. 500.

[35] See Article 4, and 20-38 concerning the role and different types of documents used in LCs.

[36] For legal issues related to the principle of strict compliance see Chapter VI (below).

[37] See below Chapter VII.

sensitivity of issues related to them (which are legal in nature) are the main reason for the present status of law of LCs at international level. The UCP 500 provides only some general provisions concerning these principles (Articles 3 and 4), but the rest of important issues (such as their real concepts and exceptions) have not been codified at the international level and have been left to be decided by courts in different jurisdictions. As a result the same issue could be interpreted differently under different national laws.

It is true that there would be issues treated similarly in different jurisdictions; and, it is also true that providing a set of international standards to cover all details relevant to one issue would be impractical. However, this does not justify to discourage any attempt towards harmonisation and unification of law of LCs internationally. There is a real and practical need, as pointed out elsewhere,[38] that the law of LCs to be unified and codified, as much as it is possible worldwide; parties to an international letter of credit transactions would prefer to face a set of international standards rather than different national laws concerning LCs. Moreover, recent activities by international organisations like UNCITRAL for preparing an international convention concerning SLCs and Bank Guarantees (BGs), are examples which confirm such a need for having possibly unified and codified international rules concerning the legal as well as practical aspects of LCs.[39] In that respect, the next chapter of the present study deals with SLCs in more detail in order to establish whether a standby letter of credit is a type of LC; and if so, the impact of the recent UNCITRAL's activities upon the law of LCs at the international level.

[38] For more details see relevant discussion in Section B, Chapter X (below).

[39] See Section A.2.1.3 in Chapter III and Section A.2 in Chapter X (below).

CHAPTER III

STANDBY LETTERS OF CREDIT

(SLCs)

SECTION A: INTRODUCTION AND GENERAL BACKGROUND

1. INTRODUCTION

Standby letters of credit (SLCs) have been used in the USA for many years; they have been introduced for the first time under Articles 1 and 2 of the UCP 400 (1983) by the ICC; a similar policy has been followed in UCP 500 (1993). Since, as discussed below, UNCITRAL has begun a study related to SLCs, it is worth to consider the background, definition, function, classification, similarities of SLCs with and differences from the traditional LCs as well as bank guarantees (BGs) in order to find more about SLCs, their importance in international trade, and practical difficulties (like fraud) which may arise as a result of using them.

2. HISTORY AND GENERAL BACKGROUND

2.1. Historical background

2.1.1. Activities related to SLCs

A standby letter of credit is a new device essentially similar to the traditional commercial letter of credit, but it also involves some differences (discussed later). This type of credit originated in the USA after the Second World War because of the prohibition of the Federal and State Banking Law on national banks acting as guarantors or surety for the obligations of third parties. This prohibition concerns only domestic banks, but a bank's branches outside the USA are allowed to give service as guarantors or sureties.[1] In English commercial law a similar

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[1] Schmitthoff, C.M., "Schmitthoff's Export Trade, The law and Practice of International Trade", 8th ed., 1986 [hereinafter referred to as Schmitthoff], p. 364; Naegele, T.D., "Unsound Banking Practices: Standby letters of credit and other bank guarantees", Feb. 14, 1975, of Senate Comm. on Banking, Housing & Urban Affairs, 94th Congress, 1st Sess., Compendium of major issues in Bank regulation 647, pp. 621-85, at p. 627; UNCITRAL, "B. Stand-by letters of credit and guarantees: report of the Secretary-General (A/CN.9/301) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XIX, 1988, pp. 46-61 [hereinafter referred to as UNCITRAL Y.B., 1988], at p. 47, para. 4 pointed out: "Stand-by letters of credit, which are issued primarily by banks in the United States of America and less frequently in some other countries, thus serve the same purpose as do bonds or guarantees used in most countries."; Ellinger, EP, "Letter of credit", Horn, Norberth and Schmitthoff, CM, "Studies in International Economic Law, The Transactional Law of International Commercial Transactions", Kluwer, 1982, Vol. 2, pp. 241-273 [hereinafter referred to as Ellinger's paper in IEL 1982], p. 247.

mechanism, generally called bonds exists, but in contrast to SLCs, it is said that the bond's roots go back to the 14th century. They were used in cases of debt and for loans in the 16th century.[2]

For many years no provision was made for SLCs under UCP. Nevertheless, in UCP 400 (1983) reference to such a credit was included in Articles 1 and 2; UCP 500 is similar to UCP 400 in this respect. Although there is in the USA no reference to SLCs in Article 5 of the Uniform Commercial Code (UCC), there seems no differentiation between LCs and SLCs was accepted by the draftsmen of the code; so Article 5 of UCC applies consequently to both types of credit.[3]

2.1.2. The ICC's activities regarding bank guarantees (BGs)

The ICC Commission on Banking and Commercial Practice worked for more than a decade (1965-78) to prepare recommendations for standardizing terms and regulations concerning guarantees agreements. The final text of the Uniform Rules for Contract Guarantees (URCG) was adopted by the ICC on 20 June 1978.[4] Although the UCRG has prepared a background for uniformity concerning the guarantee contract, several shortcomings and disadvantages have meant that the URCG has not found popularity among traders.[5] Noticing it the ICC

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[2] Ventris, F.M., **"Banker's Documentary Credits"**, Lloyd's of London press Ltd., 1983, 2nd ed., p. 134 [hereinafter referred to as Ventris].

[3] Banks, J.L., **"The standby letter of credit: what it is and how to use it"**, Montana Law Review, 45 n. 1, pp. 71-86, Winter 1984, p. 74, par. 1 [hereinafter referred to as Banks].

[4] ICC Pub. No. 325; the provisions covers three types of guarantee (namely tender guarantees, repayment guarantees, and performance guarantees) which are issued by a seller or supplier of services; and it is applicable if adopted by contracting parties in their transaction; see Marshall, Wolfgang Freiherr von, **"Recent developments in the field of standby letters of credit, bank guarantees and performance bonds"**, Chinkin, C.M. and Davidson, P.J., **"Current problems of international trade financing"**, Singapore Conferences on International Business Law, Malaya Law review and Butterworth & Co., 1983 [hereinafter referred to as Singapore Conferences 1983], pp. 261-82, at pp. 261-2 [hereinafter referred to as Marshall]; see also paragraph 1 of Article 1 of the URCG which provides that, "The application of the Rules is voluntary. This means that it must be evidenced by a specific statement in the guarantee document itself, that the guarantee is "subject to the Uniform rules for Tender, Performance and repayment Guarantees ("Contract Guarantees") of the International Chamber of Commerce (Publication No. 325)"."

[5] Those difficulties are as follows: **1. Terminology**- Article 1, para. 1 of the URCG employs a general term, "contract guarantees" which includes those guarantees which are subject to the provisions (namely tender, performance and repayment guarantees). A question may arise whether such a term covers the standby letter of credit. It is suggested that the language adopted in the introduction to the rules by emphasizing that "the

has established a new Working Party to prepare a publication on the standby letter of credit, guarantees, and similar undertakings to pay "on first demand" of a beneficiary.[6]

2.1.3. UNCITRAL's activities related to SLCs and BGs

The UN Commission on International Trade Law **(UNCITRAL)** decided to include in its work programme, as a priority, the topic of the standby letters of credit at its eleventh session in 1978.[7] A similar decision was made in 1982 by the

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link between the performance of the guarantor's undertaking and "default by the principal"" (Article 2, Sec.d), it is doutful that there is any room for application of the URCG to the SLC. It is said: "The principles which govern the rights and duties of the various parties in a commercial letter of credit would be seriously weakened if the obligation to pay depended on consideration of actual default." [See Marshall, ibid., p. 272]; another writer supported that argument by saying that the view adopted in the URCG is "In sharp contrast to the United States regulatory policy on standbys and to the UCP principle of abstraction (as applicable to standbys since the 1983 UCP Revision)." [See Kozolchyk, Boris, **"Bank guarantees and letters of credit: time for a return to the fold"**, University of Pennsylvania, Journal of International Business Law, Vol. 11.1, 1989, pp. 1-79, at pp. 11-12 [hereinafter referred to as Kozolchyk's bank guarantees].

2. Shortcoming as to the simple or first demand guarantee- In the introduction to the URCG it was said that, "by establishing the principle of the need to justify a claim under a guarantee [...] it has not been found advisable to make provision for so called simple or first demand guarantee, under which claims are payable without independent evidence of their validity." [See ICC Pub. No. 325, pp. 8-9]; the above view is illustrated in Article 9 of the URCG and because of the importance of the matter in discussion the Article is reproduced below: "**Article 9**- It has been pointed out in the introduction that the concepts on which these Rules are based are: **a.** that a claim should only be made, and honored, if the beneficiary has a legal right to make the claim based on a failure of the principal to perform, or correctly to perform the underlying contract; **b.** that the claim should be justified by production of some form of "evidence" of such default by the principal. It is reasonable to expect the nature and the form of such "evidence" to be based in the guarantee. The parties to the contract can very well specify the necessary documentary evidence ("documentation") in the contract, and it can then be stated in the guarantee, for example, a certificate, possibly in a stated form, given by a named party such as an accountant, surveyor, arbitrator or other person. (As indicated in discussion of Article 3 above, it should be of such a nature as to permit the guarantor himself to verify whether or not the documentation submitted is that called for.) If, however, the guarantee is silent- as are guarantees payable on first or simple demand- Article 9 speaks and says that documentation as stated therein must be submitted. For the purpose of the beneficiary's declaration "that the principal's tender has been accepted" (paragraph (a) of this Article) the acceptance must, of course, have been unconditional. Also, the "court decision or an arbitral award" referred to in paragraph (b) of this Article means a decision or an award given in proceedings between the beneficiary and the principal."; the conditions required by the article clearly indicate difficulties which may arise in applying the first demand guarantee under the URCG; and because of that the provisions has not found enough support among traders.

[6] Marshall, Singapore Conferences 1983, supra (f.n. 4), p. 272; Kozolchyk's bank guarantees, ibid., pp. 12-3 and for other points concern to the URCG look atthe same reference, pp. 58-69; Arthur Loke, **"Standby credits and performance bonds: the lesson of the Iranian exprience"**, Singapore Conferences 1983, supra (f.n. 4), pp. 283-96, at pp. 286-7 [hereinafter referred to as Loke].

[7] UNCITRAL Y.B., 1988, supra (f.n. 1), at p. 48, para. 8 said: ""Stand-by letters of credit" to be studied in conjunction with the International Chamber of Commerce" (A/33/17, paras. 67(c)(ii)a, 68 and 69)."; Guest, AG, **"Current work of the United Nations Commission on International Trade Law"**, Singapore

Commission regarding traditional letters of credit and their legal problems.[8] As a result, the General Secretary of UNCITRAL submitted a preliminary study on standby letters of credit (A/CN.9/163), in 1988;[9] a Working Group (WG) was established in 1989 for considering issues related to standby letters of credit (SLCs)[10] and bank guarantees (BGs)[11] in order to study the needs as well as the readiness of international business communities, government and non-government international organisations for an effort towards a **uniform law (UL)**.[12] In the same year, the Commission decided that the situation was

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conferences 1990, supra (f.n. 4), pp. 90-100, pp. 99-100 (standby credits) [hereinafter referred to as Guest]; Bergsten, Eric E., "A new Regime for International Independent Guarantees and Stand-by Letters of Credit: The UNCITRAL Draft Convention on Guaranty Letters", The International Lawyer, Vol. 27, No. 4, Winter 1993, pp. 859-879 [hereinafter referred to as Bergsten].

[8] UNCITRAL Y.B., 1988, supra (f.n. 1), at p. 47, para. 1 stated: "The Commission at its fifteenth session in 1982 decided to request the Secretary-General to submit to a future session of the Commission a study on letters of credit and their operation in order to identify legal problems arising from their use, especially in connection with contracts other than those for the sale of goods (A/37/17, para. 112). The proposal for such a study was made on the occasion of the Commision's consideration of the work of the international Chamber of Commerce (ICC) then in progress to revise the 1974 version of the Uniform Customs and Practice for Documentary Credits(UCP)."; it is pointed out in the same reference that, "This kind of assistance was rendered in connection with ICC's efforts to prepare uniform rules on contract guaratees and its work of preparing the 1974 and 1983 revisions of UCP." [UNCITRAL Y.B., 1988, supra (f.n. 1), p. 48, para. 9]

[9] UNCITRAL Y.B., 1988, supra (f.n. 1), p. 48, para. 8.

[10] "While the traditional documentary credit provides the seller (or similar performing party) with a secure mechanism for payment by the buyer, the stand-by letter of credit is a default instrument in that it covers the risk of non-performance or defective performance by a contractor, supplier or other obligor." [UNCITRAL Y.B., 1988, supra (f.n. 1), p. 47, para. 3]

[11] UNCITRAL Y.B., 1988, supra (f.n. 1), at p. 47, para. 4 said: "Stand-by letters of credit, which are issued primarily by banks in the United States of America and less frequently in some other countries, thus serve the same purpose as do bonds or guaratees used in most countries."; and also at p. 47, para. 5 of the same reference pointed out: "Stand-by letters of credit and guarantees (or bonds), while functionally equivalent or at least similar, differ as to their legal treatment for the formal reason that the stand-by letter of credit is a letter of credit. Thus, the laws and rules governing documentary letters of credit would generally be applicable to stand-by letters of credit."; regarding the ICC's activities see p. 48, para 11 of the above reference where it is said: "In 1978, ICC adopted and published its "Uniform Rules on Contract Guarantees" (ICC Publication No. 325), which do not recognize first demand guarantees."

[12] UNCITRAL, "IV. STAND-BY LETTERS OF CREDIT AND GUARANTEES. A. Report of the Working Group on International Contract Practices on the work of its twelfth session (Vienna, 21-30 November 1988) (A/CN.9/316) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XX, 1989, pp. 183-200 [hereinafter referred to as UNCITRAL Y.B., 1989], at p. 183, para. 1 said: "At its twenty-first session, the Commision considered the report of the Secretary-General on stand-by letters of credit and guarantees (A/CN.9/301). Agreeing with the conclusion of the

sufficiently mature to begin a more detailed study for the preparation of a UL affecting SLCs and BGs.[13] The Commission's view was confirmed later by the WG.[14]

In the present research study there is no intention to consider details of the discussions of the UNCITRAL WG; these discussions lie outside the purpose of the present thesis; however, those parts of UNCITRAL's study somehow connected to LCs and having a particular impact on the documentary letters of credit rules and provisions, are marginally included in the present study, for

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report that a greater degree of certainty and uniformity was desirable, the Commision noted with approval the suggestion in the report that future work could be carried out in two stages, the first relating to contractual rules or model terms and the second pertaining to statutory law."

[13] See UNCITRAL Y.B., 1988, supra (f.n. 1), at p. 58, para. 97 said: "[...] since there are some important matters that remain subject to mandatory law and may not be regulated by the agreement of the parties, including by uniform rules incorporated into the agreement, it may be desireable to strive for greater **uniformity at the statutory level**. For example, uniform rules may contain provisions consistent with the independent nature of a guarantee, but the final and full recognition of such independence depends on its acceptance by the law."; it is also stated: "Probably the most important topic for a uniform law would be the vexing problem for **frudulent or abusive calls and appropriate court measures**. The problem, which was at the heart of a previous note of the secretariat on stand-by letters of credit (A/CN.9/163), cannot effectively be dealt with by contractual rules. Without understanding the difficulties of agreeing on the scope of the fruad exception and of supportive court measures, it is submitted that at least an attempt in this direction might be made. Based on suggestions by practitioners, it is further submitted that it would be useful to consider **whether a uniform law might cover not only guarantee and stsnd-by letters of credit, but also traditional letters of credit**. While the extent and the circumstances of fraud in documentary credits may be different, the legal problem is essentially the same and it can not be solved by contractual rules (i.e. UCP). [...] Other topics that could be addressed in any future uniform law are, for example, **court jurisdiction, arbitration and the applicable law**. A uniform law could help to overcome the present disparity in matters that are goverened by mandatory provisions of law. It could also come to the aid of parties who did not settle other questions in their guarantee agreement or letter of credit. Finally, a uniform law could and should guarantee the parties' freedom and give full effect to their agreement, including a reference to UCP or any uniform rules on guarantees that might be adopted. If the Commission were to pursue the idea of a uniform law, it may wish to request that secretariat to prepare a study, in consultation with ICC, on the possible features and the issues that might appropriately be covered. The study might also suggest whether a **model law** or **convention** would be preferable to a uniform law, or that issue might be deffered to a later time. " [UNCITRAL Y.B., 1988, supra (f.n. 1), at p. 58, paras. 98 and 99]

[14] "The Working Group recalled the preliminary deliberations by the Commision as reflected in the report on the twenty-first session: "While some doubts were expressed as to the practical need and usefulness of such a uniform law, there was wide support for the view that successful work in this direction was desirable in view of the practical problems that could only be dealt with at the statutory level. The Commission was aware of the difficulties inherent in such an effort relating to fundamental concepts of law, such as fraud or similar grounds for objections, and touching upon procedural matters. Nevertheless, it was felt that, in view of desirability of legal uniformity and certainty, a serious effort should be made." [UNCITRAL Y.B., 1989, supra (f.n. 12), p. 194-195, para. 122]

instance, interest devoted to SLCs and their relevant issues and as such accepted as a matter for consideration by UNCITRAL.[15]

2.2. General background

2.2.1. Definition

A standby letter of credit[16] is an undertaking by a bank to make payment to a third party (the beneficiary of the credit) or to accept bills of exchange drawn by him. English law has tried to describe such a device in a series of decided cases. It is in general accepted that performance bonds/ guarantees are in principle similar to the traditional commercial letter of credit. For instance, Lord Denning, M.R., in **Edward Owen v. Barclays Bank International,**[17] expressly said that "The performance guarantee stands on a similar footing to a letter of credit."[18] The autonomous character of a performance guarantee/bond has been also noted in another case.[19]

In the USA there is no precise definition of the standby letter of credit in Article 5 of UCC; but in practice it has also been accepted that Article 5 applies to SLCs. However, SLCs are defined by The Federal Reserve Board and the Federal Deposit Insurance Corporation in the USA in the following terms: "Any letter of

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[15] See Section A in Chapter X for other points related to the UNCITRAL's activities.

[16] This type of credit was also called "guarantee letter of credit"; but this title was quickly changed because it was understood that the word "guarantee" was inappropriate term and might bearing in mind the prohibition of issuing guarantee inside the United States of America; Banks, supra (f.n. 3), p. 74, f.n. 20 and see also G.A. Penn, A.M. Shea, and A. Arora, "The Law and Practice of International Banking", Banking Law, Vol. 2, London, Sweet & Maxwell, 1987 [hereinafter referred to as International Banking Law (Int.B.L.)], at p. 287, f.n. 77.

[17] [1978] 1 All ER 976; [1978] 1 Ll.L.R. 166.

[18] See Lloyd's Report, head note of the case, col. 2; R.D. Harbottle v. Nat West, [1977] 2 All E.R. 862.

[19] Howe Richardson Scale Co. v. Plimex Corp., [1981] 1 Ll.L.R. 161, at p. 165, col. 2, Roskill, L.J., said: "The bank in principle, is in a position not to identical with very similar to the position of a bank which has opened a confirmed irrevocable letter of credit. Whether the obligation arises under a letter of credit or under a guarantee, the obligation of the bank is to perform that which is required to perform by that particular contract and that obligation does not in the ordinary way depend on the correct resolution of a dispute as to the sufficiency of performance by the seller to the buyer or by the buyer to the seller as the case may be under the sale and purchase contract."

credit which represents an obligation to the beneficiary on the part of the issuer, (1) to repay money borrowed by or advanced to or for the account of the account party, or (2) to make payment on account of any indebtedness undertaken by the account party, or (3) to make payment on account of any default by the account party in the performance of an obligation."[20] In Article 2 of UCP 500 a standby letter of credit is defined in a way similar to that of a letter of credit.[21]

2.2.2. Classification of standby letters of credit

Nowadays there are different types of SLCs or bonds in domestic and international trade practice. In one general classification SLCs or bonds are divided into "on demand" and "conditional". In another category the contractual obligations of the account party differ, for example as to performance bonds, or tender or bid bonds (described below).

2.2.2.1. On demand and conditional bonds

1. First demand bonds

This is a type of SLC/bond, also called a "suicide form" among bankers and traders; it is noteworthy as the most popular kind of bond among the issuers and beneficiaries of issued credits, because the rights and duties of the parties to a credit contract are therewith made clear and precise. Although in a first demand SLC the burden of proof is on the beneficiary, he has no great difficulty to prove the failure of the account party or the bank's customer, since such type of credit is payable on the beneficiary's first demand without any particular document(s) required to be presented (as proof for his allegation(s) or conditions for payment). Moreover, the bank's duty under such a credit is an absolute obligation and the bankers are obliged to honour the amount of the credit on demand by the beneficiary.[22]

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[20] Banks, supra (f.n. 3), p. 74, f.n. 21, Regulation H. 12 C.F.R. S.S. 208. 7(d), 32.2(e) 337.2(a), (1983).

[21] See ICC Publication No. 500.

[22] See **Harbottle** case, supra (f.n. 18); Int. B.L., supra (f.n. 16), p. 268; G.A. Penn, "Performance Bond: Are bankers free from the under-lying contract?", L.M.C.L.Q., 1985, pp. 132-35 [hereinafter referred to as Penn].

2. Conditional bonds

In the case of conditional bonds the mechanism is similar to that used for a traditional letter of credit, i.e., the beneficiary has to prove the failure of the bank's client according to the terms of contract. In other words the bank must determine whether the customer's default is a breach of the contract or not. Of course, in most cases bankers are faced with the legal arguments of both parties; so, to avoid such a situation, most bankers insist on an arbitration clause being included in all conditional bonds.[23]

2.2.2.2. Other types of bonds

There are different sorts of bonds/guarantees which a bank's customer may ask for the beneficiary of the credit. They are:

1. Performance bonds

This kind of bond has been used for a long time by beneficiaries to protect themselves against default of the other parties in sale or construction contracts.[24]

2. Tender or bid bonds

In order to ensure the customer's signing of a bid contract, the other party to the contract (beneficiary bidder) usually requires tender/bid bonds. Unfortunately, fluctuation of market prices means that many customers try to avoid their contractual obligations, and the bidders are obliged to include additional costs in re-awarding the contract to another party. Therefore, the beneficiary bidder usually uses this mechanism, and this type of bond is usually issued for a period of 90 days at first instance, but because of lengthy negotiations they are nearly always unilaterally extended creating a common problem with this type of bonds.[25]

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[23] See Penn, ibid.; Int. B.L., supra (f.n. 16), pp. 268-70.

[24] According to statistic in construction industry the number of failures in completion the contract by contractors and number of insolvencies are very high. See for instance Williams, K.P., "Performance bonds: used and usefulness", L.M.C.L.Q., 1983, pp. 423-39, at p. 423, f.n. 1 [hereinafter referred to as Williams]; Int. B.L., supra (f.n. 16), pp. 263-65.

[25] Int. B.L., supra (f.n. 16), pp. 262-63; Williams, ibid., p. 423, f.n. 4.

3. Advanced payment bonds

The employer (buyer) usually pays to the other contracting party, particularly in construction contracts, a percentage of the contract price (usually 10 to 20 per cent) as an advance payment, in order to enable to commence work. Sometimes the employee (seller or contractor) fails to carry out his obligation. So, to safeguard his position, the employer requires an advanced payment bond.[26]

4. Retention money bonds

An employee contractor is usually, under the terms of contract, entitled to receive a percentage of the contract price after completion of his duty in each stage of the work. So when the contract is completed, the total amount of the contract price will have been paid by the employer. To safeguard the employer/ buyer's payment during the progress of the contract, a sort of device called a "release of retention money bond" is used. Such a bond puts the contractor/seller under an undertaking to return any money they have received from the employer/ buyer in case of failure to complete a contractual duty at each stage of the work.[27]

2.2.3. The mechanism of standby letters of credit

As described above, SLCs or bonds are one type of credit. So, like a traditional commercial letter of credit, a standby letter of credit is simply an engagement by an issuer, usually a bank, to honour drafts or demands for payment by the beneficiary under the terms of the credit contract. Moreover, it is a low cost system like the traditional commercial letter of credit.

Differences between SLCs or bonds and LCs arise from different purposes and duties included in the contract by both parties, and also from the documentation (explained below). As a matter of fact there is a great potential risk

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[26] Int. B. L., supra (f.n. 16), p. 265.

[27] Int. B.L., supra (f.n. 16), pp. 265-68; Williams, supra (f.n. 24), p. 423, f.n. 4; there are other types of bonds like labour and material bonds, maintanance period bonds; and also it is suggested that the bonds could be classified into "documentary" and "non-documentary" bonds, in order to mitigate the disadvantages of first demand bonds. It is suggested that there could be some cluse in the contract that the beneficiary of the credit is entitled to use the credit when he can show a good cause of action against the seller/contractor by giving documents, in support of his contention, to the bank; see also Int.B.L., supra (f.n. 16), pp. 270-71.

for both the issuing bank and its customer with respect to the "on demand" bonds. Therefore, there are some suggestions to mitigate the risk and safeguard the position of banks and their customers against the beneficiary. They are as follows:

1. "Counter indemnity" by the issuing bank

One solution suggested to support the issuing bank's position in the case of "on demand" bonds is "counter indemnities." It is clear that under English law the issuing bank is bound to make payment promptly, in the absence of fraud, when demand is made by the beneficiary. It means though, in English law, the issuers of the "first demand" bonds (issuing bank) are bound to make payment promptly when demand is made by the beneficiary of the credit but they are also entitled to obtain the amount of money paid, from their customers under a proper "counter-indemnity" clause.

The second method has been particularly devised in recent years for large contracts involving always large bonds. Individual banks could not afford such a bond and have preferred to syndicate it. Therewith the risk is divided between several banks. This method of syndication is said to be no different in structure from a syndicate loan agreement, apart from the fact that the former is built on a first demand bond.[28]

2. Solutions for a bank's customer

Two suggestions may operate to mitigate the risk of on demand bonds and try to help the bank's customer (usually a seller or contractor); firstly by using the services of private insurance to insure the customer against the risk of losing his assets against unreasonable or unjustified demand for bonds; secondly by using the services provided by the Export Credit Guarantee Department (ECGD) in the United Kingdom. The ECGD provides schemes to support users of on demand bonds in case of unfair calling of bonds.[29]

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[28] Int.B.L., supra (f.n. 16), p. 283, f.n. 66.

[29] Int.B.L., supra (f.n. 16), pp. 285-86 & f.n. 77; Ventris, supra (f.n. 2), p. 135.

SECTION B: A COMPARISON BETWEEN SLCs AND LCs, AND SLCs AND PERFORMANCE BONDS AND GUARANTEES

1. STANDBY LETTERS OF CREDIT AND LETTERS OF CREDIT

1.1. Similarities

The standby letter of credit is in many ways similar to LCs. The SLCs, more importantly, are in principle similar to LCs. In other words, the doctrine of autonomy and the principle of strict compliance are also applied to SLCs.[30] As to the required documents, types and their roles, there is a distinction between SLCs and LCs. They are more important in the latter form of credit.

There is a tendency in respect of the autonomous nature of SLCs (both in the USA and in the UK) to question whether the rule of independence should be broken or not. For instance, it is suggested that as the risk under SLCs is very high for the bank's customer, because there is no documentation as in the case of traditional LCs, Article 5 of the UCC should be amended to facilitate attacks on the problem by breaking the rule of independence and to permit suing the beneficiaries for breach of the underlying contract.[31] In a case[32] Eveleigh, L.J., accepted the view that if the underlying agreement is lawfully avoided or there is a total failure of consideration on the part of the buyer, he would be prepared to grant an injunction and to restrain the bank from payment of the credit to the beneficiary.

Although such suggestions try to mitigate the risks imposed upon the bank's customer, some disadvantages may emerge, firstly, when in the wake of breaking the principle of independence the creditors are forced back to elaborate contracts like a guarantee contract; secondly, no intention may exist on the part of

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[30] Schmitthoff, supra (f.n. 1), p. 364.

[31] "Fraud in the transaction: Enjoining letters of credit during the Iranian Revolution", 93 Harvard Law Review, 992 (1980), pp. 1013-15.

[32] Potton Homes Ltd. v. Coleman Contractors (overseas) Ltd., The Times, 28th Feb. 1984; Int.B.L., supra (f.n. 16), pp. 272-3, and look at particularly for cases referred to in f.n. 32, at p. 273.

the parties when negotiating SLCs, since for such a type of credit the beneficiaries' position is of great importance.[33]

1.2. Differences

A standby letter of credit and LCs are different from each other as to the function of the credit, its beneficiary, and the required documents. A traditional letter of credit is a device for payment in a sale contract, so there should be some positive performance to entitle the beneficiary to demand the credit;[34] but in the case of SLCs, in contrast to LCs, failure of the applicant for the credit in carrying on his contractual obligation entitles the beneficiary to draw a draft or demand for the amount of the credit.[35]

As to the beneficiary of the credit in SLCs, mostly but not always the buyer customer is the beneficiary of the credit and the seller (in case of sale contracts) or contractor (in case of construction agreements) are applicants for the credit. Of

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[33] Becker, J.D., "Standby letters of credit and the Iranian cases: Will the independence of the credit survive?", Uniform commercial Code Journal, Vol. 13, No. 4, 1981, pp. 335-47 [hereinafter referred to as Becker]; Penn, supra (f.n. 22), pp. 133-34.

[34] "The value of the documentary credit, appreciated especially in sales transactions involving carriage of goods by sea, lies in its twin objectives, namely to raise credit and to secure payment of the purchase price. The credit meets the common interest of both parties not to tie up funds during the transport of goods. Even more importantly, it safeguards the different interests of buyer and seller. The buyer is assured that payment is made only against document that confer title of the goods to him or at least provide evidence of their shipment and of certain qualities (e.g. by certificate of inspection, examination or origin). The seller when parting possession of the goods is assured of payment, or honour of a bill of exchange he may wish to discount, by a financially strong and reliable third party, often a confirming bank in his own country. He is thus protected against the risk of the foreign buyer's inability or unwillingness to pay." [UNCITRAL Y.B., 1988, supra (f.n. 1), p. 49, para. 19]

[35] Banks, supra (f.n. 3), pp. 74-5; G. Weisz and J.I. Blackman, "Standby letters of credit after Iran: Remedies of the account party", University of Illinoise law Rev., Vol.1, 1982, pp. 355-84, pp. 358-60 [hereinafter referred to as Weisz]; "While the traditional documentary credit provides the seller (or similar performing party) with a secure mechanism for payment by the buyer, the stand-by letter of credit is a default instrument in that it covers the risk of non-performance or defective performance by a contractor, supplier or other obligor." [UNCITRAL Y.B., 1988, supra (f.n. 1), p. 47, para. 3]; It is also stated: "In contrast to the documentary credit, which secures payment due to the beneficiary for his regular performance of a commercial obligation, the stand-by letter of credit is designed to provide security or indemnity to the beneficiary for the unlikly contingency, and the need to protect against it, may arise in respect of a great variety of commercial or financial obligations. Stand-by letters of credit may thus be used to underwrite undertakings in various contexts, as are bank guarantees and bonds." [UNCITRAL Y.B., 1988, supra (f.n. 1), p. 50, para. 26]

course, there are some types of SLCs where the buyer/employer is the applicant for the credit; these include the bid credit, or advanced payment bonds.

Lastly, there is an important difference between the documents. In SLCs there is no need that a required document(s) has any link with the underlying agreement. As a contrast, tendered documents in the traditional form are directly related to the underlying contract, e.g. sale contract, carriage contract and so on.[36]

2. STANDBY LETTERS OF CREDIT, PERFORMANCE BONDS, AND BANK GUARANTEES

Standby letters of credit (SLCs), bonds (for instance performance bonds (PBs)), and bank guarantees (BGs) are different forms but have a similar purpose.[37] However, they also involve mutual distinctions, as follows:

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[36] Professor Schmitthoff illustrated such point in following terms: "The difference between these two types of credit is that in the ordinary letter of credit arrangement the documents which the beneficiary has to tender, normally, relate to an underlying sales transaction or a similar contract and usually include a transport document, but in a standby letter of credit the required documents need not include a transport document: a document of any description may be required, e.g. a demand by the beneficiary of a statement by him that the other party is in default. The standby letter of credit is thus often similar in effect to the bank guarantee." [see Schmitthoff, supra (f.n. 1), pp. 363-64]; Int. B.L., supra (f.n. 16), pp. 287-8 & f.n. 79; Weisz, ibid., p. 358, par. 3; UNCITRAL, "2. Independent guarantees and stand-by letters of credit: discussion of further issues of a uniform law: amendment, transfer, expiry, obligations of guarantor, liability and exemption; note by the Secretariat (A/CN.9/WG.II/WP.68) [Original: English]", Yearbook of the United Nations Commission on International Trade Law. Vol.XXII, 1991, pp. 330-339 [hereinafter referred to as UNCITRAL Y.B., 1991, part b.2] at p. 337, para. 54 said: "In considering whether a rigid or a more flexible standard of compliance would be appropriate, account should be taken of certain differences between the commercial letter of credit and the guaranty letter. Firstly, the commercial letter of credit provides a secured payment mechanism likely to be utilised in the ordinary course of the transaction, while the guaranty letter is designed to indemnify the beneficiary for the consequences of a contingency that is unlikely to occure. Secondly, the documents tendered under a commercial letter of credit (e.g. bill of lading) are likely to be merchantable, while the statements or documents required under a guaranty letter are rarely of such type. Thirdly, the documents required under a commercial letter of credit tend to be more standardised than those required under a guaranty letter, and they are explained and regulated in detail by the UCP."

[37] "A question may arise that for what reason(s) it is in different name and forms in different legal systems. It is said that: "It can be answered with certainty only for the use of standby letters of credit by American banks which had to use the form of a letter of credit because it is settled in the US banking law that ordinary guarantees are not legitimate banking business within the meaning of the National Bank Act. The use of standby letters of credit by banks was expressly recognized by rulings of the Comptroller of the Currency issued in 1974. The use of the other two forms, i.e., of bonds and of bank guarantees, can only be explained by the general exprience that lawyers always prefer to employ the legal tools with which they are familiar from their own legal systems. Even international commercial lawyers from continental Europe have

2.1. Standby letter of credit and performance bond

In the **Edward Owen** case Lord Denning pointed out that "performance guarantees are virtually promissory notes payable on demand."[38] However, it has been suggested that SLCs are distinguished from PBs on two grounds; firstly, they are not issued for an existing debt; secondly, SLCs are not negotiable instruments.[39]

2.2. Standby letter of credit and bank guarantee

Although SLCs and BGs are similar in function there are several distinctions between them:

2.2.1. Primary and secondary obligation

Under SLCs the responsibility of a party who issues such a credit is a primary one; while, by contrast, a guarantor's undertaking is a secondary obligation since he promises to pay if the main debtor fails to carry out his duty under the credit contract.[40]

2.2.2. Doctrine of autonomy

A standby letter of credit is separate from its underlying transaction, but, on the other hand, the guarantee arrangement is not independent from its underlying agreement. As a result of this distinction a guarantor can use any and all defence

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developed the bank guarantee while English lawyers, burdened with the problems of the doctrine of consideration have used the well known form of bond for the new purposes. A growing tendency can now be observed to use standby letter of credit outside the USA, e.g., by banks in England, Australia, India, Japan, and South Korea." [Marshall, supra (f.n. 4), at p. 267]

[38] [1978] 1 Ll.L.R. 166, at p. 171 stated: "[...] the performance bond is merely one type of surety contract. As such it is governed by the general principles of the law of principal and surety. These contracts do not require the use of bond, but its employment obviates the need for the consideration moving from the creditor to the surety."; H.J. van der Vaart, "Standby letters of credit and the problem of bad faith calls", Yale Journal of World Public Order, 1981, Vol. 8, No. 1, pp. 36-61, at pp. 42-3 [hereinafter referred to as Vaart]; Williams, supra (f.n. 24), at p. 425.

[39] Vaart, ibid., p. 43.

[40] Banks, supra (f.n. 3), pp. 75-81; Weisz, supra (f.n. 35), pp. 355-84; Richard J. Driscoll, "The role of standby letters of credit in international commerce: reflections after Iran", Virginia Journal of International Law, 1980, Vol. 20, No. 2, pp. 459-504, p. 470 [hereinafter referred to as Driscoll].

that a primary obligor has against a creditor.[41] There are two American decisions opposed to one another. In the first case the Federal court took the view that the bank is under duty to pay upon the actual existence of facts regarding the performance of the underlying agreement, and such requirement is said to be not "too far from the basic purpose of letter of credit, namely, providing a means of assuring payment cheaply by eliminating the need for the issuer to police the underlying contract."[42] In the second authority it is stated that if the issuer fails to require any document for a particular fact, then there is a presumption that there is no need for the beneficiary of the credit to present a document to that effect.[43]

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[41] Banks, supra (f.n. 3), pp. 75-6 described this point clearly as following: "It is well established today that **the standby letter of credit is not guaranty.** [...] An instrument is a standby letter of credit if "the issuer has a primary obligation that is dependent solely upon presentation of conforming documents [or demands for payment] and upon the factual performance or non-performance by the parties to the underlying transaction. [...] By contrast, if the condition of compliance are phrased in factual rather than in documentary terms, the honouring of the instrument becomes contingent upon the actual occurrence or non-occurance of a factual event. Under such conditions, the issuer, rather than examining documents which state that an event has or has not occurred, would be required to examine questions of fact relating to the performance of the underlying contract. These are the charectristics of a guaranty, not of a standby letter of credit."; Vaart, supra, p. 41; "As regards guarantees, uncertainty arises from the fact that the autonomy or independent nature of the undertaking is not yet recognised in full and firmly established in all jurisdictions." [UNCITRAL Y.B., 1988, supra (f.n. 1), p. 57, para. 92]

[42] **Wichita Eagle & Beacon Publishing Co. v. Pacific National Bank**, 343 F. Supp. 332 (N.D. Cal. 1971), rev.d. 493 F.2d 1285 9th Cir. 1974), p. 1286; Banks, supra (f.n. 3), p. 77; John F. Battaile III, **"Guaranty letters of credit: Problems and posibilities"**, Arizona Law Review, 1974, Vol. 16, pp. 822-38, p. 842 [hereinafter referred to as Battaile]; Henry Harfield, **"Enjoining letter of credit transactions"**, Banking Law Journal, 1978, 95, pp. 596-605 [hereinafter referred to as Harfield's article]; Becker, supra (f.n. 33), p. 341 (about the problem of ultra vires); Banks, supra (f.n. 3), p. 77, f.n. 39 it is said that: "Note that requiring the conditions to exist is different from requiring a document (such as an affidavit) from the beneficiary stating that the conditions exist. In the first instance, the burden of determining facts relating to the underlying contract is place upon the bank. In the second instance, the bank's only burden is to examine the document to see if, on its face, the document appears to comply with the terms of the letter of credit."; Banks, supra (f.n. 3), at pp. 77-8 suggested that the above decision was not made under the UCC since at that time the state of California had not adopted such provision. So, under the literal interpretation of section 5-112(1)(c) of the UCC the above court may took opposite view since under the mentioned section "a letter of credit need not required presentation of a document provided that the letter of credit conspecuously states that it is a letter of credit or is conspecuously so entitled.

[43] In **Bank of America v. Whitney-Central National Bank**, 291 F. 929 (5th Circ. 1923), at p. 935 the court stated: "A bank may issue its letter of credit unconditioinally, and without requiring documents, or it may prescribe such conditions and require such documents as it sees fit. [...] It follows that when any particular fact is not required to be presented by documents the letter of credit is unconditional as to such fact, and in that event the issuing bank is presumed to rely upon the presentation of the person in whose favour the credit is issued."; Banks, supra (f.n. 3), p. 78.

2.2.3. Guarantees in the USA

In the USA banks may not legally guarantee third parties' debts since this is ultra vires; but there is no legal prohibition against issue of a standby letter of credit.[44]

CONCLUSIONS

The importance of the documentary letters of credit system in international trade makes clear how significant the recent activities by the UNCITRAL concerning SLCs and BGs are and how they are opening up a new dimension with respect to the issue under consideration here, namely, the necessity of having a uniform law relating to LCs. Although points raised above confirm that SLCs have more similarities with LCs than BGs (similarity in principles, operations, and relevant rules and provisions accepted by courts as well as by international business bodies like the ICC) UNCITRAL has preferred to study SLCs beside BGs for their common operational legal character and functional equivalence[45] and has taken the view that SLCs have more differences with LCs than with BGs.[46] This

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[44] Vaart, supra (f.n. 38), p. 42, at f.n. 28 said: "[...] Jarvis suggests that "the main reason why banks issue standby latters of credit is to get around ultra viers problems." Jarvis, "Standby letters of credit", 10 U.C.C. L.J. 38, 45 n. 21 (1977); Driscoll, supra (f.n. 40), p. 470; see alse Becker, supra (f.n. 33).

[45] "The view was expressed that the stand-by letter of credit should be dealt with clearly separately from the independent guarantee because of its different functional origin. The prevailing view, however, was in favour of a joint treatment in view of their common operational legal character and functional equivalence." [UNCITRAL, "IV. GUARANTEES AND STAND-BY LETTERS OF CREDIT, A. Report of the Working Group on International Contract Practices on the work of its thirteenth session (New York, 8-18 January 1990) (A/CN.9/330) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XXI, 1990, pp. 227-238 [hereinafter referred to as UNCITRAL Y.B., 1990], p. 229, para. 14]; see also previous notes and UNCITRAL, "II. GUARANTEES AND STAND-BY LETTERS OF CREDIT, A. Report of the Working Group on International Contract practices on the work of its eighteenth session (Vienna, 30 November- 11 December 1992) (A/CN.9/372) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XXIV, 1993, pp. 139-154 [hereinafter referred to as UNCITRAL Y.B. 1993, part a], p. 140, para 13.

[46] "By its **function and purpose**, the stand-by letter of credit differes considerably from the traditional commercial letter of credit or documentary credit and is equivalent to independent bank guarantees and similar indemnities. [...] As regards stand-by letters of credit, it is often doubtful whether a given provision of the law on letters of credit is applicable, i.e. appropriate in view of the special nature and purpose of the stand-by letter of credit. As regards guarantees, uncertainty arises from the fact that the autonomy or

view is in contradiction to the facts, as admitted even by the ICC Commission, namely, that national laws treat SLCs and LCs similarly.[47] Therefore, for reasons pointed out previously, it is more preferable that rules and provisions related to SLCs and LCs should be studied together and one international set of standards govern both of them; because, by adopting a different approach (as it is accepted by UNCITRAL) a new occasion for conflict of laws would arise between UCP 500 and a future set of standards provided by UNCITRAL. In other words, the international business communities would face two sets of standards for SLCs, namely, the first one (UCP published by the ICC) treating them like LCs while under the second type (the future UNCITRAL's set of standards) they would be treated as being similar to BGs. Although there may be similar provisions about SLCs in both sets of the above mentioned standards, there would be also distinctions between them in contradiction with the task of UNCITRAL, namely, to provide a more unified front regarding an international payments system.[48]

In conclusion, for reasons pointed out above, there is a marked need and practical interest for having an international unified and codified set of standards concerning LCs. However, before considering different aspects of unification/ codification of the law of LCs it is necessary to know more about the current system; therefore, questions related to UCP 500 and legal issues related to LCs (common law perspective) are to be discussed below.

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independent nature of the undertaking is not yet recognised in full and firmly established in all jurisdictions." [UNCITRAL Y.B., 1988, supra (f.n. 1), p. 57, paras. 91 and 92]

[47] "Stand-by letters of credit and guarantees (or bonds), while functionally equivalent or at least similar, differ as to their legal treatment for the formal reason that the stand-by letter of credit is a letter of credit. **Thus, the laws and rules governing documentary letters of credit would generally be applicable to stand-by letters of credit.** [...] For guarantees and bonds, the legal framework is different. As discussed below (Part II, B), it is characterized by a varied development of national laws, in particular case law, towards recognizing the independent (non-accessory) legal nature of the guarantee and by attempts to prepare uniform rules." [UNCITRAL Y.B., 1988, supra (f.n. 1), p. 47, para. 5]

[48] As to the question: "What would be the final decision by the Commission in order to prevent the emerge of such a problem?, and other points concerning UNCITAL's activities see Chapter X (below).

PART TWO

THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (UCP)

This part of the study will focus on issues related to articles of the UCP 500 involving uncertainty. The contents are divided into two chapters (IV and V). Chapter IV, discusses the UCP 500, its general structure, and compares it with the previous version of the UCP (UCP 400). Moreover, issues which should be considered in a future revision of the UCP are also discussed. Chapter V is devoted to a comparative study of the UCP 500 (as the only international customary/ contractual rules related to LCs) and Article 5 of the UCC in the USA (as a national legislation related to LCs). In conclusions, an attempt is made to assess what can be learned to improve the current revision of the UCP.

CHAPTER IV

UCP 500: ITS STRUCTURE;

RELATED ISSUES

SECTION A: STRUCTURE OF UCP 500; ITS DIFFERENCE FROM UCP 400

1. STRUCTURE OF THE UCP 500

The main structure of UCP 500 is, generally speaking, similar to its previous version (UCP 400); however, the number of sections has increased from six to seven: the last section of UCP 400 has been divided into two different sections in the UCP 500, as section F (Transferable credit) and section G (Assignment of proceeds). Moreover, each article is distinguished by a sub-title for better access to the Articles of the UCP.[1]

2. UCP 500 AND UCP 400: DIFFERENCES

A comparison between the present and previous versions of UCP makes it clear that:

(1) The number of articles in UCP 500 has decreased from 55 to 49 through the consideration of some articles with due regard to similarities in contents. For instance, the text of Articles 6, 13, and 26 of the UCP 400 have been replaced by an addition to Articles 3, 5, and 23 of the UCP 500. Moreover, Article 47 of present UCP covers three articles of the previous version, namely, Articles 51, 52 and 53. For other examples see tables 1.1 and 1.2 (below).[2]

(2) Of 49 Articles in UCP 500 four articles are identical in both codes, namely Articles 22, 38, 41, and 45. In addition, Articles 24 (Non-negotiable Sea

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[1] Ellinger, E.P., "The Uniform Customs and Practice 1993: a brief review of their salient points", JBL, Jan. 1994, p. 28 [hereinafter referred to as Ellinger, JBL 1994], and from the same writer, "The Uniform Customs and Practice for Documentary Credits- the 1993 Revision", LMCLQ, part 3, August 1994, p. 377 [herinafter referred to as Ellinger, LMCLQ 1994]; Rendell, Robert S., "New ICC rules impact letters of credit", International Financial Law Review, Vol. 12, Iss. 11, Nov. 1993, pp. 33-35 [hereinafter referred to as Rendell, November 1993], where it is pointed out while the UCP 500 is a comprehensive set of guidlines dealing with all aspects of letter of credit practice, it does not address every issue that may arise in a letter of credit transaction; see also Rendell, Robert S., "New ICC rules impact letters of credit (Part 1)", International Financial Law Review, Vol. 12, Iss. 10, Oct. 1993, pp. 28-30 [hereinafter referred to as Rendell, October 1993].

[2] For more details see ICC, "Documentar credits: UCP 500 & UCP 400 compared", ICC Publication No. 511.

Waybill), 27 (Air Transport Document), and 28 (Road, Rail or Inland Waterway Transport Documents) are new. The rest of the articles have undergone minor and/or substantive and stylistic changes.

SECTION B: UCP 500 AND RELATED ISSUES

As a result of the changes, the UCP 500 provides a much better set of standards related to LCs than any other previous versions of the UCP;[3] however, points in the present provisions require more clarification and/ or change of approach. They are related (see below) to all parties to a credit transaction.

1. ISSUES RELATED TO THE APPLICANT FOR A CREDIT

Because of banks' strong bargaining power, the UCP's provisions are sometimes in favour of banks; the interests of other parties to the documentary credit, particularly these of an applicant for a credit, are not well protected under the UCP 500. Examples relevant thereto are considered below.

1.1. The bank's position on transmission of messages

1.1.1. "delay [...] other errors arising"

Under Article 16 of the UCP 500[4] all the risks involved in transmitting a message are carried by the applicant for a credit. There may be an objection that transmission of a credit is one of the issuing bank's obligations, so in case of delay, error, etc., the bank should be held responsible for any failure. It has been agreed that "the bank could not avail itself of this Article because it would have been negligent, not because of transmission, but because of the failure to verify

[3] For more details see Ellinger, JBL 1994, supra (f.n. 1), at p. 28 said: "This is not to say that the new Revision is of a revolutionary nature. In most regards, it follows the pattern of its predecessor. It may be fairly described as an innovative consolidation, which has clarified many of the points left in doubt under the regime of the 1983 Revision and which breaks new ground by making detailed provisions for transport documents used in respect of the carriage of goods by air and by land. The Working Group has also improved the draftsmenship and, in many regards, has setteled some controversial issues."

[4] See ICC Pub. No. 500, where Article 16 provides: "Banks assume no liability or responsibility for the consequences arising out of delay and or/loss in transit of any message(s), letter(s) or document(s), or for delay, mutilation or other error(s) arising in the transmission of any telecommunication. Bank assume no liability or responsibility for errors in translation and/or interpretation of technical terms, and reserve the right to transmit Credit terms without translating them."

such an important document."[5] As far as English law is concerned, a bank would not find a good defence where there is negligence by the bank or its agent. For instance, in **Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.**,[6] regarding the issue of duty of care owed by professional people and whether it is limited to contractual relationships, Lord Devlin said: "I think therefore, [...] that the categories of special relationships which may give rise to a duty to take care in words as well as in deed are not limited to contractual relationships or to relationships of fiduciary duty, but include also relationships which [...] are "equivalent to contract", that is, where there is an assumption of responsibility in circumstances in which, but for the absence of consideration, there would be a contract [...] I shall therefore content myself with the proposition that wherever there is a relationship equivalent to contract, there is duty of care. Such relationship may be either general or particular. Examples of a general relationship are those of solicitor and client and of banker and customer."[7]

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[5] Ventris, F.M., "Bankers' Documentary Credits", first suppliment to the second edition, Lloyd's of London Press Ltd. 1985, at p. 21 [hereinafter referred to as Ventris 1985].

[6] [1963] 1 Ll.L. Rep. 485 (HL).

[7] Ibid., at p. 515-516; Ventris, F.M., "Bankers' Documentary Credits", Lloyd's of London Press Ltd., 1983, pp. 186-189 [hereinafter referred to as Ventris], at p. 186 said: "This case is very important [...] because the thorough discussion in the House of Lords of the duty of care owed by professional people enlarged the principle accepted for the first time in **Donoghue v. Stevenson** (1932) A.C. 562 that a duty of care could be owed by one person to another despite there being no lines between them."; and at pp. 164-65 of the same reference above concerning **Donoghue** case it is pointed out: "[...] Lord Atkin in his speech said that the question to be resolved was the most important [...] in the present case the sole issue to be decided was, as a matter of law, was there any duty owed by the defender to the pursuer to take care? [...] his Lordship said that the doctrine appeared to be that a man must take reasonable care to avoid acts or ommissions which he can reasonably forsee would be likely to injure those, so closely and directly affected by the act, that a man ought reasonably to have them in contemplation as being so affected when directs his mind to the acts or omissions which are called in question. His Lordship then continued: "[...] A manufacturer puts up an article of food in a container which he knows will be opened by the actual consumer. There can be no inspection by any purchaser and no reasonable perliminary inspection by the consumer. Negligently, in the course of prepration, he allows the contents to be mixed with poison. It is said that the law of England and Scotland is that the poisened consumer has no remedy against the negligent manufacturer. If this were the result of the authorities I should consider the result a grave defect in the law, and so contrary to principle that I should hesitate long before following any decision to that effect which had not the authority of this House. [...] It is a proposition which I venture to say that no one in Scotland or England who was not a lawyer would for one moment doubt. It will be an advantage to make it clear that the law in this matter, as in most others, is in accordance with sound common sense."; McInerny v. Lloyds Bank Ltd.,[1973]2 Ll.L.R. 389, [1974]1 L.L.R. 246 (CA).

One may argue that the above authority is not related to the situation arising under Article 16 of the UCP since it is agreed by contracting parties (the bank and the applicant for a credit) that the bank's customer should accept risk(s) involved in the transmission of a message. This may be true in case of international transaction but if a letter of credit is not ruled by the UCP or if the UCP is silent as to the point in discussion (liability or responsibility of the bank concerning the transmission of messages), the result would be different if the applicable law of contract is English law. Moreover, it is possible that an English court may take the view that contracting parties in a letter of credit are not allowed to agree upon something different from the established law and business practice(s); and a similar possibility exists between different jurisdictions. This is another example how the UCP, as the only existing international set of standards concerning LCs, provides something which is the opposite of what common sense suggests and would be cause of unjust conclusions in international trade; it should be revised.

1.1.2. Technical terms

Article 16 of UCP 500 provides that banks have no liability or responsibility in case of error in translation and/or interpretation of **technical terms**. This is a general provision and covers all kinds of technical terms, particularly those used in banking.[8] Can a bank apply the above rule as a good excuse where the applied technical terms dealt purely with banking affairs? If no, how would it be possible to distinguish between technical terms applied in the banking business and those used in other activities (business or non-business) related to LCs? In case of any dispute regarding the point under consideration whose point of view should be preferred, the bank's, the applicant's for a credit, or that of a third person? Who is such a third person?

[8] Article 13(a) of UCP 500, which replaces Article 15 of UCP 400, provides that the compliance of the stipulated documents is to be determined "by international standard banking practice as reflected in these articles."

Another point of concern is whether banks are liable or responsible for their error(s) in translation and/or interpretation of **non-technical terms**. There is nothing clearly stipulated under Article 16 of UCP 500. One may suggest, by way of implication, that banks would be liable and/or responsible for their failure. On the other hand, it is possible to argue that silence in the UCP provisions does not justify to conclude that banks accept some sort of liability or responsibility for their errors in the course of translation or interpretation of non-technical terms. Moreover, the last sentence of Article 16, namely, "Banks [...] reserve the right to transmit Credit terms without translating them", supports the view that banks are not interested in accepting any liability or responsibility concerning the point under consideration and words **"Credit terms"** are wide enough to cover both technical and non-technical terms.

It seems, consequently that the last sentence of Article 16 is not clear and should be preferably reviewed in a future revision of the UCP.

1.1.3. Translation of terms of credit

It has been stated that banks have no obligation to translate a credit; their duty is only to transmit it. Therefore, to prevent any problems arising from translation, the applicant for the credit should as a duty supply the credit's translation himself.[9] Although bankers have such rights under Article 16 of UCP 500, it seems that by translating a credit they would waive their rights. If they do not wish to lose them, then they have to ask their clients to provide the credit's translation. If banks choose to translate credit terms before transmitting them they should then accept liability or responsibility for any loss caused as a result of their failure. One may argue that by transferring any liability or responsibility to the banks the applicant for a credit would lose more than gain since banks do not aquire to translate credit terms, and it would cause more harm for the banks' customer namely accepting the task of translating of credit terms as well as liability or responsibility of errors raised in that respect. Although such an

[9] Ventris 1985, supra (f.n. 5), pp. 21-22.

argument bears some justification and sense, when Article 16 is compared with Section 5-107(4)[10] of the UCC, it becomes clear that the latter provides a more sensible approach concerning the issue under consideration.[11] For instance, there is a possibility for the applicant for a credit to transfer risks of unreasonable translation or interpretation to banks whereas such a flexibility is not accepted under the UCP. It seems, therefore, the procedure adopted by the ICC provides unfair provisions concerning LCs in international trade.

This and other issues (mentioned above) should be reconsidered by the ICC in order to provide a more equitable system of provisions.

1.2. Disclaimer for acts of the issuing bank as an instructed party

Points would arise regarding sub-sections (a) and (b) of Article 18 of UCP 500:[12]

1. Where it is accepted that there is no contractual relationship between the applicant for a credit and the other bank(s), as agent(s) of the issuing bank, why should the former be liable for the latter's default?[13] So, the point is whether the issuing bank has some sort of duty against its customer, and whether when a bank takes initiatives to choose the other bank(s) services, why must the issuing bank not accept the result of its failure? The above cited article clearly demonstrate another example for the bargaining power of the issuing bank involving an unjustified risk for the applicant for a credit.

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[10] Sub-section 4 of Section 5-107 of the UCC in the USA provides: "Unless otherwise specified the customer bears as against the issuer all risks of transmission and reasonable translation or interpretation of any message relating to a credit."

[11] For more details see below Chapter V, Section B.1.3.1.

[12] Article 18 (a) provides: "Banks utilizing the services of another bank or other banks for the purpose of giving effect to instructions of the Applicant do so for the account and at the risk of such Applicant."; and paragraph (b) of the same article provides: "Banks assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank(s)." [ICC Publication No. 500]

[13] Ventris, supra (f.n. 7), at p. 24 said: "It must be extremely rare that the applicant for the "credit" choses the advising/confirming bank, unless it is a branch of the issuing bank, when its choice is automatic. Generally, the confirming bank is nominated by the beneficiary or the issuing bank."

2. Under the common law an agent is responsible to his principal for the acts and omissions of appointed sub-agents. So one may suggest that Article 18(b) is an exception to this general principle; even in such a case the issuing bank is not entitled to enjoy this exception where the intermediary bank is carrying out its instructions.[14] In addition, in case of negligence by the intermediary bank (as the sub-agent), neither that bank nor the issuing bank (as the agent of the applicant for the credit) would be able to invoke Article 18. For instance, the ICC Banking Commission was asked to give its opinion on the responsibility of the issuing bank towards its customer under Article 12 of the UCP 74 (Article 18 of UCP 500); the Commission decided that: "Article 12 established a principle according to which the issuing bank was exonerated from all liability for the errors of the advising bank whether this bank had been chosen by the credit applicant but this immunity did not apply where the issuing bank had been guilty of negligence."[15]

It seems, therefore, necessary that points related to Article 18 above should be clarified in a next revision of the UCP.

2. ISSUES RELATED TO THE BENEFICIARY OF A CREDIT

2.1. Amendment or cancelation of a revocable credit

Article 6(a) of the UCP 500 provides that a credit may be revocable as defined in Article 8(a): "A revocable credit may be amended or cancelled by the

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[14] Ventris, supra (f.n. 7), at p. 24 said: "[...] the Court could hold that the agent is only exonorated by this Article for the sub-agent not carrying out the agents instructions but he is not exonorated from responsibility if the sub-agent does something to his instructions. Moreover, if sub-agent is guilty of gross negligence (assuming that there can be degree of negligence) this Article would probably avail neither him nor the agent. In the **Suisse Atlantique** case [1966]1 Lloyd's Rep. 529, the House of Lords thoroughly examined the application of exception clauses in contracts and it is clear that if the contract as performed by one party bears no resembelance to the contract as agreed between the parties then the guilty party cannot shelter behind the exceptions clause. He is deemed to have "stepped out of the contract". Further, **Lee Cooper Ltd. v. C.H. Jeakins & Sons Ltd.** [1963]1 All E.R. 280 showed that the principal can sue in tort the sub-agent."

[15] ICC Doc. 470/336, 470/342 (meeting on Dec. 1987); "Decisions (1975-1979) of the ICC Banking Commission" on queries relating to Uniform Customs and Practice for Documentery Credits", ICC Pub. No. 371 [hereinafter referred to as ICC Pub. No. 371], p. 30.

Issuing Bank at any moment and without prior notice to the Beneficiary."[16] It can be understood from this definition that this type of credit does not provide sufficient security for the beneficiary of a credit. Nevertheless, it is a cheap type of credit and suitable for usage in trade where parties to the contract know each other very well or belong to the same company. The revocable credit may be applied in situations where also economic or political risks are involved.[17] However, legal problems related to such a type of credit exist, as follows.

2.1.1. Time for amendment or cancellation of the revocable credit

The ability of the issuing bank to amend or to cancel a revocable credit under paragraph (a) of Article 8 of UCP 500, quoted above, is a right that cannot be challenged either by the applicant or by the beneficiary of the credit, even if the bank would be tempted to abuse such a right. For supporting the bank's position one may argue that both the bank's client and the beneficiary agreed to such a right for the bank prior to issuance of a revocable credit under the UCP. However, the question is: what is the real meaning of the terms **"at any moment"** in Article 8(a) of UCP 500? Does it mean that the bank's right continues even after documents are tendered to the bank? It is rightly stated by a writer that when documents are presented for examination to the banker, from that moment the credit can no longer be cancelled or modified on the basis provided under Article 8(a) of UCP. He has said: "The situation is different, however, between moment C (the moment at which the beneficiary presents his documents to the bank) and moment D (the moment at which the bank examines the documents). The beneficiary has handed over his documents. He has for his part complied with all his obligations under the terms of the documentary credit. Nevertheless, he still

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[16] See UCC Sec. 5-103, 1-106(3) and 5-106(4); Schmitthoff, C.M., **"Schmitthoff's Export Trade, The law and Practice of International Trade"**, 8th ed., 1986 [hereinafter referred to as Schmitthoff], p. 359; Gutteridge, H.C. and Megrah, M., **"The law of The Banker's Commercial Credit"**, London, 1984, 7th ed., p. 123 [hereinafter referred to as Gutteridge].

[17] Kozolchyk, B., **"Letters of Credit"**, 9 International Encyclopedia of Comparative Law, Chapter 5, 1979 [hereinafter referred to as Kozolchyk], p. 23 and f.n. 99-101.

has to wait for a time before the credit can be paid, this being the time required by the bank in order to examine the documents. During this period the credit can no longer be cancelled, in view of the fact that it has been concluded as far as the beneficiary is concerned. [...] by accepting the documents it concludes a specific part of the credit and the credit automatically passes to the final stage- that of examination- which stage is terminated by the conclusion: "The documents are in order" or "the documents are not in order."[18] Moreover, in accordance with a general principle of contract law, the bank's advice is an offer and it remains open until it is cancelled by the offeror (namely the issuing bank); if the offeree makes his acceptance in accordance with the terms of the offer then the contract will be established. So, if the issuing bank as the offeror does not want to carry on its undertaking it must inform the other party to the proposed contract. If the bank merely modifies or cancels its offer without giving any notice to the beneficiary, the latter may suffer much damage. This argument can also be supported in common law.[19] So, there is no further justification for that provision in the above cited situation.

2.1.2. Notice of modification or cancellation

Under Article 8(a) of UCP 500, an issuing bank is entitled to amend or to cancel the revocable credit **"without prior notice to the beneficiary".**[20] Related

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[18] De Rooy, F.P., "Documentary Credit", 1984, pp. 28-29 [hereinafter referred to as DeRooy].

[19] Donoghue v. Stevenson [1932] A.C. 562; Hedley Byrne & Co. Ltd. v. Hellers & Partners Ltd. [1963]1 Ll.L.R. 485; Ventris, supra (f.n. 7), at p. 166 pointed out that: "[...] in **Cominco Ltd. v. Bilton** [1973]2 Lloyd's Rep. 261, at p. 273, a case before the Supreme Court of Canada, Mr Justice Spence quoted with approval the following passage from "Carver Carriage By Sea, 1963": "**Donoghue v. Stevenson** established that everyone must take reasonable care to avoid acts or omission which he can reasonably foresee would be likely to injure persons so closely affected by his act that he ought reasonably to have them in contemplation when directing his mind to te acts or omissions in question". "Injury" in this sense does not only mean personal wounding but any act worsening the position of another party."

[20] Article 8(a) provides: "A revocable Credit may be amended or cancelled by the Issuing Bank at any moment and without prior notice to the Beneficiary." [ICC Pub. No. 500]; There is also a potential trap in the UCP 500 for amending irrevocable letters of credit. In that respect a writer said: "[...] a letter of credit can be amended without your agreement. The reason behind an irrevocable letter of credit is so it cannot be canceled or amended without your agreement. But the new rules allow agreement to be expressed or implied. [...] The reason for the new rule is that the most letter of credit amendments are made by the beneficiaries' request, and the beneficiaries simply start complying with them without ever giving anyone their formal

issues are: **(1)** Do these terms mean that the bank is under an obligation to give notice to the beneficiary? **(2)** If the answer is positive, does such a notice play an essential requirement for amendment or cancellation of the credit? And **(3)** In what period of time should the bank send notice to the beneficiary? Concerning the first question, one line of argument is that the bank is under no obligation to give any notice to the beneficiary; and if in practice banks rather send a notice to the beneficiary it is a voluntary practice. To support this view one may refer to **Cape Asbestos Co. v. Lloyds Bank**,[21] where the seller brought an action against the banker on the basis that it was the duty of the bank to give notice of cancellation of the credit. Bailhache, J., in the course of his judgment said that although in practice bankers gave notice in such case, it was solely dependent on the bank to give notice of cancellation to the beneficiary.[22]

In contrast, it can be argued that the real meaning of terms **"without prior notice"** is that banks are obliged to send a notice of amendment or cancellation of revocable credit to the beneficiary of the credit; acceptance of the opposite view would make Article 8(a) of UCP 500 in effect similar to what Article 2 of 1962 UCP provided that, "such a credit may be modified or cancelled at any moment **without**

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agreement. [...] So the drafters of the UCP 500 included a rule stating that "compliance" will be deemed to mean "acceptance." [...] This is specially troublesome given that the amendment and your documents can cross in the mail- you might accept an amendment you did not even know about! Whenever presenting documents under a letter of credit, include an indication of which amendments you have accepted and which you have rejected, then state, "in-action on any amendments not listed is not to be taken as acceptance." [Baker, Walter "Buddy", "**Preparing yourself for the UCP 500**", Business Credit, March 1994, p. 16, at p. 17.]

[21] (1921)3 L.D.B. 314, or [1921] WN 274; Lord Denning, M.R., in **W.J. Alan & Co. Ltd. v. El Nasr Export and Import Co.**, [1972] 2 Q.B. 189, at p. 207; for similar decision in the U.S.A. see **United States Steel Products Com. v. Irving Bank-Columbian Trust Co.**, 9 F. 2d. 230 (2nd Cir. 1925).

[22] Ibid., at p. 315 said: "It is to be observed that the notice was given by the bank on the opening of the credit is of the opening of a revocable credit and not of a confirmed credit. That tells the person in whose favour the credit is opened that he may find that the credit is revoked at any time. That being the representation which is made by the bank to the person in whose favour the credit is opened, the seller in this case, are the bank under any legal obligation to him to inform him when the credit is revoked? [...] I have come to the conclusion that, however wise and however prudent, and however much in the interest of business, such a notice may be, there is no legal basis upon which I can found an obligation on the bank to give such a notice under such circumstances."; Ellinger, E.P., "**Documentary letter of credit**", Singapore, 1970 [hereinafter referred to as Ellinger], pp. 12-13; Gutteridge, supra (f.n. 16), pp. 19-20.

notice to the beneficiary."[23] It seems that by adding the term **"prior"**, draftsmen of the UCP have indicated that banks should accept, to some extent, responsibility in the situation under discussion. So, the second line of argument is better under the present text of Article 8(a).

In respect of the second question above, the preferred approach is that giving notice to the beneficiary is not a condition precedent for amendment or cancellation of a revocable credit.[24] Regarding the last query above, nothing has been provided under the UCP. For more certainty in the provisions, a reasonable period of time (namely one banking day following the day that the issuing bank decided to amend or to cancel the revocable credit) should be agreed between contracting parties.

2.2. Late negotiation

Here the question is whether an alleged "late negotiation" could ever constitute a good reason for rejecting tendered documents and consequently refusing payment under the credit by banks. The ICC Banking Commission in 1985 decided that such questions were meaningless: "The Commission confirmed [...] that the beneficiary had the right to have non-confirming documents corrected, provided he then represented them within the time limits laid down by the credit.[25] [...] The Commission also considered that the bank in the present case was entitled to assert a claim of non-conforming documents, but was not entitled to rely on a claim of "late negotiation"."[26]

2.3. Rectifying non-confirming documents

The beneficiary of a credit or a remitting bank is entitled to rectify non-confirming documents before the expiry date of a credit. This policy has been

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[23] ICC Pub. No. 222.

[24] De Rooy, supra (f.n. 18), p. 27.

[25] See ICC Pub. No. 371, supra (f.n. 15), case R.13, page 25.

[26] DeRooy, supra (f.n. 18), pp. 15-18.

approved by the ICC Banking Commission.[27] There is also another procedure accepted in practice by banks, namely, rejected documents may be sent to the issuing bank for its approval by the paying bank.[28] A question may arise: is a paying bank liable to pay in a situation where the issuing bank's approval of documents was received after the expiry date of the credit? This point was decided positively by the ICC Banking Commission: "Where faulty documents were submitted by the confirming bank to the issuing bank for approval within the framework of the documentary credit transaction, this action was to be regarded in effect as a request for amendment of the credit. However, the confirming bank remained bound by its obligation to effect payment in the event that documents were approved, and was deemed to have implicitly agreed to the date of expiry of the credit being extended for a reasonable period so as to allow the issuing bank sufficient time to reply unless, at the time of sending the documents to the issuing bank for approval, it gave express advice to the contrary."[29]

2.4. "Any cause beyond their control"

Under English law it has been held that, according to the operation of the "ejusdem generis" rule,[30] this does not include shortage of labour;[31] it was also

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[27] ICC Pub. No. 371, supra (f.n. 15), at p. 25 it is said: "The beneficiary and the remitting bank always had the possibility of putting the documents in order provided this was done before expiry of the credit, and that the documents were then presented within the time allowed in the terms of Article 41, and provided also that the documents still complied with the credit terms."

[28] A similar practice is confirmed by the ICC between the issuing bank and the applicant for a credit in Article 14(c) of UCP 500.

[29] ICC Pub. No. 371, supra (f.n. 15), pp. 25-27; ICC Doc. 470/328, 470/330 (April 1987).

[30] Ventris, supra (f.n. 7), at p. 22 said: "This is a rule of law concerning construction to the effect that general words of indefinite extent must be construed as relating to matters of the same kind as the specific words preceding the general words, i.e., consignor, carrier or insurer. For example, it was held that "strikes, lockouts, civil commotions, or any causes or accidents beyond the control of consignees" did not cover a shortage of labour caused by a plague. (**Mudie v. Strick** (1909) 14 Com. Cas. 135, 227.)"; Bride, Roger, **"Osborn's concise Law Dictionary"**, 7th ed. 1983, at p. 128 said: "[of the same kind or nature]. The rule that where particular words are followed by general words, the general words are limited to the same kind as the particular words."

[31] **Jenkins v. Walford** (1918)87 L.J.K.B. 136.

decided that the control of port appliances by the military is not a matter beyond control.[32] So, it is important to know the real meaning of the above phrase. For instance, is the government's order to close banks for a certain time, because of devaluation of the currency, a matter beyond the bankers' control?[33] And if it is so, is it covered by Article 17 of UCP 500? It seems such an order is usually based on a legislation for emergency situations and banks are obliged to follow the rule of law; so this case would possibly be accepted as one cause among "any other causes" (stipulated in Article 17) beyond banks' control and would be covered by that article. The point above, however, needs clarification in a next revision of the UCP.

2.5. Transferable credit

The letter of credit, unlike a bill of exchange or promissory note, is not a negotiable instrument and it is usually issued to a specified beneficiary, since the buyer/ applicant for credit as a security measure wants to know who is going to supply or manufacture the goods or merchandise. So, as a general principle, a letter of credit is non-negotiable. However, sometimes for different reasons, e.g. where the seller is acting as a middleman, he may be looking for a credit which can be negotiated. This problem arose after the Second World War and, as a solution, the use of credit in a transferable form has been increased.[34] A transferable credit is defined in Article 48 of UCP 500.[35] Under Article 48(a)(i) it is

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[32] **Aktieselskabet Frank v. Namagara Copper Co.** (1920)25 Com. Cas. 212.

[33] See Ventris 1985, supra (f.n. 5), at p. 22 pointed out that it is suggested that the point under consideration would not be covered by the UCP, but no reason mentioned.

[34] Davis, A.G., **"The law relating to commercial letters of credit"**, 3rd ed., 1963 [hereinafter referred to as Davis], p. 29; Gutteridge, supra (f.n. 16), at p. 99 said: "The main purpose of making an irrevocable credit transferable to a third party is to enable the beneficiary to acquire and pay for the contract goods which he can not supply himself and may therefore have to get from elsewhere. Speaking of a bank's confirmed credit Denning, L.J. said in **Trans Trust S.P.R.L. v. Danubian Trading Co. Ltd.** [[1952] 2 Q.B. 297, C.A.; [1952]1 Ll.L.R. 348; [1952]1 All E.R. 970]: "It is irrevocable by the banker; and it is [by the buyer] often expressly made transferable by the seller. The seller may be relying on it to get the goods himself. If it is not provided, the seller may be prevented from getting the goods at all."

[35] See ICC Pub. No. 500 and appendix 1 for Section 5-116 of the UCC.

provided that the beneficiary "may request transfer of the credit". Why is the issuing bank's consent for transferring the credit after its issue necessary? The reason for it is that "A request for transfer is not a binding unilateral declaration of intent but is akin to a credit amendment and, as such, requires the transferring bank's acceptance of the beneficiary's transfer request before it becomes enforceable."[36]

A similar question had been raised in Singapore, in **Lariza (Singapore) Private Ltd. v. Bank Negara Indonesia 1946**.[37] The Privy Council held that the issuing bank is not under a duty to accept the seller's instructions in connection with a credit's transferability. Lord Brandon said: "Such a consent can not be given in blanket form in advance, so as to apply to any request for transfer which may subsequently be made, whatever its extent or manner may be. It has to be an express consent made after the request and it has to cover both the extent and the manner of the transfer requested."[38]

The above manner of proceeding is the opposite of what was accepted under Article 46(a) of the UCP revision (1974) recognising a right for the

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[36] ICC Document No. 470-37/4, p. 37 [The text of the UCP 400 was under revision by two Working Groups (WG) in Commission on Banking Technique and Practice of the ICC. As result of such attempt two drafts namely **Document No. 470-37/4** (dealing with Articles 1-24 and 54-5) and **Document No. 470-37/5** (relating to Articles 25-53) were prepared.]; Ellinger, I.MCLQ 1994, supra (f.n. 1), at p. 401 said: "One intersecting verbal change is in definition of a transferable credit. Article 54(a) defined such a credit as one in which the beneficiary had "the right to request" the transferring bank to effect transfer. The new Art. 48(a) has replaced the quoted words by the phrase "may request." When read together the cl. (C) under which the transferring bank is "under no obligation to effect such transfer except to the extent and in the manner expressly consented by such bank", the new provision gives added support to the transferring bank's right to refuse to transfer the credit."; McLaughlin, G.T., **"Letters of credit: Basic principles and current controversies"**, Australian Business Law Review, Vol. 17, No. 5, October 1989, p. 302, pp. 309-310.

[37] [1985] 2 M.L.J. 81, Singapore C.A. in [1986] 1 M.L.J. 287; see [1986] J.B.L. 62 and 309; Schmitthoff C.M., **"The transferable Credit"**, JBL, Jan. 1988, pp. 49-55 [hereinafter referred as Schmitthoff's article], at pp. 52-53.

[38] Schmitthoff, ibid., p. 53; De Rooy, supra (f.n. 18), at p. 42 said: "This provision offers a protection to the bank at which the credit is made available. It is not only in the interest of the applicant for the credit that the beneficiary should be reliable, but also in that of the bank. Transfer of the credit to another beneficiary may affect the bank's position and it is therefore logical that such a transfer can not be made without its consent."

beneficiary to give instruction to his bank to transfer the credit to a third person.[39] Would the new policy accepted under Article 48 of the UCP 500 be justified? The answer depends on the time of request for a transferable credit. It seems sub-section (a) of Article 48 provides only a solution when the beneficiary, after issuance of the credit, looks for its transfer to another person; but, what would be the bank's position if the issued credit is in a transferable form? In this situation one may suggest that by adopting the view accepted in Article 48, the usefulness of the transferable credit would be at risk, since the seller is looking for a transferable credit and has said so in his contract with the buyer but later he faces a new situation, namely, obtaining the banker's agreement. Moreover, it may well be argued that by issuing the credit in a transferable form, the bank "expressly" consents to the transfer of such a credit and, therefore, there is no room for any later objection. It seems Article 48 (a) of the UCP 500 covers part of the practice; therefore, it should be revised as to the above considered point.

3. ISSUES RELATING TO BANKS

3.1. Incorporation of the UCP in the credit

"Credit is issued subject to Uniform Customs and Practice for Documentary Credits, 1983 revision, ICC Publication N. 400". These terms were added, for the first time, to Article 1 of the UCP 400 (1983). The reason for such change was that under previous versions of the UCP (namely 1962 and 1974), banks were only required to notify their adherence to the ICC, approach individually or collectively

[39] See ICC, "The uniform customs and practice for documentary credit", ICC Pub. No. 290 (1974 revision) [hereinafter referred to as ICC Pub. No. 290], for Article 46(a) provided: "A transferable credit is a credit under which the beneficiary has the right to give instructions to the bank called upon to effect payment or acceptance or to any bank entitled to effect negotiation to make the credit available in whole or in part to one or more third parties (second beneficiaries)."; and the reason for such a change was said to be the ICC Banking Commission's decision in which it was agreed that "the advising bank was always free to refuse the beneficiary's transfer instructions on the basis of the provisions of Article 46(b)."[ICC Doc. 470/315, 470/331, 47/342; Whebel, B.S., "UCP 1974/1983 Revisions compaired and explained-Documentary credits", ICC Pub. No. 411 [hereinafter referred to as ICC Pub. No. 411], p. 84; Ellinger, E.P., "The Uniform Customs - thier nature and the 1983 Revision", LMCLQ 1984, pp. 578-606, at p. 603 [hereinafter referred to as Ellinger 1984]].

through their national or central bank;[40] but under the UCP 400 it was accepted that the above quoted terms were added to the article.[41] This is an important point particularly in the USA where both UCP and UCC are applied in one state or between different states. A similar policy has been followed under UCP 500 (Article 1).[42] So, those who redrafted the UCP apparently tried to remove any ambiguity in relating to the application of the UCP in international trade. However, there are a few relevant points, as follows.

3.1.1. Method of incorporation of UCP within an issued credit

How is the UCP incorporated into a credit? What is the position under UCP 500? There are three possibilities: **(1)** annexing the text of UCP to an issued credit; **(2)** incorporating particular terms, as suggested by Article 1 of UCP 400 (mentioned above) into the text of the credit; and **(3)** using any terms to show adherence of interested parties to the UCP. The method of incorporation of the UCP into the credit under Article 1 of UCP 500 as a result of using the terms "they are" may be interpreted as either in the first or second (above cited) situation, since these terms would relate both to the main text of the UCP and to those terms which are used at the beginning of Article 1 of UCP 500, namely, **"The Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication N. 500"**. As to the above methods 1 and 2, it seems the latter is better since it is in line with what has been accepted in banking practice. Referring

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[40] UCP 1962 (ICC Pub. No. 222) and UCP 1974 (ICC Pub. No. 290) were identical as to the point under consideration. For instanse, General Provisions and Definition (a) of UCP 1974 provided: "These provisions and definitions and the following articles apply to all documentary credits and are binding upon all parties thereto unless otherwise expressly agreed."

[41] ICC Pub. No. 411, supra (f.n. 39), at p. 11 said: "At the time the 1974 Revision was introduced an ICC Banking Commission document (No. 470/251 of 1975.03.04) "requested banks to arrange for the insertion [...] of a clause reading: "subject to Uniform Customs and Practice for Documentary credits (1974 Revision), ICC Publication No. 290 ", adding that "in order to avoid possible misunderstanding it is requested that banks do not use wording other than that given above."

[42] Article 1 of UCP 500 is not identical to Article 1 of UCP 400 and provides: "The Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication N. 500, shall apply to all Documentary Credits [...] where they are incorporated into the text of the Credit."

to the point in discussion it seems, therefore, that the text of Article 1 of UCP 400 was more clear than the text of Article 1 of UCP 500.[43]

In respect of the above third situation, there are no references relating to it either within the present UCP or in its previous version. Therefore, what would be a bank's position if parties to a credit contract express their intentions by using words different from those laid down in the Article 1 of UCP 500? Generally speaking, if there are sufficient reasons to accept that parties to a credit agreement are interested in applying the UCP, such an intention should not be disregarded because different terms are used in the text of the credit.[44]

3.1.2. Silence in the letter of credit as to application of the UCP

What would be a bank's position if an issued credit is silent as to the incorporation of the UCP into it? Would such a credit be governed by UCP provisions? One may argue that, unless there is no other indication to the contrary in the credit, the UCP should, as the only international customary law related to LCs, be applied to such a credit.[45] A writer has pointed out, however, that it is questionable to draw similar conclusions in case of standby letters of credits (SLCs). He has said: "It is, at the same time, to be doubted that the UCP applies to a standby credit in which it is not expressly incorporated. The reason for this is

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[43] Article 1 of UCP 400 provided: "These articles apply to all documentary credits [...] They shall be incorporated into each documentary credit by wording in the credit indicating that such a credit is issued subject to Uniform Customs and Practice for Documentary Credits, 1983 revision, ICC Publication N. 400."

[44] This view would find support in English law. for instance, in **Forestal Mimosa v. Oriental Credit** [1986] 1 WLR 631, held that a marginal note incorporated into the credit contract was sufficient; it is said: "No change will be needed in the few cases where banks use forms which states that the credit is "issued subject to the ICC Uniform Customs and Practice for Documentary Credits currently in force." [ICC Pub. No. 411, supra (f.n. 39), p. 10].

[45] Ellinger, LMCLQ 1994, supra (f.n. 1), at pp. 382-83 said: "Article 1 continues to treat the UCP as a set of standard terms and conditions applicable to documentary credits and standby credits by incorporation. Notably, though, Gatehouse, J's decision in **Harlow and Jones Ltd. v. American Express Bank Ltd.** [1990]2 LLLR. 343, indicates that, in view of the universal adoption of the Code by banks all over the world, it would, as a matter of business practice, apply to a documentary credit even if it was not expressly incorporated therein. It is true that Gatehouse, J's decision related to the Uniform Rules for Collection and not the UCP. But, as the UCP has attained a considerable greater degree of acceptance in international banking than the Uniform Rules for Collection, the ruling ought to apply even more decisively to this Code. It can, therefore, be assumed that the UCP applies to a documentary credit unless expressly excluded."

that, in practice, some standby credits are not meant to be governed by the UCP. Indeed, if a standby credit provides for payment against a "clean" draft or, in other words, against a bill of exchange which is not accompanied by additional documents, it falls altogether outside the definition of a documentary credit in Art. 2."[46]

In contrast, it may be suggested that the text of Article 1 of UCP 500 is clear enough concerning the above questions, so credits issued in the above condition should not be governed by the provisions in question. Generally speaking, the latter view is better because it discourages issuing a credit in the above condition, provides more certainty and prevents further disputes, particularly in circumstances where other rules about LCs (like Section 5 of the UCC in the USA) may have existed at the time of transaction. However, in situations where there are at the time of contract no other rules about LCs except the UCP, or where parties to a credit contract agreed on application of the UCP but there is no reference to such a fact in the issued credit, then the first above mentioned opinion would be helpful to prevent an unjustified end to the credit contract. Consequently, the issue of application of UCP relating to the situations discussed above should be reconsidered.[47]

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[46] Ellinger, LMCLQ 1994, supra (f.n.1), p. 383.

[47] For more details concerning legal nature of UCP (namely whether it is a customary or a contractual provisions in nature) see the relevant discussion in Chapter XI; as to conflict between the UCP and terms of contract see Elliner, JBL 1994, supra (f.n. 1), at p. 32 said: "One interesting decision on documentary credits is **Royal Bank of Scotland v. Cassa di Risparmio delle Province Lombard** [Unreported, decision of January 21, 1992, CA]. Here the Court of Appeal held that a confirming bank's action for reimbursement ought to be instituted in New York, where reimbursement was expressly made due in the credit. Rejecting an argument to the effect that the specific term ought not to be considered in isolation but be read together with the provisions of Article 21 of the UCP [1983 Revision], their lordships considered the general question of inconsistencies between the UCP and an express term of contract. Mustill L.J. pointed out that the UCP did not constitute an independent Code or source of law but, merely a set of customs and practice by which merchants might wish to be bound. His Lordship concluded, on this basis, that where a specific term, such as the place of reimbursement, was expressly stated in the credit, there was no need to refer, in addition, to the UCP. In such a case, the express term in question took precedence over the relevant provisions of the UCP. [...] However, according to earlier authority, this principle applies in documentary credit case only where the letter of credit manifists a clear intention to exclude the respective provision of the UCP. Otherwise, the clause in question and the relevant provision of the UCP have to be read together with a view to reconciling them if possible." [Emphasis added; the referred authority is **Forestall Mimosa Ltd. v. Oriental Credit Co.** [1986]1 WLR 631]

3.2. Instructions to issue or amend credits

3.2.1. "Instructions [...] must be complete and precise"

Article 5(a) of UCP 500 provides that instructions for issuance or amendment of a credit "must be complete and precise." The issue related to these terms is how is it possible to conclude that an instruction is not complete or not precise? Would an incomplete or unclear instruction establish any obligation for banks? With reference to the first point, that is, instructions **"must be complete and precise"**, one has to look at the rules and provisions, customs, usage of trade, and those measures that a reasonable person would accept on the basis of the circumstances of each case. Although this issue may seem to cause no difficulty in most cases, there are situations in which a dispute may arise between contracting parties. For instance, in a credit contract in connection with markings on goods, the credit simply stated: "marking=xyz La Celba via Puerto Cortes Honduras CA", and documents which were tendered gave additional information. The ICC Banking Commission, when its recommendation was sought, refused to accept the view that presented documents are in compliance with the terms and conditions of the credit.[48] This decision was reconsidered at the request of the Belgian Banking Association on the grounds that in practice it would jeopardize payment in numerous documentary credits in modern transport practice; the Association suggested that the Commission should express the following opinion: "If a credit requests a special marking, this request should be formulated in the credit by means of one or the other of the two following phrases: either (1) marking is restricted to [...]; or (2) marking should include."[49]

The ICC Banking Commission accepted the above suggestion and modified its previous decision by saying: "If a credit stipulated markings it should

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[48] ICC, "Opinions of the ICC Banking Commission on queries relating to Uniform Customs and Practice for Documentary Credits 1984-1986", ICC Pub. No. 434 [hereinafter referred to as ICC Pub. No. 434], pp. 3-4 (ICC Documents 470/451, 470/450).

[49] Ibid., pp. 4-5.

also clearly state whether only such markings were acceptable. If it did not so state, banks would accept documents which included any markings in addition to the stipulated markings."[50] This point is not particularly mentioned in the UCP 500. For the sake of having a clarified set of standards in international trade it seems necessary that it should be included in a next revision of the UCP.

In respect of the above raised second question (namely would an incomplete or unclear instruction establish any obligation for banks?), although Article 12 of UCP 500 provides a solution by directing that "the bank requested to act on such instructions may give preliminary notification to the beneficiary for information only and without responsibility",[51] the procedure in question may itself generate some uncertainty. For instance, from what moment does the expiry date of a credit start, from the time of issue of the credit or from the time when complete and clear instructions have been received? Article 12 of UCP 500 refers only to the time of advising, confirming and amending a credit in a situation under consideration and provides nothing about the point involved in the above question.[52] In contrast, Article 14 of UCP 400 was more clear than Article 12 of UCP 500 regarding the point in discussion; since under that Article the time of issuance of a credit in case of incomplete or unclear instructions also started from the time the necessary information was received and the bank was then ready to act on the instructions.[53] Article 14 of UCP 400 provided a more just solution in the above presented situation because it was clear as to the time of issuance of a credit in case of incomplete or unclear instructions and put the matter of issuance

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[50] Ibid., p. 5 (ICC Doc. 470/460/, 470/468).

[51] ICC Pub. No. 500.

[52] The relevant part of Article 12 of UCP 500 provides: "[...] The Issuing Bank must provide the necessary information without delay. The Credit will be advised, confirmed or amend, only when complete and clear instructions have been received and if the Advising Bank is then prepared to act on the instructions."

[53] Article 14 of UCP 400 provided: "If incomplete or unclear instructions are received to issue, confirm, advise or amend a credit [...] The credit will be issued, confirmed, advised, or amend only when necessary information has been received [...]." [Emphasis added; and for the full text of the article see ICC Pub. No. 400]

of a credit and its effect on expiry date of such a credit in the same line as accepted for advising, confirming or amending a credit. Therefore, Article 12 of UCP 500 and paragraph (c) of Article 42[54] should be revised as to the time of issuance of credit where instructions are incomplete or unclear.

Moreover, in connection with the procedure stated under Article 12 of UCP 500, it is suggested that such a practice provides a complicated procedure for the advising bank while there is no real benefit to the beneficiary. It is suggested the Article 12 should be redrafted as follows: "If incomplete or unclear instructions are received to issue, confirm, advise or amend a credit, no action will be taken so to do until complete and clear instructions have been received."[55]

3.2.2. "Excessive detail"

In Article 5 (a) it is stated, "banks should discourage any attempt: (i) to include excessive detail in the Credit or in any amendment thereto." What does **"excessive detail"** mean in commerce? No definition has been suggested, since it is difficult for banks to decide which part of their client's instructions is excessive and which part of the mandate is essential. For this reason the ICC Banking Commission recommended only that banks should educate their customers to avoid such difficulties.[56] As confusion and misunderstanding may arise between banks and their customers concerning the meaning of terms "excessive detail", it would be more appropriate to revise Article 5(a)(i) either by defining the terms in question or removing them from the provisions in an amended text of the UCP.[57]

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[54] Article 42(c) of UCP 500 provides: "If an Issuing Bank states that the Credit is to available "for one month", "for six months", or the like, but does not specify the date from which the time is to run, **the date of issuance of the Credit by the Issuing Bank will be deemed to be the first day from which such time is to run**. Banks should discourage indication of the expiry date of the Credit in this manner." [Emphasis added.]

[55] Ventris, supra (f.n. 7), at p. 14.

[56] ICC Pub. No. 411, supra (f.n. 39), p. 15.

[57] Ellinger, I.MCLQ 1994, supra (f.n. 1), at p. 384 stated: "As the meaning of "Excessive details" is, in any event, far from clear, it is to be doubted whether a definite prohibition would have been more useful than the current provision."

3.3. Legal structure of a second confirmation

There may be situations in which an irrevocable letter of credit is confirmed not by one but by two or more banks. A question was raised by a Japanese bank as to the legal structure of a second confirmation of a confirmed credit. There is no express provision dealing with this point under the UCP, and the ICC Banking Commission did not express any opinion in its meeting in April 1985.[58]

It seems that the legal and contractual relationship between the confirming banks depends on the circumstances of the case: **(1)** if the second confirming bank receives the request for adding its confirmation directly from the issuing bank, there is then no privity of contract between that bank and the first confirming bank and their positions in relation to the issuing bank and the beneficiary of the credit are similar; but **(2)** if the second confirming bank is asked by the first confirming bank to add its confirmation to the credit, then their relationship is as principal and agent, and there is no transaction between that bank and the issuing bank.

What would be the beneficiary's obligation in such a situation? It seems the beneficiary is obliged to look for the second confirming bank for payment in the above second situation; in the former circumstances he is entitled to present documents to each one of the confirming banks, at his choice, unless otherwise accepted under the credit arrangement. It is submitted here that the next revision of the UCP should consider the above made suggestion.

3.4. "All credit must clearly indicate [...] and [...] nominate"

Those who redrafted the UCP by using the word "must" have tried to make clear the importance of issues concerning the type of credit and the nominated bank in sub-sections (a) and (b) of Article 10 of UCP 500. What would be the validity of a credit if none of the conditions in question, that is, to indicate and nominate clearly exist in the credit? In October 1986 the ICC Banking Commission

[58] ICC Pub. No. 434, supra (f.n. 48), pp. 8-10 (ICC Doc. 470/450, 470/452).

stated: "If a bank has issued a credit and complied documents are presented it must pay. If it sets up a system for presentation through a specified bank then there is a risk if documents are presented through another bank. It must take steps to avoid the problem of two sets of documents being presented."[59]

As a result of the above quoted decision there is a possibility that, by implication, an issued credit in a situation under discussion is accepted as a valid credit; but, the issuing bank puts itself in a risky position by issuing such a credit.[60]

3.5. Meaning of teletransmission

What is the meaning of "teletransmission" in sub-section (a) of Article 11 of UCP 500? In April 1985 the ICC Banking Commission was asked to state its view as to the meaning of the term and the Commission agreed that the view expressed by the Austrian National Committee about the meaning of the "teletransmission" under the UCP provisions was correct.[61] The Austrian National Committee stated: "The expression "teletransmission" in this Article does not include telephone conversation, but does include instructions given by telefax (telecopier). As a consequence a letter of credit transmitted by telefax (bearing the correct test key) constitutes the operative credit instrument."[62]

What would be the validity of a credit if it is transmitted by **SWIFT** (The Society for Worldwide Interbank Financial Telecomunication)? With regard to the effect of using the SWIFT system for establishing a commercial credit, a West German Bank drew the attention of the ICC Banking Commission by stating that it

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[59] ICC Pub. No. 434, supra (f.n. 48), pp. 13-14.

[60] Ibid., pp. 14-15.

[61] ICC Doc. 470/444, 470/452; Ventris 1985, supra (f.n. 5), at p. 12 said: "It will be observed from the expression to be found in the 1974 Revision "advice sent by cable, telegram or telex" has been replaced by that of "teletransmission". The latter, however, has not been defined, whereas in view of the key role it plays in documentary credits it should have been. For example, a message can be given by telephone and is thus a "teletransmission", but no one would suggest that it is an acceptable method of advising or confirming a "credit" as it leaves no trace of its own." [Emphasis added]

[62] ICC Pub. No. 434, supra (f.n. 48), p. 19.

is not a good practice to open a credit by SWIFT (type 700), since it is a bank-to-bank message and is transferred without any signature on the part of the receiving bank. Furthermore, it is a matter of importance whether such a credit could be considered a legally binding instrument of the sending bank towards the beneficiary of the credit. So, a recommendation by the ICC Banking Commission was requested to the effect that, "in the future, commercial letter of credits are opened in writing only." The Commission decided that using the SWIFT documentary format 700 is good practice.[63]

Although there is no direct reference to that system in the UCP, in accordance with SWIFT protocol messages sent by that system incorporate UCP provisions, unless otherwise expressly excluded.[64] Therefore, the sender bank is legally bound to the beneficiary under Article 10 of the UCP 83. As a result, the Commission announced that, "the SWIFT procedures offered greater accuracy and reliability than telex" although there is no signature of the receiving bank in either system.[65]

3.6. Insolvency of an advising bank

In sub-section (b) of Article 11 of UCP 500 it is provided that the issuing bank must use the services of the same advising bank for advising an amendment to the issued credit. It is a useful procedure, to prevent any confusion between contracting parties. However, there may be situations where using the services of the same advising bank become impossible, namely, when the advising bank becomes insolvent. What would be the issuing bank's duty in such a situation? It seems there is no other option for the issuing bank than to use the services of

[63] Ibid., pp. 19-20.

[64] The ICC Banking Commission gave its consideration to the requirement of the SWIFT namely whether the UCP phrase should be explicitely transmitted in the telecomunications between the banks as the following: "The Commission considered that banks advising credits issued through SWIFT should ensure in accordance with SWIFT Rules that the appropriate UCP incorporation clause included in the credit advice sent to the beneficiary." [ICC Pub. No. 434, supra (f.n. 48), p. 21; ICC Doc. 470/ 479, 470/481].

[65] See Chapter IX for issues related to Electronic Data Interchange (EDI).

another advising bank, but the bank should carry all precautions to prevent any dispute over the issue of amendment of the credit at a later stage.

3.7. Meaning of "similar credit"

Although under sub-section (a)(ii) of Article 5 of UCP 500 banks should discourage any attempt "to give instructions to issue, advise or confirm a Credit by reference to a Credit previously issued (similar Credit)", it is still possible that a bank is faced with such instruction. What is then the meaning of "similar Credit" in UCP 500 if a credit previously issued was subject to amendment? Would it be possible to follow the procedure which was laid down under Article 13 of UCP 400 namely, "it shall be understood that the similar credit will not include any such amendment(s)"?[66] There is an objection to the method suggested by the UCP 400 to tackle the problem. One writer has pointed out that "it goes to the contrary of what a businessman would understand. If one were to ask for a similar credit to be opened, one would normally mean the same credit in its final form."[67] This view seems to be sound to reflect business practice, and should be taken up by the ICC in order to prevent confusion and misunderstanding between banks and their customers. An alternative solution is that the ICC takes the view that banks should not accept any request refers to terms "similar credit" and prevents such a practice totally.

3.8. Assignment of the benefit of a credit

Article 49 of UCP 500 provides that even if the credit does not provide for the transferability of the credit, the seller's right of assignment is not affected and he is entitled to use his right "in accordance with the provisions of the applicable law." Therefore, as a general principle the beneficiary of the credit is entitled to assign his benefit under the credit to a third person without the agreement of the

[66] Article 13 of UCP 400 provided: "When a bank is instructed to issue, confirm or advise a credit similar in terms to one previously issued, confirmed or advised (similar credit) and the previous credit has been the subject of the amendment(s), it shall be understood that the similar credit will not include any such amendment(s) which is/are to apply to the similar credit. [...]."

[67] Ventris 1985, supra (f.n. 5), p. 13.

applicant/buyer, unless otherwise stipulated in the credit.[68] Moreover, the assignee's position against the applicant for the credit is similar to the assignor (the beneficiary of the credit) and he remains responsible for defences which may be available to a debtor against the assignor. However, these are issues related to Article 49 of the UCP.

1. Concerning the situation where an issuing bank did not honour its undertaking against an assignee in the case of an irrevocable credit, the ICC Banking Commission decided that the remedy should be found in transactional law and UCP did not cover such situations.[69]

2. Another point is that Article 49 of UCP 500 does not cover the decision given in **Singer and Friedlander Ltd. v. Creditanstalt Bankverein,**[70] in which it was stated that an assignee has to present documents in the name of the first beneficiary.[71]

CONCLUSIONS

There has been substantial growth over the last fifty years in the use of documentary letters of credit as a means of financing international business transactions and the law regulating LCs has developed enormously to keep pace with this growth. The previous Chapters of the present study made clear that the law regulating documentary credits is largely customary/contractual in nature. The

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[68] English law supports an assignment of proceeds since it is a "**chose in action**", and in accordance with s. 136(1) of The Law of Property Act 1925, a chose in action can be assigned in writing absolutely to another person as third party. Of course, an express notice of an assignment must be given to the debtor; Schmitthoff's article, supra, at p. 49 stated: "In English law there are two types of assignment, legal and equitable assignment. Section 136 of the Law of Property Act 1925 provides that a legal assignment must be "in writing, absolute and not purporting to be by way of charge only, and that written notice of assignment must be given to the debtor." Under that rule the seller's position is similar to that provided under Article 55 of UCP (1983). The equitable assignment on the other hand does not require conditions which are stipulated for the legal type of assignment, in particular there is no need to give a written notice to a debtor."

[69] ICC Pub. No. 371, supra (f.n. 15), p. 96.

[70] [1981] Com.L.R. 69.

[71] Ellinger, supra (f.n. 39), pp. 578-606, p. 604.

Uniform Customs and Practice for Documentary Credits (UCP) which seek to facilitate trade and harmonize commercial procedures provide the most prominent set of standards concerning LCs at the international level. Several questions, however, should be considered: **1.** Are there any grounds for further improvement of UCP 500? **2.** If yes, what are those possible changes and their impacts on the UCP? **3.** Did the ICC achieve its goals namely for providing a simplified, modernised, justified, codified and unified set of standards concerning LCs at international level? **4.** If no, what would be a substitute solution for the ICC?

Concerning the first question above, although the latest revision of the UCP in 1993 (UCP 500) provides better provisions compared with previous versions of the UCP,[72] there are issues, as pointed out under the present and following Chapters, which remain unsettled. Therefore, UCP 500 is far from perfect[73] and still requires further consideration and revision.[74] In respect of possible changes

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[72] Ellinger, JBL 1994, supra (f.n. 1), at p. 28 said: "This is not to say that the new Revision is of a revolutionary nature. In most regards, it followes the pattern of its predecessor. [...] The new Revision provides a much neater set of standard contract terms than any earlier version of the Code."; the same writer also pointed out: "The Working Group's main contribution is in the drafting of the new rules which govern transport documents not covered previously in the Code. Another four areas worth specific mention are, respectively, the provisions defining the banks' undertaking in irrevocable credits (Art. 9), the definition of negotiation and of a "Nominated Bank" (Art. 10), the provision rendering non-documentary requirements in the credit of no-effect (Art, 13(c)) and the tyding up of the provisions on transferable credits (Art. 48)." [Ellinger, LMCLQ 1994, supra (f.n. 1), p. 402.]

[73] Ellinger, LMCLQ 1994, supra (f.n. 1), at p. 402 said: "There are [...] a number of areas in which the new Revision misses the mark. **First** and foremost is the provision concerning letters of credit available by negotiation, in which the beneficiary is asked to draw his draft on the applicant. The relevant problems, respecting Art. 9(a)(iv), have been discussed in details earlier. **Secondly**, the meaning of "value" in Art. 10(a)(ii) should have been defined so as to avoid confusion. **Thirdly**, it is to be doubted if a separate provision was required for each of the separate transport documents governed by the Code. As charterparty bills of lading (Art. 25) and non-negotiable sea waybills (Art. 24) are largely governed by the provisions applicable to marine bills of lading, they could, in all probability, have been regulated in clauses tagged on to Art. 23." [Emphasis added]; Dolan, John F., **"Weakening the letters of credit product: The new Uniform Customs and Practice for Documentary Credits"**, International Business Law Journal, No. 2, 1994, pp. 149-177 [hereinafter referred to as Dolan], at p. 149 said: "[...] the latest version of the Uniform Customs may contain misguided attempts to protect banks from problems in the latter of credit transaction that they are better equipped to face. Unfortunately, in the four instences discussed here, the new Uniform Customs allocate the costs to commercial parties less able to bear them than the banks themselves."

[74] The UCP is widely accepted in the banking world and has been achieved considerably success towards the harmonization of international banking rules relating to documentary letters of credit. It has undergone neumerous revisions (five times in 1951, 1962, 1974, 1983 and 1993) in an attempt to match the high growth

and their impact upon the UCP (second query above), generally speaking, they concern a wide range and include all parties to LCs transactions (the applicant for a credit, the beneficiary, and banks). As pointed out previously, the applicant for a credit seems placed in a risky position since the bargaining power of banks can lead to some unjustified provisions, namely, under Articles 16 (disclaimer on the transmission of messages) and 18 (disclaimer for act of an instructed party) in favour of banks.[75] As a writer has rightly pointed out, Articles 16 and 18 bring in the long term more harm for banks in long term since they weaken LCs reputation as banking products.[76]

Regarding some issues concerning the beneficiary of a credit, namely, points related to "amendment or cancellation of a revocable credit" (Article 8(b)), "notice of modification or cancellation" (Article 8(a)), "late negotiation", "rectifying non-conforming documents", "any cause beyond their control" (Article 17), and "transferable credit" (Article 48(a)), quoted in the present study, it is necessary, for reasons pointed out above that the ICC take further steps for having within the UCP articles which are simpler and clearer than has been done in the last revision of the provisions.[77] A similar concern should be expressed about issues related to

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in international trade and its new commercial requirements as they have arisen overtime; for more details see history of LCs in Chapter I, Section B.1 (above).

[75] See discussions related to "the bank's position on transmission of messages" and "disclamer for acts of the issuing bank as an instructed party" under the present Chapter, Sections B.1.1 and B.1.2 (above).

[76] Dolan, supra (f.n. 73), pp. 170-72; as to the applicant of a credit it is said by the same writer: "Applicant should beware the unfair rule of Article 13(c) allowing banks to ignore nondocumentary conditions. It will serve applicants well, especially in the standby credit transaction, to insist that the rule allowing or commanding banks to disregard nondocumentary conditions be removed from credit subject to UCP 500." [See Dolan, supra (f.n. 73), at p. 172]

[77] For instance, Article 7(c) of UCP 400, under which such a credit was deemed to be revocable, was regarded as out of date; and under Article 6(c) of UCP 500, a letter of credit that gives no indication as to whether it is revocable will be deemed irrevocable. This change aligns UCP 500 more closely with Section 5 of the Uniform Commercial Code in most states in the USA; for more details concerning the UCC see Chapter V (below); Herula, Donald and Powell, Robert, "Provisions Lie a head for L/C Transaction", Business Credit, July/August 1993, p. 18; Dolan, supra (f.n. 73), at p. 171 said: "Beneficiaries may want to eliminate the rule that document checkers are bound not by general banking practices and common sense but by the mythical "international standard banking practice." Beneficiaries should also consider the advisability of refusing credit issued by a bank to support it own undertaking."

banks, such as "incorporation of the UCP in the credit" (Article 1), "instructions to issue or amend credits" (Article 5(a)), "legal structure of a second confirmation" (Article 9(b)), "all credits must clearly indicate and nominate" (Article 10(a)and 10(b)), "meaning of teletransmission" (Article 11(a)), "insolvency of advising bank" (Article 11(a), "meaning of "similar credit"" (Article 5(a)(ii)), and assignment of the benefit of a credit (Article 49).

About the above third question, the worldwide acceptance of the UCP shows its popularity in the commercial world. Such a success, however, does not mean that UCP 500 is complete or perfect and there is no room for its further improvements. Contents of the present Chapter as well as of Chapters that follow make clear the shortcomings which exist in UCP provisions. A real need for improvements exist, as pointed out above (namely under the third question) and the ICC should as always co-ordinate efforts towards another revision of the UCP.

As to the above last mentioned question, generally speaking, LCs issues can be classified into two categories: **1.** Issues related to banking practices and international customs, and **2.** Issues concerning legal aspect of LCs. For the first type of issues, some of which have been considered in the present Chapter, the ICC has sufficient authority to provide better provisions as it has done in the past. In respect of the second category above the ICC may not be able to involve itself, even if there is a strong desire by the ICC to do so because of a lack of expertise in legal subjects and, more importantly by the lack of a mandate for the ICC as a non-governmental organisation. As a result a gap concerning laws related to LCs at the international level exists. How would it be possible to fill the gap? In other words, what would be a substitute solution for the ICC if the UCP reached the end of its functional maturity? These questions are considered below later; but it is important already to consider issues which should necessarily be noticed with respect to any international set of standards concerning the legal aspects of LCs. In that regard a comparative study between UCP 500 and Article 5 of the UCC in the USA, would help to paint a better picture with regard to other shortcomings in the UCP and to draw lessons that would be useful for supporting a view favouring

the idea of a progressive unification/codification of the law of LCs at an international level. Moreover, particular legal details relating to the principle of strict compliance, doctrine of autonomy, and banker's right of securities can be usefully examined from the common law perspective (mainly English Law) in order to find out how English law may play an effective role in shaping the law of LCs at an international level.

CHAPTER V

ARTICLE 5 OF THE UNIFORM COMMERCIAL CODE (UCC) AND UCP 500

SECTION A: GENERAL BACKGROUND

1. INTRODUCTION

In the previous section the last version of the Uniform Customs and Practice for Documentary Credits (UCP 500) and issues related to it have been considered. In the present Chapter the discussion is focused on Article 5 of the Uniform Commercial Code (UCC) of the United States of America; its advantages and disadvantages will be compared with those of the UCP 500 since Article 5 of the UCC is largely applied in the USA and, like the UCP, deals directly with issues related to documentary credits at present.[1] The reason for doing such a comparative study is to point out what lessons may be learnt from Article 5 of the UCC and how to use them as a good background for any international set of standards in a mandatory form for letters of credits (LCs).

To provide a solid foundation several points should be clarified at the beginning.

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[1] Lowenfeld, Andreas F., **"International private trade"**, Matthew Bender, New York, 1977 [hereinafter referred to as Lowenfeld], at p. 113 said: "When the Uniform Commercial Code was being drafted and promoted in the various state legislatures in the late 1950's and early 1960's, there were two kinds of objections to including an article on letters of credit, both primarily within the banking community and their counsel. Some thought it was not necessary to have such an article at all, since the Uniform Customs and Practice covered the subject adequately and on the worldwide scale; others, led by the New York Clearing House Association (a bankers'group), would accept nothing less in authority to opt out of the Code's provisions on letters of credit in favour of the UCP."; Rummer, Patricia, **"Proposed UCC revisions: Restructuring for the future"**, Commercial Law Bulleten, Sep/Oct 1991, p. 13 [hereinafter referred to as Rummer], at p. 16 said: "The drafting committee at work on a revision of Article 5 (letters of credit) have two major tasks, says Carlyle Ring, who chairs the committee. It must: 1) create rules for the new widely used standby letters of credit, and 2) decide how to blend UCC provisions on letters of credit with **international law**, given the widespread international use of letters of credit. "An even more important goal, however, is to draft the rules in such a way that they don't get in the way of future developments in letters of credit" observing Ring."; McLaughlin, G.T., **"UCC Article 5 Symposium: Should deferred payment letters of credit be specifically treated in a revision of Article 5?"**, Brookline Law Review, Vol. 56, Spring 1990, p. 149; The American Law Institute, **"Uniform Commercial Code Revised Article 5, Letters of Credit (with amendments to Articles 1, 2, and 9), Proposed Final Draft (April 6, 1995)"**, submitted by the Council to the Members of the American Law Institute for Discussion at the Seventy-Second Annual Meeting on May 16, 17, 18, and 19, 1995 [hereinafter referred to as Proposed Final Draft (PFD)]. As of the date of publication, this draft has not been considered by the members of the American Law Institute and does not represent the position of the Institute on any of the issues with which it deals. The action, if any, taken by the members with respect to this draft may be ascertained by consulting the Annual Proceedings of the Institute, which are published following each Annual meeting. (The Reporter is Professor James J. White of the University of Michigan); for the text of PFD see appendix 2 below.

2. POINTS CONCERNING UCC IN GENERAL

2.1. National and international standards

National and international interests should be differentiated from one another and efforts should be directed towards rules and provisions related to LCs which are accepted internationally since documentary credits are applied worldwide. As opposed to the UCP which is a set of standards accepted by banks in many countries (mostly as customary rules at an international level), Article 5 of the UCC is only enforceable in all states in the USA except in the states of New York, Alabama, Missouri, and Arizona where UCC in a modified form is applied;[2] thus, issues related to documentary credits are dealt with from a different perspective, namely in the light of a national rather than international interest.[3]

2.2. Mandatory and non-mandatory standards

The issue of mandatory or non-mandatory standards relating to documentary credits is also important as a good system of law is one which provides more certainty for the interested parties to a letter of credit located in different countries

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[2] Lowenfeld, ibid., at pp. 113-114; Article 5 of the UCC has been adopted in a uniform form by most states of the USA, but as an exception the states of New York, Alabama, Arizona, and Missouri do not apply Article 5 without modifying it. A note under Article 5-112 (1) provides, "The bracket language in the last sentence of sub-section (1) should be included only if the optional provisions of Section 5-114(4) and (5) are included." The brackect language in the last sentence of sub-section 1 of Article 5-112 states: "[except as otherwise provided in sub-section 4 of Section 5-114 on coditional payment.]" And sub-section 4 of Section 5-114 provides: "[(4) When a credit provides for payment by the issuer on the receipt of notice that the required documents are in the possession of a correspondent or other agent of the issuer (a) any payment made on receipt of such notice is conditional, and (b) the issuer may reject documents which do not comply with the credit if it does so within three banking days following its receipt of the documents; and (c) in the event of such rejection, the issuer is entitled by charge back or otherwise to return of the payment made.] Moreover, in sub-section 5 of Section 5-114 stated: "[(5) In the case covered by sub-section (4) failure to reject documents within the time specified in sub-paragraph (b) constitutes acceptance of the documents and makes the payment final in favoure of the beneficiary.] And also, in a note under Section 5-114 it is said; "Note: Subsections (4) and (5) are bracketed as optional. If they are included the bracketed language in the lase sectence of Section 5-112 (1) should also be included."; for further details see James J. White and Robert S. Summers, "Handbook of the law under UCC", 1972, p. 612 [hereinafter referred to as UCC] and disscussion related to the history of LC in Chapter 1.

[3] The goals for drafting the new Article 5 of the UCC were: (1) conforming the Article 5 rulles to current customs and practices; (2) accomodating new forms of letters of credit, changes in customs and practices, and evolving technology, particularly the use of electronic media; (3) maintaining letters of credit as an inexpensive and efficient instrument facilitating trade; and (4) resolving conflicts among reported decisions. [See PFD, supra (f.n. 1), at p. xvii (Prefatory Note)]

with different legal systems. Consequently, such an element in international legal standards leads all parties to an international transaction to a better and similar understanding for the system in operation, e.g., (in this case) LCs. By such a policy the credibility of the documentary credit system is increased and interested parties become aware that the rules of the system are the same worldwide and they are treated and interpreted similarly by courts in different system of law.

The UCP provisions are in the form of a "non-mandatory" nature and can only be enforced if parties to a credit contract stipulate and refer to the UCP in their transaction; in contrast, Article 5 of the UCC is legislative in nature; therefore, banks and other interested parties to documentary credits are obliged to follow the rule, unless otherwise stipulated in the rule.[4] The effect of those distinctions emerges as to the rights and duties of contracting parties by adopting a different approach and style as to issues related to the letters of credit.

2.3. Issues of conflict of law

The present study shows how issues related to letters of credit are treated differently in the USA, since many states in the USA follow Article 5 of the UCC whereas in a few states, as mentioned above, parties to a credit transaction are able to choose between the UCP and Article 5 of the UCC.[5] This can also be true where the legal residences of parties to a credit contract were located in different countries. So, the issue of conflict of law becomes relevant in such a situation. In addition, different points of view between English lawyers and their American colleagues, as to issues connected to documentary credits, are also to be noted.

For the present study the text of Article 5 of the UCC is accepted as a basis for analysis and the UCP 500 is compared with it.[6]

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[4] For instance see Section 5-103(c) of the PFD, supra (f.n. 1), suggested that parties to LCs transaction can, to some extent, agree upon terms which are different to Article 5. [See appendix 2 for the text of Section 5-103(c)]

[5] See a note under Section 5-112(1) and sub-sections 4 and 5 under Section 5-114 of the UCC, supra (f.n. 2); it was pointed out that Sections 5-114(4) and (5) were omitted since they were optional. [PFD, supra (f.n. 1), p. xxviii (table of disposition)]

[6] See appendix 1 for the text of Article 5 of the UCC.

SECTION B: COMPARISON BETWEEN ARTICLE 5 AND UCP 500

1. ISSUES CONSIDERED UNDER BOTH UCC AND UCP: DIFFERENCES

1.1. Issues related to the provisions

1.1.1. The legal nature of Article 5 of the UCC

Trade and banking services are well established in the USA. Letters of credit (LCs) have been used for a long time as a commercial instrument for payment as well as securing services in domestic and international transactions in the USA;[7] however, the law concerning LCs has mostly been developed through cases, since the USA, like the United Kingdom (UK), belongs to the system of common law.[8]

Article 5 of the UCC provides a legal instrument in the form of national legislation, as an independent source of law for the further development of rules related to documentary credits. Although Article 5, beside case law, provides a better chance for understanding the use of LCs in the USA, some other points should be noted. Firstly, Article 5 of the UCC deals with some but not all aspects of LCs; this is admitted in sub-section 3 of Section 5-102.[9] Secondly, the nature of Article 5 is national rather than international. This can limit its applicability in other

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[7] See discussion related to the history of LCs under Chapter I, Section B (above).

[8] Except Section 135 of the negotiable Instruments Law; for more details see UCC, supra (f.n. 2), Official Comment on Section 5-101, p. 417.

[9] The text of sub-section 3 of Section 5-102 of Article 5 of the UCC states: "This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not by itself require, imply or negate application of some or a converse rule to a situation not provided for or to a person not specified by this Article."; see also the prefatory note of the Proposed Final Draft (PFD), supra (f.n. 1), at p. xv concerning reasons for revision of Article 5 of the UCC said: "When the original Article 5 was drafted 40 years ago, it was written for paper transactions and before many innovations in letters of credit. Now **electronic and other media** are used extensively. Since the 50's, **standby letters of credit** have developed and now nearly $500 billion standby letters of credit are issued annually worldwide, of which $250 billion are issued in the United States. The use of **deferred payment letters of credit** has also greatly increased. The customs and practices for letters of credit have evolved and are reflected in the Uniform Customs and Practice (UCP), usually incorporated into letters of credit, particularly international letters of credit, which have seen **four revisions since the 1950's**; the current version is effective in 1994 (UCP 500). Lastly, in a number of areas, **court decisions** have resulted in conflicting rules." [Emphasis added]

countries that seek different national interests; but, at least, it can set up an example concerning the type of issues related to LCs and whether they should be covered by a national or international legal instrument. There is no similar legislation regarding to LCs in the UK.

In a comparison with the last version of the Uniform Customs and Practice for Documentary Credit (UCP 500), a crucial distinction between UCC and UCP emerges. The latter is not in a legislative form that automatically binds contracting parties; it is a code of practice adopted voluntarily by parties to a credit contract.[10] However, the advantage of the UCP is that the provisions are applied by banks in many countries; for this reason it is more international rather than national in character. Nevertheless, UCP and its legal nature, as far as Article 1 of the UCP 500 is concerned, are in the form of a contractual agreement. By some concession,[11] the UCP may be accepted as mostly a source of **"customary law"** in international private law. The legal nature of its provisions, as a set of standards which covers in general banking practices in countries where trade and banking systems are internationally well established, is far from being mandatory in nature. The lack of such an element may potentially cause disputes among parties to a letter of credit in international transactions, since different approaches may be adopted by courts in different countries with similar as well as different legal systems. The issue of the legal nature of the UCP is dealt with elsewhere;[12] however, to conclude the present remarks and to draw a lesson from Article 5 of the UCC it is not impossible to put forward a set of standards for LCs in the form of a **"legislative"** instrument at an international level addressing mainly international interests. Such a task can be partly based on experience gained when preparing

[10] See Article 1 of the UCP 500; ICC Pub. No. 500 (1993).

[11] For instance, it is accepted that the UCP reflects the view of banks and all intersted parties to the credit rather than the view of few strong banks and companies; and also other elements which are necessary for establishing an international customs such as duration.

[12] See related discussion under Chapter XI, Section B.2 (below).

Article 5 of the UCC which provides for uniformity between the different states in the USA and partly on results achieved when preparing the UCP and its acceptability worldwide.

1.1.2. Scope of Article 5

As to the issue of the scope of Article 5 of the UCC, generally speaking, both UCC and UCP cover those types of LCs which are issued by banks.[13] Sub-section 1 of Section 5-102 of the UCC and Article 2 of the UCP 500 deal with that point.[14] However, there are distinctions between Article 5 of the UCC and the UCP regarding letters of credit issued either by a person other than banks or those credits which require no documentary draft or a documentary demand for payment. Paragraph (b) of sub-section 1 of Section 5-102 refers to the first type of credit, namely, "to a credit **issued by a person other than a bank** if the credit requires that the draft or demand for payment be accompanied by a document of title.";[15] and paragraph (c) of the same sub-section is related to another type of credit and

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[13] Ellinger, E.P., "The Uniform Customs and Practice for Documentary Credits- the 1993 Revision", LMCLQ, Part 3, August 1994, p. 377 [hereinafter referred to as Ellinger, LMCLQ 1994], at p. 383 said: "Like the 1983 Revision, the new Code does not define the word "bank". The issue, was apparently, considered by the Working Group. [ICC Brochure No. 511, p. 5]."; what is the meaning of "bank"? Bank means,"establishment for keeping money and valuables safely, the money being paid out on the customer's order.", Hornby, A.S., "Oxford Advanced Dictionary of Current English", p. 61; see also Ellinger, E.P, "Modern Banking Law", 1987, pp. 51-74 (for legal definition and previlages of bank at Common law); it is suggested by the same author that, "the common law definition of a "bank" [...] is based on treating a bank as an institution engaged in banking business. The nature of this type of business has not been determined by Parliament. Its construction has accordingly remained in the hands of the courts." [the above reference, at p. 51]; Section 2 of the Bills of Exchange Act 1882 defined a "banker" in terms that, ""banker" includes a body of persons whether incorporated or not who carry on the business of banking"; in Commissioners of the State Savings Bank of Victoria v. Permewan, Wright & Co. Ltd. [(1915) 19 CLR 457], Isaaca, J., described the meaning of banking business (at p. 471) as: "the collection of money by receiving deposits upon loan, repayable when and as expressly or impliedly agreed upon, and the utilisation of money so collected by lending it again in such sums as are required."; and also in United Dominions Trust v. Kirkwood, [1966] 2 QB 431, 447, Lord Denning, M.R., described the main facts of banking business as follows: "There are, therefore, two characteristics usually found in banks today: (i) They accept money from, and collect cheques for, their customers and place them to their credit; (ii) They honour cheques or orders drawn on them by their customers when presented for payment and debit their customers accordingly. These two characteristics carry with them also a third, namely: (iii) They keep current accounts, or something of that nature, in their books in which the credits and debits are entered."

[14] See ICC Publications No. 500 and appendix 1, for paragraph (a) of Section 5-102(1) of the UCC.

[15] Emphasis added; see appendix 2 for Section 5-102(9) of PFD.

refers "to a credit issued by a bank or other person if the credit is not within paragraphs (a) and (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled."

According to what has been said above it becomes clear that both UCP and UCC have a common ground in one aspect and a different one in another. This leads to a distinction between laws related to the documentary credit system. How would it be possible to prevent the emergence of different bodies of rules and provisions? In other words, is it a good idea to widen the scope of application of the law of LCs to those types of credits issued by non-banking institutions providing similar services in international trade? One may argue that the main issuers of LCs in world trade market are banks; credits are issued by non-banking institutions but not in a large share of the markets; therefore, there is no need to enlarge the scope of the only existing provision related to LCs, namely, the UCP 500.[16] Moreover, by adopting such a policy the documentary credit system would be damaged since banks may see such a policy as a threat to their control of events and may withdraw such a service from their banking activities.

The following points should also be noted. Firstly, although a large share of documentary credits in international trade and business market belongs to banks, it does not mean that the law related to LCs should not be wide in its scope. It is not an advantage for the law to stick to a narrow rather than wider policy. Secondly, a need for enlargement of the law related to LCs seems necessary (see the special rules provided under Article 5 of the UCC, discussed above). The USA is a large country with many states and strong participation in international trade. So, it is not practical to think about an international set of standards regarding LCs without referring to the question of its necessity. Thirdly, as to the possible harm which

[16] Ellinger, LMCLQ 1994, supra (f.n. 13), at pp. 383-84 pointed out: "The incorporation of the UCP in a letter of credit issued by an institution which may not, technically, constitute a bank cannot, in itself, cause any loss, or be of a direct disadvantage, to the parties involved. Whether or not an institution such as, for instance, a building society should be allowed to issue documentary credits is a question for the determination of the central Bank in that institution's country. It is not a matter to be setteled in a set of standard terms drafted by the ICC."

banks may suffer by widening the scope of law, namely, covering LCs issued by non-banking institutions, there may be a set back for banks and they may lose some of their interest at the beginning, but in the long term they would benefit more than now from such a policy. The reason is that by removing a monopoly from the system and allowing competition a better and cheaper service would be available for parties to an international sale contract. This would encourage businessmen to look more than before to LCs and such an increase in demand may generate a great need for documentary credits. As a result, banks that control large shares of LCs' market would also benefit. Consequently, it is a sensible policy to work preferably for establishing an international set of standards for LCs with a wider scope of rules. Moreover, following a similar approach a next revision of the UCP would provide more harmony between the provisions in question and Article 5 of the UCC.

1.2. Issues related to some types of credit

1.2.1. Standby letters of credit (SLCs)

Under Article 5 of the UCC nothing is provided directly in connection with standby letters of credit (SLCs), whereas as one of the modifications under UCP 400 (1983), that type of credit, largely in use in international trade, is precisely named in Articles 1 and 2; a similar policy was adopted under UCP 500 (1994).

Is it possible to draw a distinction between UCC and UCP relating to SLCs? One may suggest that Article 5 of the UCC does not cover SLCs since there is no reference to such credit under Section 5-103 where "credit" or "letter of credit" are defined. Such a suggestion may find some support in sub-sections 2 and 3 of Section 5-102. Sub-section 3 (quoted above) and sub-section 2 provide: "Unless the engagement meets the requirements of sub-section (1), this Article does not apply to engagements to make advances or to honour drafts or demands for payment, to authorities to pay or purchase, to guarantees or the general agreements." What are the requirements under sub-section 1? There are two requirements under that sub-section, namely, there must be a "documentary draft" or a "documentary demand" for payment by the beneficiary of a credit.

Is such an interpretation acceptable and does it match with real practice in the USA? It seems that an opposite argument is preferable, for reasons that follows. Firstly, SLCs have been known as a commercial device for securing payment and services by American lawyers for a long time and there have always been arguments about their legal nature, namely, whether they are or not guarantees. It seems those who wrote Article 5 of the UCC kept this point in mind and tried intentionally to avoid confusion. Although there is no direct reference to SLCs in Article 5 of the UCC, SLCs are accepted as one type of LCs by courts in the United States.[17] Moreover, under sub-section 1 of Section 5-102 one of the requirements for the enforceability of Article 5 is that an issued credit requires "documentary demand for payment"; this requirement, mostly applied in case of SLCs which provide security for advance payment against service(s) of employees by employment and usual arrangement, is a "first demand" standby letter of credit. Paragraph (b) of Section 5-103(1) supports this view by saying that, "A "documentary credit" or a **"documentary demand for payment"** is one of honour of which is conditioned upon the presentation of a document or documents. "Document" means any paper including document of title, **security**, invoice, certificate, **notice of default and the like.**"[18]

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[17] Standby letter of credit is a device basically similar to LCs with some differences. This type of credit is originated in the USA specially after the Scond World War because of prohibition of National Bnaks of Fedeарl and State Banking Law from acting as guarantor or securities for obligations of third parties. This prohibition is only for domestic banks., but banks' branches outside the USA are allowed to give service as a guarantor or surities. Some of references related to SLCs are Schmitthoff, C.M., **"Schmitthoff's Export Trade, The Law and Practice of International Trade"**, London, 8th ed. 1986, p. 364; Naegel, T.D., **"Unsound Banking Practices; Standby letters of credit and other bank guarantees"**, Feb. 14, 1975, of Senate Commission on Banking, Housing & Urban Affairs, 94th Congress, 1st Sess., Compendium of major issues in bank regulation 647, pp. 621-85, at p. 627; Banks, J.L., **"The standby letter of credit: what it is and how to use it"**, Montana Law Review, Vol. 45, No. 1., Winter 1984, pp. 71-86, at p. 74; Penn, G.N., Shea, A.M., and Arora, A., **"The law and practice of international banking"**, Banking Law, Vol.2, London, 1987, p. 287 [hereinafter referred to as International Banking Law (INT.B.L.)]; Williams, K.P., **"Performance bonds: used and usefullness"**, LMCLO, 1983, pp. 423-39, at p. 423.

[18] Emphasis added; and for more details see discusssion about "fraud in transaction" in Section B of Chapter VII (below); the point concerning SLCs was also noticed by draftsmen of PFD and as mentioned previously it was one of the reasons for revision of Article 5 of the UCC. [See the Prefatory Note of PFD, supra (f.n. 1), at p. xv]

1.2.2. Silence as to revocability and irrevocability of a credit

Dealing with the issue of revocability and irrevocability of a credit, paragraph (c) of Article 6 of UCP 500 provides: "In the absence of such indication the credit shall be deemed to be irrevocable." This is a new modification and in contrast to what was accepted under Article 7(c) of UCP 400.[19]

There are two different views on this point. One view suggests that in order to make a banker responsible against his customer or the beneficiary of a credit there must be a clear and precise instruction by applicant for a credit to that effect. In contrast it is said that the main purpose of issuing a credit is to provide sufficient security for the seller and that is the intention of both the seller and the buyer under a sale contract. Therefore, if there is no indication in the credit as to its nature it should be accepted that the credit is irrevocable, unless otherwise expressly agreed.[20] The latter view is preferable. However, there is no such indication either under Section 5-103 or in any part of Article 5 of the UCC.[21]

1.3. Issues concerning bank-customer relationship

1.3.1. Risks of transmission, translation, and interpretation of any messages related to a credit

Section 5-107(4) of the UCC provides: "Unless otherwise specified the customer bears as against the issuer all risks of transmission and reasonable

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[19] ICC Publication No. 400 (UCP 1983).

[20] International Banking Law, supra (f.n. 17), p. 294; Davis, A.G., "The law relating to commercial letters of credit", 3rd ed., 1963, p. 35 & f.n. 2 [hereinafter referred to as Davis]; in **International Banking Corp. v. Barclays Bank**, it was held: "On the evidence, a cable credit used in the Far Eastern trade and hence, of necessity, advised by a correspondent bank, was irrevocable unless it appeared on the face of it that it was revocable." [quoted from (1925) Legal decisions affecting bankers, Vol. 5, p. 1]; **Gidden v. Anglo African Produce Co.**, (1923) 14 Ll.L.R. 230; for American authority see **Foglino & Co. v. Webster**, 216 N.Y.S. 225 (1926).

[21] It was officially said that the Code itself settles this issue with respect to the sales contract (Section 2-325), and also provided that this issue intentionally was left for the court's decision under Section 1-103, and general Provisions of Code in Article 1 particularly Section 1-205 [look at Official Comment (number 1) to Sec. 5-103, UCC, supra (f.n. 2), at p. 421, col. 1]; fortunately, the point under consideration was clarified under Section 5-106(a) of PFD, supra (f.n. 1), suggested, "[...] A letter of credit is revocable only if it is so provided."

translation or interpretation of any message relating to a credit." A similar policy is accepted under Article 16 of UCP 500. However, there are differences between them, as follows.

1. Under Article 16 of UCP 500 all risks relevant to transmission and interpretation of a message relating to a credit are put on the shoulder of the applicant for a credit and there is no possibility to transfer such risks to the bank. A different approach is accepted under the UCC, since by providing the term **"unless otherwise specified"** there is a possibility for an alternative solution agreed by contracting parties, namely, the bank becomes responsible for its failure.

2. Under sub-section 4 of Section 5-107 an applicant becomes responsible if the banker proves that he adopted a reasonable procedure for the translation or interpretation of a message relating to a credit transaction. This is not the case under Article 16 of UCP 500; even more strangely, under the same article banks reserve a right to transmit credit terms without translating them. How is it possible to support such a view where translation of a message is the only way for communication between the bank and the beneficiary of a credit? Why on earth banks, instead of accepting some sort of responsibility trying to transfer risks caused by their failure to the applicant or by sending an untranslated message, cause confusion for the beneficiary of the credit? The point under consideration has been discussed elsewhere,[22] but in short, it is accepted in the present study that if banks choose to translate or interpret a message relating to a credit, then they should also accept any unsatisfactory result caused by their action. If, on the other hand, banks are not able or are not interested to translate or interpret a message, then they should inform their customers from their decisions in due time, rather than sending an untranslated message to the beneficiary.

One may argue that the second sentence of Article 16, firstly, related to errors in translation and/or interpretation of **"technical terms"**; secondly, banks' reservation is about translation of terms of credit and not terms of any message

[22] See discussion related to Article 16 of UCP 500 in Section B.1.1 of Chapter IV (above).

related to the credit. In other words, banks are responsible for their errors in translating and/or interpreting terms other than "technical terms" as well as they have no right to transmit any message without translating it first. If this argument is right, several questions should be considered first in order to give support to such an approach. As to the first argument, what is the meaning of "technical terms" under Article 16 of UCP 500? And, how can these terms be distinguished from other terms used in a credit transaction? Moreover, who is in charge of making the decision that a term is technical or non-technical? As to the second argument (above), is it really possible to make any distinction between terms and conditions of a credit transaction and those messages which are related to such a transaction? In other words, on what grounds can one justify that terms and conditions which are expressed within letters and correspondence messages between contracting parties to a letter of credit are less important than those terms and conditions stipulated in the letter of credit contract? If it is so, then any messages relating to an amendment or cancellation of a credit should not be treated in the same way as the first message or letter about the issuance of credit. Certainly, it is not true that in real business activities banks as well as other interested parties do invest sufficient care in order to prevent any mistakes occurring in that aspect. Consequently, and generally speaking, there is no justification to follow the above cited arguments. Therefore, it is suggested that the second sentence of Article 16 of UCP 500, for reasons considered above, should be revised in a way that banks assume liability or responsibility for their errors in translation and/or interpretation of terms of credit and any messages relating to it if they choose to carry such a duty. If banks decide otherwise, then they should promptly inform their customers about such a decision.

As far as Section 5-107(4) of the UCC is concerned, as discussed previously, it provides a more reasonable approach relating to the issue of concern, namely, risks of transmission and translation/or interpretation of any message relating to a

credit. Similar terms could be applied for an international set of standards about LCs.[23]

1.3.2. The issuer's obligation to its customer

Section 5-109(1)(b) of the UCC provides: "(1) An issuer's obligation to its customer [...] unless otherwise agreed does not include liability or responsibility [...] (b) for any act of omission of any person **other than itself or its own branch** or for loss or destruction of a draft, demand or document in transit or in the possession of others."[24] The relevant provisions under UCP 500 are found in paragraph (b) of Article 18: "Banks assume no liability or responsibility should the instructions they transmit not to be carried out, even if they have themselves taken the initiative in the choice of such other bank(s)." Comparing these provisions, it becomes obvious that the position of the applicant for a credit is more vulnerable under the UCP than under the UCC, since under the latter a bank is responsible for any act or omission committed either by itself or by its own branch, whereas in a similar situation under the UCP such a bank has no liability or responsibility towards its customer for any act or omission of itself as well as for its own branch's failure.

As to the meaning of **"its own branch"**, no distinction is made under Section 5-109(1)(b) of the UCC between the branch(es) of the bank located in the same country as the principal bank doing its business, and those which are located in other country(ies). Therefore, it seems that the principal bank is liable or responsible for any act or omission of its own branch(es) without considering the location of those branches; but under UCP 500 it seems there is a different accepted view regarding the point under consideration, namely, banks are not responsible for the failure of their branch(es) located in another country, since the last sentence of Article 2 states: "For the purpose of these Articles, **branches of a bank in different**

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[23] The issue under consideration was omitted as inadvisable default rule under PFD; see table 2,1 (below).

[24] Emphasis added; see also appendix 1 for the complete text of Section 5-109; for a similar issue under PFD see Section 5-108(f)(2) where, as a new provision, it was suggested: "(f) An issuer is not responsible for [...] (2) an act or omission of others."; it is, however, not clear whether term "others" includes the bank's branch, or not.

countries are considered another bank."[25] Then, by implication, it is possible to argue that the scope of paragraph (b) of Article 18 of the UCP is not so wide and banks assume liability or responsibility for an act or omission of their branches located in the same country as the principal bank carrying out its banking activities. However, such an argument may be challenged on the ground that the language used in Article 18(b) is so general that it can also cover branches not located in different countries.

To end such arguments it is of great necessity that rules and provisions related to LCs should be as much as possible clear and precise in order to prevent confusion and prevent any dispute between parties interested in the credit transactions. In addition, the present discussion points out that UCP 500 is not far from confusion regarding the banks' obligations to their customers. Therefore, for reasons considered above, there is no harmony between UCP 500 and UCC as far as the issue is related to banks' liability or responsibility for any act or omission of themselves or their own branches located in other country(ies). This is another example which points to a need for more harmonization and/or unification of standards about LCs in international trade.

1.4. Issues concerning bank-beneficiary relationship

1.4.1. Time allowed for honour or rejection of documents

In paragraph (a) of sub-section (1) of Section 5-112 of the UCC it is provided that a bank is entitled to defer honour of a draft, demand, or credit **"until the close of the third banking day following receipt of the documents"**. In cases where a bank needs more time for checking presented documents, the beneficiary's consent is essential according to paragraph (b) of the same sub-section.[26]

The procedure is different under the UCP 500. In Article 13(b) banks are obliged to examine presented documents within **"a reasonable time, not to**

[25] Emphasis added.

[26] See appendix 1 for Section 5-112(1)(b).

exceed seven banking days following the day of receipt of documents.";[27] moreover, in that period of time banks should also determine whether to take up or refuse tendered documents as well as to inform the person from whom they received documents.[28] As to the meaning of the time limitation, it is clarified in the ICC's draft for revision of UCP 400 (1983) as follows: "The fact that a bank has up 7 days to examine the documents does not mean that it is reasonable to take up all that time in a purported examination, or to wait until the 6th day before commencing the examination."[29]

As it is clear, there is no harmony between UCP 500 and UCC regarding the period of time for examining documents and deciding whether to take up or refuse them by banks.[30] Each procedure has its advantage and disadvantage. For

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[27] ICC Pub. No. 500; Ellinger, E.P., "The Uniform Customs and Practice: a brief review of their salient points", JBL, Jan. 1994, p. 28 [hereinafter referred to as Ellinger, JBL 1994], at pp. 29-30 said: "The new Article 13(b) provides for a "reasonable time not to exceed seven banking days following the day of the receipt of the documents." Such time is granted to the issuing bank, to the confirming bank and to a "nominated bank" acting on their behalf. A related point is covered in Article 14(c), under which the issuing bank may "in its sole judgment approach the applicant for a waiver" of discrepancies discovered in the documents. However, the time spent on such an approach does not extend the period for rejection set out in Article 13(b)."

[28] The limitation of seven days was accepted as a compromise between proposals which for a five days or a ten days limitation; Dolan, John F., "Weakening the letters of credit product: The new Uniform Customs and Practice for Documentary Credits", International Business Law Journal, No. 2, 1994, pp. 149-177 [hereinafter referred to as Dolan], at p. 158 said: "The analogue to Article 16 of UCP 400 is in Article 13 and 14 of UCP 500. While Article 13(b) retains the requirement that the bank examine the documents within a reasonable time (not to exceed seven banking days), the article contains no estoppel provision. Thus the issuing bank's failure to examine the documents promptly does not invoke the estoppel. Article 14(e) does fashion an estoppel, but the estoppel applies only if the bank fails to give notice of defects without delay after determining not to honour the beneficiary's draw. The change effectively removes much of the incentives for the bank to examine the documents promptly and, therefore, increases the risk that the beneficiary will incur loss if his documents do not conform."

[29] ICC Documents No. 470-37/4 (a draft suggested by Working Group in Commission on Banking Technique and Practice of the ICC for revision of UCP 400 (dealing with Articles 1-24 and 54-55)), at p. 25; Dolan, ibid., at p. 159 pointed out: "The seven banking day limit provides little comfort. Any seven banking day period will include at least one weekend and could include two. [...] The delays can be even longer under the rule UCP 500 fashions for nominated banks; moreover, letters of credit subject to this rule of diminished responsibility for banks are a less attractive commercial product than those issued subject to UCP 400, and the loss to commerce in general is bound to be significant. The change reduces celerity. It is axiomatic that it will impel sellers to charge higher prices or to look for commercial alternatives."

[30] Baker, Walter "Buddy", "Preparing Yourself for the UCP 500", Business Credit, March 1994, p. 16 [hereinafter referred to as Baker], at p. 19 said: "All banks will now be limited to seven banking days to examine letter of credit documents. At first, this sounds like the old "three-day rule" is being more than

instance, the UCC's advantage is the speed of procedure but it requires that banks, in one or in different countries, should be able to apply a system for communication and handling the banking business activities related to each other, e.g. in the USA where banks use similar and more advanced technologies in banking activities. On the other hand, the procedure accepted under the UCP 500 provides more flexibility, namely, banks located in different countries and with different capability are able to carry out their undertaken LCs contract; nevertheless, such an advantage leads to less speedy banking procedures. Different from the UCC, it is understood from the UCP's provisions that the procedure for examining tendered documents may take more time in some countries where there are less opportunities to benefit from latest technologies in their banking business.

From an international point of view, it seems the UCP has adopted a more workable solution for the issue under consideration; but, for improving the provisions and provide more harmony between the UCP and the UCC, on the one hand, and for providing a better set of standards for LCs internationally on the other, an orthodox view can be adopted, namely, banks must examine tendered documents and make a decision within three banking days after receiving documents; and if there is a need for an extension of the time, then it should be agreed upon by the interested party. However, such a time should not exceed more than seven banking days following the day of receipt of the documents. This suggestion would provide more speed as well as flexibility for the documentary credit operation and provide

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doubled, and that it will take longer to get documents examined, but the three-day rule is greatly misunderstood. The three-day rule is not in the UCP 400, but rather in the Uniform Commercial Code of the United States, and it does not actually limit the time allowed for examination of documents. What it says is that the issuing or confirming bank is obliged to pay the presentor of documents under their LC by the end of the third banking day after presentation, if the documents comply with the LC. First, this rule makes no mention of what is supposed to happen if documents do not comply or how long banks have to decide whether they do or do not. Even if they comply, the penalty to a bank that takes a couple of weeks to examine documents is that it will have to pay interest for the extra time. If it takes two weeks to check the documents but then finds a discrepancy, there is no penalty, based on the premise that there was never any obligation to pay in the first place. Second, the Uniform Commercial Code only applies to letters of credit that are either issued or confirmed by banks in the United States. The three-day rule does not apply to an unconfirmed export LC. The UCP on the other hand, has always allowed a "reasonable time"to examine documents. Like the three-day rule, the reasonable time rule has only applied to issuing and confirming banks. The UCP 500, for the first time, imposes an obligation on a "nominated" bank."

more harmony between existing rules and provisions related to LCs, namely, Article 5 of the UCC and UCP 500.[31]

Another distinction between the UCP 500 and the UCC concerns the beginning of the period of time (discussed above). Under sub-section 1(a) of Section 5-112 of the UCC it is accepted that the period of 3 banking days starts **"following the receipt of the documents"**; but under Article 13(b) of the UCP 500 the period of 7 banking days begins from **"following the day of receipt of the documents"**. There can be one day difference in operating the credit system under the UCC and the UCP. For instance, if a bank receives documents at 9 a.m., on January 1, 1995, under the UCC the bank's time for examining documents and making a decision ends at 5 p.m., on January 3, 1995. There is no change in bank's position, even if the bank receives documents before closing time of the bank namely 5 p.m., on January 1, 1995. So, in practice the bank may lose one day under the UCC. But, under the UCP the bank's position is not affected by the time of receiving documents, since the period of time for examining documents and taking a decision starts from the day following the receipt of the documents; therefore, in the above example the bank has time until January 8, 1995 instead of January 7, 1995, if the credit is governed by UCC.

In conclusion, it becomes clear that there is no harmony between the UCC and the UCP as to the points under consideration. Therefore, any international set of standards related to LCs should provide clear provisions relevant to the time of examining tendered documents, its beginning and end in a manner that parties to a credit transaction may be aware of their positions; in that respect, advantages of the UCP and UCC, considered above, are helpful.

1.4.2. Indemnities

The issue of indemnities, this meaning and scope as well as time limitation, is clearly considered under Section 5-113 of the UCC.[32] Although there is a reference

[31] Section 5-108(b) of the PFD supported the view accepted under Article 13(b) of UCP 500; see appendix 2 for the text of Section 5-108(b).

to it under the UCP 500 (paragraph (f) of Article 14), there is no provision relating to its operation under the UCP 500. Another distinction between the UCC and the UCP 500 is that the latter, in the same above mentioned paragraph, provides another method, namely, **"payment under reserve"** although there are no details as to its procedure.[33] In that respect UCP is more advanced than the UCC, since there is no indication concerning the issue of payment "under reserve" within the UCC.

Consequently, the UCC, relating to the issue of indemnity, provides better and more detailed rules than the UCP, whereas the latter, as far as the matter of payment "under reserve" is concerned, provides another alternative for the beneficiary of a credit. In that respect the UCP is more flexible than the UCC, although no provision is provided concerning the meaning and procedure of payment "under reserve" in the UCP. Therefore, any international sets of standards relating to LCs should emphasise these points and provide for a more unified practice in international trade.[34]

1.4.3. The issuer's privilege to honour the credit

Under the second sentence of Section 5-114(1) of the UCC an issuer of a letter of credit may add some conditions to the credit, for his own protection against

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[32] See appendix 1; as to the necessity of the indemnities the official comment to the Section 5-113 said: "A draft and accompanying documents may almost comply with the terms of the credit, but fail in some particular. The issuer is then not obligated to honour the draft, but it may be willing to do so if properly indemnified against the particular defect. Subsection (1) makes clear that it is proper for a bank seeking payment, acceptance, negotiation or reimbursemnet under the credit to give such indemnities, and that doing so is a proper part of the business of banking and therefore not ultra vires." [See UCC, supra (f.n. 2), at p. 434]

[33] Documents presented by the beneficiary/seller are not always in accordance with the credit's conditions; but such distinctions may not important from the bank's point of view. On the other hand, the bank is not interested to lose its customer. Therefore, a practical solution for that situation is that the bank arrange the payment in a way called **under reserve** namely if the applicant for the credit or the issuing bank as the case may be rejecting tendered documents the beneficiary must give back the amount of money he received from the bank. In other words, the bank has a right of recourse against the beneficiary for the amount of the credit paid 'under reserve'. The leading authority in English law is **Banque de l'Indochine Et. Sues v. J.H. Rayner (Mincing Lane) Ltd.**, [1983] 1 All E.R. 1137, at p. 1144 (the relevant part of judgment by Kerr, L.J. in the Court of Appeal).

[34] Unfortunately Section 5-113 of the UCC was suggested to be omitted under PFD, supra (f.n. 1). This position would cause confusion and more distinction between UCC and UCP 500.

the beneficiary, as a privilege for issuing the credit. It says: "The issuer is not excused from honour of such a draft or demand by reason of additional general term that all documents must be satisfactory to the issuer, **but an issuer may require that specified documents must be satisfactory to it.**"[35] There is nothing under the UCP 500 precisely referring to the same matter.

Here several questions may arise: **(1)** Is such a provision necessary at all?; **(2)** If so, then what is the solution where a conflict of interests arises between the issuers of LCs (mostly banks) and their customers? In other words, should the bank's satisfaction overrule the applicant's requirements under the credit? **(3)** If there is a justification for having such a rule, why is it accepted in a limited form, namely, that banks' requirement must be connected only to specified rather than all documents? As to the first query, generally speaking, both banks and their customers look at documents as security instruments, namely, as valuable papers which replace the amount of money paid under the credit. However, there may be differences between the bank's point of view regarding the meaning of a security measure and the views of an applicant for a credit; for instance, a bill of lading, an insurance policy, an invoice, or any other document required in a particular form by the applicant under the credit may be accepted as a good document from the applicant's point of view but such a document may not meet the bank's conditions. Therefore, it is accepted as a non-satisfactory document by the bank. So, in general, it is possible to have a situation where a distinction may arise between the bank and its customer relating to the importance of a document.

One additional point should be addressed here before considering other questions, namely, whether banks are entitled to ask for document(s) other than those required by the applicant in order to match their satisfaction. If the answer is positive then it may be further asked whether banks are able to process such a requirement on their own behalf or whether they should bring their request under the name of their customers (the applicant for a credit). It is noticeable that in the

[35] Emphasis added; for the text of the Section 5-114(1) see appendix 1 (below).

relevant part of Section 5-114(1) of the UCC, quoted above, it is only stated that "specified documents must be satisfactory", and there is nothing about the point raised above. Does that phrase refer only to documents mentioned by the applicant for the credit? Or can the meaning of above phrase also be extended to documents asked for directly by banks? The first impression by reading the above phrase is that it covers only those documents which are required by the bank's customer (applicant for a credit); so, the bank's satisfaction is limited to those documents and nothing else. Therefore, there is no chance for banks to require new document(s) in their own name. However, it is possible to imply from the above phrase that if banks have any request for new documents, other than asked for by the applicant, such a request should accompany the applicant's request. Although such a procedure may fit the procedure accepted under Section 5-114(1) of the UCC, namely, documents must be specified, it is more appropriate to suggest that banks should also be allowed to benefit from a direct requirement, namely, asking for documents similar to or separate from those documents required by the applicant for a credit and bring their request in their own name.

Regarding the second above question, namely, concerning a conflict of interest between the bank and its customer, which one of them should be preferred? Nothing is mentioned under the UCC. It seems that in such a dispute the bank's satisfaction should be put first since it is the bank that accepts more risks at the beginning by paying for documents which may, in a later stage, turn into waste paper. Also, the bargaining power of banks should not be forgotten, since in practice it is the banker who dictates his points of view to the applicant and if the latter would like to enjoy the full benefit of the documentary credit system, it is necessary for him to direct his action in a direction that meets also the bank's conditions for issuing the credit.

In respect of the above third question, namely, for what reason(s) is it under Section 5-114(1) provided that only "specified" and not "all" documents must be satisfactory to the issuer of a letter of credit, one may argue differently. In an official comment it has been pointed out that accepting a different view would destroy the

whole purpose of issuing an **irrevocable credit**; however, the procedure can be different in case of a **revocable credit**. Because of the importance of the matter, the relevant part of the official comment says: "Attempts by the issuer to reserve a right to dishonour by including a clause that all documents must be satisfactory to itself are declared invalid as essentially repugnant to an irrevocable letter of credit. Such a reservation can be made by issuing a revocable credit. See Section 5-106. Particular documents, such as bills of lading or inspection or weight certificate can, of course, be required to be satisfactory to the issuer."[36]

As considered previously, distinctions exist between a revocable and irrevocable credit;[37] but a connection between the point accepted under Section 5-114(1) and differences between them are not clear. Why should the same policy accepted under that section (as mentioned above) not be accepted in case of a revocable credit? In other words, whether any difference between revocable and irrevocable credits is really a matter for distinction as far as the bank's right under sub-section 1 of Section 5-114 is concerned.

The main distinction between a revocable and an irrevocable credit is related to the bank's undertaking against its customer and the beneficiary. In the case of a revocable credit the bank is entitled to modify or cancel the credit without giving any notice to its customer or the beneficiary of the credit or asking for their consent (Section 5-106(3) of the UCC), whereas under an irrevocable letter of credit the procedure is different, namely, after the credit is established it can be modified or revoked only by consent of the applicant and the beneficiary of the credit (Section 5-106(2) of the UCC). The procedure is similar under the UCP 500, although there are distinctions between UCC and UCP as considered earlier (Chapter IV, Section B.2.1 above). If this is the case, what is then the nature of the bank's right under Section 5-114(1) of the UCC? Is it a type of modification of the credit, which in the case of an irrevocable credit requires the consent of other parties; or is it not a modification

[36] See UCC, supra (f.n. 2), p. 436.

[37] See relevant discussions in Secetions B.1.2.2 (present chapter) and B.2.1 (Chapter IV) above.

of the credit, as a part of credit's conditions agreed upon by contracting parties when establishing the credit? Even if it is accepted as a modification of the credit, then by consent of all the parties to a credit contract such a modification may or may not be enforceable. If the answer is positive, which seems to be so, as pointed out above, then there is no justification for the policy accepted under sub-section 1 of the Section 5-114, namely, that an issuer may require that "specified", not "all", documents must be satisfactory to his conditions under the credit.

Another matter which may arise is about the meaning of terms "specified" and "all"; one may argue that the former refers to documents stipulated under the credit but the latter is more general and covers both stipulated as well as non-stipulated documents, namely, because of trade usage or conditions stated under the credit contract the beneficiary should also tender them.[38] Therefore, it is not a complex issue and the real meaning of term "specified" under Section 5-114(1) concerns all documents stipulated in the credit contract; so those documents must also be satisfactory from the bank's point of view.

If the above argument is accepted, then the above quoted official comment becomes meaningless because the last part of the comment put forward several examples of what is a particular document, e.g. bills of lading or inspection or weight certificate. Moreover, in most of credit transactions, documents are numbered and specified by contracting parties, and situations where the beneficiary is obliged to provide further document(s) because of trade usage or other conditions stated in the credit imposing further duties upon the beneficiary, are accepted as exceptions to the general rule. Therefore, the interpretation of terms **specified** and **all** as suggested above would lead to a meaning totally in contradiction with the intention of parties to the credit transaction. It is hence appropriate to suggest that the term "all documents" refers only to all those documents which are precisely stipulated in

[38] For more details see the relevant discusion about stipulated and non-stipulated documents in Section A of Chapter VI (below).

the credit and the term "specified documents" means document(s) which is/are selected by banks from those documents stipulated in the credit.

To sum up the present discussion, it seems the last sentence of Section 5-114(1) of the UCC needs to be clarified for reasons considered above.[39] Concerning the UCC and the UCP 500, regarding the point under consideration, it seems the policy adopted by the UCC, namely, providing some provisions relating to the rights of the bank over documents, is preferable and it is necessary for any future attempt for providing an international set of standards about LCs to deal with the given issue properly.

1.4.4. Transfer and Assignment of a credit

Transferability and assignability of a letter of credit are matters of importance in the documentary credit operation; therefore, both Article 5 of the UCC (Section 5-116) and UCP 500 (Articles 48 and 49) address these issues.[40] There are, however, differences between UCC and UCP, as follows.

1.4.4.1. Transferability of the right to draw

Sub-section (1) of Section 5-116 provides: "The **right to draw** under a credit can be **transferred** or **assigned** only when the credit is **expressly** designated as transferable or assignable."[41] Article 48(b) of the UCP 500 relating to the right to draw under a credit has pointed out: "A credit can be transferred only if it is **expressly** designated as **"transferrable"** by the issuing bank."[42] There is no reference under the UCP 500 to the effect that the right to draw under a credit is also assignable in the same way as it stipulated under the UCC. On the contrary,

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[39] The point under consideration seems was noticed by draftsmen for revision of Article 5 of the UCC and Section 5-108(a) of PFD, supra (f.n. 1), clarified the issuer's position; see appendix 2 for text of suggested section above.

[40] See relevant discussions in Section B of Chapter IV (above), and appendix 2 for Sections 5-112, 5-113, and 5-114 of PFD, supra (f.n. 1) below.

[41] Emphasis added; Smith, Michael J., "Transmitting the Benefit of a Letter of Credit", JBL, September 1991, pp. 447-56; Tettenborn, A.M., "Transferable and negotiable documents of title- a redefinition?", LMCLQ, part 4, Nov. 1991, pp. 538-42.

[42] Emphasis added.

under Article 48(b) of the UCP it is stated that using the term "assignable" does not render a credit transferable and it shall be disregarded.[43]

Is the right to draw under a credit assignable as pointed out under the UCC? Before answering this question it is necessary to clarify the following point: what is the right to draw under a credit and what is its distinction from the right to proceed under the credit? In other words, would a transferor and an assignor be in the same position under a transferable and assignable credit?

1.4.4.2. Right to draw under a credit and assignment of proceeds

In a credit contract it is the beneficiary of a credit who is entitled to demand payment under the credit. This right is a **right to draw** under a credit, given exclusively to the beneficiary and nobody else, unless otherwise expressly agreed by contracting parties. The mechanism for passing the right to draw under a credit to a third party (transferee) is that of **transfer** of the credit. In order to transfer a credit, the beneficiary of the credit must obtain the issuing bank's prior consent.[44]

Another beneficiary's right under the credit is a **right to proceeds** of a letter of credit.[45] It means that the beneficiary, instead of transferring all or a portion of a credit, asks the issuing bank to pay some or all of the amount of the credit to others by **assignment** of his right to proceeds. In that respect there is no need for the issuing bank's consent.

From the above remarks, it becomes clear that the beneficiary of a credit has two different rights under the credit, and for enforcing each of them a special

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[43] Article 48(b) of the UCP 500 states: "A Credit can be transferred only if it is expressly designated as "transferable" by the Issing Bank. Terms such as "divisible", "fractionable", "assignable", and "transmissible" do not render the Credit transferable. If such terms are used they shall be disregarded."

[44] When is the most suitable time for reaching such an agreement? This issue may be a ground for dispute between the bank and the beneficiary of the credit; for more details, see the relevant discussion above under present chapter.

[45] McCullough, Burton V., "Letters of credit", Matthew Bender, USA, 1993 [hereinafter it is referred to as McCullough], ss. 4.07[2], p. 4-111, at f.n. 32 stated: "The term "proceeds" means the cash, draft, acceptance, or other form of payment resulting from honour of a letter of credit, and should not be interpreted either to mean the right to draw under the letter of credit or to include the beneficiary's draft when drawn, negotiated, or presented to the issue of the credit."

mechanism should be applied. In other words, the issue of transferring the right to draw under a credit should be distinguished from the assignment of proceeds under the credit. Why? The following discussion explains the reason for such a distinction.

1.4.4.3. Beneficiary's position under transfer and assignment of a credit

What distinction exists between a transfer and an assignment, so that the former requires the issuing bank's consent? There may be reasons why the issuing bank may not be interested to give the beneficiary of the credit the privilege of transferring the letter of credit. Firstly, the bank and its customer (the applicant for a credit) have a special confidence in the beneficiary and by transferring the right to draw under the credit to another person such a trust would be damaged since some or all part of the beneficiary's obligations under the credit may be transferred to the second beneficiary (the transferee). Secondly, the beneficiary may have a debt to the bank or the applicant; therefore, a right to set-off exists only against the beneficiary, not the transferee; and lastly, by transferring the credit the procedure of letters of credit loses its simplicity. So, for these reasons banks are not primarily interested in agreeing to the beneficiary's request to transfer the credit unless an adequate security is substituted, namely, that the creditworthiness of the second beneficiary (the transferee) is proved and accepted. On the other hand, in the case of assignment of proceeds the character of the assignee is not important from the bank's point of view, since no title is passed from the beneficiary (assignor) to the third party (assignee) and the bank's interests or its customer's position, as the case may be, are not at risk. In other words, in the assignment of proceeds, contrary to the issue of transferring the right to draw, the assignee is not in the same position as the beneficiary of the credit; therefore, his rights and obligations are not the same as those of the beneficiary.

1.4.4.4. Concluding remarks

Although it has been officially stated that the meaning of assignment or transfer of a credit is uncertain under the law,[46] the above discussion helps to clarify

[46] Official Comments related to Section 5-106 of the UCC, No. 1: "Since, however, there is general confusion of thoughts as to the meaning of "assignment or transfer of a credit" the law remains uncertain. If

that transferability and assignability of a credit are two separate issues with different effects on the relationship of the contracting parties to a credit transaction. This view is supported by the approach accepted under Articles 48 and 49 of the UCP 500 as well as Section 5-116(2) of the UCC.[47] As experienced bankers have avoided using the terms "transferable" and "assignable" interchangeably for many years, the UCC should be revised regarding the issue under consideration. As to other issues related to the transfer of a credit, the UCP is better drafted and it provides more detailed provisions.[48] By contrast, the mechanism for executing a right to proceed is fully expressed by the UCC under Section 5-116(2).

2. ISSUES CONSIDERED UNDER UCC ONLY

2.1. Rules concerning letters of credit in general

2.1.1. Meaning of document

Paragraph (b) of sub-section 1 of Section 5-103 provides a clear distinction between the meaning of **"document"** and **"document of title"**. The former has a much broader meaning. The importance of such a difference appears when Sections 5-102(a) and 9-105(1)(e) are applied.[49] There is no such indication under UCP 500.

"assignment of the credit" includes delegation of performance of the conditions under the credit then the initiating customer, who in many cases has put his faith in performance or supervision of performance by a beneficiary of established reputation, may be deprived of real and intended security."

[47] The relevant part of the Section 5-116(2) of the UCC is: "(2) Even though the credit specifically states that it is nontransferable or nonassignable the beneficiary may before performance of the conditions of the credit assign his right to proceeds."

[48] There are the transferring bank's obligation (Article 48, paras. (c)&(d)), transferability and fractionability of a transferable credit (Article 48(e)), and rights of the first beneficiary (Article 48, paras. (f) to (j)). It seems Section 5-111 of the UCC deals with those matters, but in a very broad language; as pointed out previously Sections 5-112, 5-113, and 5-114 in PFD suggested more deailed provisions concerning issues relevant to the transferable credit and assignment of proceeds and in that respect it seems the UCC become closer to what has been accepted under the UCP 500; there is, however, a distinction arises between UCC and UCP as to issue of transfer by operation of law (Section 5-113 of PFD); see below appendix 2 for text of mentioned sections of UCC above.

[49] See appendix 1 and UCC, supra (f.n. 2), p. 421, col. 2, par. 2; and also look at appendix 2 for Sections 5-102(a)(6) (document) and 5-102(a)(14) (record).

2.1.2. List of definitions

From paragraph (c) of sub-section 1 of Section 5-103 to the end of the section the words dealing with definitions of terms apply under Article 5 of the UCC.[50] There is nothing similar to that under UCP 500, although it gives definitions for those terms applied under the UCP, but they are not arranged in one particular article as in the UCC. Surely, for the sake of clarity of a set of standards for LCs at an international level, the procedure adopted by the UCC is preferable.[51]

2.1.3. Formal requirements; signing

Section 5-104 provides that an issued LC must be in **"writing"** and **"signed"** by the issuer (the issuing bank or a person other than the bank who issues the credit).[52] Similar requirements must be followed by a confirming bank in case of confirmation of a credit, and by the issuer or the confirming bank if the issued credit is subject to any modification(s).[53] Although there is no such clarification under UCP 500, one may understand from the whole circumstances that the same requirements are also necessary under the UCP in order to have a credit as proved to be issued, confirmed, and amended. It is impossible to accept the opposite view it causes uncertainty since the letter of credit is not a simple banking practice capable to contain all conditions in a non-written form of contract and without any apparent authenticity. There are many examples within the text of UCP 500 that support this view.

For instance, UCP 500 provides that banks undertake to pay the amount of a credit only when **"stipulated documents"** comply with the **"terms and conditions"** of the credit (Articles 2, 9(a)&(b), and 13(a)). Both expressions require a written form

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[50] See Section 5-102 of PFD concerning definitions in appendix 2 (below).

[51] Megrah, Maurice, **"A uniform code for documentary credit practice?"**, International and Comparative Law Quarterly, Vol. 8, Jan. 1959, p. 41, gave his support to such idea.

[52] For similar point under PFD, supra (f.n. 1), see below appendix 2 for Section 5-104 (formal requirements) as well as Sections 5-102(a)(6) and 5-102(a)(14).

[53] See below appendix 1 for the text of Section 5-104.

of the credit. Regarding the point that a credit must also be signed by the issuing bank under Article 7(a), it is said that the advising bank shall take reasonable care and check the **"apparent authenticity"** of the credit; and if it is not possible to establish such authenticity it must inform, without delay, the issuing bank. And if the advising bank chooses to act upon such a credit, it must inform the beneficiary of its decision (paragraph (b) of Article 7).

However, in order to have a clarified situation under an international set of standards related to LCs, it is advisable that this above examined requirements are precisely indicated under the new instrument.

2.1.4. Consideration

Section 5-105 of Article 5 of the UCC provides: "No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms."[54] This emphasis is important, particularly when dealing with an irrevocable letter of credit.[55] **"Consideration"**, as a well known principle in the common law legal systems, is one of three basic essentials for the creation of a contract.[56]

English and American law

Turning to the irrevocable letter of credit, it is said: "In the case of irrevocable credit it is difficult to show any consideration given by the seller to the banker prior to the tender of documents. Yet courts have expressed the view that an irrevocable

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[54] Harfield, H., "Bank Credits and Acceptance", New York, Ronald Press, 5th. ed., 1974 [hereinafter referred to as Harfield], at p. 55, suggested: "The bank's letter of credit is a legally enforceable instrument, rooted in the law of merchant and contractual in its nature. There is neither need nor utility to employ Procrustean Techniques to establish its validity."; for the same issue under PFD, supra (f.n. 1), see appendix 2 for Section 5-105 (consideration) below.

[55] "A credit may be either revocable or irrevocable." (Section 5-103 (1)(a) of the UCC and Article 6 of UCP 500)

[56] See "Chitty on Contracts", 25th ed., Vol. 1, London, Sweet & Maxwell, 1983, p. 25, para. 41; the other two principles are agreement and contractual intention. What is a consideration? Generally speaking, it has been established for a long time under English law that a "promise" is not binding unless it is either made under "seal" or supported by "consideration". The essence of consideration is that in order to make a promise enforceable as a contract "something value in the eyes of the law" must be given by the promisee. Therefore, it is traditionally defined as: "Consideration is either a detriment to the promisee (in that he may give value) or some benefit to the promissor (in that the may receive value)." [The same reference above, pp. 80-81, para. 144 and at p. 81, f.n. 11 of the same reference (for referred cases).

credit cannot be revoked after it reaches the hands of the seller, which could be a considerable time before the tender of documents."[57] In other words, no consideration moves from the beneficiary of the credit (as the promisee) towards the issuing bank (as the promisor).[58]

The doctrine of consideration is not known to civil law;[59] and there is no indication similar to Section 5-105 of the UCC under UCP 500.

The issue under discussion causes no problem for those parties to a letter of credit whose contracts are governed either by Article 5 of the UCC or UCP 500 but concerns the law which governs their contract originated from legal systems other than the common law. However, for LCs issued under the UCP and with English law as the applicable law of the contract, or the law of any other country with a legal system based on common law but with no legislation similar to Article 5 of the UCC, there is always a question whether by issuing an irrevocable letter of credit, banks undertake responsibility towards the beneficiary even without consideration passed from him. For certainty in the documentary credit system, it is important to find a solution to this situation. To change a principle of law is not an easy task in any legal system; however, business practice and the reality of global trading dictate a mandate, namely, relating to international contracts like LCs. An exception to the principle of consideration can be accepted on the ground of **commercial character**

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[57] Ellinger, E.P., **"Documentary Letters of Credit"**, Singapore, 1970 [hereinafter referred to as Ellinger], p. 40; Harfield, supra (f.n. 54), at p. 53, says: "Although the letter of credit is a contract between banker and beneficiary, the beneficiary undertakes no duty of performance- if he chooses not to meet the conditions of the credit, he is not obliged to do so."

[58] For more details about the issue under consideration see **Dexters Ltd. v. Schenker & Co.**, (1923) 14 Ll.L.Rep. 586, at p. 588, where Green, J. Stated that the seller/beneficiary is under no obligation to tender documents to anyone before he receives the letter of credit; **Erquhart Lindsay & Co. v. Eastern Bank**, [1922] 1 K.B. 318, at pp. 321-22, Rowlatt, J. held that "upon the plaintiffs' acting upon the undertaking contained in this letter of credit", consideration moved from the seller towards the bank; The Law Revision Committee in its 6th interim report (Cmnd. 5449, par. 29, 1937) made recommendation, among others, as following: "That an agreement should be enforceable if the promise or offer had been made in writing by the promisor or his agent. That there a contract by its express terms supports to confer a benefit directly on a third party it shall be enforceable by the third party in his own name."

[59] Ventris, F.M, **"Bankers' Documentary Credits"**, Lloyd's of London Press Ltd., 2nd ed., 1983, p. 60 [hereinafter referred to as Ventris].

of the contract. Although there is no direct court decision relating to the irrevocable credit, the view in question has been accepted by some English courts, in a similar situation, in order to tackle the problem. For instance, in **The Euromedon**,[60] where a stevedore, who caused damages to the consignee's goods, sought to benefit from an exemption clause in the bill of lading, although, there was no direct contractual relationship between stevedores and the consignee. Lord Wilberforce found consideration between them and said: "If the choice [...] is between a gratutious promise, and a promise for consideration [...] there can be little doubt [...] the whole contract is of a commercial character, involving services on the one side, rates of payment on the other, and qualifying stipulations as to both. The relation of all parties to each other are commercial relations entered into for business reasons of ultimate profit. To describe one set of promises in this context as gracious or nudum pactum seems paradoxical and is prima facie implausible."[61]

Consequently, there is no uniformity in standards applied to an irrevocable credit regarding to the above discussed point, while in practice a similar attitude has been accepted by courts in different legal systems. Therefore, in order to provide a code of standards about LCs there is a need for harmonisation and clarification; and it is appropriate to make certain in case of an irrevocable letter of credit that banks' undertaking connected to their intention as well as their action is based upon such decision and there is no need that a counter-promise passes from the beneficiary (as the promisee) towards the banks. Consequently, the opening time for the bank's offer and its end is another matter, considered in another part of the present section (sub-section 2.2.2 below).

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[60] [1974] 1 All E.R. 1015; The New York Star, [1980]3 All E.R. 257.

[61] Ibid., pp. 1019-1020.

2.1.5. "Notation" credits

This type of credit is widely used in United States-Japanese trade.[62] Section 5-108 of the Uniform Commercial Code (UCC) of America defines such a credit in terms as: "(1) A credit which specifies that any person purchasing or buying drafts drawn or demands for payment made under it must note the amount of the draft or demand on the letter or advice of a credit is a "notation credit."[63]

The purpose of this credit is to solve problems which may arise by the application of "partial shipments" credits, because under such an arrangement banks (the issuing, confirming, or the intermediary bank) must be aware whether the total amount of the credit has been utilized and what has been left. Sometimes, drafts drawn for portion of the credit, may be sent to more than one intermediary bank by mistake. There is no such provision under the UCP 500.

For more precise standards related to LCs it seems a provision similar to Section 5-108 of the UCC should be stipulated in any code of standards related to LCs; and in that regard, it seems the UCC provides better rules than the UCP 500. However, if there is enough evidence that the use of such a type of credit is outdated, then for more harmonisation between UCC and UCP 500 it would be appropriate to remove such a section from Article 5 of the UCC.[64]

2.2. Rules concerning parties to a credit transaction

2.2.1. Right of applicant to amendment of a credit

Sub-section 3 of Section 5-106 of the UCC provides: "Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be

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[62] Kozolchyk, B., "Letters of Credit", 9 International Encyclopedia of Comprative Law, Chapter 5, 1979 [hereinafter referred to as Kozolchyk], at p. 36, f.n. 178 said: "Typical notation be noted", rather than "the issuer will honor on condition that the draft is noted', or "all amounts negotiated should be endorsed on the reverse side [...].", which are also found in United States issued notation credits."

[63] There is nothing similar to that provision in UCP 500.

[64] It was suggested by draftsmen of PFD, supra (f.n. 1), that Section 5-108 of the UCC should be removed as an outdated provision.

modified or revoked only with the consent of the customer."[65] In similar circumstances, UCP 500 provides no support for the applicant for a credit and paragraph (d)(i) of Article 9 of the UCP says: "an irrevocable Credit can neither be amended nor cancelled without the agreement of the Issuing Bank, the Confirming Bank, if any, and the Beneficiary."

To compare these provisions it seems the view adopted by the UCC is better, since in case of modification of a credit, without consulting the applicant for the credit, the bank's customer may be put in an unwanted situation. One may argue that in the situation under discussion, bank(s) as agent(s) of the applicant for the credit is(are) responsible to look after the interest of its (their) principal; therefore, if there is any lack of judgment or if any failure occurs as a result of a decision made by the bank(s), the applicant is entitled to sue the bank(s). Moreover, paragraph (d)(i) mentioned above, relates to those types of modification which concern the banking business and procedure adopted for operation of LCs. In other words, the changes in question are operational rather than substantive, involving no harm for the applicant (the bank's customer); therefore, there is no need for the applicant's agreement in such circumstances and by adopting an opposite policy unnecessary delays would occur in the operation of LCs.

To respond to the above arguments, the following points should also be considered. Firstly, what is the scope of **"amendment"** under Article 9(d)(i) of UCP 500? There is no limitation of the application of the term under the UCP; the only exception to the above policy is the first part of the same paragraph from Article 9 of the UCP which provides: "Except as otherwise provided by Article 48 [...]."; and Article 48 of UCP 500 relates to a **"transferable credit"**, which under paragraphs (h) and (i) of that article, is accepted that terms and conditions of the transferable credit can be different from the original credit regarding the amount of the credit, any unit price stated therein, the expiry date of the credit, the last date for the

[65] Similar standing was suggested under PFD, supra (fn. 1), in Section 5-106(b); for text of referred section see appendix 2.

presentation of documents in accordance with Article 43, the period of shipment, and substitution of the first beneficiary's invoice(s) and draft(s) with those of the second beneficiary(ies). Therefore, the scope of "amendment" is quite wide and covers all types of amendments, namely, substantive changes (like those mentioned above regarding a transferable credit) as well as those which are connected to operational aspect(s) of LCs.

Secondly, if the issuing bank (as agent of the applicant) usually consults about any changes with its principal, why such an informal procedure should not be replaced with a formal consultation, namely, the necessity of the applicant's consent in case of any amendment of an irrevocable credit? By adopting such a policy, an unnecessary dispute would be prevented between the issuing bank and its customer; moreover, a set of standards related to LCs, as far as the point under discussion is concerned becomes more predictable, justifiable, and reliable. Also, harmonisation would be achieved between UCC and UCP.

Thirdly, in case of cancellation of an irrevocable letter of credit similar arguments, with more strength, can be put forward since it is difficult to accept that an applicant for a credit has no right under the UCP if an issued irrevocable LC is cancelled without his notice and any consultation in advance.

Consequently, it is preferable that the future standards of LCs adopt a different policy from what is accepted under UCP 500 regarding the right of the applicant for a credit in case of amendment or cancelation of an irrevocable letter of credit.[66]

2.2.2. Time of establishment of a credit

Under UCP 500 no provision is made for the time of establishment of a credit. By contrast, that point is clarified under Section 5-106 (1) of the UCC which provides: "**(1)** Unless otherwise agreed a credit is established **(a)** as regards the

[66] See also Ventris, supra (f.n. 59), at p. 10, where he says: "Sub-paragraph (d) [UCP 400] does not mention the applicant for the "credit" as having to give his agreement also [...]. The previous Article provided for the agreement of all parties to the credit, so the ommission of the applicant for the credit is deliberate, but the reason for this is not clear [...] Surely, as the terms and conditions of the "credit" have to be agreed in the first place between the applicant for the "credit" and the beneficiary, it is difficult to see why their agreement on an amendment should not be suffice. What if the two main parties agreed and one of the banks does not?"

customer as soon as a letter of credit is sent to him or the letter of credit or an authorized written advice of its issuance is sent to the beneficiary; and **(b)** as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance."[67]

This is one of the areas which it seems necessary to cover in the future set of standards related to LCs. Therefore, considering some of the related issues in detail seems necessary, because an important stage of each contract is the point when it is established, since the rights and duties of contracting parties start from that moment.

2.2.2.1. Between the buyer and the issuing bank

As mentioned earlier with respect to the operation of LCs (Chapter II), a letter of request (based on the application provided by the issuing bank) is sent to the bank by the applicant for a credit. Bankers, after receiving the buyer's request, need time to determine whether it complies with the terms of the application. Several questions may arise at this stage: Does the contractual relationship between the issuing bank and its client start from the time of sending the application for issuing a credit? Or, does the time of the contract begin from the moment of the bank's acceptance of the applicant's request either by a letter or by its conduct, namely, issuing a credit? If the bank's acceptance is necessary, which seems so, then within what period of time the bank is obliged to give its decision? Except Germany, which has adopted a precise attitude, most of the countries like France and states which accept the common law choose a procedure by which bankers are obliged to open the letter of credit within a "reasonable time".[68] However, there is a distinction

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[67] For similar point under PFD, supra (f.n. 1), see below appendix 2 for Section 5-106(a).

[68] Kozolchyk, supra (f.n. 62), p. 43; Ellinger, supra (f.n. 57), at p. 154 stated: "The banker should open the credit with reasonable speed can be supported in common law countries as well. [...] When a contract does not specify a special time for the performance a reasonable time is to be presumed."; see also **Ford v. Cotesworth** (1868) L.R. 4, Q.B., p. 127, per Blackburn, J., at p. 133 (Q.B.), or (1870) Q.B. 544 (Exch. Ch.); About French law it is said, in above references, that its position is similar to what has been accepted by common law countries; as to German law it is said that a precise attitute has been adopted by that law. For instance, see Kozolchyk, supra (f.n. 62), p. 43 it is said: "In Germany commentators do not follow this rule and adopt a regid attitute as regards the liability of a bank fails to issue the credit or to notify the customer promptly that his application has been rejected."; on the other hand Ellinger, supra (f.n. 57), at p. 154 stated

between American and English law as to the time of establishing the credit between the issuing bank and its customer.

1. American law

Under Section 5-106(1)(a) of the UCC, mentioned above, there are two possibilities relating to the time of establishment of the contractual relationship between the issuing bank and its client.[69] The issue related to the point in discussion is how long the issuing bank is entitled to spend time for considering the client's application before a credit is issued? No certain time is provided under Section 5-106(1)(a) of the UCC; and by using general terms like **as soon as** the issue of time for acceptance or rejection of a letter of request is left open since different banks may adopt different procedures.

2. English law and UCP 500

There is no provision similar to Section 5-106(1)(a) of the UCC in English law,[70] and the situation is similar under UCP 500. In respect of the second point, namely, how long an issuing bank is entitled to determine about its applicant's letter of request, English law has taken the view that the issuing bank is obliged to open the letter of credit within a "reasonable time".[71] UCP 500 is also uncertain about this issue.

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two different view of German lawyers related to the issue in discussion, e.g., Kerb's view is that "the banker must notify the seller of the credit not later than the date on which the buyer is obliged to open it under the contract of sale"; the second view is Wiele's opinion which is said: "The banker should act with the diligence of a reasonable banker is preferable."

[69] The Uniform Commercial Code (UCC), in its official comment being provided that: "The primary purpose of determining the time of establishment of an irrevocable credit is to determine the point at which the issuer is no longer free to take unilateral action with respect to the cancellation of the credit or modification of its terms."

[70] Kozolchyk, supra (f.n. 62), p. 42, col. 1, and f.n. 207.

[71] Kozolchyk, supra (f.n. 62), p. 43; Ellinger, supra (f.n. 57), at p. 154 said: "The banker should open the credit with reasonable spead can be supported in coomon law countries as well. [...] When a contract does not specify a special time for the performance, a reasonable time is to be presumed"; see also **Ford v. Cotesworth**, (1868) L.R. 4, Q.B. 127, per Blackburn, J., at p. 133 (QB); (1870) L.R. 5, Q.B. 544 (Exch. Ch.).

Although applying general terms like "as soon as" or "reasonable time" provide more flexibility for banks, they are also causes for uncertainty. In order to prevent misunderstanding between the issuing bank and its customer, it is preferable that a period of time be ascertained. As to the time of establishment of credit between the bank and the applicant for the credit, a similar provision to what is accepted under Section 5-106(1)(a) of the UCC is suggested for any international set of standards related to LCs.

2.2.2.2. Time of establishing an irrevocable letter of credit contract between the issuing bank and the beneficiary of a credit

When does a contractual relationship between an issuing bank and a seller/beneficiary begin in an irrevocable letter of credit? Although there are two parties and one consideration[72] in an issued irrevocable letter of credit, there is no contractual relationship between the banker and the seller under English law, unless consideration moves from the offeree (the beneficiary) to the offeror (the issuing bank). Some of the questions related to the issue of consideration and its application to LCs have been mentioned above, under the present section of the study; other related points are discussed here. For instance, is it necessary that a consideration pass from a beneficiary to an issuing bank at the time when the credit is issued as an offer or should it be passed at some other time? Generally speaking, consideration is valid if it is not **"past";** it must given in return for a promise and whether a consideration is past or not, is a matter of fact.[73] Consideration is one of the elements for establishing a contract under English common law; it differs from "acceptance". It seems that it always passes at the time of acceptance or after it. Therefore, there is no necessity that consideration must move from a promisee (the

[72] It is also called "nudum pactum"; Rann v. Hughes (1778) 7 Term. Rep. 350 n.; see also relevant discussion about "consideration" in Section B.2.1.A of the present chapter (above).

[73] Eastwood v. Kenyon (1840) 11 A. & E. 438; "Chitty on contracts", Sweet & Maxwell, London, 25th ed., Vol. 1, 1983, p. 93, para. 164.

seller) at the time of the promise/offer made by the offeror (the bank).[74] So, there is always some lapse of time. Then the relevant point is: at what precise moment a contract is formed between the issuing bank and the beneficiary of the credit? There are several points of time, in the issuing bank-seller contractual relationship, that might be taken as the proper time for establishing the credit contract. These are as following:

1. Time of issuing the credit by the issuing bank.

2. Time of posting or sending the credit by teletransmision as the final action of the corresponding bank.

3. Time of receiving the issuing bank's instructions by the corresponding bank.

4. Time of informing the seller's bank by the agent of the issuing bank.

5. Time of receiving the credit by the seller.

6. Time when the seller express his acceptance expressly or impliedly to his bank.

7. Time of presenting proper documents in accordance with the conditions of the credit.

1. Position in English law

Situation six (above), namely, the time when the promisee/ beneficiary expresses his acceptance expressly or implicitly to his bank, seems the most

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[74] De Rooy, F.P., **"Documentary Credits"**, Kluwer Law and Taxation publishers, 1984 [hereinafter referred to as DeRooy], at p. 92 suggested that, "[...] neither the applicant nor the bank can withdraw the credit once it has been issued"; the situation dealing with the corresponding bank will be noticed later; there is a dicta in English law that was stated in **Dexters, Ltd. v. Schenker & Co.** (1923)14 LI.L.Rep. 586, at p. 588 Greer, J., suggested that an irrevocable letter of credit becomes binding as soon as it reaches the hands of the seller/ beneficiary. That decision seems better than what was decided in **Urquhart Lindsay** for two reasons; first of all, it is like to the position of the American, German, and French law, so there will be more harmony among the different legal systems. Secondly, the test which was laid down by Rowlatt, J., in **Urquhart** case would lead to uncertaintity since it is difficult for bankers to understand whether the seller starts acting upon the offer, or not. In addition from the seller point of view the rule in **Dexters** is much more desireable and he becomes certain as soon as he recevies the credit; for more detail see Ellinger, supra (f.n. 57), pp. 11-12; it is also suggested by Kozolchyk, supra (f.n. 62), at p. 106, col. 2, para. 2 that: "From the legal stand point, the time of receipt and acquisition of possesion of the credit instrument seems the most consistent with the nature of the credit instrument."; that view also found support by Section 5-106(2) of the Uniform Commercial Code (UCC), and article 9(d)(i) of UCP 500 seems accepted similar attitude.

suitable time under English law for establishing the credit contract, regarding the issuing bank as well as the beneficiary of the credit, because an express or implied acceptance of the issuing bank's offer is given at that time.[75] Moreover, under the same law there are no regulations or decided cases requiring that the seller/beneficiary should announce his acceptance in a specified form; and, also a good consideration moves from the promisee to the promisor (the issuing bank) at that time, since the seller agrees to tender these documents which comply with the terms and conditions of the credit to the bank if he wishes to receive the amount of the credit. Therefore, there is no requirement that the consideration must move from the promisee/seller to the promisor/bank prior to situation six.[76]

2. Position in American law

Section 5-106 (1)(b) of UCC makes it clear that a credit is established as regards the beneficiary from the time of receiving a credit or an authorised written advice of its issuance (namely situation 5).[77] As to the position of the issuing bank, there is no reference under the UCC since in practice it is accepted that the issuing bank's undertaking under an irrevocable letter of credit starts from the time of issuance of the credit.

3. Position in UCP 500

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[75] Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd. [1922] 1 K.B. 318, a dicta which was suggested that an offer becomes binding when the offeree acts upon it; Davis, supra (f.n. 20), p. 78; Gutteridge, H.C. and Megrah, M., "The Banker's Commercial Credits", London, 7th ed., 1984, p. 64 [hereinafter referred to as Gutteridge].

[76] It seems that Ellinger in the theory of "forbearance" accepted this view that prior to that time, i.e. the seller receives the credit, it is necessary that a consideration moves from the promisee (the seller) to the promisor (the banker).

[77] Section 5-106(1)(b) of UCC states: "[A]s regards the beneficiary when he receives a letter of credit or an authorised written advice of its issuance."; Ellinger, supra (f.n. 57), p. 11; Gutteridge, supra (f.n. 75), pp. 26-30, which supports the view that the credit contract is established after documents are presented by the seller; however, in Section 5-106(a) of PFD, supra (f.n. 1), it was suggested that the time of issuance of a credit is the time that the issuer becomes responsible towards the beneficiary of a credit; but nothing was suggested concerning the point under consideration namely the time of enforceability of a credit against the beneficiary; see appendix 2 for text of Section 5-106(a) of PFD.

There is no article relating to the point in discussion under UCP 500. However, what is clear from the practice is that the issuing bank accepts a definite undertaking under an irrevocable letter of credit from the time of issuing it (namely situation 1 above). As to the beneficiary's position, in contrast to the UCC, there is nothing under the UCP.

4. Analysis: The importance of the offeror's intention in forming a contract

From the above discussion it becomes clear that different views may be suggested under Common law, relating to the time of establishment of an irrevocable letter of credit contract regarding the issuing bank as well as the beneficiary of a credit. Therefore, a question of importance may be raised at this point: do the revocability and irrevocability of an offer, at common law, depend on consideration? If the answer is affirmative, as it seems to be under English law, an irrevocable credit would have to be accepted as an exception to the general principles of contract law, because of the **"commercial character"** of LCs there is no need for consideration.[78] A similar attitude has been adopted in American law under Section 5-106(1)(a) of the UCC.

On the other hand, one may argue that the revocable or irrevocable nature of an offer, more than anything else, depends on the intention of the offeror/promisor, but, when the contract is established as a result of such an intention, it can then only be cancelled or modified by the agreement of all contracting parties. For instance, in the case of a revocable credit, the intention of the offeror/promisor (the issuing bank) is to impose nothing upon itself and the offeree expresses his agreement about such a decision by signing the contract at a later stage. So, the bank reserves for itself a right of modification or cancellation of the credit without giving any notice to other parties to the credit contract (the applicant for the credit and the beneficiary), or without asking for their consent. By contrast, in the case of an irrevocable letter of credit it is the offeror's decision to make an obligatory offer and

[78] See Section B.2.1.2 of the present chapter concerning the doctrine of consideration and "commercial character" of LCs which is accepted by some English courts as an exception to the general principle of contract law in English law.

to impose a duty upon himself, namely, to keep his offer open within the period of time accepted under the offer. So, when such an offer puts a burden upon the bank it becomes responsible from the time of issue of the credit. Such an undertaking becomes enforceable when the offeree accepts the bank's offer. As regards the offeree, his duties start from the time of his acceptance of the offer; in other words, from the time of establishing the contract. From that moment the terms of the contract can only be changed or cancelled by agreement of all parties thereto. Therefore, it is more appropriate to analyse the revocable or irrevocable nature of an offer in general, and the letter of credit in particular, on the basis of the offeror's intention rather than of consideration.

Consequently, as to the time of establishment of an irrevocable credit contract as regards the issuing bank, from different points of time mentioned previously, it seems situation 1 (namely from the time of issuing the credit) is preferable for reasons discussed above. This view can find support in English courts which have accepted LCs as exceptions to the general principles accepted under contract law because of their **"commercial character"**; and also banks in practice have adopted such a view, supported by the ICC. However, there is no reference as to the time of establishment of the credit binding the issuing bank under Section 5-106 of the UCC.

As to the beneficiary's position, it seems situation 6, namely, the time when an offer is accepted expressly or implicitly from the conduct of the offeree, is the most appropriate since after receiving a credit the beneficiary may reject it on the ground of its discrepancy with terms and conditions of the sale contract. This view has been supported under English law for above stated reasons, although it is different from the view accepted in American law under Section 5-106 (1)(b) of the UCC. There is no reference relevant to this point under UCP 500.

Consequently, for having a more precise and reliable set of standards related to LCs in international trade, it would be appropriate to provide provisions about the time of establishment of an irrevocable letter of credit transaction affecting all interested parties thereto.

2.2.3. The presenter's reservation of lien or claim over presented documents

Sub-section 2 of Section 5-110 of the UCC provides: "Unless otherwise specified a person by presenting a documentary draft or demand for payment under a credit relinquishes upon its honour all claims to the documents and a person by transferring such draft or demand or causing such presentment authorizes such relinquishment. An explicit reservation of claim makes the draft or demand non-complying."[79] It is a reasonable rule and the entire purpose of the documentary credit system from the applicant/buyer point of view is preserved by that sub-section. If the beneficiary/seller would like to keep some control over presented documents, such a desire must be specifically agreed upon by contracting parties to a letter of credit. There is no provision for emphasis over the applicant's right over tendered documents after honouring a draft or demand for payment under the UCP 500. Therefore, in respect of clarifying the rights and duties of parties to a credit transaction, it seems appropriate that a provision similar to the one considered above should also be stipulated within any set of standards related to LCs.

2.2.4. Additional warranties on presentment of documents by the beneficiary

Although under the doctrine of strict compliance as one of the pillars of the documentary credit system, a beneficiary is to be paid only if the documents he presents comply with terms and conditions of the credit contract,[80] there is no reference under the UCP regarding the beneficiary's warranty to present documents which cover all necessary conditions stipulated in the credit. By contrast, such an

[79] Section 5-110(2) was omitted in PFD, supra (f.n. 1); see table 2.1 (below).

[80] For instance see Articles 2, 4, and 13 of UCP 500; and regarding the principle of strict compliance look at relevant discussions in Chapters II (Section B.2.1) above and VI (below).

additional warranty is emphasised under sub-section 1 of Section 5-111 of the UCC.[81]

Is there any benefit in requiring such an additional warranty? One may argue that there is no need for confirming such a point since under the credit operation the beneficiary is only entitled for payment if he presents those documents which are required by the credit contract and comply with terms and conditions of it. In other words, an additional warranty by the beneficiary for the same issue adds nothing to the fact that if the documents are not satisfactory the beneficiary loses his right of payment under the credit and banks are entitled to reject his documents and refuse payment. On the other hand, it is possible to say that by emphasising the need for such an additional warranty, the beneficiary becomes responsible, in case of a dispute between him and the bank as regards the issue in consideration, namely, as to who is responsible to prove that tendered documents comply with conditions stipulated in the credit. In other words, the burden of proving the matter is on the beneficiary rather than on the bank examining the documents. Questions may arise as to why the burden for proving the compliance of presented documents with credit's conditions should be on the beneficiary rather than on the bank? Why the bank should not be responsible for its decision to reject tendered documents? In

[81] See below appendix 1 for the text of that section. To understand the purpose of Section 5-111, in an official comment said: "The purpose of this section is to state the peculiar warranty of performance made by the beneficiary and to make clear the intermediary character of the persons moving the documents from the beneficiary to the customer. The beneficiary's warranty of compliance with the conditions of the credit in subsection (1) is expressly extended to all interested parties unless agreed to the contrary. So far as the draft or the relavant documents are concerened, the beneficiary's warranties are usually those of an ordinary transferor or indorser for value although varying circumstances may alter this. The usal warranties of an intermediary, listed in subsection (2), are primarily its own good faith and authority. See also Comment to Section 5-114(2)." ["Uniform Commercial Code", The American Law Institute and the National Conference of Commissions on Uniform States Laws, 1972 Official Text, with Comments and Appendix showing 1972 changes, p. 431]; In South African Reserve Bank v. Samuel, (1931), 39 LI.L.R. 87, at p. 93, Rowlatt, J. decided that it is the first obligation of the beneficiary to present documents which comply with terms and conditions of the credit and if he fails to carry out such undertaking he loses his right(s) under the credit. The relevant part of his judgment is as following: "When one discovered what exactly the letter of credit means, then I think the person acting under it is bound to act under it quite literally, and can not be at liberty to say: "In the end it will all come out the same", or "I might have thought so and so, and you would not have objected if I had asked you that in the first instance".; similar provision was suggested in Section 5-110(a) of PFD, supra (f.n. 1); look at appendix 2 for text of the referred section.

other words, it is the bank that should provide sufficient reasons for its decisions for refusing payment under the credit.

In connection with the second question, Article 14(d)(ii) of UCP 500 supports the idea that it is the bank's duty to state all the reasons for rejecting documents presented by the beneficiary in a special notice.[82] It says: "Such notice must state all discrepancies in respect of which the bank refuses the documents."[83] Although there is no similar provision under the UCC, as another distinction between the UCC and the UCP 500, it is surely the bank's responsibility to provide sufficient reasons for rejecting presented documents under the credit transaction.[84] Regarding the first question above one should make a distinction between the bank's undertaking and the beneficiary's duty as far as documents are concerned. The bank's responsibility to examine tendered documents and their compliance with credits' conditions is a duty against its customer (the applicant for a credit); there is no such undertaking for banks against the beneficiary of such a credit. As a matter of fact, it is the beneficiary who accepts under the credit transaction that banks are only obliged to pay the amount of the credit if documents presented by him comply with conditions stipulated in the credit. Therefore, it is reasonable that the burden of proving the compliance of documents with conditions of the credit should be put upon the beneficiary rather than the bank in case of any dispute between them.

The importance of the beneficiary's undertaking as to the point under consideration becomes clear when the issue of **"right of recourse"** arises; are, in

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[82] For the procedure of such a notice see Article 14(d)(i) of the UCP 500.

[83] Article 16(d) of the UCP 400 (1983) was drafted differently regarding to the point in discussion and said: "If the issuing bank decides to refuse the documents, it must give notice to that effect without delay [...] Such notice must state the discrepancies in respect of which the issuing bank refuses the document." The reason for such a change of policy namely the bank must state **all** discrepencies in its notice seems that draftsmen of the UCP felt that it is better to make the provisions more specific and precise. However, in **"The Lena"**, [1981] Ll.L.R. 68, Mr. Justice Parker stated that it is the issuing bank's right to check all documents and such a bank is not bound to give all reasons for its rejection at once; moreover, there is no provision similar to Article 14(d)(ii) of the UCP 500 under the UCC.

[84] See Section 5-114 (4)(b) of the UCC that says: "the issuer may reject documents which do not comply with the credit itself if it does do within three banking days following its receipt of the documents."

the case of insolvency of the applicant for a credit, banks entitled to bring an action against the beneficiary for the amount paid under the credit, on the ground of "breach of warranty" by the beneficiary? In other words, would the beneficiary's obligation to present documents required under the credit to some extent affect the bank's undertaking, namely, examining tendered documents? This point has been considered in more detail elsewhere;[85] in brief, if it is accepted that there is a reasonable ground to support the view that to some extent the beneficiary agrees under the credit transaction to provide documents compliant with credit's conditions, there is no justification to free banks from their main duties under the credit contract, namely, examining presented documents and deciding to accept or to reject them within a period of time agreed by the contracting parties. Supposing that tendered documents are not in compliance with the credit's conditions, by accepting them, banks waive their rights under the credit transaction. Therefore, it is not reasonable, at a later stage, for the same bank to be entitled to bring an action against the beneficiary on the ground of "breach of warranty". This argument can be supported by Section 5-114(5) of the UCC which provides: "Failure to reject documents within the time specified in sub-paragraph (b) constitutes acceptance of documents and makes the payment final in favour of the beneficiary."[86]

Consequently, points relevant to our discussion are: **(1)** there is a distinction between the UCP 500 and the UCC as to the issue under consideration; **(2)** the UCC, by providing a precise rule, prevents further confusion; in that respect, it is an advantage of the UCC, comparing it with the UCP 500, and it is appropriate that any international sets of standards relating to LCs should adopt a similar policy, namely, to provide a provision which makes the responsibility of both the beneficiary and the bank(s) clear within the credit contract relating to required documents and their compliance with conditions of the credit.

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[85] See Chapter VIII, Section A.2.2 (discussion related to wrongfull acceptance of tendered documents).

[86] For similar view see Article 14 (e) of the UCP 500 that provides: "If the Issuing Bank [...] fails to act in accordance with the provisions of this Article [...] the Issuing Bnak [...] shall be precluded from claiming that the documents are not in accordance with the terms and conditions of the Credit."

2.2.5. Insolvency

In a volatile and unstable international trade market the issue of bankruptcy of one of the parties in an international transaction may be a point of factual relevance to business activities. This applies also to banker's commercial letters of credit, particularly with the increased application of LCs in recent decades. A question of importance may arise: **would the rights of parties under the LC transaction be affected by bankruptcy law (namely, in case of insolvency of a party to a contract would all his creditors be treated similarly)?** To consider this point, different possibilities exist (discussed below), because insolvency is not an issue limited only to one party and under letters of credit all three parties (the applicant for a credit, the issuing bank, and the beneficiary) risk losing their solvency; but the bank's insolvency is the most important (considered first, below). Regarding the relevant international standards, UCP 500 provides no rules; but the issue under consideration has received attention under Section 5-117 of the UCC.

2.2.5.1. Bank's insolvency

1. The effect of the issuing bank's insolvency on the beneficiary

The effectiveness of a letter of credit is based on the fact that the obligation of the issuing bank to pay the beneficiary is independent of the underlying transaction between the beneficiary and the account party. This is known as the "independence doctrine" of letters of credit or "doctrine of autonomy".[87] One of the matters which would have an impact on the beneficiary's right of payment under LCs is insolvency of the issuing bank undertaking to provide payment.[88] As a result

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[87] For more details about the doctrine of autonomy see relevant discussions in Chapters II (Section B.2) above and VII (below).

[88] Harfield, supra (f.n. 54), pp. 236-57 [about the insolvency of the issuing bank]; at pp. 236-37 the same writer pointed out why the insolvency of the issuing bank, and not the other banks, is important from the beneficiary's point of view. He said: "A letter of credit transaction is predicated upon the continuing solvency of the issuing bank. The expectation of this continuing solvency makes the letter of credit desireable to the beneficiary [...] So long as the issuing bank is solvent, it is relatively immaterial whether or not an advising, negotiating, or confirming bank fails. The advising bank is merely a conduit for communication; it undertakes no responsibility. [...] Similarly, although a confirming bank does undertake a direct, independent responsibility to the beneficiary, the failure of the confirming bank leaves the beneficiary with his direct independent right against the issuing bank. [...] Finally, the failure of a negotiating bank is a matter of small

If there is any loss for the applicant he may recover it under the insurance policy. If the seller wishes to pursue his rights against the banker's insolvency, he must carry out his side of contract.[91] Therefore, the issuing bank's insolvency does not automatically end the contract between the bank and the beneficiary and the latter is not relieved from fulfilling his part of the contract.

2. Bank's insolvency and its impact on the applicant

Similarly, the applicant for a credit should understand his rights in the event his bank becomes insolvent and take precautions to avoid "bank risk". The applicant's liability under the contract of reimbursement is to reimburse the amount of credit paid by the issuing bank. There is a possibility that the issuing bank after accepting a time draft and before maturity of the draft and payment goes into bankruptcy; therefore, the bank liquidator takes the position that the applicant for the credit is obliged under the contract of reimbursement to put the bank in funds one day before the maturity of the draft. What would be a safe procedure for the applicant while there is a risk that the funds become a part of the general assets of the insolvent bank and the holder of the draft could only receive a pro rata share of that assets? A sound practice is that the applicant for the credit makes a special agreement with the bank liquidator that the funds paid under the contract of reimbursement meet the bank's undertaking under the letter of credit. If such an agreement is achieved then the applicant safeguards himself against the risk of payment for more than the face amount of the draft. What would be done by the applicant if the bank's trustee does not agree with his suggestion, namely, to pay the funds received from the applicant for honouring the draft issued under the letter of credit transaction? Does the law support the applicant's action if he chooses to pay the amount of the draft directly to the holder of the draft? There are some cases

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Sales Corporation, 206 N.Y. 499, 184 N.E. 68 (1933 App. Div. 655, 255 N.Y. Supp. 841 (1st Dep't., 1932) and UCC Section 5-117; it is likely that a similar decision would be reached in the UK."

[91] Gutteridge, supra (f.n. 75), at. p. 42 pointed out that, "It would seem that insolvency does not automatically end the contract between the parties, nor is it breached, and thus it follows that the seller is not relieved from fulfilling his part of the contract."; Davis, supra (f.n. 20), pp. 92-5.

decided in the USA which uphold the applicant's decision in the above mentioned circumstances. For instance, in **Bank of US v. Seltzer**,[92] the defendant buyer caused the plaintiff to issue a letter of credit in favour of a Japanese seller. The sellers' time draft had been accepted by the plaintiff issuing bank, but before payment the bank went into bankruptcy. Under the reimbursement contract between the issuing bank and its customer (Seltzer), the latter was obliged to put the bank in funds one day before the maturity of the draft. The defendant, firstly, offered to arrange for payment under one condition, namely, that the liquidator held the funds specifically for payment of the draft upon its maturity. Alternatively, the applicant/ defendant offered to pay the amount of draft directly to the holder upon condition that the bank trustee release him from his liability under the reimbursement contract. The liquidator did not accept these suggestions and refused to honour the draft upon its maturity date. Then, the defendant paid the draft and so advised the liquidator when the latter brought an action against the former according to the reimbursement contract. The court held for the defendant on the ground that there had been a failure of consideration between the bank and its customer, namely, the bank failed to perform its undertaking under the reimbursement contract (paying the amount of the draft issued under the letters of credit) as a result of its bankruptcy, and having breached its contract there was thus a failure of consideration.[93]

It is said that the onus of proof is on the buyer/ applicant to prove that the fund was deposited for a special purpose, namely, paying the beneficiary's drafts under the letter of credit.[94] It is also pointed out that if the applicant for a credit put the banks in funds but there is no special reference to the purpose of those funds, it

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[92] 233 A.D. 225, 251 N.Y.S. 637 (1931); Harfield, supra (f.n. 54), p. 243.

[93] Similar result was accepted in Greenough v. Munroe, 46 F. 2d 537 (S.D.Y.N. 1931); for more details about the relationship between the bank and its customer in case of insolvency of the bank see section 3.05 of McCullough, supra (f.n. 45); and Gutteridge, supra (f.n. 75), p. 36; see also Ellinger, supra (f.n. 57), pp. 143-45 and pp. 173-74 and Davis, supra (f.n. 20), pp. 61-64 [about the question of the rights of the applicant for the credit who has placed the banker in funds to enable him to meet the beneficiary's draft under the letter of credit and the bank becomes insolvent prior to payment].

[94] Davis, supra (f.n. 20), at p. 62.

should be used for the banks' undertaking under the credit, the seller beneficiary may not be entitled to benefit from such deposit.[95]

2.2.5.2. Insolvency of the applicant for a credit

A similar dilemma would arise between the bank and its customer (the applicant for the credit or the account party) when the latter becomes a debtor in bankruptcy. Then the question is: does the bank honour the beneficiary's draft and provide payment under the credit, placed in the same position as other creditors of an insolvent account party? In other words, does the bank's security under the letter of credit (right of reimbursement) put the bank in a better position than other creditors who do not have such a security.[96]

In case of commercial letters of credit the insolvency of the applicant for the credit causes less harm for the bank since in that type of credits banks usually take documents as a security measure; so, in case of insolvency of the applicant they use the documents and resell the goods to recover their money paid under the credit.[97] In case of standby letters of credit (SLCs) banks may face difficulties if they

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[95] Davis, supra (f.n. 20), pp. 93-94; the same writer suggested that there is a possibility that the beneficiary may benefit from such a fund and that is where the bank and its customer both become insolvent. In such situtions it is said that the **Rule in Ex parte Waring** (1815), 19 Ves. 345 applies. The Rule can be briefly stated as follows: "Where the customer has remitted bills or given other securities to his banker to meet acceptances and both become insolvent, the securities held by the banker are available to the holders of the acceptances which the securities have been remitted to meet." [for further details about the Rule see pp. 94-95 and p. 205 of the same reference.]

[96] Rodenberg, James A., **"Letters of credit in bankruptcy: Can the independence doctrine survive preference attacks?"**, Commercial Law Journal, Vol. 96, No. 4, Winter 1991, pp. 431-56, at p. 439 said: "A survey of the bankruptcy case law addressing letter of credit situations in which the account party is the debtor reveals a progression from very basic and general principles to, recently, very technical and specific issues. [...] The first issue confronted by the courts when the account party to a letter of credit was the debtor was whether a letter of credit was property of the debtor."; see also Colou, Edgardo E., **"Letters of credit in times of business and bank failures"**, Banking Law Journal, Vol. 107, Iss. 1, January/February 1990, pp. 6-37 that in the abstract of the article said: "How to deal with a letter of credit when the bank customer has gone bankrupt has proven to be a difficult issue for bankruptcy courts. The heart of the problem seems to be how to maintain intact the properties and characteristics of letters of credit but, at the same time, respect the equity and fairness principles embodied in the Bankruptcy Code. The question of whether a bankruptcy court should estimate letters of credit as a **contingent claim**, even though they are contingent on a future event, can be answered only through cases and treaties that have dealt with similar issues. The establishment of an escrow account in the insolvency or reorganisation plan should persuade a bankruptcy court to obstain from estimating letters of credit." [Emphasis added.]

[97] For more details see discussion relevant to the bank's security in Chapter VIII.

do not arrange for proper security since in such a case, contrary to the use of commercial letters of credit, banks do not have control over valuable documents. Under SLCs the bank's customer (applicant for the SLCs) has usually defaulted not by failing to pay for the amount of the credit when the goods have arrived, but by failing to conduct the promise made under the transaction, e.g., building a factory. In such a situation, if banks provide no security for their services, they may find themselves as unsecured creditors beside other creditors of the insolvent customer.

As to the insolvency of the applicant for the credit and its impact upon the beneficiary's right of payment under the credit, it is worth pointing out that the latter's benefits under LCs are not affected as a result of the former's bankruptcy, since the beneficiary's payment under the credit is not made out of the property of the applicant, but out of the bank's own funds. Therefore, if there is any dispute in that respect it is between the applicant and his bank.[98]

In respect of the time of insolvency of the applicant and its impact upon his contractual relationship with the issuing bank, several points of time should be differentiated, as follows.

1. Prior to the time of acceptance of the applicant's application for issuing a credit

The applicant submits an application for the issue of a credit, but before his application is accepted by the issuing bank the applicant, unknown to the bank, files an assignment for a receiving order or is declared bankrupt. If subsequent to the effective date of bankruptcy a letter of credit is issued and accepted by the beneficiary, would the trustee (appointed to control the applicant's assets) and the issuing bank contest the validity of the credit? It is hard to support the idea that in

[98] One of the first cases in the USA that considered the effect of the applicant's bankruptcy on LCs is In re Marine Distributors, Inc., 522 F. 2d. 791 (9th Circuit 1975). In that case the banks' customer (the applicant for the credit) became insolvent and the trustee in bankruptcy tried to obtain an injunction against the bank restraining the issuer from honouring the letters of credit. The court held for the bank and the beneficiary of the credit on the ground based upon the "doctrine of autonomy" namely that the applicant for the credit is not a party to a letter of credit transaction between the bank and the beneficiary; therefore, the bank has an independent obligation namely to pay the beneficiary.

such a situation the beneficiary should be prevented from receiving his payment under the credit if he is carrying out his obligations under the credit transaction. The main reason in favour of such argument is the doctrine of autonomy.

2. Prior to the Issue of the credit

Prior to the issue of the credit the applicant files an assignment in bankruptcy, and before any documents are presented by the beneficiary the issuing bank receives a notice from the applicant's trustee advising the bank that any assets which belongs to the applicant now form part of the bankrupt estate. As a result of such a notice is the issuing bank entitled to stop payment under the credit transaction if the beneficiary presented required documents? An author has rightly pointed out that the bankruptcy of the applicant has no effect on the right of the beneficiary under the letter of credit since, firstly, on the date of contract the applicant had full capacity to enter into the contract; and secondly, the letter of credit is independent from the underlying contract.[99]

3. Following the issue of the credit

There should be no problem in such a situation because the credit transaction between the issuing bank and the beneficiary is an independent contract.[100]

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[99] Sarna, Lazar, "Letters of credit: Bankruptcy, fraud and identity of parties", The Canadian Bar Review, Vol. 65, 1986, pp. 303-27, at p. 312 [hereinafter it is referred to as Sarna].

[100] It is a common case and there are many decided cases related to issue under consideration. For instance in a Canadian decision **Re Meridian Developments Inc. and Toronto-Dominian Bank**, (1984) 11 D.L.R. (4th) 576 (Alta. Q.B.) held in favour of the view that banks's undertaking is independent. On the other hand in an American case **In Re Twist Cap, Inc. v. Southeast Bank**, 1 Banker, 284 (Banker D. Fla. 1979), the court enjoined the issuing bank from making payment under the letter of credit following the bankruptcy of the applicant under a standby letter of credit on the ground that the contract was executory, and under section 365(a) of the Bankruptcy Code in the USA which provides that the trustee may assume or reject any executory contract or unexpired lease of the debtor. That decision was severely creticised. [For more details about that decision see Baird, Doglas G., "Standby letters of credit in bankruptcy", University of Chicago Review, Vol. 49, Part 1, Winter 1982, pp. 130-54]]; and for other relevant matterials see Verkuil, Paul R., "Bank solvency and standby letters of credit: Lessons from the USNB failure", Tulane Law Review, Vol. 53, 1979, pp.314-28, Mclaughline, Gerald T., "The impact of Federal Criminal and Bankruptcy Laws on letters of credit", Commercial Lending Review, Vol. 4, No. 1, Winter 1988-89, pp. 28-38, at p. 31 said: "Recently, however, courts have had to grapple with whether or not standby letters of credit can be used to effect eve-of-bankruptcy preferential transfers to creditors. Since monies paid under a letter of credit are the property of the issuing bank, not the property of the bankrupt debtor, the letter of credit mechanism may

2.2.5.3. Beneficiary's insolvency

Under letters of credit the insolvency of the bank or its customer (the applicant for the credit) is a cause for disputes between interested parties but the beneficiary's insolvency has received less attention since it has less impact upon the banks' undertaking under the credit, namely, payment against documents which comply with terms and conditions of the credit.[101] However, there are several possibilities: **1)** a letter of credit is issued for the beneficiary and before the performance under the credit the beneficiary goes into bankruptcy; **2)** the beneficiary becomes insolvent after the performance under the credit and before presenting any document(s) to the bank; **3)** the beneficiary becomes bankrupt after presenting the documents required under the credit and before their acceptance by the bank; and **4)** the beneficiary's insolvency comes after his documents are accepted by the bank and before payment. In all of the above situations the question may arise **whether the trustee in bankruptcy can draw on the letter of credit.**

As pointed out above, payment under the credit is conditional, namely, against documents in compliance with the credit's conditions; therefore, in the above situations 1 and 2 no documents are presented, so the paying bank is under no duty to provide payment under the credit. Even if the trustee in bankruptcy chooses to carrying out the beneficiary's obligations and presents required documents under the credit, he may face the banks's objection on the ground that documents are not issued (e.g. commercial invoice) and presented (e.g. bills of lading, insurance policy etc.) by the beneficiary himself as required under the credit transaction.[102]

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arguably be able to execute preferential transfers. It seems clear, however, that the law should not allow a debtor to do indirectly what it cannot do directly."

[101] See Articles 2, 4, and 13 of UCP 500.

[102] The whole structure of the documentary credits system is based on the faith of the bank upon the beneficiary as far as documents are concerened, So, even if documents like bills of lading, insurance issued by person other than the beneficiary they should be presented by the beneficiary of the credit and no body else and this issue is also confirmed under Article 48(h) of the UCP 500 namely "the Credit can be transferred only on the terms and conditiones specified in the original Credit [...]"; and as to the situation that the documents must be issued by the beneficiary himself see Article 37 (a)(i) which provides that a

Is such an argument acceptable? To challenge that argument it is possible to suggest that the position of a trustee in bankruptcy is different from the position of a second beneficiary (in case of transferable credit) requiring the bank's prior agreement, since, he is appointed by the law relevant to the bankruptcy in particular circumstances and it is obvious that the law overrules any agreement made by parties to a private contract in case of conflict between the terms of that contract and the law.[103] So, in general, the bank's argument may be rejected by courts on the ground explained above; however, it is sounder for the trustee to reach some sort of agreement with the bank before starting any performance under the credit.

In respect of situation 3 above (namely, the beneficiary becoming insolvent after presenting the required documents and before his documents are accepted by the banks) the trustee's position is different from that stated under situation 2. In those circumstances if tendered documents are in compliance with the credits' conditions, then the bank is obliged to arrange payment under the credit and the beneficiary is entitled to assign its right to proceed to the trustee (under Article 49 of the UCP 500).[104] By contrast, if presented documents are rejected by the bank for

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commercial invoice "must appear on their face to be issued by the Beneficiary made in the Credit (except as provided in Article 48)."

[103] Sarna, supra (f.n. 99), at p. 309 stated: "Even if the trustee in bankruptcy find himself in such a position, he may find it is unable to enforce the rights of the bankrupt beneficiary because of the strict compliance rule. [...] in case Swift Air Lines v. Crocker National Bank, US Bankruptcy Appl. (1983), 30 B.R. 490, reported in (1984), 2 I.B.L. 143 the issuer refused to make payment upon being presented a document signed by the trustee in bankruptcy of the corporate bankrupt. Under law the trustee has a full power under the lc the beneficiary must sign documents peresenting for the payment [...] following the bankruptcy the beneficiary is not permitted to act on its own behalf [...] therefore the trustee was prevented from asserting the beneficiary's right under the credit."

[104] Here other points may arise namely whether a bankrupt beneficiary is able to apply his right of proceeds under the credit even after he becomes insolvent. It is obvious that after bankruptcy the beneficiary has no right to act in his own name; therefore, do the trustee assign the right of the proceeds to another person (the assignee) instead of the insolvent beneficiary? There are nothing relating to those issues under Article 49 of UCP 500 and Section 5-116 of the UCC; Sarna, supra (f.n. 99), at p. 308 said: "In the event of bankruptcy of the beneficiary under the letter of credit one might readily assume that the beneficiary's rights vest in the trustee, permitting the trustee to act in stead of the beneficiary for all purpose, including presentation of documents, execution of drafts and demand for payment. There are, however, objections to this assumption. Those objections relate to certain letters of credit which on their face are said not to be assignable, or are not assignable as a result of the governing code of rules. The other basis of attack is the literal wording of the letter of credit, which requires the personal intervention of the beneficiary at the most crucial stages of the letter of credit transaction, namely, presentation of documents and demand for payment."; as to the issue of

any reason, then the trustee's position should be considered under situation 2 (discussed above). A conclusion similar to what is discussed with respect to situation 3 (namely, the beneficiary going into bankruptcy after presenting documents stipulated under the credit and before acceptance but accepted later by the bank) would be acceptable for situation 4, namely, where the beneficiary becomes bankrupt after his documents are accepted by the bank(s) and before payment.

2.2.5.4. Section 5-117 of the UCC

The Uniform Commercial Code (UCC) addresses, under Section 5-117, bank insolvency by requiring that any funds held as collateral by the issuing bank for a documentary credit must be used to pay drafts presented under the credit. Any excess must be returned to the importer. By contrast, the UCP 500 contains no provisions relating to the insolvency of the issuing bank.[105]

As to sub-section 1 of Section 5-117 a question may arise: does UCC cover only those credits which are issued under paragraphs (a) or (b) of section 5-102(1) of the UCC? In other words, what is the solution where an issued credit is not within those mentioned in the above paragraphs but falls under paragraph (c) of section 5-102(1): "but conspicuously stated that letter of a credit or is conspicuously so entitled." It has been said that the reason for accepting such a policy is to prevent abusing the provision in case of ambiguity.[106] It seems there is a distinction between Section 5-117 and Section 5-102(1). If a credit falls into the last category of

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assignment the same writer pointed out: "Accordingly, if a credit is silent as to the matter, it is presumed to be non-transferable; on the other hand, the silence of the credit does not prevent the beneficiary from assigning its rights to proceeds. It is evident that an assginee would have no right to proceeds unless the demand mechanism is appropriately triggered by the beneficiary itself presenting the documentation and making the appropriate demand for payment." [Sarna, supra (f.n. 99), p. 308]; for more details about the right of assignment of the proceeds under the credit see relevant discussion under the present section.

[105] Ellinger, JBL 1994, supra (f.n. 27), p. 28; in the Proposal Final Draft (PFD) for revision of Article 5 of the UCC the omission of Section 5-117 was suggested; see table 2.1 (below).

[106] In Official Comment to Section 5-117 said: "The section is limited to transactions under Section 5-102(1) (a) and (b) to prevent abuse in situations where the commercial purpose of facilitating the movement of goods, securities or the like may be lacking."

section 5-102(1), i.e. paragraph(c), and is supported by law, there should be no objection that such a credit be confirmed and covered by Section 5-117 too.

2.2.5.5. Concluding remarks

A letter of credit assures payment from one party to another by making arrangements for a bank to lend its full faith and credit to the transaction. The process assumes that the issuing bank is at least as creditworthy as its customers, but this is not always true. The best way that the other parties to a credit transaction (applicant for a credit and the beneficiary) can reduce the risk of **bank insolvency** is to consider carefully the financial strength of banks from which they obtain their LCs services.[107]

One important issue generated as a result of the bankruptcy of the issuing bank is whether the law of bankruptcy has any impact on the **"doctrine of autonomy"** accepted under the documentary credit systems. In other words, whether the beneficiary's special right of payment under the credit would be affected in such a situation. There are two views regarding this question, but the preferred opinion is that the bank's trustee is not entitled to put the beneficiary of a credit in the position of other creditors of the bank and treat him similarly. On the other hand, it becomes clear that the bank's insolvency does not automatically put an end to the credit transaction and if the beneficiary likes to pursue his rights under the credit, he must carry out his side of the contract, namely, by presenting documents required by the credit contract and compliant with its terms and conditions.

As to the banks's insolvency and its impact upon the applicant for a credit, who under the reimbursement contract must reimburse the amount of the credit one day before the maturity of the credit, or deposit funds for the purpose of meeting the beneficiary's draft(s) drawn under the letter of credit, it is accepted by courts in the

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[107] Locher, Gabriel, **"Hedge your bets in L/C transactions"**, Business Credit, Vol. 94, Iss. 6, June 1992, pp. 28-29 stated: "When reviewing any bank's financial statements, the following points should be considered: 1. Is the bank adequately capitalized?; 2. Does the bank's capital position meet or exceed regulatory requirements? 3. Is the allowance for loan losses inadequate, given the bank's level of non-performing or past due loans?; 4. What is the ratio of non-performing loans to total loans? Crucial to the health of a financial institution is the state of its loan portfolio."

USA and supported by writers that the bank's trustee is not entitled to prevent the applicant from paying the beneficiary directly in case the trustee does not agree to treat the beneficiary as a preferred creditor and release the applicant from his duty, namely, by paying the full amount of the credit if the beneficiary has fulfilled his side of contract under the credit; and the bank's liquidator too is not allowed to deal with the applicant's funds deposited for LCs as general assets of the insolvent bank. Of course it is for the applicant to provide sufficient proof that the deposited funds are for meeting payment under the letter of credit.

In respect of the bankruptcy of the applicant for a credit and its impact upon his relationship with the beneficiary as well as the issuing bank, it is concluded that because of the "doctrine of autonomy", the applicant's insolvency does not have any impact on the right of the beneficiary to receive payment which is secured by the issuing bank under the credit transaction; similarly, the time that the applicant becomes insolvent (namely prior to the acceptance of the applicants application for issuing a credit, prior to the issuance of a credit, and after a credit being issued) has no impact on the beneficiary's right of payment under the credit. However, as to the effect of the applicant's bankruptcy upon the issuing bank's position, it depends on the type of credits and security measures which are agreed by the contracting parties, namely, the applicant and the issuing bank under the contract of reimbursement. As to banker's commercial letters of credit, the issuing bank faces less difficulties since in such a type of credit the bank usually takes the documents as security against payment by the applicant; and if the latter fails to provide the amount paid by the bank, the issuing bank can refund the money paid under the credit by reselling documents; but in the case of SLCs, the issuing bank does not have such a security measure and if the bank provides no reliable security it may lose its special right under the contract of reimbursement and be treated as one of general creditors by the applicant's liquidator.

Regarding the position of a trustee in bankruptcy involving the beneficiary's insolvency, and the question whether he is entitled to draw on the letter of credit instead of the bankrupt beneficiary, four possibilities are considered in the present

study: **(1)** the beneficiary becomes insolvent prior to performance under the credit; **(2)** the beneficiary becomes insolvent after the performance and before presenting documents required under the credit to the bank; **(3)** the beneficiary becomes bankrupt prior to the time that his documents are accepted by the bank; and **(4)** the beneficiary's bankruptcy occurs after his documents are accepted by the bank. In brief, it is pointed out that under the above possibilities 1 and 2 the bank has no duty to pay and if the beneficiary's trustee choose to carry out the beneficiary's side of contract (providing required documents under the credit), he may face two objections. Firstly, documents presented by the trustee do not comply with credit's terms and conditions and therefore they are rejectable under the principle of "strict compliance"; secondly, the trustee is not the assignee accepted under Article 49 of the UCP 500 (assignment of proceeds), since the procedure is not started by the beneficiary and before his bankruptcy; therefore, the trustee is not entitled to proceeds under the credit transaction. In response to such objections, it is argued that the position of the trustee who is appointed by the law is different from that of the ordinary assignee and as a result he is able to proceed under the credit if the trustee finds it is appropriate to adopt such action.

In respect of above situations 3 and 4, the trustee's position is less complex and if the bank accepts the documents presented by the beneficiary before his bankruptcy, then the lawful person to receive the payment under the credit is the trustee appointed by the law. If, he rejects tendered documents, then the trustee's position is referred back to situation 2 (above namely, the beneficiary becomes insolvent after the performance and before presenting required documents under the credit to the bank).

Lastly, the existing rules related to the issue of insolvency (Section 5-117 of the UCC) are not comprehensive since they cover only some aspect of the bank's insolvency in case of LCs, namely, they deal only with the bank's insolvency and provide no provisions about the bankruptcy of the applicant for a credit and the beneficiary. From an international legal point of view, the present set of standards related to LCs (UCP 500) provides no provisions about the issue of insolvency. The

reasons for adopting such a policy by the ICC are due partly to the legal nature of the subject and partly to practical difficulties, for example, concerning a comparative study between different legal systems for establishing more harmonious or uniform attitudes about the issue of insolvency, lack of expertise, the business interests of the banks what would like to have control over the system and lead the system in a direction safeguarding primarily their interests, and expenses; therefore, the ICC has deliberately paid no attention to the issue of insolvency, and as a result there is no provision stipulated within the UCP even in the last revision of its provisions in 1993 (UCP 500).

SECTION C: CONCLUSIONS

1. INTRODUCTION AND COMMON POINTS

In the light of what has been covered in the present Chapter it becomes clear that the basic principles governing the letter of credit transaction are widely recognised by both UCP 500 and Article 5 of the UCC. They include the notion that letters of credit are autonomous transactions or are independent of the underlying contracts on which they are based. The issuer is not concerned with or bound by underlying contracts; he deals exclusively in documents and not in goods or services to which the documents may relate. The issue of the letter of credit and its acceptance by the beneficiary entitles the beneficiary to a direct claim against the issuer in the event of the issuer's unjustified refusal to pay.

On the other hand, there are distinctions between UCP 500 and UCC, as follows.

2. DISTINCTIONS BETWEEN ARTICLE 5 OF THE UCC AND UCP 500

2.1. Distinctions as to the general structure of the UCC

2.1.1. Legal nature of the rules

The UCP is not "law" in its specific meaning since it is not the act of any legislature or court; but, because it is expressly agreed by parties to a letters of

credit transaction (Article 1 of UCP 500), the UCP is part of a contract.[108] By contrast, Article 5 of the UCC is a piece of legislation and therefore mandatory in nature.

2.1.2. Scope of the rules

2.1.2.1. National and international legal dimention of LCs

Another distinction between UCP and Article 5 of the UCC is that the former mostly addresses issues relevant to international documentary letters of credit whereas the latter focuses mainly upon providing a more unified law from a national perspective. In this respect, distinctions exist between them regarding the scope of application of rules and provisions as well as rights and duties of different parties to the credit transaction.[109]

2.1.2.2. Letters of credit issued by banks and other financial institutions

A further distinction between the UCC and UCP 500 is that the latter covers LCs issued by banks; while Article 5 of the UCC considers those type of credits issued by other financial organisations (Section 5-102(1)(b) and (c)).[110]

2.2. Distinctions concerning issues of LCs

2.2.1. Issues considered by both the UCC and UCP 500

The UCP is the product of work by bankers. Bank lawyers and traders are mostly interested in the practical aspects of LCs rather than in the legal issues related to them. This is obvious from different Articles of the UCP 500, particularly,

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[108] The opposite view suggested that the UCP based on customs and practices accepted at international level by banks; for more details concerning the legal nature of the UCP see relevant discussion in Chapter XI, Section B.2 (below).

[109] Other differences between UCP and UCC are: **1.** Court of appropriate jurisdiction may enjoin honour of draft or demand under the credit transaction (Section 5-114(2)(b)); **2.** As to the time of reimbursement by the issuer (Section 5-114(3)) a similar principle is governed by both UCP and UCC; nevertheless, UCC precisely provides that such a right should be honoured immediately and provided: "[...] not later than the day before maturity of any acceptance made under the credit."; **3.** Conditional payment (Section 5-114(4)(a)- As to that issue it is officially stated that the situation was clarified to solve problems arising because of the currency restrictions of other nations; no similar provision being provided by the UCP; **4.** Improper dishonour and anticipatory repudiation (Section 5-115)- This subject is another example where no provision is foreseen in the UCP.

[110] See discusion concerning scope of Article 5 of the UCC in Section B.1.1.2 of the present chapter (above).

those related to documents (Articles 24-44). In that respect UCP is much more detailed than Article 5 of the UCC; moreover, beside points mentioned above (namely legal nature as well as scope of Article 5 of the UCC), it is clear that in many instances (as pointed out in Section B(1) of the present Chapter) the UCC has taken a more positive view concerning the rights of the applicant for a credit. For instance, in case of failure in translation or interpretation of any messages related to LCs by banks or their agents, the UCC provides some protection for the applicant whereas such a relief has been denied under the UCP.[111] A similar flexibility appears concerning the bank-beneficiary relationship particularly in case of assignment of proceeds.[112]

On the other hand, UCP 500 is clearer than the UCC as to issues concerning SLCs (Section B.1.2.1 above), revocability or irrevocability of a credit where there is no indication in the credit as to its type (Section B.1.2.2 above), and transferable credit (Section B.1.4.4 above).

2.2.2. Issues considered only under Article 5 of the UCC

In contrast to UCP 500, Article 5 of the UCC covers important issues like fraud, bank's insolvency, indemnities, time of establishment of a credit and many other issues.[113] The importance of these legal issues leaves no doubt that a set of international standards relevant to LCs is not complete unless issues considered out above are considered as relevant thereto. Moreover, Article 5 of the UCC provides a more equitable rule as far as the applicant for a credit is concerned, namely, safeguarding the right of the applicant in case of amendment of the credit.[114] In addition, as to the time of establishing a letter of credit between bank and other parties to the credit transaction, the UCC provides a clear rule whereas the UCP is

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[111] For more details see Section B.1.3.1, in the present chapter and Section B.1.1.3, in Chapter IV (above).

[112] See the relevant discussion in Section B.1.4.4 of the present chapter (above).

[113] As to issue of fraud see Chapter VII, Section B (below) and regarding bank's insolvency, indemnities, and time of establishment of a credit look at Section B.2 of the present chapter (above).

[114] See relevant discussion in Section B.2.2.1 of the present chapter (above).

silent on the point under consideration.[115] This is true when the UCC considers issues like consideration and a necessity for formal requirements and signing of the issued credit before it becomes enforceable, or where a list of definitions are provided in order to simplify the application of the rules.[116]

3. DISTINCTIONS BETWEEN ENGLISH AND AMERICAN LAW

Letters of credit in the USA are governed beside case law, by either the UCP or Article 5 of the UCC (as the case may be) and it is possible to find credits which are governed by both.[117] This of course may be a cause for uncertainty because of differences existing between them; parties to a credit contract should expressly clarify their intentions. It is obvious that in case of conflict, Article 5, because of its mandatory nature, would overrule UCP provisions. UCP offers an advantage, however, for users of LCs in the USA, namely, issues related to letters of credit are better regulated in it. This is not the case under English law and there is not any particular Act of Parliament relating to LCs in the UK.

Moreover, concerning the issue of consideration, as pointed out previously,[118] the position of English law is based on court decisions when considering the relationship between banks and the beneficiary of a credit, while Article 5 of the UCC (Section 5-105) provides that no consideration is necessary to establish a relation between banks and the beneficiary.

4. COMPARATIVE OBSERVATIONS ON UCP 500 AND UCC

UCP 500 codifies some issues related to LCs, but what would be the position of the ICC concerning issues covered by Article 5 of the UCC? In other words, what can be added to the UCP? Different possibilities may be envisaged:

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[115] For more details look at Section B.2.2.2 of the present chapter (above).

[116] For relevant discussions see above Section B.2.1 of the present chapter.

[117] See introduction to Section A of the present chapter and sources on standards and rules of LCs in Section B.2 of Chapter I (above).

[118] See above Section B.2.1.4 of the present chapter.

1. The ICC could consider only issues covered by both UCC and UCP. This would solve part of the problems but it would leave the greater part of differences between those set of standards concerning LCs unresolved.

2. The ICC could consider issues not particularly related to the legal aspect of letters of credit transactions such as fraud, insolvency, indemnity as well as issues not linked to one particular legal system such as consideration. By adopting such an approach to some extent a harmonisation between UCP 500 and the UCC could be achieved; but having two sets of standards would still provide a cause for confusion between parties to LCs transactions and the law of LCs would remain ununified at an international level, and a possible further development would remain untouched.

3. The ICC could consider all differences that exist between UCP 500 and the UCC in order to provide a uniform international set of standards relating to LCs, including legal standards as well as customs and practices relevant to LCs. This could be the most suitable approach towards unification of the law of LCs in international trade. To be successful in its efforts, the ICC, among other things such as having a strong desire, expertise, and strong financial support, could necessarily achieve a reasonable balance between the different interests of parties to a letter of credit. As it is pointed out: "The essence of uniform law revision is to obtain a sufficient consensus and balance among the interests of the various participants so that universal and uniform enactment by the various states may be achieved."[119] Would it be possible for the ICC to accept such a challenge? If no, what would be a substitute solution?

In the last revision of the UCP (UCP 500) the ICC tried to reduce distinctions between UCP provisions and Article 5 of the UCC by changing its attitude in Article 7(c) of UCP 400 (now Article 6(c) of UCP 500),[120] and to some extent harmonise

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[119] See PFD, supra (f.n. 1), at p. xvii (Prefatory Note).

[120] See discussion concerning the situation when a credit is silent as to type of credit in Section B.1.2.2 of the present chapter (above).

the UCP with UCC. A similar view was shared by draftsmen of the Proposed Final Draft (PFD) for revision of Article 5 of the UCC.[121]

Although efforts have been made for harmonising sets of standards related to LCs, there exist still a large gap between them; experience from the past shows and supports the view that there is a desire to seek a common solution concerning issues related to LCs, but such a desire seems to be not sufficiently strong to bridge the gap and remove distinctions existing between the UCC and UCP 500. As a result, the unification of law of LCs through harmonisation of the UCC and UCP 500, as a first step, seems to need considerable time, unless a change of attitude emerges on both sides, the ICC or the USA.

As to the second question (what would be a substitute solution for delayed harmonisation between UCP 500 and the UCC on the law of LCs?), letters of credit remain a major instrument in international trade as well as domestic transactions. To facilitate this usefulness and competitiveness, the need is felt that beside custom and practice related to LCs the question of unified law should be decided worldwide.[122]

A lesson that can be drawn from the experience of preparing Article 5 of the UCC is that if a strong desire for and commitment to unification of law of LCs, supported by adequate finance and expertise, provide a real opportunity to obtain a unified law concerning LCs at an international level between different legal systems, this can become possible as it has become possible between different states with different jurisdictions in the USA. Moreover, the time is ripe, more than ever, for a

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[121] See PFD, supra (f.n. 1), at p. xvii (Prefatory Note) said: "the goals of drafting effort were: conforming the Article 5 rules to current customs and practices; accomodating new forms of letters of credit, changes in customs and practices, and evolving technology, particularly the use of electronic media."; and for an example see appendix 1 for Section 5-112(1)(a) of the UCC (time allowed for honour or rejection of documents) and appendix 2 for Section 5-108(b) of PFD as to the same issue; for relevant discussion see Section B.1.4.1 of the present chapter (above).

[122] Some other issues which are suggested for revision of the UCC are: 1. Choice of law; 2. Subrogation; 3. statute of limitation; 4. Transfer by operation of law. [See PFD, supra (f.n. 1), pp. xxiii-xxv (Prefatory Note)]

comparative study between different legal systems concerning LCs under auspices of one of the United Nations Organisations (such as UNCITRAL or UNIDROIT).[123]

Regarding the unification/codification of law of LCs at an international level, for reasons discussed elsewhere (with respect to the legal nature of the issues and practical difficulties affecting the preparing a uniform code of standards, banker's business interests, and costs), it is not possible for the ICC to accept the task of providing a set of international standards about LCs covering both issues of the practical aspects of the current system and legal matters relevant to the documentary credit system in international trade; and there is also no justification to leave the task of preparing a uniform code of standards totally under the national law of each state which otherwise may decide differently. As having uniform provisions regarding the practical issues of the documentary credit system is rightly important, similar sensitivity should be applied by parties dealing with credit transactions, particularly banks and also international organisations working in the field of international trade able to promote the idea of a uniform law dealing also with legal issues related to LCs. In such a context, experience in preparing the UCP and Article 5 of the UCC can be of great help as well as a source of information, a solid foundation and a cornerstone for the further development of the documentary credit system in the future.

The need for the unification/codification of the law of LCs at an international level, the advantages and disadvantages of a uniform solution, compared with the UCP, are considered below in Chapters X and XI; the present chapter confirms our previous concern about the UCP as the only existing source of law concerning LCs at an international level; but, for reasons submitted above, the UCP does not respond to all the needs of the international business community as to LCs. In that respect the next few chapters (Chapters VI-VIII) are devoted to legal issues relating to LCs from a common law perspective (particularly English law).

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[123] For more details concerning the readiness of the international community and the world of commerce condition see Chapter X, Section B.2 (below).

PART THREE

LEGAL ISSUES RELATING TO LETTERS OF CREDIT (COMMON LAW PERSPECTIVE)

In a commercial letter of credit the role of a bank, as a mediator and as one of the parties to the credit arrangement, is an important one. To keep the balance between the applicant and the beneficiary of the credit, and in order to safeguard its interests, a bank is obliged to choose a more cautious approach when dealing with tendered documents or where there is an allegation of fraud by the beneficiary or his agent.[1] Questions may also arise in circumstances in which the applicant/ buyer, as a result of becoming insolvent or for any other reason, is not able to reimburse the bank's money. For such eventualities sufficient security has to be arranged by banks.[2]

Dealing with issues related to the above points is not always an easy task for the banks. As a result they have sought to find support for their decisions from courts of law in the past. There are good reasons to believe that this situation may not be different in the future, unless legal issues related to LCs are clarified by appropriate legal texts, in advance, for banks and other parties to credit arrangements. Clarification may reduce the probability of disputes. As a result, time and costs in law suits and public money could be saved. Moreover, the documentary credit system could become more reliable with predictability and certainty. The present Part deals with legal issues which in relation to LCs would need to be clarified in precise terms anchored in appropriate legislative or other (international) instruments, with benefits to all those interested as parties to letters of credit in international trade.

[1] See relevant discussion in Section B, Chapter VII (below).

[2] For issues related to banks' security see Chapter VIII (below).

CHAPTER VI

THE BANK'S DUTY TOWARDS THE APPLICANT FOR A CREDIT (THE PRINCIPLE OF "STRICT COMPLIANCE")

SECTION A: LEGAL ISSUES RELATED TO THE PRINCIPLE OF STRICT COMPLIANCE

There are situations in which the bank must decide to accept tendered documents or to refuse payment under the credit.[3] The situations in question may be as follows.

1. AS TO DOCUMENTS REQUIRED UNDER LETTERS OF CREDIT

1.1. "Stipulated/ not stipulated documents"

Under Article 2 of UCP 500 it is provided that payment is available, "against stipulated documents, provided that the terms and conditions of the credit are complied with." A question of importance may arise as to what is meant by **"stipulated documents"**? Does it mean that required documents must be expressly numbered in the credit itself, or are there situations in which a beneficiary of the credit should understand what kind of documents are necessary even if it is not specified in the credit? If the answer is positive, what would be the bank's obligation under the second paragraph of Article 13(a) of UCP 500 (namely "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.")?[4]

1.1.1. In English law

In Banque de l' Indochine et Suez S.A. v. J.H. Rayner (Mincing Lane) Ltd.,[5] one of the credit's condition was that the carrying vessel should be a "conference line" ship, but there was no call in the credit for any documents relating to it. The defendant beneficiary argued that he was not under a duty to prepare documents which showed that the goods had been carried by a conference line vessel. The argument was rejected by the court of first instance and in the Court of

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[3] As to concept of principle of strict compliance see relevant discussion in Section B.1, Chapter II (above).

[4] There was nothing like this point under UCP 400 (1983).

[5] [1983] All ER 468; [1983]1 All ER 1137 (CA); [1983]1 Ll.L.R. 228 (CA).

Appeal, Donaldson, M.R., stated: "This is an unfortunate condition to include in a documentary credit, because it breaks the first rule of such a transaction, namely that the parties are dealing in documents, not facts. The condition required a state of fact to exist. What the letter of credit should have done was to call for a specific document which was acceptable to the buyer and his bank evidencing the fact that the vessel was owned by a member of conference. It did not do so and as, accordingly, the confirming bank had to be satisfied of the fact, it was entitled to call for any evidence establishing that fact."[6]

What would be the court's point of view now that the LC is subject to UCP 500? Would it be the same as the above decision of the Court of Appeal? To answer these questions, first of all, the position of parties to the credit contract must be examined under the UCP, in order to find whether there is any difference between UCP 500 and its previous version namely UCP 400.

1.1.2. UCP 500

The related part of Article 2 of UCP 500, mentioned above, is similar to Article 2 of UCP 400. But, Article 13, subsection (a) of the present UCP, regarding the point in discussion, shows differences with Article 15 of UCP 400. Firstly, terms "stipulated in the Credit" is added to the first paragraph; secondly, a new point, namely, the second paragraph of Article 13 (a), as mentioned above, is provided. Would these changes affect the beneficiary's position in connection with documents which are related to facts of the case? To give an answer to this question it is necessary to find what is the correct interpretation **"not stipulated in the credit"**? There are two possibilities:

(1) Wide interpretation- The first argument is that terms "not stipulated in the credit" mean all types of documents which are not numbered precisely in the credit. This interpretation includes both documents which are not related to facts as

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[6] Ibid., p. 1140; similar decision was held in Lebenon in Sta'tni Banka Ceskoslovenska v. Arab Bank Ltd., (1972), Partic jurisdiction, 45, Revue Jurisdiciaire Libanaise; Gutteridge, H.C. and Megrah, M, "The Law of The Banker's Commercial Credit", London, 1984, 7th ed., pp. 118-19 [hereinafter referred to as Gutteridge].

well as those which are connected to the facts of the case. This is in favour of the beneficiary and the bank since the burden is for the applicant for the credit to ascertain necessary documents; moreover, this interpretation can also be supported by Article 4 of the UCP 500.[7] In contrast, the wide interpretation view is the opposite to what was decided by the Court of Appeal in **Banque de l' Indochine et Suez S.A. v. J.H. Rayner (Mincing Lane) Ltd.**, as mentioned above.

(2) Narrow interpretation- The next argument is that the real interpretation of terms "not stipulated in the credit" is that these terms do not cover documents which are connected to facts of the case. So, the UCP's position as to the point in discussion, either in the previous or present version, has not been changed since the second paragraph of section (a) of Article 13 of UCP 500 is only related to those types of documents which are not, for any reason, stipulated in the credit and not those which are connected to facts of the case. For instance, there may be a situation in which the applicant for the credit forgets to call for an insurance policy or an invoice and the beneficiary, for any reason, presented such a document.

This view is in favour of the applicant and puts the burden upon the beneficiary to present the necessary documents even if they are not stipulated in the credit but it is related to the facts of the case. Moreover, this argument is supported by the decision of the Court of Appeal in **Banque de l' Indochine** case.

However, by accepting the narrow interpretation, banks would face difficulties in their relationships with the beneficiary. Since, under Article 13(a) of UCP 500 the bank may choose to reject tendered document which it is in the eyes of the beneficiary a necessary document that must be presented, and vice versa; then, the question is: **Which interpretation is to be preferred?**

It seems the wide interpretation view is a better approach for the point in discussion for the following reasons: firstly, to ascertain documents for presentation is the applicant's duty so if he, for any reason, does not ask for any particular

[7] Article 4 of the UCP 500 provides: "In Credit operations all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate."

document even if it is related to the facts of the case, he should accept the responsibility for such a failure; and under the second paragraph of Article 13(a) the draftsmen of UCP 500 try to make it clear that the burden is upon the applicant rather than the bank. Secondly, it is not always easy for the beneficiary to guess which types of documents are important in the eyes of the applicant/ buyer; and, even if he can understand the needs of his customer and tries to provide necessary documents for him, the beneficiary will face rejection under Article 13(a), so it is a futile effort. The beneficiary's position in the present circumstances, therefore, is uncertain since there would be a strong possibility that the point under consideration (second paragraph of Article 13(a) of UCP 500) would be interpreted differently by courts in the UK.

1.1.3. In American law

As to the situation under consideration (namely non-documentary conditions) Article 5 of the UCC provides no rule like Article 13(a) of the UCP 500 quoted previously; however, in a draft suggested for revision of Article 5 of the UCC,[8] in Section 5-108(g) it was suggested: "if an undertaking [...] contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated."[9]

1.1.4. Concluding remarks

As a result of above discussion it becomes clear that the point in discussion, namely, the meaning of "stipulated/ not stipulated in the credit" is far from clear for interested parties to the credit contract. Since, under both situations, namely, the wide or narrow interpretation of Article 13(a) of UCP 500 (second paragraph), parties to the credit arrangement are not sure what would be their responsibilities regarding document(s), particularly where the credit was issued in the United

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[8] The American Law Institute, "Uniform Commercial Code Revised Article 5. Letters of Credit (with ammendments to Articles 1,2, and 9), Proposed Final Draft (April 6, 1995)", Submitted by the Council to the Member of the American Law Institute for Discussion at the Seventy-Second Annual Meeting on May 16,17,18, and 19, 1995 [hereinafter referred to as PFD (Proposed Final Draft)].

[9] See below appendix 2 for complete text of Section 5-108(g).

Kingdom. It becomes also clear that there is a difference between UCP 500 and UCP 400 as to the point under consideration, namely, the burden of proof and relevant risks transferred from the beneficiary to the applicant for a credit; such a change of position, however, does not clarify the beneficiary's task of presenting necessary documents under LCs since as pointed out above terms such as "stipulated/ not stipulated documents" are far from clear and are subject to different interpretations. Another matter of concern is that the UCP as a non-mandatory provision is open to be changed, namely, parties to LCs are able to contract differently from what has been provided under the UCP. Such flexibility of the provisions could itself be another cause of uncertainty and banks would be careful when dealing with documents. Therefore, the point in discussion would be a ground for more disputes and the cause of uncertainty for international users of the letters of credit in future.

1.2. Two documents presented in one document

A problem may arise where the beneficiary of a credit presents two or more documents in one document. What is the solution under the UCP 500 or English law? There is no direct reference to the point in consideration within the present UCP. However, one may suggest that the beneficiary's action is not contrary to Article 13(a) since he presented all required documents and therefore meets conditions stipulated under the article although documents are not separated from each other. Further, there is no reference within the UCP which provides that required documents must be presented separately. In contrast, it is possible to challenge the above argument by literal interpretation of the terms of the credit transaction, namely, when a credit calls, e.g., for "two documents", it means two documents which are physically separated from each other. As considered below, it is vital to safeguard the right of an applicant for a credit in situation under consideration.

As far as English law is concerned there is no case regarding the above point.

1.2.1. In American law

In American law the point in discussion received attention and it seems the beneficiary's action can be supported by that law. In **Richard v. Royal Bank of Canada**,[10] an invoice and a certificate of weight were stipulated in the documentary credit. The beneficiary of the credit only presented the invoice but the weight was properly certified on it. It was held that it was a good tender and there is no need for a certificate of weight.[11]

Although such a decision may seem attractive, it can put the applicant for the credit in a difficult position in circumstances where he would wish to resell the goods using separate documents. So, it is not for the banker to deviate from his principal's instructions. Moreover, the seller/ beneficiary knows about the documents and if there is an undesirable stipulation in the credit he can ask for modification.

What would be the banks' responsibility, on the other hand, if the seller instead of one document presents two or more documents to the same effect? It seems such a tender does not impose any risk for the applicant buyer and beneficiaries' action should be accepted as a good tender.[12] However, as previously pointed out, banks are entitled under Article 13(a) of UCP 500 to accept one of the documents and return the rest of them to the beneficiary.

1.2.2. Concluding remarks

The UCP needs to be clarified relating to the situation when two or more documents are presented within one document.

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[10] 23 F. 2d 430 (1928).

[11] It is said that there are also authorities in French law which supports the beneficiary's action; for instance Paris, 15-7-1942, Rev. Ge'ne'rale de droit Comm., 1943 72. Contrast: T. Com. Marseille, 8-6-1928, Dor Sup. vi 379. [See Ellinger, EP, "Documentary letters of credit", Singapore, 1970 [hereinafter referred to as Ellinger], at p. 295 and f.n. 89]

[12] Netherlands Trading Society v. Wayne and Haylitt Co. , (1952) 36 H.K.L.R. 109.

2. THE DESCRIPTION OF THE GOODS

The rule of strict compliance has been applied, more than in any other situation, to the goods' description in the tendered documents.[13] The reason was explained by Goddard, L.J., in the **Rayner v. Hambros Bank**[14] in following terms: "It does not matter whether the terms imposed by the person who requires them to open the credit are reasonable, or seem to be reasonable, or unreasonable. Of course, they may be terms which, as between themselves and the beneficiary, they would not be entitled to impose. The bank is not concerned with that. The bank, if it accepts the mandate to open the credit, 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 my judgment, in paying against a bill of lading for anything except Coromandel ground nuts, and it is no answer to say: "You know perfectly well machine shelled groundnut kernels are the same as Coromandel groundnuts". For all the bank knows, its customer may have a particular reason for wanting "Coromandel groundnuts" in the bill of lading. At any rate, that is the instruction which the customer has given to the bank, and if the bank wants to be reimbursed by the customer, it must show that it has performed its mandate [...] The question is: what was the promise which they made to the beneficiary under the credit, and has the beneficiary availed himself of that promise?"[15]

A question of importance may arise as to whether the description of the goods must be identical in all documents presented by the beneficiary. In other

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[13] The following differences between description of goods in the letter of credit (A) and documents tendered (B) are as examples held by courts to be bad presentation. Those examples are as followes. **1.** (A) Yellow Pine Flooring, (B) Yellow Pine Lumber [**Brown v. Ambler**, 66 M.D. 391 (18887)]; **2.** (A) Alicante Bouchez Grapes, (B) Grapes [**Laudisi v. Amer. Exchange Nat. Bank**, 239 N.Y. 234 (1924)]; **3.** (A) Standard White Granulated, (B) Granulated White Suger, Java Suger No. 24 [**National City Bank v. Seattle Nat. Bank**, 121 Wash. 476 (1922)]; **4.** (A) Dried Grapes, (B) Raisins [**Bank of Italy v. Merchants Nat Bank**, 236 N.Y. 106 (1923)]; **5.** (A) 100% Acrylic Yarn, (B) Imported Acrylic Yarn [**Courtaulds N. Amer. Inc. v. North Carolina Nat. Bank**, 528 F. 2d 802 (1975, 4th Cir.)].

[14] [1942] 2 All ER 694 (CA).

[15] Ibid., p. 703.

words if goods are described by different terms in the invoice and in the bill of lading, and if those descriptions together express what is required by the credit, does that make it a good tender?

2.1. In English law

For many years the view adopted by the courts was that the description of the goods should be in every individual document similar to what had been stipulated in the credit.[16] But it has been accepted, at least, by English and American authorities in recent years that if documents are read together and if they give a perfect description of the goods they constitute a proper tender.[17]

However, there are some conditions applying to the rule **"reading documents together"**. Firstly, all documents should give a full description of the subject matter. Secondly, only those documents which are stipulated in the credit can be read together. As to this point a question may arise: what would be the role of tendered documents which are not stipulated in the credit transaction if there are distinction(s) between them and documents which are required under the credit contract? In other words, would description of goods in additional documents treated as a good ground for rejection of goods and stop payment under LCs? In **Soproma S.p.A. v. Marine & Animal By-Products Corporation,**[18] it was decided negatively; it was pointed out, however, that the situation would be different concerning particular documents like an invoice which would offer the applicant for a credit a well-justified reason for doubting the reliability of the other documents.[19] The third

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[16] Bank of Montreal v. Recknagel, 109 N.Y. 482, 17 N.E. 217 (1888); London & Foreign Trading Corporation v. British and North European Bank (1921) 9 Ll.L.R. 116; Ellinger, supra (f.n. 11), pp. 307-308.

[17] Laudisi v. American Exchange National Bank, 239 N.Y. 234, 146 N.E. 347 (1924), p. 349.

[18] [1966]1 Lloyd's Rep. 367.

[19] Ibid., at pp. 389-90 where it is said: "The sellers' invoice described the goods as "CHILEAN FISH FULL MEAL,70% protein". The invoice from the shippers, Empresa Pesquera Eperva, which in error was included among the shipping documents, described the goods as "CHILEAN FISMEAL minimum 67% protein". The certificate of quality issued by Empresa Pesquera Eperva stated that "the analysis or composition of goods is in accordance with the following analysis: Protein 67 per cent. minimum". The analysis certificate signed by German Fernandino Salamanca stated that the analysis gave the following results: "Protein 69.7 per cent.".

limitation is that the descriptions of goods in different documents must not be inconsistent with each other. For instance, in **Bank Melli Iran v. Barclays Bank**,[20] the goods were described in the invoice as "in a new condition"; whereas a certificate described them as "new". It was held that those description were not similar with each other since there is a difference between "new" and "in a new condition".[21] Which one of approaches above is in harmony with the practice and is more preferable? To deal with this point the UCP 500 is considered first.

2.2. UCP 500

In the UCP 500, Article 37(c) adopts a solution similar to the above second attitude (reading documents together). It provides: "The description of the goods in the commercial invoice must correspond with the description in the Credit. In all other documents, the goods may be described in general terms not inconsistent with the description of the goods in the Credit." As to the meaning of **"correspond"** two views may be expressed: **(1)** it means identical; therefore, a difference would be emerged between the UCP and the rule "reading documents together" applying to the invoice, since in the latter there is the possibility that the description of goods is different from the terms of the credit. **(2)** the term "correspond" does not mean

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The Bord of Appeal made no finding as to the effect of any of these inconsistencies since they took the view that the only documents which need to be tendered were the invoice and the bills of lading. So far as the tender of the documents under the letter of credit is concerned, this view was, in my judgment, erroneous. Quite apart from the shippers' invoice, which probably in law is irrelevant, though it may well have afford the buyers with a well-justified reason for doubting the true protein content of the goods shipped, it is in my judgment plain that the two documents relied upon by the buyers in their rejection, namely, the shippers' certificate of quality, and the certificate of analysis, did not constitute valid shipping documents under the letter of credit as was in fact acknowledged by the sellers, when [...] they instructed the Italian bank to withdraw these documents and substituting in their place [...] In my judgment, the documents so tendered were not a good tender against the letter of credit." [Emphasis added]; Ellinger, supra (f.n. 11), at p. 309 said: "Thus, when a credit stipulates for payment against a bill of lading and an invoice, only these can be read together. The fact that the tender includes an additional documents, which gives a perfect description of the goods, is immaterial. However, if an additional document, which contradicts a statement in one of the stipulated documents, is tendered, this may constitute a "red flag", and the person to whom the documents are tendered may be entitled to doubt the trustfulness of the other documents."

[20] [1951] 2 Ll.L.R. 367, p. 375.

[21] Similar attitute was expressed in **Laudisi v. American Exchange National Bank**, 239 N.Y. 234, 146 N.E. 347 (1924); Ellinger, supra (f.n. 11), p. 309.

identical and as a result no differences exists between the UCP and the rule "reading documents together".

In a question relevant to the point under consideration the ICC Banking Commission gave its comment as following: "That **"correspond"** was not synonymous with **"identical"**, but meant that the description in the commercial invoice must not be contradictory with the description in the credit; [...] it was important to base one's interpretation closely on the wording of the relevant Article of the Uniform Customs and Practice; Article 32(c)[22] stated that the descriptions had to correspond, but did not require identical wording."[23]

It seems the first above view ("correspond" means "identical") is much preferable because the description in the invoice is made by the beneficiary of the credit himself, so it is more likely to be accurate. Moreover, his view will be preferred against other descriptions in other documents made by others. In addition, if the opposite view is accepted then there is no reason to differentiate the description of goods in a commercial invoice with the description of the same goods in other documents; then, Article 37(c) would become meaningless. In contrast, by accepting the above first view a difference would emerge between the UCP and the rule "reading documents together" regarding the description of goods in the commercial invoice; but, it seems the UCP's approach (based on the first above view, namely, "correspond" means "identical") for reasons pointed out previously is preferable.

As to the above point, namely, for what reason(s) the rule "reading documents together" would be more sensible than the view expressed in the **Rayner v. Hambros Bank** (above), one may rightly argue that the former is more in harmony with practice accepted by the banking business. Moreover, if the description of goods in a credit transaction includes details, more than what is required in the credit, such a description should not be interpreted in a manner that

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[22] Article 32(c) (UCP 1974) was equivalent to Article 37(c) in the UCP 500.

[23] ICC, "Decisions (1975-1979) of the ICC Banking Commission" on queries relating to Uniform Customs and Practice for Documentary Credits", ICC Publication No. 371 [hereinafter referred to as ICC Pub. No. 371], at pp. 35-36 (ICC Document 470/371, 470/373). [Emphasis added]

justify the applicant's action or his call to put an end to the letter of credit contract. Further, if different descriptions of goods in different documents presented under LCs are not contradictory but, in contrast, complete each other, such a difference should not be accepted as a good reason for rejecting documents by banks or the applicant for a credit.

2.3. Article 5 of the UCC

Sections 5-109(2) and 5-114(1) of the UCC emphasise the point that the tendered documents must comply with terms of the credit on their face.[24] A similar attitude has been followed in a draft suggested for revision of Article 5 of the UCC.[25]

In comment No.1 to that section it was emphasised that strict compliance does not mean "oppressive perfectionism" and the task of interpreting the principle of strict compliance lies with court.[26]

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[24] Section 5-109(2) provides: "An issuer must examine documents with care so to ascertain that **on their face they appear to comply with the terms of the credit** [...]."; and Section 5-114(1) : "An issuer must honour a draft or demand for payment which **complies with the terms** of the relevant credit [...]." [Emphasis added; for full text of those sections see appendix 1.]

[25] In Section 5-108(a) of PFD, supra (f.n. 8), suggested: "[A]n issuer shall honour a presentation [...] appears on its face strictly to comply with the terms and conditions of the letter of credit." [See appendix 2 for full text of Section 5-108(a)]

[26] Because of the importance of the issue the relevant part of the comment quoted below: "This section combines some of the duties previously included in Sections 5-114 and 5-109. [...] The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant. By requiring that a "presentation" appear strictly to comply, the section requires not only that the documents themselves appear on their face strictly to comply, but also that the other terms of the letter of credit such as those dealing with the time and place of the presentation are strictly complied with. [...] Strict compliance does not mean slavish conformity to the terms of the letter of credit. By adopting standard practice as way of measuring strict compliance, this article indorses the conclusion of the court in **New Braunfels Nat. Bank v. Odiorne**, 780 S.W.2d 313 (Tex.Ct.App. 1989) (beneficiary could collect when draft requested payment on "Letter of Credit No. 86-122-5" and letter of credit specified "Letter of Credit No. 86-122-S" holding strict compliance does not demand oppresive perfectionism). [...] The section rejects the standard that commentators have called "substantial compliance", the standard arguably applied in **Banco Espanol de Credito v. State Street Bank and Trust Company**, 385 F.2d 230 (1st Cir. 1967) and **Flagship Cruises Ltd. v. New England Merchants Nat. Bank**, 569 F.2d 699 (1st Cir. 1978). Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury." [Emphasis added; see PFD, supra (f.n. 8), pp. 22-23]

As to the point under consideration, namely, description of goods in documents presented under the credit, particularly in a commercial invoice, nothing is precisely provided in the UCC.

2.4. Concluding remarks

The issue of description of goods and its connection to the principle of strict compliance has received similar treatment under both English law and the UCP 500, namely, goods may be described in terms not inconsistent with the description of goods in the credit transaction. There is a possibility, however, that a distinction would emerge between the UCP's approach under Article 37(c) and the rule of "reading documents together" accepted in English law concerning the description of goods in a commercial invoice if the term "correspond" is interpreted as "identical". If the term "correspond" is interpreted differently, then there would be a harmony between the UCP and the view accepted in English law; as a result there would be no need for having Article 37(c) if a commercial invoice is supposed to be treated in the same way as other types of documents tendered under the credit transaction as far as the description of goods is concerned. As a result of such a doubt it is suggested in under the present study that Article 37(c) should be clarified concerning the term "correspond" and replaced with the term "identical".

It becomes clear that differences still exist between the UCP and the UCC as well as the courts' interpretation of the principle of strict compliance both in the UK and in the USA. As a result a uniform approach concerning the principle seems necessary more than ever.

3. COMPLIANCE WITH TIME

3.1. No expiry date stipulated in a credit

Article 42 of UCP 500 provides that "all credits must stipulate an expiry date [...] for presentation of documents for payment, acceptance, or with the exception of freely negotiable Credits." If there is no time mentioned in the credit, how long can it be taken as an open credit?

3.1.1. In English and American law

There is no authority on that point in English law.[27] In an American case it was hold that a credit in such circumstances "should be treated as remaining open for a reasonable time. In computing the reasonable time the court took into account the length of the shipping period."[28] Article 5 of the UCC provides no rule concerning the point under consideration. In contrast, that point was noticed in PFD and under Section 5-106(c) of PFD it is suggested: "If there is no stated expiration date or other provision that determines its duration, **a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.**"[29]

3.1.2. UCP 500

In the latest revision of the UCP there is nothing on this point, but Article 38 of the UCP 222 (1962) relating to the revocable letter of credit provided: "The validity of a revocable credit, if no date is stipulated, will be considered to have expired six months from the date of the notification sent to the beneficiary by the bank with which the credit is available." The reason for providing no provision as to the point under consideration in the UCP 500 seems partly related to the fact that, at present, it is rare for a credit to be issued without any indication as to its expiry date, and partly because of discouraging banks to issue a credit in that condition. However, what would be the solution if such a case arises? Would a letter of credit issued in the above indicated condition be accepted as a valid credit under UCP 500? It is possible to give a positive answer to that question, since Article 42 of UCP 500 is silent as to the point under consideration. In contrast, one may argue that the interpretation of Article 42, particularly paragraph (a), is not in the interest of all parties to the credit contract because it may lead to confusion and unnecessary

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[27] Ellinger, supra (fn. 11), p. 301.

[28] Lamborn v. National Park Bank of New York, 123, Misc. 211, 204 N.Y.S. 557, p. 559 (1924).

[29] Emphasis added; see appendix 2 for full text of Section 5-106 particularly sub-section (d) concerning issue of expiry date in a perpetual letter of credit.

disputes between banks and other parties to a credit contract. It is more preferable, therefore, to argue that an issued credit without any reference to expiry date can be accepted as a void credit unless otherwise agreed by contracting parties (e.g., it is a valid credit but it must be amended in a certain and short period of time). The next query that may arise is from what moment does the expiry date of the credit start? It seems that the time of issue of the credit by the issuing bank, as provided by subsection (c) of Article 42 of UCP 500 as well as Section 5-106(c) of PFD above, should be accepted as the beginning of the expiry date of the credit unless otherwise stipulated in the credit transaction.

3.1.3. Concluding remarks

It becomes clear from the above discussion that banks' responsibility is not clear in a situation where an issued credit is silent as to its expiry date. Moreover, if the suggestion made for revision of the UCC (Section 5-106(c) of PFD) would be accepted for the new version of the UCC, then, a distinction would arise between the UCC and the UCP since Article 42(a) of UCP 500 provides nothing about the point under consideration; therefore, there is a need for adopting a uniform approach in both sets of standards relating to LCs in order to prevent any further distinctions between them in the future.

3.2. Ambiguity as to the date of availability of a credit: date of acceptance v. date of negotiation

As to the issue of the expiry date of a credit a problem may arise if such a date is **ambiguous**. For instance, in **Midland Bank Ltd. v. Seymuor,**[30] where there was an argument whether the date of negotiation of drafts drawn under the credit is the final date in which the credit to be available or the date of acceptance of negotiated drafts, it was held that the date of negotiation of a draft is not an essential part of a documentary credit so the date of availability or expiration of credit is the date of its acceptance.[31] Devlin, J., concerning the meaning of term

[30] [1955] 2 LI.L.R. 147.

[31] Ibid., pp. 164-7; Ellinger, supra (f.n. 11), p. 301.

"available" said: "I think that "available" means that this credit can be drawn on in the manner prescribed. That is how it is made available, and the manner prescribed is by presenting the draft and documents to the bank or to the bank's agent, that is, the draft that is to be accepted and the shipping documents that are there specified. That would be appear to be the prima facie and simple meaning of the word "available"."[32] What is the solution for the question in discussion under UCP 500?

Article 42 (a) of UCP 500, in contrast with Article 46 (a) of UCP 400 relating to a negotiable credit, provides: "All credits must stipulate an expiry and a place for presentation of documents for payment, acceptance, or with the exception of freely negotiable Credits, a place for presentation of documents for negotiation. An expiry date stipulated for payment, acceptance or negotiation will be construed to express an expiry date for presentation of documents." But concerning a situation similar to the **Midland Bank** case the UCP is silent and paragraph (c) of Article 42 provides only that banks should discourage indications like "the credit is to be available "for one month", or "for six months", or the like" since they do not specify the date from which the time of availability of a credit starts. Therefore, what would be the solution under UCP 500 for a situation similar to the case **Midland Bank** above? Would it be possible to extend the meaning of availability of a credit to the time/place of negotiation of a credit? It seems, based on the first sentence of Devlin, J.'s statement concerning the meaning of "available" quoted above, "available" means that a credit can be drawn on in the manner prescribed and with the new approach concerning negotiable credits accepted under Article 42(a) of UCP 500, a credit would also be accepted being available at the time of its negotiation. Moreover, by widening the meaning of availability of a credit it would also prevent any confusion and disputes between parties to a letter of credit transaction.

There is no reference as to the point in consideration under the UCC and the proposal draft for its revision.[33] Because of the uncertainty as to the meaning of the

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[32] Ibid., p. 164.

[33] See Section 5-106(c) and (d) of PFD in appendix 2.

justifiable? To answer this query it is worth to consider what is the position of UCP regarding the point in discussion.

3.3.2. UCP 500

Article 42(b) of the UCP 500 provides that "Except as provided in sub-Article 44(a), documents must be presented on or before such expiry date." In sub-section (a) of Article 44 it is said: "If the expiry date of the credit [...] falls on a day on which the bank to which the presentation has to be made is closed for reasons other than those referred to in Article 17, the stipulated expiry date [...] shall be extended to the first following day on which such bank is open." Article 17 is related to the force majeure circumstances and its contents is as follows: "Banks assume no liability or responsibility for the consequences arising out of the interruption of their business by Acts of God, riots, civil commotions, insurrections, wars or any other caused beyond their control, or by any strikes or lockouts. [...]."

As it becomes clear from the above, the UCP is only considering the issue of expiry date from the bank's opening hours and it is silent about delay in the post. So, one may argue that since there is no direct reference to delay in post within the UCP then under Article 42(b) the beneficiary accepts presentation of documents on or before the expiry date and if there is any risk of delay he should bear the responsibility.[37]

In contrast, it is possible to argue that the main reason behind the extension of the expiry date of credit in Articles 17 and 44(a) is that of the interruption of the bank's business or its closure caused by a reason beyond the bank's control; there may be other reasons for bank's closure, like insolvency, but the bank's control over its business activities is the main factor for allowing the extension of expiry date of the credit. Because if it is not the case then the bank may face the argument, made by its client (the applicant for the credit) that it acts beyond its mandate that documents must be tendered within a certain time and not after that. Moreover, a

[37] It is said that there is support for such argument in English, French, and German law [see Ellinger, supra (f.n. 11), pp. 302-303].

bank may also receive an objection from the beneficiary of the credit regarding unnecessary delays for checking presented documents in the above cited circumstances.

If banks are exempt rightly from any liability caused by delays beyond their control, then why should not a similar principle be accepted for the beneficiary in the case of delay in the post (something which is beyond his control), or indeed, in other situations mentioned under Article 17 of the UCP.

3.3.3. Concluding remarks

As a result of above discussion it seems that the beneficiary's action regarding events which are beyond his control should receive the same treatment as is accepted for the banks under the UCP.

3.4. The date of shipment and its connection to the expiry date

Just like the date of expiry, the date of shipment has an important role in a documentary credit operation as far as the applicant/buyer is concerned. The question may arise whether the extension of one of them automatically extends the other one.

3.4.1. UCP 500

Under Article 44(b) of UCP 500 it is accepted that if the expiry date of a credit is extended, "the latest date for shipment shall not be extended by reason of extension of the expiry date." There may be reasons for the extension of the expiry date of the credit, none of which may be related to the shipment of goods, e.g., giving extra time for presentation of all documents.[38] It is also accepted in that article that if there is no time for shipment "the banks will not accept transport documents indicating a date of shipment later than the expiry date stipulated in the Credit or amendments thereto."

What would be the answer if the date of shipment is extended? Would the expiry date of credit be automatically extended? There is nothing to support such a

[38] Juris (G.) & Co. v. Banque D'Athens 246 Mass. 546, 141 N.E. 576, p. 577 (1923); Ellinger, supra (f.n. 11), pp. 303-304.

meaning in UCP 500, but such an attitude had been supported by Article 39 of the 1962 version of UCP.[39]

3.4.2. In English law

It has been said it is reasonable to accept that if the date of shipment is extended, the expiry date of the credit is also extended as a result. In a decided case it was said: "[I]n agreeing to pay for shipment by named steamers without any stipulation as to the time within which shipments were to be made, the limitation of time has already been abandoned."[40] As a result of this decision English courts may take the view that there is a link between the date of shipment and the date of expiry date of a credit; so, by extension of the time of shipment the expiry date of a credit is automatically extended. Would such an attitude be in harmony with UCP 500? It seems the reason for removing terms similar to what had been stipulated in Article 39 of UCP 22 (1962), namely, "any extension of the stipulated of latest date for shipment shall extended for an equal period the validity of the credit" from the UCP 500 may be taken as disagreement by draftsmen with an automatic extension of the expiry date of the credit as a result of extension of the date of shipment. As a result, a distinction would emerge between English law and the UCP.

Regarding a solution for the situation under consideration it is reasonable to say that in every case permission of the banker is necessary, unless otherwise stipulated in the credit. Nevertheless, this point needs consideration and it should be clarified in the next revision of the UCP.

3.5. Time of presentation of documents

As to the time of presentation of required documents by the beneficiary a point need to be clarified: whether those documents should be tendered before any payment by banks under LCs, or there may be situations in which it is accepted that

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[39] Article 39 of UCP 222 (1962) was provided: "Unless otherwise expressly stated, any extention of the stipulated of latest date for shipment shall extended for an equal period the validity of the credit. Where a credit stipulates a latest date for shipment, an extension of the period of the validity shall not extended the period permitted for the shipment unless otherwise expressly stated."

[40] English, Scottish and Australian Bank , Ltd. v. Bank of South Africa, (1922) 13 Ll.L.R. 21, p. 24.

one or some of documents required under LCs is(are) tendered after payment of the amount of the credit. For instance, sometimes a business procedure may modify or negative the principal's mandate; in **Friedlander v. Bank of Australia**,[41] the appellant buyer asked the respondent banker to issue a credit and among the conditions it was instructed that the seller's drafts should be accompanied by an insurance policy, bill of lading and certificate of weight. The seller had informed the banker before the credit was issued that he sold the goods under a condition that he was bound to deliver wheat with separate policies for each 100 tons, and therefore, insurance policies could not be issued unless the bill of lading was received by the banker. It was accepted by the bank but the appellant/buyer refused to reimburse the amount of credit to the banker. The High Court of Australia held for the banker on the ground that, "it was not a condition precedent to the contract between the bank and the appellant that the drafts should, at the time of presentment for acceptance, be accompanied by policies of insurance, and that, if it was, the appellant had rendered its performance impossible and so had excused the bank from performance of it."[42]

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[41] (1908-1909) 8 Commonwealth Law Reports (Australia), 85.

[42] Ibid., at p. 86; the relevant part of Griffith, CJ's view at p. 95, quoted below: "This being a contract between the parties, the London brokers, as already stated, informed the bank before the actual issue of the credit that appellant and Scot Robson had agreed that the insurance should be effected in London. In order, therefore, to give effect to this altered state of things it becomes necessary that the conditions of the credit should be correspondingly altered, and that they should be such as bind the bank to accept Scot Robsons's drafts coming from Buenos Aires although not accompanied by the policies, which (by reason of the change of place of insurance) would not be there. The credit was accordingly issued in such terms as would give effect to the contract as it then stood. Under these circumstances it cannot, in my opinion, be disputed that the appellant before breach waived the (assumed) condition embodied in the contract [...] in accordance with existing obligations under the contract between the appellant and the respondents as **modified by the waiver**, and the bank were bound to accept the drafts drawn in accordance with their terms."; concerning the meaning of "condition precedent" Griffith, CJ at p. 96 stated: "The rule for determining whether a particular stipulation in a contract is a condition precedent [...] it is a recognised rule that, **in the absence of expressed intention to the contrary**, a stipulation which does not go to the substance of the contract (or, as it has been called, the root of the matter), but merely affects it incidentally, and a breach of which may be componsated for in damages, is not a condition precedent. It is manifest that the stipulation as to the policies was introduced for the protection of the appellant, and that he would be equally well protected whether the policies were attached to the drafts at the moment of presentment or handed to the bank on the following day. An there is no expressed intention to the contrary." (concerning the meaning of condition precedent see also O'Connor J.'s remarks at p. 99); in contrast, Issac J. dissenting and at p. 103 he said: "The first question argued was whether the bank, by accepting the drafts without the specified policies of insurance, exceeded the authority given to them by the defendant. In my opinion they did. The contrary contention rests upon a

This is an important decision, particularly from the applicants point of view since it endangers his position under the credit operation. Would it be possible to support the view accepted in the above case under the UCP and carry it out for other situations?

UCP 500

Article 13(a) of UCP 500 provides that, "Banks must examine **all documents** stipulated in the Credit with reasonable care [...]";[43] and under Article 14 (d)(ii) banks must state **all discrepancies** in a notice of rejection. How is it possible for the bank to carry out its duty under the above articles in a situation like the **Friedlander** case mentioned above? Moreover, concerning the point decided in the above case under Article 2 of the UCP it is clearly pointed out that a bank's promise of payment or of acceptance and payment of the beneficiary's draft(s) is against stipulated documents; so the time of presentation of documents should be before the time of payment by the bank.

One may argue that the banks' decision in the above case can be justified as an example for amendment of the credit allowed under Article 9 (d)(i) of UCP 500: "An irrevocable Credit cannot be amended nor cancelled without the agreement of the Issuing Bank, the Confirming Bank, if any, and the Beneficiary." If this is the case, then the next query is how can the applicant's rights be guaranteed? If the banker acts as a special agent for the applicant then he should look after his principal's interests by sticking to his mandate; and in case of amendment of the credit the first priority should be the protection of the interests of his client. Otherwise, the applicant's requirement for particular documents would be meaningless. However, if the principal's instruction is not clear or the banks' deviation is in the interest of the applicant for the credit, the bank's decision in

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foundation which, so far as I can see, has no existence in fact or in law.", and at p. 109 the same judge said: "But what was the justification for the bank departing from their explicit instructions? The departure was intentional- it could not well be other wise." [Emphasises are added]; Davis, AG, "The law relating to commercial letters of credit", London, 3rd ed., 1963 [hereinafter referred to as Davis], p. 134.

[43] Emphasis added.

particular circumstances, as considered later, can also be supported in English law.[44]

As a result of the above discussion it becomes obvious that under the UCP banks are under a duty to check all required documents before acceptance of the beneficiary's draft(s) or payment under the credit; therefore, the position of parties to a credit in a situation like the case mentioned above would be different. As to the concept of "condition precedent" and its effect upon the relationship of parties to a letter of credit, it is vital to remember the importance of the principle of strict compliance in LCs' operation; without it the system would collapse. It is also necessary to draw attention to the importance of amendment of a credit and how it would affect the applicant's rights under the credit. In that respect the applicant's instructions should be regarded important and mandatory and banks without express intention to the contrary are not entitled to deviate from it and the decision of the High Court of Australia should be interpreted under particular circumstances of the case, namely, the applicants for the credit (the appellant in the above case) waived his right under the credit transaction by accepting insurance documents issued in London instead of Buenos Aires (decision taken by majority of judges).[45] As a result of a distinction between the UCP and national law of a relevant jurisdiction, different attitudes would be taken concerning the same issue by different judges (as it happened in the above case); it is, therefore, vital both for the bank and its customer that the point under consideration (the time of presentation of documents by the beneficiary) should be clarified in any future set of standards concerning LCs at the international level.

[44] See discussions concerning the issue of amendment of a credit in Chapter IV (Section B.2.1) and Chapter V (Section B.2.2.1) and "fair interpretation" in Section B.1.2 of the present Chapter (below).

[45] See f.n. 42 (above) for relevant quotation of the case.

SECTION B: OTHER ISSUES RELATED TO THE PRINCIPLE

1. EXCEPTIONS TO THE PRINCIPLE OF STRICT COMPLIANCE

Are there any exceptions relating to the principle of strict compliance? There may be situations in which the application of the principle may be like for other rules, limited. UCP 500 (Article 14(d)(i)) only refers to one of situation, namely, doctrine of waiver (considered later), but nothing is provided regarding other possible limitations to the rule of strict compliance; therefore, the banker's responsibility is not clear relating to such exceptions to the principle (noticed later), and there would be a cause for dispute between a banker and other parties to the contract, as the case may be.

The issue of exceptions to the principle of strict compliance has received attention in different legal systems; but there may be differences between them. Some of the possible exceptions to the principle of strict compliance are as follows.

1.1. De minimis rule

As mentioned above (discussion concerning "the description of goods"), there may be insignificant variations between the tendered documents and the terms and conditions of the credit. Those documents can be accepted as good tender under two conditions. First of all, the deviation is too slight to affect the total purpose of compliance.[46] Moreover, such a deviation imposes no detriment upon the buyer/ applicant for the credit. To support such a view under English law one can refer to McNair, J's view in **The Soproma**,[47] where it is pointed out that although it is accepted by English law that the de minimis rule does not apply in case of LCs, he should be reluctant to accept the strict compliance in situations

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[46] See Kozolchyk, B., Letters of credit", International Encyclopedia of Comparative Law, Vol. 9, Chapter 5, 1979 [hereinafter referred to as Kozolchyk], p. 83 and f.n. 460, as to commenting on the case **Rayner v. Hambros Bank**, [1942]2 All ER 694 (CA), where it is said that that decision is not accepted by the modern law, but the decision of **Midland Bank Ltd. v. Seymour**, [1951]2 Ll.L.R. 367, is preferable since all documents are read together; for more details concerning the rule "reading documents together" in discussion connected to "the description of the goods" in Section A.2 of the present Chapter (above).

[47] Soproma S.p.A. v. Marine & Animal By-products Corporation, [1966]1 Ll.L.R. 367.

where it is the only reason for rejection of documents presented under LCs.[48] So, on the ground of what is said above and the rule "reading documents together" considered previously[49], there is a possibility that documents tendered by the beneficiary would be accepted as complied with terms of credit contract even if minor discrepancies exist between them and credit's conditions.

1.2. Fair interpretation

If the principal's instructions are not clear, then if the person who acts upon it interprets that mandate in a fair and honest manner he deserves to benefit from it, even though the principal intended another meaning. Such a principle is laid down in **Ireland v. Livingston**,[50] where Lord Herschell described the principle and said: "If a principal gives an order to an agent in such uncertain terms as be susceptible of two different meanings, and the agent bona fide adopts one of them and acts upon it, it is not competent to the principal to repudiate the act as unauthorized because he meant the order to be read in the other sense of which it is equally capable."[51] This is one of the ways that the strict compliance application would be limited.[52]

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[48] The relevant part of McNair, J.'s decision at p. 390 (col. 1-2) quoted below: "Seeing that **the de minimis rule** does not apply to the tender of documents under a letter of credit (see **Moralice (London), Ltd. v. E.D. & F. Man**, [(1954]2 Lloyd's Rep. 526), I suppose in strict law I should have effect to this objection, but I confess that **I should be reluctant to do so if it stood alone**." [Emphasis added]; Kozolchyk, supra (f.n. 46), p. 83 & f.n. 468 and pp. 84-5.

[49] See relevant discussion in Section A.2 of the present Chapter (above).

[50] (1872), LR 5, HL, Cas. 395.

[51] Ibid., at p. 416; Davis, supra (f.n. 42), at p. 133 concerning the point under consideration said: "For example, in **Equitable Trust Co. of New York v. Dawson Partners Lted.** [(1926), 25 Ll.L. R. 90 (CA); 27 Ll.L.R. 49 (HL)], where a cable code-word capable of conveying the meaning of both singular and plural was used, the correspondent bank, interpreting the word in the singular, when the trasmiting bank intended the plural, was held to be free from any liability for so doing." [Emphasis and the date of case are added.]

[52] For a similar argument see discussion concerning the discretion theory in Section B.2.1 of the present Chapter (below).

1.3. Rules and customs approved by a court

Sometimes banking customary rules approved by a court decision may impose obligations upon banks while at first they may seen to be a deviation from the principle of strict compliance but they are not so. Such a deviation would be interpreted as an exception to the principle and parties to LCs transactions should be aware of such a possibility. For instance, in an American case[53] because of a missing bill of lading the presenting bank tendered a letter of indemnity instead and this was accepted as a banking solution locally; but the paying bank rejected it and refused payment. It was held in favour of the presenting bank. Would such a decision be supported under existing law concerning LCs at international level?

Article 13(a) of UCP 500 provides: "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."; so far as the UCP is concerned there is no provision about the point decided in the above mentioned American case (**Dixon Irmaos**). Moreover, a writer considering the acceptability of such a decision in the UK and difficulty(ies) which would arise in order to prove the existence of an alleged custom relevant to LCs at the international level, has stated: "It is extremely doubtful whether this decision would be followed in England. In any event, it is submitted that it would not be followed unless the court was satisfied that the alleged custom extended not only amongst bankers but also amongst exporters and importers. Any person seeking to prove such a custom would have a heavy and, it is felt, almost impossible task."[54]

Nevertheless, the above discussion highlights the possibility of another exception to the principle of strict compliance and its application under LCs. Similarly, it becomes obvious for having such an exception that it must be first

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[53] Dixon, Irmaos & Cia. v. Chase National Bank of New York, CCA, 2d., (1944), 144 F. 2d., 759, (1944) Cert, denied, 324 US 850, 65 Sup. Ct. 687; Kozolchyk, supra (f.n. 46), pp. 85-86.

[54] Davis, supra (f.n. 42), at p. 176; Kozolchyk, supra (f.n. 46), p. 85, col. 2, where it is pointed out that the decision of the United States Circuit Court of Appeals in Dixon Irmax & Cia. v. Chase National Bank, have not been followed by European legal systems.

proved that such a practice or custom has been accepted by bankers as well as exporters and importers at an international level for a particular period of time.[55]

Another point of concern is related to the existence of different customs in different jurisdictions, potentially providing a cause of uncertainty so far as the law of LCs is concerned. In order to reduce their effect, it would be more suitable to study possible grounds for disputes and then prepare appropriate rules in legislative form rather than customary rules for them since the non-mandatory nature of customs would, to some extent, be the cause of uncertainty so far as the international law of LCs is concerned.[56]

1.4. Waiver and ratification

1.4.1. In American law (doctrine of waiver)

In order to mitigate the harshness of the doctrine of strict compliance in several American authorities it has been suggested that if, at the time of presentation of documents, the banker raises no objection then later he is not entitled to put forward any objection against tendered documents, and it is supposed that the banker has waived his right under the credit. In **Second National Bank of Allegheny v. Lash Corp.**[57] it was held: "When it [the bank] named one ground for its refusal and remained silent with respect to three, the reasonable intendment of its conduct was to lull the drawer of the drafts to inaction and cause it to let pass what time and opportunity it had to correct the infirmities of the bills of lading, and then, if sued, to reap for itself a benefit from the utterly helpless position which it had induced its adversary to drift." However, such a doctrine is limited to the situation when the banker or his customer can prove that they were not aware of

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[55] As to the issue of time and other conditions required for a practice or trade useage to be accepted as an international custom see relevant discussion in Chapter XI, Section A.2 (below).

[56] See discussion concerning international customs in Chapter XI, Sections A.2 and A.3 (below).

[57] 299 F. 371, pp. 373-74 (1924); Bank of American v. Whitney Central National Bank, 291 F. 929 (1923); Camp v. Corn Exchange National Bank, 285 pa. 337, 132 A. 189, pp. 192-93 (1926), held that the waiver rule applies also in the relationship between the bank and the buyer; Ellinger, supra (f.n. 11), pp. 287-89.

discrepancies at the time of presentation of documents; in other words they cannot be held to have waived an objection which came to their knowledge after the date of presentation, therefore, they may raise any objection in the courts later.[58] Of course the burden of proof is on the bank or its customer to prove that such knowledge reached them after that date. Would it be possible to argue that if as a precautionary measure banks or their customers (applicants for credits) do not give any reason for their refusal at the date of presentation of documents they are allowed to state any grounds they would prefer at court? If yes, would not the doctrine of waiver be a cause for delay in the operation of LCs? In respect of the above questions it has been said by a writer that "the person to whom the documents are tendered is estopped from raising additional objections only when he stated at the date of presentation grounds for his rejection of the documents. In other words, if the person to whom the documents are tendered gives no reasons for his refusal, he can later on state any grounds he discovers.";[59] and a commentator has pointed out: "The preceding formulation of the waiver rule can lead to damaging consequences for letter of credit law, and a closer look at its factual and conceptual contexts is necessary."[60]

As to the point under consideration there is no reference in Section 5-112 of the UCC.[61] However, that point has been noticed by draftsmen of the new proposed final draft (PFD) for revision of Article 5 of the UCC and in Section 5-108(c) of that draft it is suggested: "Except as otherwise provided in subsection (d), an issuer is precluded from asserting as a basis for dishonour any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given."[62]

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[58] Old Colony Trust Co. v. Lawyers' title & trust Co., 297 F. 152, p. 156 (1924).

[59] Ellinger, supra (f.n. 11), at p. 288.

[60] Kozolchyk, supra (f.n. 46), p. 86, col. 2.

[61] See appendix 1 (below).

[62] For text of Section 5-108 see appendix 2 below; however, because of importance of the issue part of comments No. 3, at p. 25 of PFD, supra (f.n. 8), concerning subsection (c) of Section 5-108 are quoted below: "The requirement that the issuer send notice of the discrepancies or to be precluded from asserting

1.4.2. In English law (doctrine of ratification)

The doctrine of waiver has not been followed by English courts. In **Westminster Bank v. Banca Nazionale Di Credito**[63] the English attitude was explained by Roche, J., as: "It is too well settled in principle and abundantly covered by authority that if a person is entitled to reject documents and he rejects them on the wrong grounds or without taking all the grounds he could take, it is nonetheless open to such person, if he is questioned about the matter, or his action is impugned, to rely upon all the grounds that he might have taken."[64]

As to the doctrine of ratification it has been said: "Ratification is a matter of intention. The behaviour of persons to whom documents are tendered can amount to ratification if their conduct can be proved inconsistent with an intention to reject. Silence can amount to ratification."[65] This opinion is based on a decision by McNair, J., in **Bank Melli Iran v. Barclays Bank**,[66] where the plaintiff after receiving documents and before rejecting them because of a discrepancy as to the description of goods, agreed to increase the amount of the credit and instructed the defendant to carry out that order. So when after six weeks the banker received an order not to pay, the court found such an order invalid and held that the instruction of Bank Melli to increase the amount of the credit was inconsistent with an intention

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discrepancies is new to Article 5. It is taken from the similar provision in the UCP and is intended to promote certainty and finality. The Section thus substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103. It rejects the reasoning in **Flagship Cruises Ltd. v. New England Merchants' Nat. Bank**, 569 F.2d 699 (1st Cir. 1978) and **Wing On Bank Ltd. v. American Nat. Bank & Trust Co.** 457 F.2d 328 (5th Cir. 1972) where the issuer was held to be estopped only if the beneficiary relied on the issuer's failure to give notice. [...] Even though issuers typically give notice of the discrepancy of tardy presentation when presentation is made after the expiration of a credit, they are not required to give that notice and the section permits them to raise late presentation as a despite their failure to give that notice." [Emphasis added.]

[63] (1928) 31 Ll.L.R.306; Ellinger, supra (f.n. 11), p. 289 & f.n. 68 (for referred authorities); **The Lena** [1981] 1 Ll.L.R. 68, where Mr Justice Parker stated that it is the issuing bank's right to check all documents and such a bank is not bound to give all reasons for its rejection at once.

[64] Ibid., p. 311.

[65] Kozolchyk, supra (f.n. 46), p. 88; Ellinger, supra (f.n. 11), p. 291.

[66] [1951]2 Ll.L.R. 367.

to reject tendered documents, so there was a ratification by the principal and silence alone could, in certain cases, indicate ratification.[67] The ratification view is thus supported by English law.

1.4.3. UCP 500

Article 14(d)(i) of UCP 500 provides: "If the Issuing Bank and/or the Confirming Bank [...] decides to refuse the documents, it must give notice to that effect [...]."; and in sub-section (d)(ii) of the same article it is said: "Such notice must state **all discrepancies** in respect of which the bank refuses the documents [...]." This approach is different from what was accepted under Article 16(d) of UCP 400[68] and seems to follow the view accepted in American law as the doctrine of waiver.

1.4.4. Waiver v. Ratification

Which one of those above approaches, i.e., the American waiver doctrine or the English ratification attitude, is preferable? It is difficult to decide which one of those approaches is to be preferred, since each one has its advantage(s). For instance, under the doctrine of waiver the beneficiary of a credit has a good chance of representing a new good set of documents and this prevents delay in the operation of LCs. In contrast, under the doctrine of ratification the beneficiary loses such protection. There are, however, several disadvantages relating to the waiver doctrine. Firstly, it is difficult to decide which reasons for rejection of documents are known by the bank at the time of presentation of documents. Secondly, that doctrine encourages the banker to give no reason for his rejection at the time of rejecting tendered documents in order to present his reasons, as much as it is possible, at a later stage, namely, in the court. This leaves the beneficiary of the credit in darkness. Finally, it is accepted under the credit contract that one of the beneficiary's undertakings is to present proper documents under the credit's terms

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[67] Ibid., at p. 378; in **Midland Bank v. Seymour** [1955] 2 Ll.L.R. 147, at pp. 168-71, Devlin, J., pointed out similiar view.

[68] The relevant parts of Article 16(d) of UCP 400 (1983) are quoted below: "If the issuing bank decides to refuse the documents, it must give notice to that effect without delay [...] Such notice must state the discrepancies in respect of which the issuing bank refuses the documents [...]."

and conditions, and there is no promise by the banker to disclose all objections at one time.[69] Because of the above limitations to the waiver rule, it seems the English doctrine of ratification is a better approach regarding the point in discussion while it provides lesser protection for the beneficiary of a credit.

Although, Section 5-108(c) of PFD relating to UCC, considered previously, would provide more harmony between the UCC and UCP 500, it would not remove the possibility of diversing decisions in different jurisdictions even belonging to the same tradition of law (like the USA and the UK with legal systems derived from Common law). For having a greater certainty and uniformity of law at international level so far as LCs are concerned, therefore, it seems a further step needs to be taken, namely, as international legislation in the form of a convention.

1.4.5. Concluding remarks

As a result of the above research it becomes obvious that as to the notice of discrepancies given by banks regarding documents tendered by the beneficiary, a distinction exists between English Law on the one hand, and American law and UCP 500 on the other. It is also obvious that by revising Article 5 of the UCC further harmonisation between it and UCP 500 would be achieved in the future; however, for a greater uniformity of law of LCs at an international level, a new approach, namely, in the form of a convention would be the best possibility under the present conditions.[70]

2. ARGUMENTS AGAINST THE PRINCIPLE OF STRICT COMPLIANCE

In order to avoid a requirement of literal compliance, arguments have been suggested, as follows.

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[69] Skandinaviska Kreditaktiebolaget v. Barclys Bank (1925) 22 Ll.L.R. 523, p. 525; Ellinger, supra (f.n. 11), pp. 291-92.

[70] See Chapters X and XI (below), for discussions relevant to the unification of law of LCs in the future.

2.1. The discretion theory

This supports the view that although the banker is under a duty to examine documents strictly, at the same time he is entitled to take up non-complying documents at his discretion.[71] The logic behind such an idea is based on the agency relationship between the banker and his customer, namely, where the instructions are **very general** in the contract the agent is able at his discretion to deviate from the principal's mandate if such a deviation is in the interest of the latter. Of course, it is clear that the scope of such a theory is very limited and the banker should use this discretion only in exceptional cases.[72] This theory has found support in an American case.[73]

In contrast, English law has shown no sympathy for such an opinion.[74] The disadvantage of the theory is that it puts the banker in a position to judge whether a document is necessary or not. It is the obligation of the seller and buyer to make a clear contract, and if there is any doubt the banker must consult with his customer.

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[71] For more details concerning the discretion theory look at Ellinger, supra (f.n. 11), at pp. 282-86, where at p. 282 pointed out: "The discretion theory originated in Germany. [...] The descretion of the bank follows from para. 665 BGB which grants an agent a discretion to deviate from the instructions of his principal, if the deviation is necessary in the interests of the latter."

[72] Ellinger, supra (f.n. 11), at p. 283 said: "The more restrictive discretion suggested by Wiele and Zahn [...] in thier view, the banker should exreise this discretion only in exceptional circumstances. [...] Perhaps the only case in which such a descretion may be justified is in the case of **ambiguious instructions**." [Emphasis added]; for similar point see discussion about "fair interpretation" in present Chapter, Section B.1.2 (above).

[73] In **Pacife Financial Corporation v. Central Bank & Trust Co.**, 296 F.2d, 68 (1961), among other documents it was stipulated that, "a certificate of title issued in blank" for an aeroplane was necessary. The banker paid against tendered documents but there was not such certificate, so those documents were rejected by the buyer. Bell, J., in course of his judgment held for the banker and at p. 71 said: "Nor was it an error for the court to fail to charge that if the terms of the letter of credit were impossible of performance there was no contract and the bank could not pay out the money under the letter of credit [...] The question was that what the appellant and the bank meant by "certificate of title issued in blank" and this question was properly submitted to the jury [...]."; in **Camp v. Corn Exchange National Bank** 285 pa. 337, 132 A. 189, p.191 (1926) said that, "The bank has a discretionary power of acceptance, but this discretion must not be abused."; **Laudisi v. American Exchange National Bank**, 239 N.Y. 234, 146 N.E. 347 (1924); Ellinger, supra (f.n. 11), pp. 283-84.

[74] For example, see **Equitable Trust Co. of New York v. Dawson Partners, Ltd.** (1927)27 Ll.L.R. 49, at p. 52 and **English Scottish and Australian Bank, Ltd. v. Bank of South Africa** (1922)13 Ll.L.R. 21, at p. 24; Ellinger, supra (f.n. 11), at p. 285 said: "In France, too, there is no room for discretion."

In only one situation in has the discretion theory received support in English law, namely, when the principals' instructions are ambiguious.[75] As a result of the above points it seems the discretion theory would be helpful in situations when an instruction is not clear or it is very general; in contrast, the wide interpretation of the theory (namely, the bank is entitled to decide which one of the required documents is necessary), would put the bank in a risky position, particularly when the disputed matter whould be considered under English law.

2.2. The technical defence theory

This theory originated in the American jurisdiction on the basis that it is the duty of courts not to give support to those objections which do not really concern the contract but are raised technically.[76]

In contrast, English law allows such a defence. For instance, in a case decided by the Court of Appeal[77] because of falling market prices of goods defendants made an attempt to escape from liability for paying for documents tendered under the credit. Scrutton, L.J., in the course of his judgment did not agree with the view of the judge in the lower court that the main motive for the defendant for his action was the falling of market price of the goods rather than several minor discrepancies concerning documents presented by the beneficiary.[78]

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[75] For details see discussion about "fair interpretation" in Section B.1.2 of the present chapter (above).

[76] In Liberty National Bank & Trust Co. of Oklahoma v. Bank of America National Trust & Saving Association, 116 F. Supp. 233 (1953) [affirmed 218 F. 2d 831 (1955)], at p. 243, concerning the point under consideration stated: "Where a letter of credit is substantially complied with every reasonable effort should be made by the Courts to uphold its validity, particularly where the objections are **technical in nature** and made in an effort to escape from the legal effect of a business bargain." [Emphasis added]

[77] Guaranty Trust of New York v. Van Den Berghs, Ltd.(1925) 22 Ll.L.R. 58, 112 (K.B.) 286, 447 (C.A.).

[78] Ibid., at p. 455, Scrutton L.J. said: "I do not attach so much importance as the learned Judge below seems to do to the falling market. It is no doubt that the reason why Van den Berghs took the legal objections they did were that, as Drews were in financial difficulties. [...] these circumstances do not affect the legal merits of the objections taken. "Falling market", though often an explanation of commercial action, does not affect its legality."

It seems the English view is better since in the documentary credits there is no ground for examining the motivation of a banker or his customer (the applicant for a credit) for his decision not to take up presented documents. Moreover, it is not an easy task to draw a line between technical and non-technical defences.[79] On the other hand, it is vital to prevent any abuse of LCs' system which would arise as a result of a rigid interpretation of the principle of strict compliance. In that respect, theories like "technical defence" and "discretion" as well as exceptions to that principle, discussed previously (particularly the "de minimis rule" and "fair interpretation" exceptions), should receive sufficient support by courts in different jurisdictions in order to mitigate the harshness of the principle of strict compliance in practice.

CONCLUSIONS

In the light of the above discussion it is clear that documents play an important role in the operation of letters of credit, particularly regarding bank and client relationships. Moreover, disputes relating to different aspects of the doctrine of strict compliance have been raised and could continue owing to the generality and unpredictability of the UCP. Further, as has been pointed out, disputes arise from time to time concerning the number of documents required under a credit, description of goods, time of presentation of document and expiry date of a credit, with regard to differences exist between English law and UCP 500; examples are related to "stipulated/ not stipulated" documents, description of goods in an invoice, connection between expiry date and the date of shipment and a negotiation credit. In respect of American law, differences also exist between court decisions and UCP 500. Examples pointed out previously relate to issues like "tendering two documents in one document", "delay in the post", "time of presentation of documents", and where the credit stipulates no expiry date.

[79] Ellinger, supra (f.n. 11), at pp. 286-87 & f.n. 59 said that the situation in French and German law is similar to English law.

As to distinctions between English and American law, they have chosen different attitudes relating to "waiver" and "technical defence" theories. Similar divergences exist regarding the discretion theory. These differences have been the cause of uncertainty between parties to a credit contract, and they could be the cause for further disputes in future unless they receive proper attention worldwide.

The questions then are: what would be the reconcilable solution(s) for the above differences? Would it be possible to solve them through the ICC? If yes, to what extent it would be possible for the ICC to provide new provisions under the UCP? Would it be the most favourite solution? If no, what would be the substitution?

Generally speaking, issues considered in the present Chapter can be classified as following:

1. Issues not considered under the UCP.

2. Issues noticed under the UCP but treated differently under the national law (English or American law).

3. Issues interpreted differently by English law (compared with American law).

As to the first type of issues (e.g., "two documents presented in one document", "no expiry date stipulated in a credit", "delay in the post" and "time of presentation of documents"), the ICC would indeed be able to study them and provide necessary provisions within the UCP. So far as the second type of issues (above) is concerned, the only option open to the ICC is to clarify the position of parties to a letter of credit under the UCP, e.g., as it is suggested concerning the term "correspond" in Article 37(c) (description of goods in a commercial invoice). As to other situations (namely, the UCP is clear but still distinctions exist between the provisions and the respective national law) the ICC has no mandatory power (as a non-governmental international organisation) to replace a national law with the UCP. Such a barrier exists when the ICC faces issues in the above third category. This is, indeed, that part of the law of LCs that requires more harmonisation and unification at an international level; LCs' issues covered by the UCP have been, to a great extent, unified internationally. In that respect the only practical path open for

dissolving differences between the UCP (as an international customary/contractual instruments) and any respective national law on the one hand, and between two or more different legal systems on the other hand is an international legislative instrument in the form of a convention. This point and its relevant issues are considered later.[80]

[80] See Chapters X and XI (below).

CHAPTER VII

THE BANK'S UNDERTAKING IN RELATION TO THE BENEFICARY OF THE CREDIT (THE DOCTRINE OF "AUTONOMY")

SECTION A. LEGAL ISSUES RELATED TO THE DOCTRINE OF AUTONOMY

The concept of the doctrine of autonomy and its importance in the operation of LCs has been considered previously.[1] In the present Chapter a number of legal points relevant to the doctrine of autonomy are discussed below.

1. LETTERS OF CREDIT AND THE SALE CONTRACT

Is there any link between a credit arrangement and its underlying sale contract? If there is any connection between them, to what extent such a link is justified? Related issues are as follows.

1.1. Differences as to terms of a sale and a credit contract

If there is a distinction between the terms of a sale contract and LCs which term(s) should be preferred? In **Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd.**,[2] where the plaintiff included an additional sum in his draft, the buyer refused to accept it on the basis that such an additional sum was a breach of the sale contract. Therefore, he instructed his bank not to pay. Rowlatt, J., rejected that argument because, under the credit conditions, the buyer and his bank undertook to honour all drafts drawn by the seller. Moreover, it was pointed out that if there is any distinction between the terms of the sale contract and the credit transaction the latter must be preferred. He said: "The basis of this form of banking facility being that the buyer is taken for the purpose of all questions between himself and his banker or between his banker and the seller to be content to accept the invoices of the seller as correct. It seems to me that so far from the letter of credit being qualified by the contract of sale, the latter must accommodate itself to the letter of credit."[3]

Professor Ellinger made a point regarding the above decision by saying that: "The two contracts are independent of each other. There is no reason why the

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[1] See relevant discussion in Chapter II, Section B.2 (above).

[2] [1922]1 K.B. 318.

[3] Ibid., pp. 322-23.

credit, which is opened after the making of the contract of sale, should qualify the latter any more than the irrevocable credit is qualified by it."[4] This point seems to be a sound criticism because, if it is accepted that the terms of a sale contract can be easily/automatically changed by any amendment of a letter of credit, then the buyer's right under the sale contract can also be changed while the applicant's agreement for any amendment or cancellation of the credit is not included in Article 9(d)(i) of UCP 500;[5] as a result, the buyer/applicant for a credit might find himself in a different position while his interests are put in danger. However, if there is evidence that the applicant for a credit gave his agreement to modification of the credit to his bank, it may be accepted that he has also waived his right under the sale contract. But, if there is nothing to prove such agreement by the applicant then conditions stipulated in the credit should be interpreted in the light of circumstances of the case, namely, intention of parties to the sale contract.

In the given case the expression "all drafts drawn by the seller" could also be interpreted as those drafts which are less than or equal to the amount of the credit, unless otherwise agreed by the applicant or his bank after the issue of a credit.

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[4] Ellinger, E.P., "Documentary Letters of Credit", Singapore, 1970, p. 184 [hereinafter referred to as Ellinger]; in **Malas (Hamzeh) & Sons v. British Imax Industries Ltd.,** [1958] 2 Q.B. 127, at p. 129, Jenkins, L.J. confirmed the independence nature of the credit by stating that the confirmed credit was an absolute undertaking of the banker "irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not [...]. [The system] would break down completely if a dispute as between the vendor and the purchaser was have the effect of "freezing" [...] the sum in respect of which the letter of credit was opened."; a similar decision made in **Frey v. Sherbourne,**(1920) 184 N.Y. Supp. 661, where it was held that the banker is not entitled to refuse payment under the credit to the beneficiary, even where the applicant for the credit has rescinded the sale transaction or it has been terminated by the seller's fundamental breach. The seller, of course, must present proper documents in accordance with the credit conditions; G.A. Penn, A.M. Shea, and A. Arora, **"The Law and practice of International Banking"**, Banking Law, Vol. 2, London, 1987, p. 309, para. 13.30 [hereinafter referred to as International Banking Law (Int.B.L.)].

[5] Article 9(d)(i) of UCP 500 provides: "Except as otherwise provided by Article 48, an irrevocable Credit neither be amended nor cancelled without the agreement of the Issuing Bank, the Confirming Bank, if any, and the beneficiary."; see appendix 1 for Article 48 (considers a transferable credit) particularly paragraph (h) numbered several exceptions in which terms and conditions specified in the original credit are changed as a result of transferring the credit; for more details concerning the right of applicant for amendment of a credit see relevant discussion in Chapter V, Section B.2.2.1 (above).

1.2. The effect of amendment of the credit's terms on the sale contract

What would be the effect of the amendments or modifications of terms of a credit transaction upon a contract of sale? In **Etablissement Soules et Cie v. International Trade Development Co. Ltd.**,[6] it was held that any modification of the terms of a credit agreement automatically changes the terms of its underlying sale contract.[7] Would such a decision be accepted in all cases of amendment of a credit? As pointed out above, the agreement of the applicant for a credit with any modification of an issued credit is vital. Since, otherwise, his position under the sale contract might be changed without his agreement and this would put his interests under the sale contract in danger. Moreover, in an American case, **Dulien Steel Products, Inc., of Washington v. Bankers Trust Co.**,[8] an action was brought against the confirming bank on the basis that the bank refused to accept the request of the issuing bank, namely, not to pay the full amount of the credit because of a later amendment of it. Although the defendant knew about the amendment and the beneficiary's consent to it, Brayan, J., accepted this argument and decided: "When a bank confirms a letter of credit the letter evidences its irrevocable obligation to honour drafts presented by the beneficiary upon compliance with the terms of the credit. The letter is quite independent of the primary agreement between the party for whose account it is issued and the beneficiary, or of any underlying transactions. Neither the issuing bank nor the confirming bank has any obligation, and is not permitted, to go behind the terms of the letter and the documents which are required to be presented, and to enter controversies between the beneficiary and the party

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[6] [1979] 2 Ll.L.R. 122; Ventris, F.M., "Bankers' documentary credits", Lloyd's of London Press Ltd., 2nd ed., 1983, pp. 249-60 [hereinafter referred to as Ventris].

[7] In giving judgment Mr. Justice Goff stated: "I am satisfied that in the present case the letter of credit which was operated by the parties, and which must be taken to have been agreed by them was in terms materially different to the original contract [...]. I therefore accepted [...] the original contract must be taken to have been amended in that respect." [See Ventris, ibid., p. 253]

[8] 189 F. Supp. 922 (1960), affirmed 298 F. 2d 836 (1962).

for whose account the letter was opened concerning any other agreements or transactions."[9]

Why is there a difference between the position of an applicant and a confirming bank within a letter of credit? If the doctrine of autonomy is applied for protecting interests of banks (an issuing or a confirming bank, if any) and a beneficiary of a credit, it should similarly be applied for safeguarding the interests of an applicant for a credit.

1.3. Concluding remarks

Could the view in **Urquhart Lindsay** and **Etablissement Soules et Cie** be accepted as an exception to the doctrine of autonomy? For above mentioned reasons, namely, that the sale contract is established first, and authorities like **Dulien Steel** it is difficult to support such an opinion. Moreover, by choosing that view the buyer's right under the sale contract would be put at risk particularly if the issued credit is governed by the UCP for there is no right recognised for the buyer/applicant under Article 9(d)(i) when a credit is subject to amendment or cancellation.

2. LETTERS OF CREDIT AND A CARRIAGE CONTRACT

2.1. Introduction

Article 3 of UCP 500 provides that there is no connection between a credit agreement and the "other" contract(s).[10] One of those transactions which may be established by a seller under a sale contract is a contract for carriage of the goods. Documents concerning that contract, like a bill of lading (BL), make up an important part of the seller's duty under the credit operation. Moreover, BL may be pledged for the interest of the issuing bank. If for any reason payment is not made by the buyer then a bank, in particular circumstances, can use BL (as a document of title) and claim possession of the goods from the carrier or his agent. Or, in contrast, the

[9] Ibid., p. 927; Elliger, supra (f.n. 4), p. 187.

[10] See appendix 1 (below).

carrier may have a desire to sue the bank instead of the owner of the goods (the buyer/ applicant). So, the issue for consideration is under what circumstances does an issuing bank become a party to the carriage contract? In other words, where the doctrine of autonomy does not apply in connection between a credit and a carriage contract?

2.2. In English law

A bank's right of possession over goods (as a pledgee of a bill of lading) or the possibility that the bank may be sued by a carrier under the carriage contract have been issues for consideration in English courts for decades. The reason for it is based upon the doctrine of "privity of contract", namely, that a stranger to a contract cannot as a general rule enforce any rights thereunder. So, a buyer of goods or in our case the issuing bank (as a pledgee) is in general unable to sue a carrier who lost or damaged the goods since he is a third party to the contract of carriage usually made between shipper (a seller of goods) and carrier. Different rules were applied in order to protect a third party's right and limit the harshness of the doctrine of "privity of contract". However, English law provides different treatment for a third party since his position may be different from one case to another. So, in this part of study we are dealing with possible rights and duties of an issuing bank (as a pledgee of bills of lading) against a carrier of goods in English legal system.

2.2.1. Section 1 of the Bills of Lading Act 1855

One of the solutions introduced and to some degree solved some of issues related to right of a third party in a bill of lading is Section 1 of The Bills of Lading Act 1855.[11] In brief, the above rule provides no support either for a bank or carrier;

[11] Terms of the Section 1 are as following: "Whereas, by the custom of merchants, a bill of lading of goods being transferable by endorsement, the property in goods may thereby pass to the endorsee, but nevertheless all rights in respect of the contract contained in the bill of lading continue in the original shipper or owner; and it is expedient that such rights should pass with the property: And whereas it frequently happens that the goods in respect of which bills of lading purport to be signed have not been laden on board, and it is proper that such bills of lading in the hands of the bona fide holder for value should not be questioned by the master or other person signing the same on the ground of the goods not having been laden as aforesaid: **1. Consignees, and endorsees of bills of lading empowered to sue-** Every consignee of goods named in the bill of lading, and every endorsee of a bill of lading, to whom the property in the goods therein mentioned

since, in the case of indorsement it covers only the situation where as a result of indorsement the property in goods is also passed to the indorsee. In this situation all rights of suit are also transferred to the indorsee and he becomes subject to the same liabilities in respect of goods. But, where an issuing bank (as a pledgee and not as a consignee or indorsee) holds a bill of lading as a security it is not a subject covered by Section 1, because in such circumstances no property in goods is passed to the bank.

This point has also been confirmed by the decision of the House of Lords in **Sewell v. Burdick**[12]: "An indorsee of a bill of lading by way of security, who converts his symbolical into real possession by obtaining delivery of the goods, ought never to derive any benefit from it."[13]

2.2.2. Doctrine of "implied contract"

As a result of lack of appropriate legislation covering rights and liabilities of a bank under a bill of lading against a carrier, disputes have arisen from time to time between the bank and the carrier of goods. In one occasion namely in **Brandt v. Liverpool**,[14] it was held that there is an implied contract where a pledgee of a bill of lading takes delivery since he is willing to accept the goods under the conditions which were specified in the bill of lading. The facts of the case are as follows. The plaintiff/ pledgee, who had accepted the bill of lading as a pledge and made advances to the shipper, brought an action against the shipowner for damages caused by delay and for which the defendant claimed a lien on the goods. In the Court of Appeal the decision of Geer, J., in the lower court was approved by their Lordships unanimously. Banks, L.J. said: "In this case the bill of lading holder

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shall pass upon or by reason of such consignment or endorsement, shall have transferred to and vested in him all rights of suit, and be subject to the same liabilities in respect of such goods as if the contract contained in the bill of lading had been made with himself."

[12] (1884) 10 App. Cas. 74.

[13] Ibid., pp. 85-86; Davenport, B.J., "Problems in the Bills of Lading Act", The Law Quarterly Review, Vol. 105, April 1989, p. 174.

[14] [1924] 1 K.B. 575.

offered the freight before the goods were delivered; and in fact paid it, and under those circumstances it seems to me that by the acceptance of the freight and the subsequent delivery the shipowners undertook an obligation to deliver the goods as described in the bill of lading."[15]

How can "implied contract" be established between the issuing bank and the carrier? Would delivery of goods itself provide good grounds for such a contract? What would be the answer if goods are not delivered as a result of presenting a bill of lading? Does the situation become different if goods are delivered before a bill of lading is indorsed to the bank? These are some of the issues raised after the decision of the Court of Appeal in the **Brandt** case, and in all of them the English courts accepted the view that the doctrine of "implied contract" has some limitations and it should be interpreted within the merits of each case. For instance, in **The Captain Gregos (No. 2)**[16] it was not only said that there must be an implied contract between a bank and a carrier but such a contract must also be on the terms of the bill of lading. For establishing an implied contract it was said in the above case that there must exist a high degree of co-operation between interested parties. Moreover, the decision of the Court of Appeal in **The Aramis**[17], where it was held that mere delivery of goods is insufficient for accepting an implied contract, was supported in **The Captain Gregos (No. 2)**. However, in a recent decision, **The Gudermes**[18] the Court of Appeal overruled the decision of Hirst, J. in the lower court on the point that although a degree of co-operation between parties is one factor for establishing an implied contract, it is not a decisive one and it can be

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[15] Ibid., p. 589; Treitel, G.H., "Bills of Lading and Third parties", LMCLQ, 1986, p. 294 and "Bills of Lading and Implied Contracts", LMCLQ, 1989, p. 162; Beatson, J. and Cooper, J.J., "Rights of suit in respect of carriage of goods by sea", LMCLQ, Part 2, May 1991, p. 196.

[16] Compania Portorafti Commerciale S.A. v. Ultramar Panama Inc., [1990]2 Ll.L.R. 395; Clarke, M., "Misdelivery and Time Bar, The Captain Gregos", LMCLQ, 1990, p. 314, and "The Consignee's Right of Action against the Carrier of Goods by Sea", LMCLQ, 1991, p. 5; Berlingieri, F., "The Hague-Visby Rules and Action in Tort", The Law Quarterly Review, Vol. 107, January 1991, p. 18.

[17] [1989]1 Ll.L.R. 213.

[18] Mitsui & Co. Ltd. v. Novorossiysk Shipping Co., [1991]1 Ll.L.R. 456, and [1993]1 Ll.L.R 311 (CA).

rejected on the merits of the case. Staghton, L.J. in that respect said: "Just as one does not imply a contract from refusal to enter into a contract, so one does not imply terms which one party has refused to accept."[19]

In the light of the above decisions it is clear that under restricted conditions the doctrine of "implied contract" can apply in relationships between the issuing bank and the carrier. The question that should be dealt with is related to the effect of that doctrine after the Carriage of Goods by Sea Act 1992 (COGSA), namely, does the Act leave any room for application of doctrine of "implied contract"?

2.2.3. The Carriage of Goods by Sea Act 1992

The Carriage of Goods by Sea Act 1992 (COGSA) is an Act recommended by the English and Scottish Law Commissions[20] to replace the Bills of Lading Act 1855, since it did not cover some of problems related to a bill of lading.[21] In respect of the point in discussion, namely, relationship between an issuing bank and a carrier, a query may arise: does the new Act provide better protection for the issuing bank? Generally speaking, under sub-section 1(a) of Section 2 of COGSA 92 it is accepted that a person who becomes "the lawful holder of a bill of lading" is entitled

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[19] Ibid., at p. 323.

[20] COGSA 1992 is based on the final recommendation of the English and Scottish Law Commissions in their Reports **Rights of Suit in Respect of Carriage of Goods by Sea** [(1991) Law Com. No. 196; Scot. Law Com. No. 130]; B.J.D., **"Ownership of Bulk Cargoes, The Gosforth"**, LMCLQ, 1986, p. 4; Hudson, A.H., **"Sales from bulk"**, LMCLQ, 1989, p. 420; Reynolds, F.M.B., **"Reform of the Bills of Lading Act"**, The Law Quarterly Law Review, Vol. 106, January 1990, p. 1; Bradgate, R. and White, F., **"The Carriage of Goods by Sea Act 1992"**, The Modern Law Review, Vol. 56, March 1993, p. 188; Howard, Tim, **"The Carriage of Goods by Sea Act 1992"**, Journal of Maritime Law and Commerce, Vol. 24, No. 1, January 1993, p. 181; Pratter, Jonathan, **"Selected Bibliography on the law of Carriage of Goods by Sea, 1975-1992"**, Journal of Maritime Law and Commerce, Vol. 24, No. 1, January 1993, p. 191.

[21] In introduction to COGSA 1992, it is stated: "Unfortunately, there were at least five types of case where this technique [means the Bill of Lading Act 1855] proved inadequate: (i) where a consignee/indorsee did not obtain full property in the goods but merely so-called special property of a pledgee: **Sewell v. Burdick** (1884) 10 App. Cas. 74; (ii) where the property did not pass at all although the buyer was on risk: **Leigh and Sillivan v. Aliakmon Shipping Co.** [1986] A.C. 785; (ii) where property passed after consignment/ indorsement, as is usual in sales of goods forming a larger bulk: **Aramis, The** [1989] 1 Ll.L.R. 213; (iv) where property passed before or independently of the consignment/indorsement: **Enichem Anic S.P.A. v. Ampelos Shipping Co.; Delfini, The** [1990] 1 Ll.L.R. 252; (v) where a bill of lading was not used at all." [Emphasises are added]

to bring an action against a carrier under the contract of carriage;[22] so, in contrast to Section 1 of the previously mentioned Bills of Lading Act 1855, right of suit is no longer connected to the right of property passed upon or by reason of consignment or indorsement.[23] As to the meaning of the lawful holder of a bill of lading Section 5, sub-section (2)(b) of the same Act provides: "a person with possession of the bill as a result of the completion, by delivery of the bill, of any indorsement of the bill, or in the case of a bearer bill, of any other transfer of the bill."

In respect of the application of the doctrine of "implied contract" after COGSA 1992 it becomes clear that the decision in **Brandt v. Liverpool** may only apply in particular situations, namely, where a person who is not a lawful holder of a bill of lading or in case where a bill of lading is lost and a person who is entitled to deliver it never receives it.[24]

2.3. Concluding remarks

UCP 500, as in its previous versions, includes a general provision under Article 3 that the documentary letters of credit are separated from the sales or any contract(s) on which it may be based; there is nothing related to the issuing bank's right to sue a carrier of goods. This is a clear indication that UCP as international customary rules left the issue for consideration by a respective national law.

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[22] Sub-section 1(a) of Section 2 of COGSA 1992 said: "Subject to the following provisions of this section, a person who becomes, (a) the lawful holder of a bill of lading; [...] shall [...] have transferred to and vested in him all rights of suit under the contract of carriage as if he had been a party to that contract."

[23] In a general note to Section 1 of the Act it is stated: "In the case of bill of lading, subs. (1) finally breakes the link between the transfer of contractual rights and the acquisition of property "upon or by reason of" consignment or indorsement, as stipulated by s. 1 of the Bills of Lading Act 1855. Lawful possession of the bill of lading, rather than having property in the goods or being on risk, becomes the key to the transfer of contractual rights to the holder."

[24] As to this point see the general note to sub-section 1 of Section 2 of the COGSA 1992, where it is stated: "Finally, there remains a question which may require resolution from the courts. What is the position where a person who is entitled to delivery of the bill of lading never receives it (say, because it is lost) or receives it only after the expiry of the one-year limitation period in the Hague-Visby Rules? In these circumstances, recovery may be denied under the Act. Recourse to an implied contract between the buyer and the carrier on the terms of the bill of lading, a so-called Brandt v. Liverpool contract ([1924] 1 K.B. 575), remains one way of circumventing problems which are not solved by the Act." [Emphasis added]; Baughen, S., "The Guidernes. What future for Brandt v. Liverpool?", J.B.L., January 1994, p. 62.

If an issued credit is subject to English or Scottish law the issuing bank either as a "lawful holder of a bill of lading" or in appropriate circumstance by application of the doctrine of "implied contract" may sue a carrier for damage or loss of goods. Moreover, the bank by virtue of taking or demanding delivery or making a claim against the carrier, becomes subject to the same liabilities under the contract of carriage as it is a party to that contract.[25] The trend in English and Scottish law from the Section 1 of the Bills of Lading Act 1855 to the decision of the Court of Appeal in **Brandt v. Liverpool** (doctrine of implied contract) and from that decision untill the COGSA 1992 has gradually changed in favour of the bank's right of suit under a bill of lading, due to the impact of reality of business activities in international trade. Therefore, the view that there is no link between a credit arrangement and a contract of carriage is no longer acceptable, at least under English and Scottish law. In that respect, it seems necessary that the point under consideration has received attention by those who are involved in preparing a set of international standards concerning LCs. However, because of the legal nature of the issue and its complexity the ICC shows less interest to involve itself in such issues; so, dealing properly with such legal issues relevant to LCs requires a new approach, namely, an international legislation in the form of a convention. By adopting such a policy a greater uniformity concerning the law of LCs would be achieved at international level.

3. DOCTRINE OF AUTONOMY AND "MAREVA INJUNCTIONS"

The applicant for a credit sometimes seeks to prevent the sellers from receiving the amount of the credit by obtaining a "Mareva Injunction"(MI) granted by courts.[26] Does applying for a mareva injunction put the independent nature of the

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[25] See sub-section 1 of Section 3 of COGSA 1993.

[26] It is named after decision in Mareva Compania Naviera S.A. v. International Bulk carriers S.A., [1975]2 Ll.L.R. 509, where for the first time such an injunction was granted; see David G. Powles, "The Mareva Injunction", J.B.L., 1978, p. 11, "Viva mareva", J.B.L., 1980, p. 218, and "The Mareva Injunction and Associated Orders", Proffessional Books Ltd., 1985; Schmitthoff, C.M., Schmitthoff's export trade, the law and practice of international trade", London, 8th ed., 1986 [hereinafter referred to as Schmitthoff], pp. 619-20; Collins, Lawrence, "The teritorial reach of Mareva injunctions", LQR, 1989,

credit at risk? Before considering that question it is useful to understand the purpose of the injunction and under what conditions it can be granted by the courts.

This is a right which has been authorized by The Supreme Court Act 1981, S. 37(1) and (3). However, courts are reluctant to grant such an injunction save in appropriate circumstances. It may be granted to prevent the seller removing or transferring assets he has received under the credit from the jurisdiction. Lord Denning, M.R., in **Z Ltd. v. A-Z and AA-LL**,[27] explained that point clearly by saying that: "The injunction does not prevent payment under a letter of credit or under a bank guarantee [...] but it may apply to the proceeds as and when received by or for the defendant."[28] In **P.C.W. (Underwriting Agencies) Ltd. v. P.S. Dixon**,[29] Lloyd, J., explained the purpose of granting such injunction by saying that, "[It is] simply to prevent the injustice of a defendant removing or dissipating his assets so as to cheat the plaintiff of the fruit of his claim."[30] Furthermore, several conditions are needed before such an injunction is granted: "The injunction may now, it seems, be granted where (a) the plaintiff has a good claim against the defendant, (b) the claim is one over which the court has jurisdiction, (c) there is evidence that the defendant has assets within the jurisdiction, (d) there is a real risk that those assets will be removed from the jurisdiction, (e) there is a real risk that if the injunction is not granted the defendant will be unable or unwilling to satisfy a judgment against him on the plaintiff's claim and, (f) there is a balance of convenience in favour of granting the injunction. The injunction is typically in wide terms, restraining the defendant from dealing with his assets that are within the jurisdiction until trial or further order;

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p. 262; see also **"Halsbury's Laws of England"**, Banking, Butterworths, London, Vol. 3(1), 4th ed., 1989, p. 260.

[27] [1982] Q.B. 558.

[28] Ibid, p. 574.

[29] [1983] 2 Ll.L.R. 197.

[30] Ibid., p. 202; Goode, R.M., **"Reflections on Letters of Credit-II"**, J.B.L., 1980, pp. 378-81, at p. 378-9 [hereinafter referred to as Goode].

and to avoid the possibility that the defendant might transfer his assets to another party within the jurisdiction who would then take them abroad, the injunction is not limited to transfer by the defendant out of the jurisdiction."[31]

As a result of the above views it seems the autonomous nature of the credit would not be changed in case of application of a MI, and the buyer is entitled to seek such a right while, at the same time, the banker is not prevented from making payment; therefore, the answer to the above asked question is negative.

For preventing any ambiguity concerning the issue under consideration, it seems necessary that the application of MI and its limitation(s) should be included within any international set of standards concerning the law of LCs. There is nothing as to the application of MI or a similar approach in the UCP 500. In contrast, Section 5-114 (2) of the UCC provides a similar solution in case of fraud in the credit operation by the beneficiary;[32] thus appears another distinction to exist between the UCC and the UCP.[33] It becomes also clear that since the UCC and the UCP are different in nature (namely, the former is in legislation form but the latter is in customary/ contractual form),[34] the MI has been left out of the UCP in the past. In order to cover legal issues concerning LCs such as MI within the UCP, the scope of the provisions set out by the ICC should be widened. Would it be possible for the ICC to change its view adopted in the past? For reasons pointed out elsewhere[35] it would be difficult for the ICC to adopt a different approach unless its structure and constitution are changed first, something which seems at present to be out of question.

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[31] Goode, ibid., p. 379.

[32] See relevant discussion in Section B.1 of the present Chapter (below).

[33] For other distinctions between Article 5 of the UCC and UCP 500 see Chapter V (above).

[34] See relevant discussion in Chapters V (Section B.1.1) above and XI (Section B.2) below.

[35] See Chapters X (Section B) and XI (Section A.3) below.

SECTION B: EXCEPTIONS TO THE DOCTRINE OF AUTONOMY

Are there any exception(s) to the doctrine of autonomy? If so, what are the exceptions and their effects on relationship between parties to a credit contract? The issue of a beneficiary's fraud, as an exception to the above doctrine, has received much attention in different legal systems as well as in English and Scottish law. Beside the issue of fraud there are other issues like illegality of the underlying sale contract, or contractual agreement for unenforceability of the doctrine of autonomy by parties to a credit transaction, which puts limitations on the application of the doctrine of autonomy.[36]

This part of the thesis is devoted to these issues, points related to them, and their impact on rights and liabilities of banks against other parties to a letter of credit. In that respect the issue of fraud is considered first, in the light of English law (Scottish law takes a view similar to English law) and American law in more details to find whether, to some extent, a common view exists between different legal systems as far as LCs are concerned. In order to have a better understanding of exceptions to the doctrine of autonomy and their impact upon the LCs system, the following discussion is presented.

1. FRAUD

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[36] Sarna, L., "Letters of Credit" The Law and Practice", 2nd ed., 1986 [hereinafter referred to as Sarna], pp. 129-152; Ellinger, E.P.,"Documentary credits and fraudulent documents" a paper published in Chinkin, C.M., Davidson P.J., and Ricquier, W.J.M., "Current Problems of International Trade Financing", Singapore Conferences on International Business Law, Malaya Law Review, 1983 [hereinafter referred to as Singapore Conferrence 1983], at p. 202 [hereinafter referred to as Ellinger's paper in Singapore conference 1983]; see Ellinger, supra (f.n. 4), p. 190 and from the same writer, "Documentary Credits and Fraudulent Documents", a paper published in Kee, Ho Peng and HM Chen, H., "Current Problems of International Trade Financing", Singapore Conferences on International Business Law, 2nd ed., Butterworths, 1990 [hereinafter referred to as Singapore Conferences 1990], pp. 139-87 [hereinafter referred to Ellinger's paper in Singapore conferences 1990]; Kozolchyk, B., "Letters of Credit", 9 International Encyclopedia of Comprative Law, Chapter 5, 1979, pp. 120-22 [hereinafter referred to as Kozolchyk] and from the same writer, "Commercial Law: The Immunization of Fraudulently Procured Letters of Credit", 58 Brooklyn Law Review 369, Spring 1992, Brooklyn Law School [hereinafter referred to as Kozolchyk's article]; Mautner, Menachem, "Letter of credit fraud: total failure of consideration, substantial performance and the negotiable instrument analogy", Law and policy in International Business, No. 18, 1986, pp. 579-647 [hereinafter referred to as Mautner]; Ellinger, E.P., "British Business Law, Banking", JBL, March 1991, p.170 & JBL, May 1991, p. 279; Bennett, H.N., "Documentary Credit, fraud and string contracts", LMCLQ, Feb. 1991, p. 43.

The International Chamber of Commerce (ICC) pointed out that fraud has sharply increased in international trade and in letters of credit (because of the wide range of documents required under this arrangement) in recent decades.[37] Presenting forged or false documents is not a difficult job if an unscrupulous beneficiary is tempted to carry it out. Are banks obliged to accept documents which on their face comply with terms and conditions of the credit but, in fact, are not genuine documents? What is a bank's obligation if documents tendered by the beneficiary are not forged but there are no goods at all, or goods are not in accordance with the credit's conditions? To what extent does the bank's knowledge (or that of its client, as the case may be), as to the genuineness of tendered documents, become important? Under the present law what type of fraud is accepted as an exception to the doctrine of autonomy. What limitations apply to fraud? What would be the effect of fraud on a third party who acts in good faith? These points and issues related to them are discussed below.

1.1. Scope of the fraud exception

If banks can prove the forgery or the fraudulent behaviour of the beneficiary through their personal knowledge or information received from their customers, they have a duty to reject tendered documents and stop any payment under the credit since these amount to waste paper.[38] And the seller seems in breach of conditions

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[37] ICC, "Guide to the Prevention of International Trade Fraud", ICC Publication No. 420 [hereinafter referred to as ICC guidance], at p. 4 stated that: "In recent decades, there has been a marked increased in trade fraud, especially since the mid-seventies, when chronic port congestion in the Middle East and Nigeria obliged vessel s to wait weeks and sometimes months to discharge. Owners and charteres naturally found the demurrage very costly and took their cargoes elsewhere to unload. From there, it was only a short step for the less honest operator to take the cargo elsewhere and usually sell it. Many variations based upon this essentially simple theme have since appeared."; see also at p. 6 of the same reference in which it is said that a letter of credit usually required over 16 separate documents among them are bill of lading, commercial invoice, insurance policy, certificate of origin, certificate of quality or survey certificate; Millett, P.J., "Tracing the Proceeds of Fraud", LQR, 1991, p. 71.

[38] Davis, A.G., "The Law Relating to Commercial Letters of Credit", 3rd ed., 1963 [hereinafter referred to as Davis], at p. 146, f.n. 4 referred to an American case and pointed out that: "Nacional Financiera s.a. v. Banco de Ponce (1949), 89 N.Y. Supp. (2d) 480: where it was not evident on the face of the documents presented that they contained an underlying false statements, payment of a draft drawn under the letter of credit was held to be proper."; Murray, Daniel E., "Letters of Credit and Forged and Altered Documents: Some Deterrent Suggestions", Commercial Low Journal, Vol. 98, No.4, Winter 1993, p. 504, at p. 504 said: "Since letter of credit sales are based upon documents rather than an examination of the goods,

stipulated in LCs, namely, to produce documents which comply with the terms of the credit.[39] In contrast, if there is merely a suspicion of fraud, forgery or false documentation, a question may arise as to whether banks are under a duty to check the genuineness of tendered documents? It is said that there is no such responsibility for banks under the above cited circumstances.[40]

Moreover, in respect of the banks' position in case of fraud there are two lines of arguments. The first is in favour of a narrow interpretation of the exception to the principle of autonomy, i.e. the seller is not liable for fraudulent action of a third party and therefore for the genuineness of the tendered documents under the credit contract.[41] The second view supports a wider interpretation of the fraud exception, namely, that a third party's fraud affects a beneficiary's position. A difference has also emerged as to the concept of "fraud in transaction" in Section 5-114 of UCC between American lawyers, namely whether fraud committed by a beneficiary is limited to LCs or also covers a contract of sale. Then the question is: which one of those attitudes is to be preferred? To find an answer to these questions, above the bank's position is considered under Common law and UCP 500 (below).[42]

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everything depends upon the integrity of the documents. In the event that the documents are forged or altered counterfeit forms are used, the total transaction becomes frustrated and the losses to innocent buyers and banks can be enormous."

[39] Sztejn v. J.H. Schroeder Banking Corp. (1941) 31 NY Supp. 631.

[40] In Basse and Selve v. Bank of Australia, (1904) 90 LT 618, Bigham, J. supported such notion by stating that: "Once they were in thouch with the right man the defendants' only remaining duty was to see that the documents which he brought purported on their face to be the documents described in the mandate. It was no part of their duty to verify the genuineness of the documents."; this view was also confirmed in Maurice O'Meara v. National Park Bank (1925) 239 NY 386; 146 NE 636; Davis, ibid, pp. 147-48 and pp. 153-54; see ICC guidence, supra (f.n. 37), at p. 14 it is stated that: "When documents are presented to a bank against a documentary credit, it is not possible for the bank concerned, niether it is required under the Uniform Customs and Practice for Documentary Credits, to verify either the genuineness of any such documents including the bill of lading or the signature thereon. The vast number of shipping companies and their agents throughout the world, most of whom are empower to issue bills of lading, make such a check totally impracticable. However, the careful choice of forwarding agent greatly reduces the risk of fraud."

[41] United City Merchants (Investment) Ltd. v. Royal Bank of Canada, "The American Accord" [1979] 2 Ll.L.R. 498; [1982] 2 WLR 1039.

[42] Generally speaking, it is said that banks are under no duty to investigate the integrity of the seller since they are only acting upon their client's instruction; so it is the buyer's responsibility to select an honest partner for his contract; in that regard see ICC guidence, supra (f.n. 37), at p. 14 pointed out: "Banks advising

1.2. Position in Common law

1.2.1. Fraud committed by the seller (Sztejn case)

In respect of fraud committed by a beneficiary of a credit the leading authority is an American case in which for the first time it was held that an unscrupulous beneficiary must not be allowed to benefit from the autonomous nature of the letter of credit.[43] So far as English and Scots law are concerned, there are many authorities which support the rule set out in the **Sztejn** case. For instance, in **Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.**,[44] Lord Denning, M.R., after describing the general principle of autonomy of the letter of

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documentary credits do so on the instructions of their principals either their own customer or another bank) and are therefore, not responsible for investigating or vouching for the standing and integrity of the beneficiaries whether they are known to them or not. It is, therefore, essential that, as previously stated, any necessary enquiries should be made by the buyer before even entering into a purchase agreement."

[43] In Sztejn v. J. Henry Schroder Banking Corporation,(1941)31 NY Supp. 631, the seller presented documents which on their face complied with credit's conditions but in fact he shipped rubbish; buyer discovered the truth and instructed his bank not to pay but the defendant negotiating bank did not comply with such a request, the plaintiff/buyer brought an action against that bank seeking an injunction. Shientag, J., held in favour of the plaintiff and in course of his judgment he explained facts of the case and his view in following words: "On the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, **where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of independece of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller**. It is true that even though the documents are forged or fraudulent, if the issuing bank has already paid the draft before receiving notice of the seller's fraud, it will be protected if exercised reasonably diligence before making such payment." [Emphasis added]; nevertheless, the same judge made an exception to that by saying: "If it had appeared from the face of the complaint that the bank presenting the draft for payment was a holder in due course, its claim against the bank issuing the letter of credit would not be defeated even though the primary transaction was tainted with fraud."; Gutteridge, H.C. and Megrah, M., "The law of bankers' commercial credits", 7th ed., London, 1984 [hereinafter referred to as Gutteridge], pp. 186-7, particularly the view expressed by Cardozo, J., in Maurice which expressed a dissenting view; Sarna, supra (f.n. 36), pp. 134-35; see also Old Colony Trust Co. v. Lawyers' Title & trust Co. 297 F. 152 (1924) that it is said this case is related to issue of fraud and the case of Sztejn was decided upon the principle accepted in that case; however the distinction between them is that in Old Colony Trust there was no goods at all and the beneficiary used a forged warehouse receipt, but in Sztejn tendered documents were related to worthless goods [Kee, Ho Peng, "The Fraud Rule in Letters of Credit Transaction", Singapore Conferences 1990, supra (f.n. 36) pp. 188-208, at p. 191 [hereinafter referred to as Kee]; Mautner, supra (f.n. 36), at pp. 592-93 and pp. 617-18.

[44] [1978]1 All ER 976; [1978]1 Ll.L.R. 166; for position in Scottish law see Centri-Force Engineering v. Bank of Scotland, The Times, December 23, 1992, held that Scottish law is similar to English law as to the issue of fraud and rules in Edward Owen and in The American Accord are also applied in Scotland; Sarna, Lazar, "Letters of credit: Bankruptcy, fraud and identity of parties", The Canadian Bar Review, Vol. 65, 1986, p. 303.

credit, referred to the Sztejn case as an exception to that principle by saying: "To this general principle there is an exception in the case of what is called established or obvious fraud to the knowledge of the bank, the most illuminating case is of **Sztejn v. J. Henry Schroder.**"[45]

Turning to **The Sztejn** decision, would the bank's position be different if the banker is informed of the fraud after the presentation of documents but before payment? In **Bank Russo-Iran v. Gordon Woodroff & Co. Ltd.**, Browne, L.J., made it clear that there should be no difference in the banker's position, namely, the bank is entitled to refuse payment.[46] It is suggested that the situation in French and German law is similar to that expressed above.[47]

1.2.2. Fraud by a third party (The American Accord case)

One of the controversial matters in dealing with the issue of fraud is whether fraud committed by a third party affects the rights of a seller/beneficiary under the doctrine of autonomy. This point arose for the first time in **United City Merchants (Investments) Ltd. v. Royal Bank of Canada, (The American Accord).**[48] Since

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[45] Emphasis added; for other authorities see **Hamzeh Malas & Sons v. British Imex Industries Ltd.** [1958] 2 QB 127; **Discount Records Ltd. v. Barclays Bank Ltd.** [1975] 1 Ll.L.R. 444; **The American Accord**, [1979]2 Ll.L.R. 498, [1982]2 Ll.L.R. 1, and [1982]2 WLR 1039.

[46] [1972] The Times 4 October (an unreported case); the related part of decision of Browne, L.J., is as following: "In my judgment, if the documents are presented by the beneficiary himself, or are forged or fraudulent, the bank is entitled to refuse payment if it finds out before payment, and is entitled to recover the money as paid under a mistake of fact if it finds out after payment."

[47] Ellinger, supra (f.n. 4), pp. 191-92.

[48] [1979] 1 Ll.L.R. 267 and [1979]2 Ll.L.R. 498 (QB); [1981]1 Ll.L.R. 604 (CA); [1982] 2 Ll.L.R. 1 and [1982] 2 WLR 1039. The facts of the case are that an English company (second plaintiffs) agreed to sell manufactured goods to a Peruvian company under an f.o.b. contract, London, for shipment to Callao and payment was to be furnished by an irrevocable confirmed letter of credit. It was also agreed by contracting parties that the price of the merchandise was doubled in order to allow the buyer to exchange Perovian currency for the excess amount in breach of Perovian exchange control regulations. A letter of credit issued by Banco Continental S.A. and correspondent to the seller through the defendants (Royal Bank of Canada). Then the seller assigned his right under the credit to the United City Merchants (first plaintiffs). After tendering required documents the defendants refused to accept the tendered bill of lading on the ground that it was a forged document and it was inaccurate in some respects: (1) It contained the notation "these goods are actually on board 15th December 1976", whereas the goods were not on board until December 16; (2) The port of loading was said to be the port of London. It was in fact Felixstowe; (3) The date of the issue of the bill of lading was said to be Dec. 15 it was in fact Dec. 16.

this case has been the subject of many discussions by legal writers, it will be discussed in more detail. The fraudulent action of the loading broker's employee in issuing a forged document had been done in a manner that precluded the seller from honouring it; additionally there was no relationship existing between the loading broker and seller as agent and principal. In the judgement Mocatta, J., held that the sellers were innocent and therefore they were entitled to receive payment. This opinion was rejected by all three judges in the Court of Appeal on the ground that if a banker knows that tendered documents are forged he is under a duty to reject the documents (on the principle of strict compliance); it did not matter whether the fraud was done by a third party or the beneficiary of the credit himself. The House of Lords accepted Mocatta J.'s view on this point and reversed the decision of the Court of Appeal on the ground that the only exception to the doctrine of autonomy is that the fraud has been carried out by the seller/beneficiary, and there is no justification for extending the application of such an exception to cases involving fraud carried out by a third party rather than the seller.

1.2.2.1. Analysis of The American Accord decision

For the first time the two pillars of the documentary credit system, namely, the doctrine of autonomy and the rule of strict compliance, stood sharply against each other, raising the question as to a bank's position if it receives documents that appear on their face to be in order but actually they are forged and the bank knows this fact. In other words, is the fraud exception to the strict rule that the bank must pay if documents are, on their face, in order, limited to the case where the fraud is that of the seller/ presenter; or does it apply in all cases of fraud known to the bank?[49] In the Court of Appeal Stephenson, L.J., took the view that "If a document, false in the sense that it is forged by a person other than the beneficiary, can entitle a bank to refuse payment, I see no reason why a document in any way false to the

[49] See Ackner, L.J.'s view in the Court of Appeal, at p. 627; and also Griffiths, L.J.'s judgment in the Court of Appeal, at p. 632.

knowledge of a person other than the beneficiary should not have the same effect."[50]

Among commentators the strongest support of the view adopted by the Court of Appeal came from Professor Goode: "The beneficiary under a credit is not like a holder in due course of a bill of exchange; he is only entitled to be paid if the documents are in order. A fraudulently completed bill of lading does not become a conforming document merely because the fraud is that of a third party."[51] The House of Lords took a different view from that expressed by the Court of Appeal(CA), namely, the only exception to the principle of independence of the credit is the seller's fraud, and it must not be extended to a third party's fraud.[52] Lord Diplock disagreed with the Court of Appeal's approach on two grounds. Firstly, the view that forgery and fraud in the letter of credit is one subject with two different names is not acceptable; nevertheless he left open the question for further analysis. Secondly, it was said that even if the correctness of the above view was accepted it was wrong to conclude that fraud by a third party has a similar effect on the position of the innocent seller/beneficiary in connection with the confirming bank's obligation,

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[50] [1981] 1 Ll.L.R. 604 (CA), p. 623, p. 628-29 (Ackner, L.J.), and p. 632, col. 2, par. 2 (Griffiths, L.J.); Cotton, Sruart, "LOCs: Not Foolproof, But Still Safe", Best's Review, Vol. 88, No. 6, October 1987, p. 56, at p. 62 said: "The American Accord case sets up a difficult standard. In essence, it is for the court to determine what the beneficiary knew, not whether the documents were genuine. US courts do not accept the American Accord approach and tend to follow the rule that if the documents are irregular in the sense that they are forgeries or contain fraudulent information, the bank can dishonor the beneficiary's demand."

[51] Goode, R.M., "Reflections on Letters of Credit- I", J.B.L. 1980, pp. 291-95, at p. 294 [hereinafter referred to as Goode's reflection I]; Schmitthoff, C.M., "Fraud affecting documentary credits: refusal of bank to pay", J.B.L. 1981, pp. 221-24, at p. 223; Ellinger's paper in Singapore Conference 1983, supra (f.n. 36), pp. 205-6; Davis, supra (f.n. 38), pp. 145-46 and p. 156; Gutteridge, supra (f.n. 43), pp. 179-80; Kozolchyk's article, supra (f.n. 36) at p. 370 it was asked: "Why should a good faith applicant agree to procure the issuance of a letter of credit and reimburse the issuing bank if the letter of credit becomes an automatic and unstoppable vehicle for the protection of fraud?"

[52] [1982] 2 W.L.R., p. 1039, at p. 1049, Diplock, L.J. in course of delivering his judgment concern to the Court of Appeal' s view states: "The Court of Appeal reached their half-way house in the instant case by starting from the premiss that a confirming bank could refuse to pay against adocument that it knew to be forged, even though the seller/beneficiary had no knowledge of that fact. From this premiss they reasoned that if forgery by a third party relieves the confirming bank of liability to pay the seller/beneficiary, fraud by a third party ought to have the same consequence."

as forgery by a third party that may affect such obligation, i.e. rejecting forged documents and refusing payment.[53]

1.2.2.2. Comment

When comparing the opinions of the House of Lords and the Court of Appeal in order to find a solution to this problem, it seems the view accepted by the House of Lords should be preferred, for the following reasons: firstly, it is obvious that forgery and fraud are two different crimes each with its own characteristics.[54] Secondly, a party to a contract is responsible for his own offence and his agent's failure. So, as the facts of the case show fraud can be carried out by a person who has no relationship with the seller/beneficiary. Moreover, the seller had no knowledge of any wrongdoing; but if a seller has such information and at the same time presents the documents, the crime of fraud can be established against him and the rule of **Sztejn** case governs the situation.[55] Thirdly, having information that documents are forged and using them intentionally are main factors for establishing fraud and forgery offenses. A similar view is accepted in the relationship between a

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[53] Ibid., at p. 1049 Diplock, L.J., expressed his view as following: "I see no reason why, and there is nothing in the Uniform Commercial Code to suggest that, a seller/beneficiary who is ignorant of the forgery should be in a worse position because he has not negotiated the draft before presentation."; **Korea Industry Co. Ltd. v. Andoll Ltd.** [1990]2 Ll.L.R. 183 (supported the House of Lords' decision in **The American Accord**); see also **Tukan Timber v. Barclays Bank** [1987] 1 Ll.L.R. 171 (QB).

[54] Bride, R., **"Osborn's Concise Law Dictionary"**, London, 7th ed., 1983, at p. 152 said that forgery as an offence defined by the Forgery and Counterfeiting Act 1981 as "making of a false instrument with the intention that it should be accepted as genuine to the prjudice of another person" (sec.1 of the Act); and at p. 153, relating to the fraud, it is said: "In general, fraud is obtaining of a material advantage by unfair or wrongfull means; it involves moral obliquity. It must be proved to sustain the common law action of deceit. Fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. To obtain damages for deceit it must be proved that the defendant intended that the plaintiff should act on the fraudulent misrepresentation, that he did act on it, and suffered damage in consequence. Fraud renders a contract voidable at the option of the injured party."

[55] See **RPPC v. Bank Leumi** [1992] 1 Ll.L.R. 513 where a fraud is committed by a third party and the beneficiary of the credit knew it; so held that the bank is entitled to refuse payment; Ellinger, E.P., **"The Uniform Customs and Practice: a brief review of their salient points"**, JBL, Jan. 1994, p. 28 [hereinafter referred to as Ellinger's article in JBL 1994], at p. 36 stated: "In **Rafsanjan Pistachio Producers Co-operative v. Bank Leumi (UK) plc**, [1992]1 Ll.L.R. 513, Hirst J. found on the merits that the application for the credit had included certain fraudulent misrepresentations of which the beneficiary, too, was aware. On those facts, his Lordship concluded that the beneficiary was precluded from enforcing the credit against the issuing bank."

bank and its customer, i.e. if the bank acts reasonably even though tendered documents are forged or there is a fraudulent seller, the bank is entitled to recover any money which is paid under the credit's conditions. So why does such a procedure not apply in the relationship between the seller and the bank (issuing or correspondent bank as the case may be)?[56]

Is it that a bank is under a duty towards its client not to accept documents which do not comply with the credit's terms? Also may it lose its security over the goods by such acceptance? It can be argued that banks are dealing with documents and not with the individuals who present them; so if there is a forged document they are entitled to reject it. In reply, one can suggest that a beneficiary stands in the same shoes, as he may lose control over his goods even where there has been no failure on his part. He is also dealing with documents and if he acts reasonably no further obligations should be imposed upon him. In addition, by allowing an extension of the scope of fraud, the documentary credit system would not be able to work more efficiently; and it would inevitably give rise to the creation of a more complicated credit contract in the future.

As to the argument that it is not just a bank or its client who should suffer from such wrongdoing in preference to the seller/beneficiary, it can be said it is part of the risk that parties to an international trade agreement should accept. Moreover, under Article 3 of UCP 500, mentioned previously, a credit contract is separate from a contract of carriage; so, if there is fraud in the carriage contract it is a matter which does not relate to the credit agreement and the banks should in no way involve themselves in such a dispute.[57]

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[56] See Mautner's article, supra (f.n. 36), pp. 623-25 for a different view namely "intention" is an strange factor to a contract where damages are measured; further, by accepting it we face a circular approach namely to prove a fraud we need to look at the beneficiary's intention and to establish a fraudulent intention we need to examine the quality of the beneficiary's performance. Therefore, it is suggested that for establishing a fraud we should look at "performance" rather then "intention" of a beneficiary.

[57] For more details see discussion concerning the meaning of "fraud in the transaction" in Section B.1.2.5. of the present Chapter (below).

1.2.3. Time of a beneficiary's knowledge as to fraud committed by a third party

In respect of the decision in **The American Accord** a point may arise: are banks entitled to refuse payment if they can prove that the beneficiary has knowledge of fraud committed by a third party after presenting the required documents under the credit contract? One may argue that on the basis of the House of Lords' decision in **The American Accord** the beneficiary's duty to present stipulated documents is ended by tendering documents. Therefore, after that time the beneficiary has no duty to inform banks if he finds later that a fraud was committed by a third party. So, in such a situation banks are not entitled to refuse payment under the credit (**narrow interpretation**).

In contrast, it may be argued that in case of fraud the beneficiary's good faith should continued even after the time of tendering documents. Therefore, if banks are aware or can prove that the beneficiary is aware of fraud committed by a third party after presentation of documents, they can protect their interests by rejecting payment under LCs (**wide interpretation**). Which one of those arguments is preferable? The second approach seems difficult to apply since it is directly opposed to a beneficiary's interest and few beneficiaries are ready to sacrifice their interests in such circumstances. However, if a bank can prove the beneficiary's knowledge as to fraud committed by a third party after the time of presentation of documents, it may be a good ground for establishing fraud against the beneficiary for using forged documents.

1.2.4. Issues of fraud in the relationship between banks

What would be the position of an intermediary bank if it is proved that documents presented by a beneficiary are forged documents or that a fraud is committed by the beneficiary of the credit? Could the issuing bank refuse payment to such a bank? It seems the relationship between an issuing bank and other banks, if they are acting reasonably, is governed by the same principles applying between the issuing bank and its client, namely, that the latter is under a duty to pay the

amount which is paid by the former and there is also no right of recourse for the issuing bank against the beneficiary.[58] However, questions may arise as to the position of a discounting and a negotiating bank, as follows.

1.2.4.1. Discounting bank

Is a discounting bank's position similar to that of other banks relating to their relation with the issuing bank in case of fraud? In other words, is an issuing bank obliged to accept a forged document presented by a discounting bank acting in good faith? An issuing bank usually furnishes a credit in the name of a specified beneficiary as promisee. On the other hand, a beneficiary/seller is entitled to assign his rights under the credit by discounting it to a third person who is a stranger to the credit contract.[59] As the above question, because the issuing bank (as promisor) does not accept any undertaking towards the discounting bank, the latter bank acts at its own risk and courts of law have been unwilling to imply any obligation by the issuing bank vis-a-vis a discounting bank.[60]

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[58] Ellinger's paper in Singapore Conference 1983, supra (f.n. 36), pp. 215-17.

[59] Article 49 of UCP 500.

[60] M.A. Sassoon & Sons Ltd. v. International Banking Cor. [1927] A.C. 711, Viscount sumner states: "It is contended that in spite of the words "when offering drafts for negotiation under this authority", which authorize negotiations to the eastern bank alone, the suceeding words "to enable the negotiating bank", convey that the authority advised in the letter of advice extends to the transaction with other negotiating banks, and should not be construed as merely meaning "to enable us when we negotiate the drafts ..." Even if this be so (and it is a very summary way of converting the terms of a discounts offer by any other bank), it does not follow that, if a third party bank negotiates, all the undertakings and all the dealings referred to in this letter of advice will be or can be made applicable forthwith to such a substituted transaction."; in Banco Nacional Ultramarino v. First National Bank of Boston, 289 F. 169 (1923), at p. 174, Peters, J. concern to the matter in discussion stated: "If the letter designates a particular person to whom the promise is made, it has been held that no other can take advantage of it, on the principle that a person has the right to select his own promisee."; and Ellinger pointed out that "Sassoon's case and the Banco Nacional case show that the courts are unwilling to turn a straight credit into a negotiation credit by implying a promise of the issuing bank to the discounting bank. It follows that, as aginst a discounting bank, the issuing bank is under no obligation to accept a draft drawn under a straight credit. It further follows that the discounting bank has no right to demand acceptance or payment from the issuing bank under a straight credit." [see Ellinger's paper in Singapore conference 1983, supra (f.n. 36), pp. 227-28]; Ellinger supported that aproach by saying: "If, in the absence of such document [i.e. fraudulent document], the discounting bank has no right to demand acceptance or payment in its own name, it follows a fortiori that the discounting bank has no such a right where the draft is accompanied by a forged or by a fraudulent document." [Ellinger's paper in Singapore conference 1983, supra (f.n. 36), p. 228; emphasis and words in the brackets are also added.]

"Holder in due course"

The next question is: does a discounting bank's position fall into the category of "holder in due course"? In **Discount Records Ltd. v. Barclays Bank Ltd.**,[61] Megarry, J. in his judgment took the view that the rights of a holder in due course, who took a draft accompanied by forged and fraudulent documents, was not affected by a dispute between parties to a credit contract over the documents. The learned judge, however, did not distinguish between a discounting and a negotiating bank.

There are two lines of arguments relating to the meaning of "holder in due course". The first is based on a broad interpretation of the terms "holder in due course", namely, extending the responsibility of the issuing bank against a discounting bank. The second view accepts, in contrast, a narrow approach. Which one of these views is to be preferred? One may argue in favour of the narrow view by saying that if a credit is assigned to the benefit of a discounting bank, the position of the assignee remains the same as that of the assignor (the seller); then in the case of the latter's fraudulent action the former will lose any law suit against the issuing bank although he acted in good faith, since there is no contractual relationship between the issuer and a discounting bank. To support this argument attention may be drawn to a decision made by a United States District Court which took the view that Article 5-114 (2) "protects one who takes a draft [...] issued pursuant to a letter of credit, rather than the beneficiary of the letter of credit who

[61] [1975] 1 Ll.L.R. 444; see appendix 2 for Section 5-114 (2) of the UCC.

issues the demand."[62] Similarly, Article 14 (a) of UCP 500 may support such a conclusion albeit by implication."[63]

Despite the above argument it seems the wide interpretation of terms "holder in due course", namely, that the issuing bank's responsibility would be extended to cover also a discounting bank, is the better one and it can be supported by a decision of the House of Lords in **The American Accord**, (discussed previously); having the intention to deceive the issuing bank by using forged documents is the central point for establishing a fraudulent action. To prove such an intention, it must first, be clear that a discounting bank as a third party knew about the fraud committed by the beneficiary of the credit. Consequently, an issuing bank is under a duty to pay a bank as a third party if that bank acts in good faith and its position should not be affected because of the lack of a contractual relationship between that bank and the issuing bank.

The meaning of "holder in due course" under Section 5-114(2)(a) of the UCC and issues related to it are considered below.

1.2.4.2. Negotiating bank

Is the position of a negotiating bank that innocently accepts a fraudulent document similar to the above situation? Generally speaking, if a bank is authorised to negotiate a credit by honouring drafts drawn by the seller/beneficiary the issuing bank is obliged to accept the tendered documents and reimburse the negotiating bank. Would a negotiating bank's position be affected by the fact that since drafts

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[62] **United Technologies Cor. v. Citibank N.A.**, 469 F. Supp. 473 (1979), p. 478; in addition Sec. 38 of the Bill of Exchange Act 1882 supports the view that bill of exchange should be issued under the credit in order to make the issuing bank responsible against the negotiating Bank; Ellinger stateted that: "This argument does not conflict with Goff, J.'s dictum in **European Asian Bank v. Punjab and Sind Bank**, [1981] 2 Ll.L.R. 651, 657 to the effect that it would be an innovation to permit the issuing bank to repudiate liability to a third party bank on the ground of fraud or forgery related to the documents. The letter of credit effected in this case was clearly of the negotiation type." [Ellinger's paper in Singapore conference 1983, supra (f.n. 36), p. 228, f.n. 134; emphasis added]

[63] Article 14(a) of UCP 500 (1993) provides: "When the Issuing Bank authorises another bank to pay, incur a deferred payment undertaking, accept Draft(s), or negotiate documents which appears on their face to be in compliance with the terms and conditions of the Credit, the Issuing Bank and the Confirming Banmk, if any, are bound: i. to reimburse the Nominated Bank which has paid, incurred deferred payment undertaking, accepted Draft(s), or negotiated, ii. to take up the documents." [ICC Pub. No. 500]

have negotiable status, there is a right of recourse against a seller/drawer for the negotiating bank?[64] There are two views: **(1)** The issuing bank may dishonouring drafts on the basis that the issuing bank is under an obligation to its customer to reject documents which are not in compliance with the credit's conditions. It is also suggested that there is no harm caused to the negotiating bank since that bank, as mentioned above, has a right of recourse against the fraudulent drawer/ seller.[65] **(2)** In contrast, it can be argued that the relationship between a negotiating bank and the issuing bank is similar to the relationship between the issuing bank and its client, not the relationship of that bank and the beneficiary of the credit (the seller). Therefore, similar principles should be applied to both situations, and by the rule in the **Sztejn** case and the other authorities applying that decision the issuing bank is only able to refuse payment if forged or fraudulent documents are presented by the seller himself or his agent.[66] Moreover, if the negotiating bank can establish that it is a "holder in due course" of the drafts the present law is on its side.[67] As a result, although a negotiating bank seems to stand in a better position than a confirming bank, because of the right of recourse against the seller, on the basis of the principles discussed above, the issuing bank is not entitled to reject documents tendered by the negotiating bank by extending the application of the fraud exception to the relationship between the banks.

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[64] Courteen Seed Co. v. Hong Kong & Shanghai Banking Cor., 216 App. Div. 495, 215 N.Y.S. 525, 529 (1926).

[65] Lord Denning in Etablissement Esefka International Anstalt v. Central Bank of Nigeria [1979] 1 Ll.L.R. 445, at p. 447 stated: "Documents ought to be correct and valid in respect of each parcel. If that condition is broken by forged or fraudulent documents being presented in respect of any one parcel, the defendants [the bankers] have a defence in point of law against being liable in respect of that parcel."

[66] For more details see discussion about the Sztejn and The American Accord cases in Section B.1 of the present chapter (above).

[67] It is supported by United Bank Ltd. v. Cambridge Sporting Goods Cor. 329 N.Y.S. 2d, 265 (1976), where the Court of Appeals in New York held that the negotiating bank had the onus of establishing that it was a holder in due course. Gabrielli, J. said: "Thus, a presenter of drafts drawn under a letter of credit must prove that it took the drafts for value, in good faith and without notice of underlying fraud in the transaction (Uniform Commercial Code, s. 3-302)." [see p. 272 of the case]; Ellinger's paper in Singapore Conference 1983, supra (f.n. 36), p. 222; Goode's reflection I, supra (f.n. 51), p. 295.

"Holder in due course" and Section 5-114(2)(a) of UCC

What is the scope of Section 5-114(2)(a) of UCC relating to the meaning of "holder in due course"? It is said the above section is related to those drafts which are negotiated by a negotiating bank or any other person who legally becomes a "holder in due course". Therefore, a beneficiary of a credit who does not negotiate his draft is not covered by that section.[68] This interpretation of Section 5-114(2)(a) is similar to that in English law.[69] Recently, however, in **The Banco Bamerindus**[70] an American court took a different view in connection with the point in discussion and held that even in a situation where a beneficiary's draft has not been negotiated the rule provided under the above section is also applicable regarding the beneficiary since he becomes a "holder in due course"; therefore, the court will not grant an injunction. The above decision confirmed a similar decision made in **Gotham**,[71] holding that although the beneficiary committed fraud, his drafts were accepted and paid by the advising bank (as paying bank) so the issuing bank is under duty to pay such a bank. However, there is a distinction between these cases since in the former the intermediate bank did not accept the beneficiary's drafts.

Can the decisions made in **The Banco Bemerindus** be justified under the principles of law considered above? It seems, for reasons pointed out previously (concerning cases **Sztejn** and **The American Accord**), where a bank or its client understand that a fraud is committed by the beneficiary they are entitled to stop payment to such a beneficiary even if his drafts were accepted by the client's bank. So, there would be no justification for accepting a wide interpretation of "holder in due course". The situation, however, is different where drafts drawn by a fraudulent beneficiary are accepted and paid by an intermediate/paying bank if the bank acts

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[68] See Kozolchyk's article, supra (f.n. 36), pp. 370-71.

[69] Ibid., p. 370; and also it is said by the same writer that the situation in France, Germany, and Italy is simialr to what has been accepted by Common law [see the same reference above, at pp. 417-20].

[70] 921, F 2d. 32 (2d Cir. 1990).

[71] Kozolchyk's article, supra (f.n. 36), p. 371.

reasonably. Nevertheless, the cited case proves the importance of issues of fraud in LCs and differences in opinion which can arise between different courts in different jurisdictions, e.g., under the English and American law.

1.2.5. Standby letters of credit and fraud exception

Is the position of the contracting parties to a standby letter of credit (SLC), on the fraud exception, similar to that involving a letter of credit? Generally speaking, there are many authorities that support the view that there is no inconsistency between these types of credit so far as fraud is concerned.[72] However, as to a "first or on demand" SLC, cases have been decided in American courts as follows.

1.2.5.1. Meaning of "fraud in the transaction"

In the United States the Uniform Commercial Code (UCC) in Article 5-114(2) provides rules concerning "forged or fraudulent or [...] fraud in transaction".[73] As to the concept of **"fraud in the transaction"**, does it only refer to the letter of credit contract (**a narrow view**), or does it also include the underlying contract of sale (**a wide approach**)?

1. Narrow interpretation

It is suggested the term "transaction" should be interpreted narrowly, limited only to the credit arrangement and not covering the underlying contract.[74] This view has been supported by some American courts.[75]

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[72] For instance see cases like Hamzeh Malas & Sons v. British Imex Industries Ltd., [1958]2 QB 127 and Edward Owen Engineering Ltd. v. Barclays Bank International Ltd., [1978]1 All ER 976, [1978]1 Ll.L.R. 166, mentioned previously; for American point of view see Wunnicke, Brooke and Wunnicke, Diane B., "Standby Letters of Credit", Wiley Law Publications, New York, 1989, pp. 293-324 and Mautner, supra (f.n. 36), p. 632.

[73] See appendix 1 for details of Article 5-114(2) and appendix 2 for Section 5-109(a) of a draft proposed by The American Law Institute, "Uniform Commercial Code Revised Article 5, Letters of Credit (with ammendments to Articles 1,2, and 9), Proposed Final Draft (April 6, 1995)", Submitted by the Council to the Member of the American Law Institute for Discussion at the Seventy-Second Annual Meeting on May 16,17,18, and 19, 1995 [hereinafter referred to as PFD], where there is no reference to "fraud in transaction".

[74] Thorup, A.R., "Injunctions against payment of standby letters of credit: How can bank best protect themselves?", Banking Law Journal, Jan. 1984, Vol. 101, No. 1, pp. 6-30, pp. 15-16 & f.n. 24 [hereinafter referred to as Thorup]; Harfield, H., "Enjoining letter of credit transactions", 95 Banking L.J., 1978, p. 596 [hereinafter referred to as Harfield's bank guarantees], pp. 605-09.

2. Wide interpretation

The second view has, in contrast,interpreted "transaction" in a broad sense including the underlying contract. In support of such an opinion it is said that the rule in the **Sztejn** case seems to support the broad exception to the rule of independence of a credit from its underlying contract.[76] It is suggested that recent authorities adopt the latter view.[77] For instance, in **Rockwell International**

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[75] For instance, the Supreme Court of Pennsylvania took a very narrow view in **Intraworld Industries v. Girard Trust Bank**, 336 A.2d 316 (1975), it is said: "We think that the circumstances which will justify an injunction against honor must be narrowly limited to situations of fraud in which the wrongdoing of the beneficiary has so visiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served. A court of equity has the limited duty of "guaranteeing that [the beneficiary] not to be allowed to take unconcientious advantage of the situation and run off with [the customer's] money on a proforma declaration which has absolutely no basis in fact."; Driscoll, R.J., **"The roll of standby letters of credit in international commerce: Reflections after Iran"**, Virginia Journal of International Law, Winter 1980, Vol. 2, No. 2, pp. 459-504 [hereinafter referred to as Driscoll],, at pp. 482-83 pointed out that: "The entire legal precedent supporting enjoining payment on letter of credit was created in the old-style commercial context wherein the transaction of presentment of the letter of credit for payment was substancially identical and congrouent with the entirely of the commercial transaction. The manufacturer and shipment of bristles, for example, is at the same time the underlying contract and the presentment of conforming documentation allowing for the payment on the letter of credit. [...] Moreover, the Uniform Commercial Code, and particularly Section 5-114(2), does not deal with or purport to regulate the underlying transaction. The context within which Section 5-114(2) is written makes clear that the "transaction" that is being discussed is the transaction of presentment, which may or may not involve "forged or fraudulent documents," or "docments [which do] not in fact conform to the warranties on negotiation."; Throup, ibid, pp. 15-16 and f.n. 24 which he said: "Indeed, the drafters of the UCC could easily have used the term "underlying" to modify the word "transaction" if that had indeed been the intent of the section."

[76] Note, **"Letters of Credit: Injunction as a remedy for fraud in UCC Sections 5-114"**, Minnesota Law review, 1979, Vol. 63, pp. 487-516 [hereinafter referred to as Minnesota Law Review], at p. 503, it was suggested: "The language of section 5-114 would appear to provide a broader exception to the rule of independent contracts than the "fraud represented in the documents" exception generally attributed to **Sztejn**. Section 5-114 allows dishonor not only when a "document [...] is forged or fraudulent," but also when "there is fraud *in* the transaction." On *its* face, this additional language would seem to provide for cases of beneficiary fraud where there are no fraudulent documents; otherwise the "fraud in the transaction" language would be nugatory."; Becker, J.D., **"Standby letters of credit and the Iranian cases: will the independence of the credit survive?"**, Uniform Commercial Code Law Journal, Spring 1981, Vol. 13, No. 4, pp. 335-347 [hereinafter referred to as Becker], at p. 343 said that: "After the unanimous decision of the New York Court of Appeals in **United Bank Ltd. v. Cambridge Sporting Goods**, holding that the shipment of mildewed boxing gloves rather than new ones "constituted fraud in the transaction within the meaning of subdivision (2) of Section 5-114, "there can be no doubt that the broad interpretation is proper." [**United Bank** case, 41, N.Y. 2d 254, 260 (1976); emphasis added]

[77] Ho Peng Kee, **"The fraud rule in letters of credit transaction"** [hereinafter referred to as Kee], Singapore Conference 1990, supra (f.n. 36), pp. 240-7; Minnesota Law Review, ibid., at p. 501; Blodgett, Mark S. and Wilson, Jerry W., **"The Impact of transaction Fraud: Strategies for the International Letter of credit"**, Review of Business, Spring 1993, p. 42, at pp. 43-44 stated: "The difficulty with "fraud in transaction" lies in determining the degree of fraud necessary to prevent payment under the letter of credit. A

Systems Inc. v. Citibank, N.A. and Bank Tejarat,[78] the United States Court of Appeal for the Second Circuit considered the matter of **"fraud in the transaction"** as follows: "The "fraud in the transaction" defence marks the limit of generally accepted principle that a letter of credit is independent of whatever obligation it secures. [...] The logic of the fraud exception necessarily entails looking beyond supporting documents. [...] we must look to the circumstances surrounding the transaction. We think that the essence of the fraud exception is that "the principle of the independence of [a] bank's obligation under the letter of credit should not be extended to protect "a party that behaves so as to prevent performance of the underlying obligation."[79]

A similar argument was submitted in **American Bell International v. Islamic Republic of Iran;**[80] facts of the case are that a contract had been entered into between American Bell and Ministry of War (its name was changed to Ministry of Defense after the Islamic Revolution in Iran in 1979) for improving Iran's international communication system, with an amount of $280,000,000. As an

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review of recent court cases in the US indicates a terend toward broadening the interpretation of fraud in the transaction. If this trend continues, then all parties to the international trade transaction must re-valuate the usefulness of the international letter of credit. [...] With the apparent broadening of the interpretation and application of the fraud exception to the international letter of credit, all parties to foreign trade transactions should be increasingly cautious. The issue of fraud in the transaction, as interpreted in recent court cases, undermines both the independence and strict compliance principles."

[78] United States Court of Appeal for the 2d Circuit, Oct. 1983; Gutteridge, supra (f.n. 43), p. 183.

[79] Sarna, supra (f.n. 36), at p. 138 concern to the practical difficulty which may arise by such interpretation stated: "It has been said that the practical difficulty of construing "transaction" to include the underlying contract is that unscrupulous or over-anxious customers would be inspired to press claims of fraud for the purpose of postponing payment. On the other hand, reading "transaction" to exclude fraud in the underlying contract not only protects the fraudulent beneficiary but also ignores the reality that a fraudulent scheme usually affects both the documents and the shipment."; and he said: "[I]t is surely a semantic diversion to treat fraud in the documentation as distinct from fraud in the transaction. What one is truly trying to express is that the content of the documents do not reflect the reality of the shipment or the performance of the obligations by the beneficiary. A forged certificate of inspection which disguises the absence or impropriety of a shipment can not be categorized as a fraud in the documentation without at the same time allowing to fraud within the transaction."; Kozolchyk, B., "Letters of credit", International Encyclopedia of Comparative Law, Vol. 9, Chapter 5, 1979 [hereinafter referred to as Kozolchyk], pp. 116-17.

[80] 474 F. Supp. 420 (SDNY 1979); see also "American International Law Cases", Reams, Vol. I, 1979-86, Second Series, pp. 357-63 [hereinafter referred to as American cases]; Driscoll, supra (f.n. 75), p. 475.

advance payment $38,800,000 was paid to the plaintiffs against a guarantee given by American Bell. The method was that the American companies provided a "first/on demand" SLC through their banks (the issuer) in favour of their Iranian counterparts, in a bank in Iran, and the latter bank issued a letter of guarantee for its customer (the beneficiary of SLC). Similar procedures were applied in the above case and the Manufacturers Honover Trust Co. (the issuer) issued a SLC for $38,800,000 in favour of Bank Iranshahr, and as a result the latter bank gave a letter of guarantee to its customer, the Ministry of Defense. Judge MacMahon in his judgment rejected the plaintiffs' contention on the ground that the Islamic Republic had already been recognised as the legitimate Government of Iran by the United States;[81] so, the plaintiffs' requirement for a preliminary injunction did not find support on a "non-conformity of demand" ground. As to the allegation of fraud made by the defendant, MacMahon, J. after consideration of both parties' argument, held in favour of the defendants on the ground that the decision of the Government of Iran is an economically rational decision to recoup its financial affairs.[82]

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[81] The **American Bell** case, ibid., p. 423; American cases, ibid., at p. 359, judge MacMahon after affirming the principle of strict complaince as a bedrock rules of credit, stated: "[...] we notice, and the parties agree, that the United States now recognizes the present Government of Iran as the legal successor to the Imperial Government of Iran. The recognition is binding on American Courts. **Guaranty Trust Co. v. United States**, 304 U.S. 126, 137-38, 58 S.Ct. 785, 82 L.Ed. 1224 (1938). [...] we point out that the American courts have traditionally viewed contract rights as vesting not in any particular government but in the state of which that government is an agent. [...] Accordingly the Government of Iran is the successor to the Imperial Government under the Letter of Guarantee." [Emphasis added]; see also **American Bell Int'l Inc. v. Manufactureres Honover Trust Co.**, No. 3157/79 (Sup. Ct. Mar. 26, 1979).

[82] American cases, supra (f.n. 80), at p. 361, col. 2 it is said: "On the evidence before us, fraud is no more inferable than an economically rational decision by the government to recope its down payment, as it is entitled to do under the consulting contract and still dispute its liabilities under that contract. While fraud in the transaction is doubtless a possibility, plaintiff has not shown it to be a probability and thus fails to satisfy this branch of the **Caulfield** test." [Emphasis added]; see also p. 358, col. 2 about **Caulfield** test which it was said: "Criteria for perliminary injunctions [1] The current criteria in this circuit for determining whether to grant the extraordinary remedy of a perliminary injunction are set forth in **Caulfield v. Board of Education**, 583 F.2d 605, 610 (2d Cir. 1978): "[T]here must be a showing of possible irrepreable injury and either (1) probable success on the merits or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly toward the party requesting the perliminary relief." [Emphasis added]; see also **"Fraud in the transaction: Enjoining letters of credit during the Iranian Revolution"**, Harvard Law Review, Vol. 93, 1980, p. 992 [hereinafter referred to as HLR], at pp. 996-99 (which provided a classification regarding to cases dealing with "fraud in transaction").

The distinction between the narrow and broad interpretation of "transaction" is important when there is fraud committed by a beneficiary related to the contract of sale rather than the credit arrangement, or in a "clean" credit where there is no requirement for presenting documents.

3. Which one of above interpretation is preferable?

It seems the wide concept of "transaction" is a better one if a beneficiary of a credit committed fraud; firstly, as pointed out in the decision of the House of Lords in **The American Accord**, the important factor relating to the issue of fraud is to prove an "intention" to doing such a crime by the beneficiary, either by himself or by his agent when he is aware of it. Secondly, where the underlying contract of sale proved to be void, as a result of the beneficiary's fraud, the situation would be similar to a case of illegality (considered later), namely the issued credit is accepted as void.

As to the position of English law relating to the point in consideration, no case has yet been decided; however, English courts may, for above mentioned reasons, support the wide interpretation of "transaction".

1.2.5.2. Could "political turmoil" be treated like fraud?

In **KMW International v. Chase Manhattan Bank**,[83] the plaintiffs, in order to obtain a preliminary injunction contended that the situation in Iran after the Revolution was so unstable that the contract was frustrated; so a demand for payment of the amount of the credit in such circumstances is similar to fraud and it must be accepted as an exception to the independent nature of the credit. The above argument found support in the court of first instance but the second court reversed the decision and required only three days notice in writing of receipt of a demand for payment before it is made by the defendants. The facts of the above case were that the plaintiffs agreed to sell telephone poles to Khuzestan Water and Power Authority (KWPA) under an irrevocable letter of credit to the amount of $347,539.55. A similar procedure to that in the **American Bell** case, i.e. furnishing a

[83] 606 F. 2d 10; American cases, supra (f.n. 80), pp. 405-410.

first demand SLC by KMW through its bank (the defendant) in favour of Iranian bank (Banque Etebarate) and the latter bank issuing a performance guarantee in favour of KWPA, was used in the instant case. It was said that "the basis of KMW's complaint was a claim that any demand under the letter of credit issued by Chase or under any performance guarantee issued by Banque Etebarate "of necessity would be false and fraudulent", that the contract had been wholly frustrated because of non-performance of that contract by the Water and Power Authority, and that persons unknown during the civil turmoil in Iran made a fraudulent drawing under the performance guarantee or under the letter of credit."[84] In contrast to above argument, Oakes, Circuit J. said: "The "unsettled situation in Iran" is simply insufficient to release any party from obligations under the letter of credit which are separate from the underlying contract."[85]

1.2.6. Limitations to the fraud exception

Several conditions must be established before banks are entitled to apply the fraud exception:

(1) Fraud must be established- A mere allegation of fraud by the banks or their clients is not sufficient to prevent a seller/beneficiary from entitlement to the security which is stipulated by the credit. In **Discount Records Ltd. v. Barclays Bank Ltd.**,[86] Megarry, J. held in favour of the defendants on the ground that a fraud committed by a beneficiary must be established and mere allegation of fraud was insufficient to prevent payment under the credit by the issuing bank.[87] **(2)** There

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[84] American cases, supra (f.n. 80), p. 406, col. 2.

[85] American cases, supra (f.n. 80), p. 409, col. 2; Driscoll, supra (f.n. 75), pp. 487-8; HLR, supra (f.n. 82), pp. 997-8.

[86] [1975] 1 Ll.L.R. 444; a similar approach was adopted by the Court of Appeal in **Bolivinter Oil SA v. Chase Manhattan Bank N.A.** [1984] 1 All ER 352 in following terms: "But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge."

[87] Ibid., at p. 447, the learned judge distinguished the instant case from the **Sztejn** on two grounds: "[I]n the **Sztejn** case [...] the complaint alleged fraud, and so the Court was dealing with a case of established fraud. In the present case there is of course, no established fraud, but merely an allegation of fraud [...]. I should also add that on the facts required to be assumed in the **Sztejn** case the collecting bank there was not a holder in due course, who would not be defeated by the fraud, but was merely an agent for the fraudulent seller.";

may be a strong suspicion by the buyer as to the forged or fraudulent documents but that is not a sufficient reason for the issuing bank to reject the documents tendered. So, the banker himself must agree with the allegation of fraud. Moreover, it is not an easy task to prove fraud because, as has been said, there is no fraud unless, "a false representation has been made (i) knowingly or (ii) without belief in its truth or (iii) recklessly, careless whether it be true or false."[88] **(3)** Banks are under a duty to prove that forgery or fraud is committed by the seller/ beneficiary himself (**Sztejn**) or that he knows of such an offence (**The American Accord**).

1.3. Fraud under UCP 500

There is no provision relating to the issue of fraud in the UCP 500. However, Article 15 provides that banks assume no duty as to the genuiness or falsity of documents presented under the credit agreement. It is noticeable, for reasons mentioned previously (namely, the ICC as a non-governmental organisation has no mandatory power and expertise over issues which are legal in nature), the ICC left the issue of fraud for to be decided by national law; as a result, UCP 500 contains no article relating to fraud and other possible exceptions to the doctrine of autonomy (consider below) in order to protect the interests of a bank or its client. This is in opposite to Section 5-114(2) of the UCC in which fraud and some of its relevant issues are considered (as noticed above). This confirms another difference between

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Schmitthoff, C.M., "Aleged fraud by seller and payment under confirmed documentary credit", J.B.L. 1976, pp. 267-9; **Boliventer Oil SA** [1984]1 Ll.L.R. 251, p. 256; Schmitthoff, supra (f.n. 26), p. 375 & f.n. 66, referred to the above case and also stated that "the English Courts have not adopted the practice of the American Courts to grant temporary restraining on the basis of strong suspicion of fraud; see also **United Trading v. Allied Arab**, The Times, July 23, 1984.

[88] **Derry v. Peek** [1884] A.C. 337, p. 374; Schmitthoff, supra (f.n. 26), pp. 375-7; in **Dulien Steel Products, Inc., of Washington v. Bankers Trust Co.** 298 F. 2d, 836 (1962), affirming 189 F. Fupp. 922 (1960), the point in discussion was arosen by the plaintiffs that on the principle of **Sztejn** case the defendants should have refused payment; but the Circuit Court of Appeals rejected that argument and distinguished the present case from the Sztejn case: "But here Bankers [defendants] never had notice of the type of fraud Sztejn seems to require. Dulien's [plaintiffs'] own behaviour was indicative more of one merely suspicious of than one certain of fraud." [see p. 841]; Ellinger, supra (f.n. 4), pp. 193-94 & p. 195; DeRooy, F.P., "**Documentary Credits**", Kluwer Law and Taxation publishers, 1984 [hereinafter referred to as DeRooy], pp. 118-19 (about Duch authorities); Ellinger's paper in Singapore conference 1990, supra (f.n. 36), pp. 211-12 (concern to decision in **Harbottle** case).

the UCP and the UCC; moreover, the importance of fraud and its related issues leave no doubt that any international set of standards concerning LCs would not be completed unless it covers fraud. Therefore, a need for more harmonisation and unification of law of LCs exists, more than ever; something needs to be addressed in a legislative form (convention) at an international level.[89]

The next points are related to those issues which would be cause of limitation of the doctrine of autonomy.

2. ILLEGALITY

Is it possible for banks or their customers under the documentary credit operation to challenge the autonomous nature of the credit if the underlying contract is illegal? [90] As a general principle there is always support for the view that if an established contract is against the law, public policy makes the agreement legally void and invalid. In respect of credit transactions only one reported case refers to the word "illegal";[91] until recently it was not considered directly. Nevertheless, in **The American Accord**,[92] one of the legal issues which arose dealt with the Bretton Woods Agreement Act 1945. Mocatta, J. at first instance held that the credit contract was vitiated because the underlying contract between the buyer and the seller was inconsistent with the Bretton Woods Agreement and therefore the seller/beneficiary

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[89] For advantages of international conventions over international customs see relevant discussion in Section A.3, Chapter XI (below).

[90] Sarna, supra (f.n. 36), at p. 132 said: "If the letter of credit is said to be independent of the underlying contract, and a contract in its own right between the issuing bank and the beneficiary, one may ask whether the illegality of the underlying contract is relevent to the enforceability of the credit transaction. To permit or force the issuing bank to pay the credit at the instance of the beneficiary would be to condone the illegal activities of the beneficiary in the contract which fathered the credit. On the other hand, the beneficiary who, in good faith, transacts with the applicant by way of contract which is held to be illegal for want of formality, or of substance in the jurisdiction of the applicant or of the negotiation bank, should not be unfairly penalized after having performed his part of the bargain."

[91] In Old Colony Trust Co. v. Lawyers' Title & Trust Co. 297 F. 152 (1924) the court said: "Obvoiusly, when the issuer of a letter of credit knows that a document, although correct in form, is, in point of fact, false or illegal, he can not be called upon to recognize such a document as complying with terms of a letter of credit."; Ellinger, supra (f.n. 4), p. 190.

[92] See discussion related to the American Accord decision in Section B.1.2.2. of the present chapter (above); Ellinger's paper in Singapore conference 1990, supra (f.n. 36), p. 202; Sarna, supra (f.n. 36), pp. 131-33.

lost his right against the banker under the credit arrangement. That decision was reversed both by the Court of Appeal and the House of Lords on the ground that a sale contract is not subject to the Bretton Woods Agreement. The seller/beneficiary was entitled to receive the purchase price under the credit. However, that decision supports the general principle that if the underlying contract is illegal the credit transaction itself becomes unenforceable.[93]

It has been suggested in a commentatory on that case that "the House of Lords did not declare that the banker is under an obligation not to pay in any circumstances under an illegal credit. In other words, there is, at present, no absolute judicial authority declaring that a banker who does pay under an otherwise unenforceable credit is liable in damages to the applicant."[94] The above suggestion

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[93] See **The American Accord**, [1982]2 WLR 1039, at p. 1050, in which Lord Diplock, who gave judgment in the House of Lords about the Bretton Woods point, stated: "The Bretton Woods Agreements Order in Council 1946, made under the Bretton Woods Agreement Act 1945, gives the force of law in England to article VIII section 2 (b) of the Bretton Wood Agreement, which is in the following terms: "Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulation of that member maintained or imposed consistently with this agreement shall be unenforceable in the territories of any member [...]."; then Lord Diplok on the meaning of "exchange contracts" and "unenforceable" gave his view as following: "I accept as correct the narrow interpretation that was place upon the expression **"exchange contracts"** in this provision of the Bretton Woods Agreement by the Court of Appeal in **Wilson, Smithett & Cope Ltd. v. Terruzzi** [1976] Q.B. 683. It is confined to contracts to exchange the currency of one country for the currency of another; it does not include contracts entered into in connection with sale of goods which require the conversion by the buyer of one currency into another in order to enable him to pay the purchase price. As was said by Lord Denning M.R. in his judgment in the **Terruzzi** case at p.714, the court in considering the application of the provision should look at the substance of the contracts and not at the form. It should not enforce a contract that is a mere "monetary transaction in disguise." I also accept as accurate what was said by Lord Denning M.R. in a subsequent case, as to the effect that should be given by English courts to the word **"enforceable"**. The case, **Batra v. Ebrahim** is unreported, but the relevent passage from Lord Denning's judgment is helpfully cited by Ackner L.J. in his own judgment in the instant case: [1982] Q.B. 208, 241f- 242b. If in the course of hearing of an action the court becomes aware that the contract on which a party is suing is one that this country has accepted an international obligation to treat as unenforceable, the court must take the point itself, even though the defendant has not pleaded it, and must refuse to lend its aid to enforce the contract. But this does not have the effect of making an exchange contract that is contrary to the exchange control regulation of a member state other than the United Kingdom into a contract that is "illegal" under English law or render acts undertaken in this country in performance of such a contract unlawful. Like a contract of guarantee of which there is no note or memorandum in writing it is unenforceable by the courts and nothing more." [Emphasis are added]; lastly, at p. 1051 of the same reference above, Lord Diplock accepted the view of the Court of Appeal about the letter of credit holding: "I agree with the Court of Appeal that there is nothing in the Bretton Woods Agreements Order in Council 1946 that prevents the payment under the documentary credit being enforceable to this extent. [...] In my opinion the sellers are entitled to judgment for the part of the second instalment which was not a monetary transaction in disguise [...]."

[94] Sarna, supra (f.n. 36), p. 133.

was put forward to support the bank's position in the situation where they acted in good faith.

Following the judgment of Diplock, L.J. in **The American Accord**, on the basis of current authority, if the underlying contract is against public policy the courts are obliged to give no support even though such action is not required by any interested party. As was decided in that case, the banker was not under a duty to pay against that part of the contract which is based on an illegal act, and by implication, if such banker does so knowingly he is acting at his own risk.

3. CONSENT OF THE PARTIES AS TO A CONNECTION BETWEEN LCs AND THE UNDERLYING CONTRACT OF SALE (CONTRACTUAL AGREEMENT FOR UNENFORCEABILITY OF THE DOCTRINE OF AUTONOMY)

In the documentary credit operation banks are dealing with documents and not with other facts, such as the performance of the underlying contract by the beneficiary.[95] However, it may be agreed between the banks and its customer that among other conditions the former is under a duty to check whether the seller actually performs the underlying sale contract or not. If the tendered documents comply with the credit's conditions but there is no evidence to show that the seller performed his undertaking under the sale contract is the bank obliged to pay under the principle of autonomy or not? On that point in **Davis O'Brien Lumber Co. v. Bank of Montreal**[96] it was decided in favour of the defendants on the basis that the letter of credit expressly stipulated that the tendered documents must evidence shipment according to the terms of the sale contract and there was no evidence to prove that the seller shipped the goods. The Court of Appeal took an even stronger view by saying that the issuing bank is under duty to ask for a certificate of shipment

[95] See Article 4 of the UCP 500 and discussions concerning the principle of stric compliance in Chapter II, Section B.1 and Chapter V (above).

[96] (1951), 28. M.P.R. 22 (N.B.C.A.), p. 550.

from the seller.[97] So the beneficiary of a credit must pay careful regard to the terms of credit and provide all necessary documents to cover all aspects of the credit, both those required expressly and also those which are needed because of any particular terms in the credit itself.

CONCLUSIONS

Generally speaking, in LCs all parties dealing with documents not goods (the principle of strict compliance) and a credit contract is separate from all other contracts and from any dispute that may arise under them (the doctrine of autonomy). These points are generally confirmed in UCP 500.[98] As to the independent nature of a credit, points are raised from time to time; for instance, is there any link between LCs and their underlying contract(s)? Is/are there any exception(s) to the doctrine of autonomy? The first question is clarified in the present study in the meaning that English law, for previously mentioned reasons,[99] would not support the view that any change in terms of LCs automatically affects the terms of an underlying sale contract.

In respect of the bank's right to sue a carrier under a carriage contract it becomes, however, clear that the bank can enjoy such a right under English law; it is the result of changing the law, namely, replacing Section 1 of the Bills of Lading Act 1855 with COGSA 1992. Therefore, under present English or Scots law, the issuing bank either as a **"lawful holder of a bill of lading"** or in appropriate circumstance by application of the doctrine of **"implied contract"** would be able to bring an action against the carrier for damage or loss of goods; similarly, the bank by suing the carrier becomes subject to the same liabilities under the contract of

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[97] Ibid., p. 558; N.M.C. Enterprises Inc. v. Columbia Broadcasting System Inc., 14, UCC R. 1427 (1974 N.Y.S.C.); Sarna, supra (f.n. 36), pp. 129-31.

[98] See Articles 3 and 4 of the UCP 500.

[99] See concluding remarks to Section A.1 of the present Chapter above (letters of credit and the sale contract).

carriage as it is a party to that contract.[100] Consequently, as a result of such a gradual transformation of the law (namely, changing the law from the Section 1 of the Bills of Lading Act 1855 to the decision of the Court of Appeal in **Brandt v. Liverpool** (doctrine of implied contract) and from that decision to the COGSA 1992) in favour of the bank's right of suit under a bill of lading (due to the impact of the reality of business activities in international trade) in English law (similarly applied in Scotland), there seems a link exists between a credit arrangement and a contract of carriage. Moreover, because of the importance of such a matter it may be necessary to give the point under consideration more attention by experts involved in preparing a set of international standards concerning LCs. A similar approved should be taken concerning the Mareva injunction (MI) and thereto relevant issues in order to remove any ambiguity since, at present, a distinction exists between the relevant contexts of the UCP 500 and Section 5-114(2) of the UCC.[101]

In respect of the above second question (is/are there any exception(s) to the doctrine of autonomy?) several possibilities (fraud, illegality, and contractual agreement for unenforceability of the doctrine of autonomy) in which the application of the doctrine of autonomy would be limited. Fraud (which is carried out by the seller/ beneficiary) has been accepted by courts in different jurisdictions as an exception while other possibilities pointed out above have received less attention. Nevertheless, none of these possibilities are covered by the UCP whereas in Section 5-114(2)(a) of the UCC rules are provided concerning fraud. Therefore, a distinction exists between the UCP and the UCC.

In the application of the fraud exception it has been concluded previously that adopting a broad interpretation of it may damage the effect and usefulness of the credit system. Therefore, the House of Lords' approach in **The American Accord** case, although it may on the one hand put banks in a difficult situation, would on the other hand prevent the application of a double standard in applying the doctrine of

[100] See sub-section 1 of Section 3 of COGSA 1993.

[101] See relevant discussion in Section A.3 of the present Chapter (above).

autonomy (namely, relations between the bank and its customer and the bank and the beneficiary are treated similarly).[102] Moreover, to apply such a relief banks must adopt careful procedures to prevent mistakes and further liability. To prove fraud under the conditions set by Common law (English or American law) is not an easy task.

A more practical solution is for the buyer in the credit contract to bring such an action against the seller outside the credit arrangement by seeking an injunction to prevent the seller from receiving the amount of the credit, or preventing the bank from honouring drafts drawn by the seller/beneficiary. In that respect questions may arise as to the entitlement of the buyer to bring an action against both the beneficiary and the banker in charge of payment; and also as to the latest deadline for such a request. On the first point, in theory, there is no reason why the buyer could not make such a request; but in practice, because of time and cost, the buyer chooses one of the above mentioned procedures, mostly trying to stop payment by his bank.[103] On the second point the New York Supreme Court held that no injunction could be issued "[...] where, prior to service of a temporary, restraining order, the issuing bank had determined that the beneficiary had complied with the terms of the letter of credit and had issued its check in compliance therewith."[104] However, it is accepted by American courts that the banks customer may lose his right to an injunction if he acts in a manner that may be implied as waiver.[105]

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[102] See Mautner, supra (f.n. 36), p. 629 where the writer accepted the decision of the House of Lords in **The American Accord**.

[103] Kozolchyk, supra (f.n. 79), p. 127, par. 224.

[104] Ibid., p. 128, par. 225; **Tranarg C.A. v. Banca Commercial Italiana**, 90 Misc. 2d, 829, 396 N.Y.S. 2d, 761 (1977); in connection to the meaning of "service of the temporary restraining order" it is said that, "the service of the temprory order was made on the defendant bank after its remittance of beneficiary's cheque to the correspondent bank in California, but prior to the clearance of the cheque between the correspondent and the issuing bank. In other words, the issuing bank had neither paid the cheque to the beneficiary nor cleared it for payment with the correspondent bank."

[105] Ibid., p. 129, para. 225.a; **J & K Plumbing & Heating v. International Tel & Tel**, 51 A.D. 2d 638, 378, N.Y.S. 2d, 822 (1976); for more details concerning the doctrine of waiver in American law see the relevant discussion in Section B.1.4, Chapter VI (above).

As pointed out above, there is a difference between English and American law in connection with the meaning of **"holder in due course"** and American courts seem more prepared to interpret these terms in a wider sense and consequently reject a request for granting an injunction to prevent payment under LCs.

As to a **"first demand"** standby letter of credit it is submitted in the present research study that such a credit contains a potential risk in itself; so, issues related to it should be necessarily noted under the UCP. Regarding the meaning of **"fraud in the transaction"** the wide interpretation of these terms rests on a better justification and has been supported by both American and English courts. In contrast, fraud committed by a third party cannot harm the right of the beneficiary under the credit contract if the latter has no knowledge of it.

In respect of the time of the beneficiary's knowledge of fraud committed by a third party, there seems no difference between a time before or after presenting documents. So, if banks can prove that the beneficiary is aware of a third party's fraud after tendering required documents they are entitled to refuse payment. This is a situation which is not covered by **The American Accord.**

As a result of what has been said above, firstly it becomes obvious that the banks' position in case of fraud, illegality, and the consent of contracting parties as to the connection between a letter of credit and its underlying contract of sale and their relevant points are issues not properly dealt with in the UCP 500. Secondly, there is a difference between the UCP and the UCC as far as the issue of fraud is concerned since the latter provides rules concerning fraud. Lastly, differences also exist between English and American law (e.g., concerning "holder in due course"). Since these issues have a great impact upon the interests of parties to an international letter of credit, particularly banks, there is a real need for their clarification at an international level.

To provide a proper and uniform solution for dealing with the above mentioned issues an international legislative instrument would be required because of the their legal rather than customary nature (namely, fraud and illegality) and their connection with the sovereignty of states. This may be the main reason that ICC has

not provided any provisions related to issues of fraud and other possible exceptions to the application of "doctrine of autonomy" under the UCP. The need for an international convention concerning the law of LCs, its advantaged over the present system governing LCs (international customary/contractual and national law) are treated elsewhere.[106]

Another matter of importance relating to LCs from the bank's point of view is the issue of security for the amount of money paid by banks under LCs (the subject of the next Chapter).

[106] See Part 4 particularly Chapters X and XI (below).

CHAPTER VIII

THE BANK'S RIGHT OF SECURITY UNDER LETTERS OF CREDIT; LEGAL ISSUES

Banks need security for payments advanced under the documentary credit operation since, in most cases, the bank's customer has to reimburse the amount of the credit after the bank makes payment to the beneficiary. The importance of security measures is obvious particularly when an applicant for a credit becomes insolvent. Another reason for the present study is that rules related to the bank's security under LCs have not yet been considered at the international level, and UCP 500 as the only international customary instrument related to LCs provides no coherent provisions regarding the issue under consideration. To provide a sufficient security, however, different methods have been used by banks in the United Kingdom. This part of the study reviews those methods which are specially provided to safeguard the issuing bank's right of security against its client in English law. Moreover, other related issues, namely the possibility of the bank's right of recourse (as a security measure) against the beneficiary and the position of a person other than a bank in connection with the bank's right of security, namely, whether that person stands in a position similar to the bank as far as the right of security is concerned, are also discussed below.

In respect of Scots law and its difference(s) from English law concerning the bank's right of security the relevant points in Scots law relating to issues discussed under the present chapter are noted below.

SECTION A: POSITION IN ENGLISH LAW

A bank's right of security is part of a wider issue in common law, namely, "a right in security" which is defined as "any right which a creditor may hold for ensuring the payment or satisfaction of his debt, distinct from, and in addition to, his right of action and execution against the debtor under the latter's personal obligation".[1] Two immediate conclusions can be drawn from the above definition:

[1] Gloag and Irvine, "Law of rights in security, heritable and moveable, including cautionary obligations", William Green & Sons, 1897, p. 1; Marshall, Enid A., "Scots Mercantile Law", W. Green & Son Ltd. Law publishers, Edinburgh, 1983, p. 406, para. 8-01 [hereinafter referred to as Marshall 1983].

(1) There must be a principal obligation to which the right in security is accessory or subsidiary. **(2)** As long as the debtor remains solvent (i.e. able to pay his debts), the creditor will have no need to resort to any right in security. Rules governing the issue under consideration are largely based on common law both in English and Scots law while the latter has been influenced by the former.[2]

There are two types of rights in security, namely, a right over the property and a right against a person. The second type of rights which are known in Scots law as "cautionary obligations" are not the subject of consideration since they are not expected to be as real rights in security.[3] In respect of the first type of rights in security, the general principle accepted at common law (both in English and Scots law) is that there must be some form of delivery (actual, symbolic, or constructive)[4] of the property to the creditor and a mere promise by the debtor to such an effect is not sufficient to create a valid right in security.[5] Various attempts, however, have

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[2] For example the term "lien" has been imported from English law; see discussion concerning lien in Section A.1.1.3.2 of the present chapter, below.

[3] Marshall 1983, supra (f.n. 1), at p. 407, para. 8-06 said: "These give the creditor a **jus in personam** (literally, "right against a person") or **jus ad rem** (literally, "right with reference to a thing"), i.e. a personal right, against some person other than the debtor." [Emphasis added]

[4] **Actual delivery** means the pledger/debtor physically transfers the moveables to the pledgee/creditor; and the main instance of **symbolical delivery** is the bill of lading, which is regarded as a symbol of the goods shipped: transfer of the bill of lading has the same legal effect as actual delivery of the goods themselves (as to the symbolic function of a paper document see relevant discussion in Section B.1.3, Chapter IX, and Marshall 1983, supra (f.n. 1), at p. 422, para. 8-84 stated: "A wider form of symbolical delivery is provided for by the **Factors Act 1889, extended to Scotland by the Factors (Scotland) Act 1890**: a **"mercantile agent"**, who is in possession of "document of title" to goods with the consent of the owner of the goods, may make as valid a pledge of the **documents of title** as if he were expressly authorised the owner of the goods, provided: (1) he is acting in the ordinary course of business of a mercantile agent when making the pledge; (2) the pledgee is acting in good faith and has given valuable consideration; and (3) the pledge is not for a debt already due by the mercantile agent to the pledge." [Emphasis added]); as to **constructive delivery** it refers to a situation where goods are in a store, and the pledger/debtor delivers them to the pledgee/creditor by addressing a delivery order to the storekeeper or by indorsing the storekeeper's warrant.

[5] The general principle is expressed in the maxim **"traditionibus, non nudis pactis, dominia rerum transferuntur"** ("by deliver, not by mere agreement, are real rights in property transferred."; and a well-known illustration of the general principle is **Clark & C. v. West Calder Oil Co. Ltd. & C.** (1882) 9 R. 1017, at p. 1033, Lord Shand said: "There is no principle more deeply rooted in the law than this, that in order to create a good security over subjects delivery must be given. If possession be retained no effectual security can be granted."; Davis, A.G., **"The law relating to commercial letters of credit"**, London, 3rd ed., 1963 [hereinafter referred to as Davis], p. 185; Marshall 1983, supra (f.n. 1), p. 409, para. 8-16.

been made to avoid the application of this principle[6] and exceptions are accepted concerning the above general principle, namely, hypothec and statutes relating to floating charges.[7]

1. THE BANK'S RIGHT TO SECURITY AGAINST THE APPLICANT FOR A CREDIT

The type of security generally depends on the strength of the relationship between the contracting parties. In brief, there are three types of security which may be used by banks against an applicant for a credit; they are as follows.

1.1. Security measures

1.1.1. The deposit of sufficient funds by the buyer/applicant

There may be situations where the buyer's credit worthiness is not clear for the bank which then requires that the applicant for the credit deposit sufficient funds (normally the amount of the credit, plus a percentage for commission, stamp duty etc.) in a special account as security for the advance payment of the credit before the credit is issued. From the bank's point of view this type of security is the best. By contrast, the applicant/buyer loses any opportunity to benefit from the documentary credit operation because one of the benefits of using such an arrangement is that the buyer is not obliged to use his funds before receiving the goods or documents of title related to them.

1.1.2. Banks take shipping documents as a pledge

Another type of security for a bank is an agreement between the bank and its client that prior to payment of the credit all shipping documents tendered by the

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[6] For details see Marshall 1983, supra (f.n. 1), pp. 409-12.

[7] See discussion concerning hypothec in Section A.1.1.3.1 and floating charges in Section A.1.1.3.3.2 of the present chapter below; for the situation in Scotland see Marshall 1983, supra (f.n. 1), at p. 408, para. 8-10 said: "There are some exceptions to the general principle as to delivery: in particular, there are, under the common law, hypothecs (see 8-30 et seq., below) which enable a creditor to exercise rights in security over movable property of which he does not have possession, and various statutes have created exceptions, of which the most important is the floating charge affecting heritable and moveable property of companies, introduced in 1961 and now governed by the Companies (Floating Charges and Receivers) (Scotland) Act 1972." [Emphasis added]

beneficiary are retained as pledge by the bank.[8] This method is based on the status as a document of title of these documents; bills of lading, for example, are accepted by English law as a good security for a holder of the bill of lading[9] Several issues may arise relating to this type of security, as follows.

1.1.2.1. The legal nature of the bank's possession

Do banks (as pledgee) have a special right of property over the goods, or do they deal with ownership of goods? Generally speaking, the banks' intention is only to secure their advanced payment to their applicants. In **Rosenberg v. International Banking Corporation,**[10] Scrutton, L.J., relating to the nature of pledge observed: "Banker's liens or banker's pledges effected in such a way give, according to the views of merchants, the bankers a right of sale. Whether you talk

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[8] "**Pledge** is a contract by which the owner of a corporeal moveable deposits it with a creditor for it to be retained by the creditor until payment or satisfaction of the debt or other obligation due to the creditor. The person who owns the moveable is called the **"pledger"**, and the creditor who obtains the moveable in security is called the **"pledgee"**." [Emphasises are added; Marshall 1983, supra (f.n. 1), p. 420, para. 8-78]; and at same reference pointed out:"The creditor has no right of use during his possession, and the security expires with loss of possession." [pp. 420-21, para. 8-79]

As to a different form of pledge accepted in Scots law in the above reference pointed out that a form of pledge known as pawn used in Scotland which has a meaning wider than the pledge; the relevant part of it quoted below: "As regards corporeal moveables other than ships and aircraft, the usual mode of creating security is **pledge**. The general law of pledge is common law, but the form of pledge known as **"pawn"** has been governed by statute- the Pawnbrokers Acts 1872 and 1960 and the Money lenders Act 1927, all to be replaced by provisions of the Consumenr Credit Act 1974 [...] The word "pawn" in the Act of 1974 has a wide definition: it means "any article subject to a pledge" (1974 Act, S. 189(1)). It must be kept in mind, however, that these provisions of the 1974 Act apply only where the article is pledged under a "regulated agreement" as defined by the 1974 Act (see 5-50 et seq., above)." [Emphasis added; Marshall, supra (f.n. 1) p. 420, para. 8-77]

[9] In **Banner v. Johnson** (1871) L.R. 5, H.L.C. 157, at p. 173 Lord Cairns gave his support to its availability of documents of title as security by saying: "The bankers may be protected for the acceptance which they have promised to give."; Miller, J.B, **"A case book on banker's commercial credits"**, pp. 8-9 [hereinafter referred to as Miller]; Ellinger, E.P., **"Modern Banking Law"**, Oxford, 1987 [hereinafter referred to as Ellinger's banking law], at p. 568 stated: "It has been said that the pledge ranks between a mortgage, which confers on the mortgagee a definite property right, and a lien, which is purely possessory in nature. [...] The main distinction between a pledge and a lien is that a lienee's only right is to detain the subject matter pending satisfaction of the debt. He does not have a right of sale."; Marshall 1983, supra (f.n. 1), at p. 408, para. 8-11 said: "Rights in security which are not exceptional are said to be **"founded on possession"**, because they comply with the general principle mentioned above. It is usual to divide securities founded on possession into two classes- those created by express contract and those implied by law. Into the first class fall the standard security over heritable property, and the **pledge** of moveable property, while securities implied by law are **lien** and retention." [Emphasis added]

[10] (1923) 14 Ll.L.R. 344.

about it as an express pledge, or whether, [...] you talk about it as an implied pledge, in my view such a transaction gives an independent right, or right of property, to the bank to secure the amount which they have advanced, and the bank are not put on inquiry unless there is something obviously wrong with the transaction."[11]

In **Sewell v. Burdick**,[12] in a similar situation it was considered that a contract of "pawn or pledge" is a special property right with the power of selling the pledge passing from the borrower to the lender if the former fails to pay his debt on time.

One should be careful, however, as to the issue under consideration (pledgee's power to sell) under Scots law, since, as pointed out by a writer, a pledgee has no power to sell the goods unless otherwise expressly agreed by parties to a pledge contract. In contrast, if a contract is in the form of ex facie absolute transfer the holder of documents has an implied power to sell the goods.[13] Accordingly a difference appears between English and Scots law concerning the

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[11] Ibid., at p. 347; Gutteridge, H.C. and Megrah, M., "The bankers' commercial credits", London, 7th ed., 1984, p. 211 [hereinafter referred to as Gutteridge].

[12] (1884)10 A.C. 74; Miller, supra (f.n. 1), p. 99; in **Bristol Bank v. Midland Railway Co.** [1891] 2 Q.B. 653, followed similar attitute; for other authorities see Gutteridge, ibid., p. 212, f.n. 4; also look at Chriystie, K.G., **"The nature & importance of the banker's security under commercial letter of credit, and the centeral concept of pledge, lien and hypothec"**, Ph.D. thesis, 1973, Glasgow university [hereinafter referred to as Chriystie]; Ellinger's banking law, supra (f.n. 9), pp. 529-601.

[13] See Marshall 1983, supra (f.n. 1), at p. 427, paras. 8-105 to 8-110, where it is said: "The express contracts by which securities founded on possession are constituted may take one or other of two general forms: (1) The contract may take the form of transfer to the creditor expressly as a security. **Pledge** belongs to this category. The creditor obtains possession of the moveables but the right of ownership remains with the person who is granting the security. (2) The contract may take the form of an **ex facie ("apparently") absolute transfer** to the creditor, so that he appears to become the owner, not merely the possessor, of the moveables. The true nature of the transaction will be explained in a separate document- a "back-letter" or other agreement- in which the creditor will undertake to retransfer the moveables to the debtor when the debt has been repaid. The two forms have different effects in relation to: **(i)** the creditor's power to sell [...] A creditor to whom moveables are transferred expressly in security (e.g. a pledgee) has no implied power to sell them. In order to sell he must either have an express power to do so conferred on him by the transferor or he must obtain a power to sell from the court. If, on the other hand, the creditor has had the moveables transferred to him **ex facie** absolutely, he does have a power of sale, which he may exercise even without giving notice to the debtor. In the "back-letter" or other agreement the creditor may have undertaken not to sell the moveables or to follow a specified procedure in selling them, and if he violates any such undertaking, he will be liable in damages to the debtor for breach of contract, but the title of the purchaser will not be affected." [Emphasis added]

pledgee/creditor's power to sell.[14] But, as a result of the above cited authorities, it becomes clear that the pledge is a transaction independent of any other agreement which may exist between the contracting parties; therefore, banks obtain an especial right of property over the goods. Consequently, the preferable approach concerning the issue under consideration is the one explained in English law.[15]

1.1.2.2. Buyer's right under a sale contract v. banks' right under the pledge

What is the effect of a buyer's right under English law (namely the right of rejecting goods under the sale contract) over the right of a bank under the pledge? Does the buyer, by practising his right, put the bank's interests under LCs in danger? Before giving any answer, it seems necessary to consider the buyer's right under the sale contract in English law. In **Kwei Tek Chao v. British Traders & Shippers Ltd.,**[16] relating to the point in discussion under a CIF sale contract the court held that the buyer has two separate rights: a right to reject documents and a right to reject goods. By accepting presented documents at an earlier stage the buyer does not lose his right to reject the goods if it becomes clear that their condition is not in compliance with the terms of tendered documents in a later stage (namely at the time of delivery of goods).[17]

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[14] For differences between the Scottish and English law as to the subject of pledge see Lingard, J.R., **"Bank security documents"**, 2nd ed., London, Edinburgh, 1988, p. 253, where it is stated that in English law a pledgee does have power to sell on default in payment after giving due notice to the pledgor; **Re David Allester** [1922] 2 Ch 211; see also Chrystie, supra (f.n. 12), pages 3, and 24 (**Hayman v. Maclintock** 1907 SC 942, where Lord President stated: "We are here dealing with Scots law of pledge and talked of this as apparently involving "absolute property with reversionary right."; and at p. 950 it is pointed out that in Scotland there is no distinction between the property right and the special property right; In law of Scotland a pledgee may lose his rights by losing possession and in case of bill of lading one can not lose his right unless he lose the documents.)

[15] For more details concerning the bank's right to sell goods see relevant discussion in Section A.1.2 of the present chapter (below).

[16] [1954] 2 Q.B. 459.

[17] Ibid., head notes (4), it is said: "Under a c.i.f. contract a buyer had a right to reject documents and a right to reject the goods, those rights being separate and distinct in law [...]."; and at p. 487 of the same case concerning the defendants' argument that the buyer by taking the documents had lost his right to reject the goods Devlin, J. in rejecting that claim said: "I think that the true view is that what the buyer obtains, when the title under the documents is given to him, is the property in the goods subject to the condition that revest if upon examination he finds them not in accordance with the contract. That means he gets only conditional property in the goods, the condition being a condition subsequent. All his dealings with documents are

In respect of the above issue there is no authority and it was left open in the above case. However, the issue and its difficulty was noticed by Devlin, J., in that case.[18] Professor Gutteridge suggested that "under an irrevocable credit the pledge drives from the seller."[19] Its meaning was explained as follows: "Seeing that under an irrevocable credit, the pledge actually derives from the seller, acting either as principal or as the buyer's agent, if the seller by so pledging could destroy the buyer's right to reject, the whole purpose of documentary credits would be lost, at any rate so far as the buyer is concerned, because it could rarely afford to dispense with his right to reject."[20]

In my opinion the buyer's promise to the bank under the credit agreement (namely to pledge documents of title as security for advanced payment by the bank)

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dealings only with that conditional property in the goods. It follows, therefore, that there can be no dealing which is inconsistent with the seller's ownership unless he deals with something more than the conditional property. If the property passes altogether, not being subject to any condition, there is no ownership left in the seller with which any inconsistent act under Section 35 [of the Sale of Goods Act, 1893] could be committed. If the property passes conditionally the only ownership left in the seller is the reversionary interest in the property in the event of the condition subsequent operating to restore it to him."; Davis, supra (f.n. 5), pp. 187-88.

[18] Ibid., at p. 488, said: "It might further be suggested that in any event, in the circumstances of this case, the buyer having pledged the goods to a banker was not in a position to reject, because it was his banker who exercised dominion over them by reason of the pledge. That, again, raises a question of some theoritical difficulty: can a buyer in effect defeat a pledge by exercising his right of rejection? One view might be that although the property is conditional by his own voluntary act in puting the condition subsequent into operation defeat the pledge. The other view would be that it can not have been contemplated as between the banker and seller that when the buyer pledged the documents he was intending to abondon or impair his right of rejection. It would certainly be very far from the circumstances of the present case in the course of the argument has taken that I should express any view on that. It is merely a matter to which attention might be paid by those who are concerened with it."

[19] Gutteridge, supra (f.n. 11), p. 212 and f.n. 7, where it is said: "The whole system of commercial credits depends on the seller's ability to give a charge on the goods and the policies of insurance", per Lord Wright in **Ross T. Smyth & Co. Ltd. v. T.D. bailey & Co.** [1940] 3 All E.R. 60, 68." [Emphasis added.]

[20] Miller, supra (f.n. 9), p. 103 (quoted from Gutteridge, ibid., 3rd ed., p. 139). [Nothing was stated by Professor Gutteridge in text of the 7th ed., 1984]; another writer suggested that: "The banker, by the very act of paying against documents, obtains an implied pledge or lien over them. That lien or pledge inevitabily arises long before the question of rejection can arise, and at the instance of the seller. The right of rejection is exercisable against the seller, but it is the seller who gives the pledge he could not obtain the value of his goods otherwise. If, therefore, he does an act which lays him open to rejection he can not assert his newly acquired title (as the result of rejection) as against the banker who has financed the transaction unless he is prepared to repay the banker the moneys he has received from him." [Davis, supra (f.n. 5), pp. 188-89]; Journal of the Institute of Bankers, 1954, Vol. 75, p. 183.

is given priority to the application of his right of rejection of the goods under the sale contract. So, he should not be entitled to break his promise to the bank; and if the applicant/buyer would like to apply his right of rejection he must compensate the bank. This argument can also be supported by the autonomous nature of the credit arrangement, namely, under the "doctrine of autonomy". As discussed elsewhere,[21] the credit contract is a separate transaction from the sale contract. Consequently, from the above different statements, it becomes clear that the issue in consideration has not yet been solved in English law; so banks should make the point clear in their contract with their clients.

1.1.3. "Letter of hypothecation" and "letter of trust or of lien"

Another security measure which a banker may use in his relationship with the applicant is the "letter of hypothecation" (LH) or "letter of trust or of lien" (LT).[22] Under each of them, while the banker keeps his control over the property of the goods, he gives permission to the buyer to act as his trustee and sell the goods.[23] There are authorities which support such a practice, and the nature of letter of hypothecation or letter of trust has been judicially considered.

1.1.3.1. Nature of the "letter of hypothecation"

As pointed out previously, hypothec is an exception to the general principle accepted at common law, namely, for having a right in security there must be some sort of delivery of goods.[24] In **Palmer v. Carey**[25] the Privy Council in an appeal

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[21] See Chapter II, Section B.2 and Chapter VII (above).

[22] "Hypothecation" is an odd term in English law and it is drive from the meaning of property in Martime law and that seems originated from Roman Law; for more details see Gutteridge, supra (f.n. 11) p. 214 and f.n. 10 & 11; Miller, supra (f.n. 9) pp. 103-04; Ellinger's banking law, supra (f.n. 9), pp. 552-55, and at p. 555, it is said: "An important exception is made in respect of letter of hypothecation made over imported goods prior to their being warehoused, stored, reshipped for export, or delivered to a person other than the debtor who executes the document."

[23] Miller, supra (f.n. 9), at p.104 stated: "This intention is usually expressed in such terms as: "I (we) hand to you herewith bills of lading for [...] on the express undertaking that you are to hold the said bills of lading, the property represented thereby, and the net proceeds thereof respectively in trust for this Bank."

[24] See relevant point mentioned at the begining of Section A of the present chapter; Marshall 1983, supra (f.n. 1), at p. 412, para. 8-30 concerning the hypothec pointed out: "A hypothec is "a real right in security, in favour of a creditor, over subjects which are allowed to remain in the possession of the debtor" (Gloag and

from a decision of the High Court of Australia reversed the High Court decision and held that there was no **"equitable assignment"**[26] between the contracting parties and therefore the respondent had no right against the assets remaining in the plaintiff's hands. The facts of the case are that the respondent, under an agreement, advanced money to a trader to buy and sell goods. It was agreed also that the respondent, after receiving the money through a letter of credit should deduct the payment advanced and one-third of the gross profits, and what remained was for the trader. Some time later the trader became bankrupt owing a large amount of the money paid under the contract which had not been repaid. The trader also had goods which had been purchased under the agreement. After the trader's bankruptcy, the respondent claimed that he had a charge over those assets. Street, J., in the lower court held that, "the agreement did not amount to an equitable assignment, and that consequently the respondent was not entitled to a charge."[27] On appeal to the High Court of Australia that decision was reversed, the High Court "being of the opinion that there was an equitable assignment by the agreement."[28] In brief, it was held that "as the agreement did not, either contractually or otherwise, create any right of the lender in either the goods or their proceeds, it did not amount

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Irvine, op. cit., p. 406). It is an exception to the general rule that for the creation of a real right in security (as opposed to a personal right against the debtor), the creditor must have possession of the property." [Gloag and Irvine, **"Law of rights in security, heritable and moveable, including cautionary obligations"**, William Green & Sons, 1897.]; and for different types of hypothec in Scots law ("conventional (created by contract" and "legal" or "tacit" (implied by law)) see Marshall 1983, supra (f.n. 1), pp. 412-419, paras. 8-33 to 8-72.

[25] [1926] A.C. 703.

[26] As to the meaning of an equitable assignment see the relevant point in Section B.3.8, Chapter IV above.

[27] Ibid., p. 707.

[28] Ibid., p. 707; at pp. 704-704 of the same case Lord Wrenbury, who delivered the judgment of the Privy Council, said: "The question on the appeal is whether on agreement dated April 30, 1917, made between Johanstone of the one part and the respondent of the other part is an **Equitable assignment**. If it is not, no other question arises. If it is then in as much as the agreement was not registered under the Bills of sale Act, a further question arises under that Act." [Emphasis added]

to an equitable assignment so as to entitle the respondent to the charge claimed."[29]

In **Re Kent & Sussex Sawmills, Ltd.**,[30] a company (Re Kent) agreed with the Ministry of Fuel and Power to supply logs (30,000 tons); thereafter it obtained facilities from its bank and it was agreed that the Ministry was to make all payments to the bank (to the Company's account). It was also agreed that the procedure was not to be revoked without the bank's consent. However, after a year the company passed a resolution for voluntary liquidation, with assets of £30,000 and a debt to the bank of £83,674. A dispute arose between the bank and the liquidator when the latter asked for a declaration that two letters of authority, between the bank and the Ministry, charged the book debts of the company under S. 79 (2)(e) of the Companies Act, 1929 (now Companies Act 1985),[31] and that, not having been registered under that section they were void as against the applicant the liquidator. The contents of the two letters between the bank (the Westminster Bank Ltd.) and the Ministry which were related were in these terms: "With reference to the above mentioned contract, we hereby authorize you to remit all moneys due thereunder

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[29] See p. 707 (par. 2) of the same case, ibid., for the related parts of decision which are as following: "Their lordships have to look at the agreement of April 30, 1917, with these principles in mind. Under art. 1 of that agreement the money when borrowed is the borrower's money, and the lender becomes a creditor. The goods when purchased are the borrower's goods. They have been bought with his money. There is nothing in the agreement to make them the lender's goods. The goods are to be sold. The proceeds of sale when the goods are sold belong to the borrower. They arise from the sale of goods belonging to him. Under art. 3, however, the proceeds are to be paid to the lender's credit at his bank. This gives the lender a most efficient hold to prevent the misapplication of the proceeds, but there is nothing in that article to give him a property by way of security or otherwise in the moneys of the borrower before or after he, the lender, has them in his charge. Article 6 was not relied on as giving an equitable charge, and it is difficult to see how it could be relied upon for that purpose. It is an article determining the distribution between the parties in manner there defined of the fund which is in the hands of one of them."

[30] [1947] Ch. 177.

[31] Companies Act, 1929, S. 79: "(1) Subject to the provisions of this Part of this Act, every charge created after the fixed date by a company registered in England and being a charge to which this section applies shall, so far as any security on the company's property or undertaking is conferred thereby, be void against the liqidator and any creditor of the company, unless the priscribed particulars of the charge, together with the instrument, if any, by which the cahrge is created or evidenced, are delivered to or received by the registrar of companies for registration in manner required by this act within twenty one days after the date of its creation [...] and when a charge becomes void under this section the money secured thereby shall immediately become payable. (2) This Section applies to the following charges [...] (e) a charge on book debts of the company." [Later it became as Sec. 95 of Companies Act, 1979]

direct to this company's account at Westminster Bank, Ltd., Crowbrough, whose receipt shall be your sufficient discharge. These instructions are to be regarded as irrevocable unless the said bank should consent to their cancellation in writing, and are intended to cover any extension of the contract in excess of 30,000 tons if such should occur."[32]

Wynn-Parry, J., in his judgment distinguished that case from **Bell v. London and North-Western Ry. Co.,**[33] because of the second sentence of the letter quoted above; and the judge accepted that the letters in the present case were an **equitable assignment**. Returning to the point as to whether it is an assignment of the whole benefit or if it is an assignment by way of security, the same judge concluded by implication, "an equity of redemption is to be discovered in the language of the second paragraph."[34] Nevertheless, the court found that those letters were inconsistent with S. 79 (2)(e) of the Companies Act 1929 (namely, that they had not been registered), and held in favour of the liquidator.

In **Ladenberg & Co. v. Goodwin & Ferrerira,**[35] a similar question was raised and the same conclusion was reached and it was held that, "the letter of hypothecation gave a charge over book debts, and that the case accordingly fell

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[32] Re Kent case, supra (f.n. 30), at p. 178.

[33] 15 Beav. 548; it was decided that: "The words of this letter are these: "You will oblige by passing the cheques that may become due on my contract No.1, of the Engby and Standford Railway, into the National Provincial Bank of England" [...] I should have thought that an effectual assignment of all that might become due to Thomas Burton under that contract had been made to the bank; but this order directs it to be paid to the account of Thomas Burton, not therefore, as it appears to me, doing more than constituting the bank to the Thomas Burton's agents for the reciept of the money." [Re Kent case, supra (f.n. 30), p. 181]

[34] Re Kent case, supra (f.n. 17), p. 181; Roger Bird, "Osborn's Concise Law Dictionary", London, 1983 [hereinafter referred to as Bird], at p. 135 defined the "equity of redemption" as: "(1) The equitable right of mortgagor to redeem the mortgaged property after the legal right to redeem has been lost by default in repayment of the mortgage money at the due date. (2) The equitable estate or interest of a mortgagor in his mortgaged land in respect of which an equitable right to redeem subsist."

[35] [1912] 3 K.B. 275; 18 Com Cas. 16.

within the provisions of S. 93 of the Companies Act 1908,[36] thus rendering the document void for want of registration."[37]

In conclusion, the letter of hypothecation may, in proper circumstances, be accepted as an equitable assignment in English as well as Scots law and give the banker special right over the assets of the pledgor; but at the same time it must not be inconsistent with other rules of law.

1.1.3.2. Nature of "letter of trust or of lien"

It is said that "A letter of trust arises where a bank-pledgee, having possession of documents of title, actual or constructive possession of the goods, received from or on behalf of the owner, delivers them to the owner or to a third parties."[38] In **Sale Continuation Ltd v. Austin Taylor & Co. Ltd.**,[39] concerning the

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[36] Now it is Section 95 of the Companies Act 1948.

[37] Gutteridge, supra (f.n. 11), p. 219; Davis, supra (f.n. 5), pp. 198-99.

[38] Gutteridge, supra (f.n. 11), p. 215; in respect of lien and its relevant issues in Scots law one should be careful since the law on this topic is complicated by the lack of uniformity in the definition of the term "lien" and "retention". The term "lien" was adopted from English law, and the original Scottish term was "retention", which includes a wide variety of rights in security like retention on property title, retention of debt and the liens of English law; as to meaning a lien it is said: "A lien is "the right of a creditor to retain moveable property, belonging to the debtor but entrusted to the creditor's possession for some purpose, until the creditor's claims against the debtor are satisfied" [Walker, David M., "Principles of Scottish Private Law", Oxford, Clarendon Press, Vol. 3, 3rd ed., 1982-83, p. 408.]; for more details concerning lien and other types of securities (pointed above) in Scots law see Marshall 1983, supra (f.n. 1), pp. 430-39; however, important points stated in that reference are quoted below:

1. As to distinction between liens and the pledge it is said: "A lien may be either created by **express contract** or **implied by law**. Where created by express contract, a lien comes very near to being a **pledge**: **the point of distinction** is that lien will arise out of another contract collateral to it or associate with it, whereas pledge will be a transaction in its own right." [p. 430, para 8-123; emphasis added]; then it is continued: "Normally, however, liens are not created by an express contract, but are implied by law from various contractual relationships established between parties for other purposes [...] A lien merely entitles the holder of it to **retain** the movables; **he has no right to sell them unless authorised by the court**." [p. 431, paras. 8-125 and 8-126; emphasis added]

2. Other main points concerning liens are: "(i) the need for possession; and (ii) the distinction between special and general liens." [p. 431, para. 8-127]; as to need for possession see pp. 431-33; in respect of the second point above it is said: "A **special lien** is one which entitles the holder of the moveables to retain them until satisfaction of an allegation arising out of the contract through which he obtained possession of them. A **general lien**, on the other hand, entitles the holder of the moveables to retain them until a balance due to him on a whole course of dealing is discharged. For instance, a carrier, whose lien is a special lien, is entitled to retain a parcel (but not any outstanding charges for the carriage of parcels previously carried), whereas a solicitor, whose lien is a general lien, is entitled to retain his client's paper until his business account and ordinary outlays for a whole series of transactions are met." [p. 433, para. 8-139; emphasis added]; it is also pointed that special lien are normally allowed and the general lien s are only allowed in limited situations by law as well as usage of trade. In that regard stated: "The most prominent of the general

trust receipt and its nature in ordinary course of business, it was said: "In such a case the seller parts with his ownership in the documents as soon as he sends the documents to the bank. His right is to be paid the draft. The ownership of the goods passes to the buyer but the bank has the possessory title of a pledgee as against the buyer. He has that title until the buyer puts the bank in funds in respect of the draft and discharges his liability for interest payable in respect of the draft. If the pledgor does not do so the bank has the usual right of a pledgee to sell as if he were the owner."[40]

The nature of the bankers' right as pledgee under the trust receipt had been noticed in **North Western Bank v. Poynter**.[41] In this case the plaintiffs (NWB) paid an advance (5000 l.) to Page & Coy (merchants in Liverpool) on security by way of pledge of the bills of lading for 3455 tons phosphate rock in value of £6783. The goods were carried in two vessel ("Cyprus" and "Starra Lee"). A bill of lading related to the cargo carried by the Cyprus was delivered to the NWB and it was agreed that the bank would have power to sell the phosphate rock. Later, the plaintiffs returned the bills of lading to Page & Coy under a letter of trust. But prior to that arrangement the Page & Coy sold 1,600 tons of phosphate to A Cross & Son through their agents (Poynter) in Glasgow. The buyer took delivery and remitted their cheque to Page & Coy. Then the merchants paid that cheque to the account of another advance payment they had taken from the NWB.

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liens recognised by usage of trade are those of factor or mercantile agent, the banker, and the solicitor." [p. 435, para. 8-149]; and concerning the banker's lien the relevant point is that, "A banker has a general lien over negotiable instruments, such as bills of exchange (including cheques) and promissory notes, belonging to his customer, provided they have come into the possession of the banker in his capacity of monetory agent [...]." [p. 435, para 8-155]

[39] [1968] 2 QB 849.

[40] Ibid., p. 861; and at pp. 861-62 as to the general understanding of a pledge and the trust receipt it was stated: "Now the essence of a pledge is that it is security against either an immidiate advance or against a present liability to make a future payment. The trust receipt contemplated that the defendants would part with the documents [...] and recover the purchase price. It was no breach of trust to do so. In my judgment the same principle applies to the money as applies to the obligation to put the plaitiffs in funds before the maturity date of the draft."

[41] [1895] AC 56.

An action was brought against Page & Coy by their agents in respect of an entirely different transaction and the latter arrested the balance of the price of the phosphate remaining in the hands of the buyer. When the plaintiffs heard of the arrestment they brought an action against the agent on the ground that the goods and its value belonged to them. The Sheriff Court and later the Second Division held for the defendants, but on appeal to the House of Lords that decision was reversed and it was held that the bank as the pledgee does not lose its right of possession over the pledge. The House of Lords explained its view in the following terms: "By the law of Scotland, as well as by the law of England, the holder of a pledge with a power of sale does not lose possession of the pledge by delivering it to an agent for the purpose of sale, although the agent may be the owner of the pledge."[42]

As a result of these authorities the commercial validity of the letter of hypothecation and the letter of trust/lien has been well established in English and Scots law. However, there are defences against the application of those securities, as follows.

1.1.3.3. Limitations to "letter of hypothecation" and "letter of trust"

1. Bill of sale

The first argument against the bank's right under the letter of hypothecation and the letter of trust is whether such a right in English law (different than Scots law) is subject to Section 4 of the Bills of Sale Act, 1878, and therefore requires registration.[43] This point was raised in **Re Hamilton Young & Co.**,[44] where the

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[42] Miller, supra (f.n. 9), p. 106; Davis, supra (f.n. 5), p. 106; for a difference between English and Scots law concerning the pledgee's power to sell see the relevant discussion in Section A.1.1.2.1. of the present chapter (above).

[43] Section 4 of the Bills of Sale Act, 1878 which does not apply in Scotland provides: "4. In this Act the following words and expressions shall have the meanings in this section assigned to them respectively, unless there be something in the subject or in the context repugnant to such construction; (this is to say),

The expression "bill of sale" shall include bills of sale, assignment, transfers, declarations of trust without transfer, inventories of goods with receipt thereto attached, or receipts for purchase money of the goods, and other assurances of personal chattels, and also powers of attorney, authorities, or licenses to take possession of personal chattels as security for any debt, and also any agreement, whether intended or not to be followed by the execution of any other instrument, by which a right in equity to any personal chattels, or to any charge or security thereon, shall be conferred, but shall not include the following documents; that is to say, assignments for the benefit of the creditors of the person making or giving the same, marriage settelments, transfers or assignments of any ship or vessel or any share thereof, transfers of goods in the

facts were that bankers made advances to traders to enable them to purchase goods for shipment to the East. The course of the transaction was that the traders goods were to be delivered to bleachers to be bleached, and thereafter they were returned to the traders or sent direct to packers for packing for shipment; and on the occasion of each advance the traders sent the bank a letter of lien accompanied by the bleachers' receipt for the goods. Regarding the dispute between the contracting parties Bigham, J., stated the question of law as: "Whether the letters of lien were "bills of sale" and therefore required registration under S. 4 of the Bills of Sale Act, 1878."[45] If the letter of lien fell within the meaning of section 4, the bank loses its right of security over the goods. The judge held for the bank on the basis that in this case the bank's right under the letter of lien was not the subject of S. 4 of the 1878 Act but fell within the exceptions in that section and therefore did not require registration. On appeal from the Bigham, J.'s decision the Court of Appeal confirmed that decision.[46]

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ordinary course of business of any trade or calling, bills of sale of goods in foregin parts or at sea, bills of lading, India warrants, warehouse-keepers' certificates, warrants or orders for the delivery of goods, or any other documents used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by indorsement or by delivery, the possessor of such document to transfer or receive goods thereby represented:

The expression **"personal chattels"** shall mean goods, furniture, and other articles capable of complete transfer by delivery, and (when separately assigned or chrged) fixtures and growing crops, but shall not include chattel interests in real estate, not fixtures (except trade machinery as hereinafter defined), when assigned together with a freehold or leasehold interest in any land or building to which they are affixed, nor growing crops when assigned together with any interest in the land on which they grow, nor shares or interests in the stock, funds, or securities of any government, or in the capital or property of incorporated or joint stock or produce upon any farm or lands which by virtue of any covenant or agreement or of the custom of the country ought not to be removed from any farm where the same are at the time of making or giving of such bill of sale;

Personal chattels shall be deemed to be in the **"apparent possession"** of the person making or giving a bill of sale, so long as they remain or are in or upon any house, mill, warehouse, buliding, works, yard, land, or other premises occupied by him, or are used and enjoyed by him in any place whatsoever, notwithstanding that formal possession thereof may have been taken by or given to any other person:

"Prescribed" means prescribed by rules made under the provisions of this Act.

[Power to exclude S.4 given by Industrial and Provident Societies Act 1967 (C.48), S.1]." [Emphasis added]

[44] [1905] 2 KB 772.

[45] Ibid., p. 779.

[46] Ibid., at p. 785 Vaughan Williams, L.J., stated: "[...] the letters of lien were not void as being bills of sale not in prescribed form and unregistered under the Bills of Sale Acts, but were [...] "documents used in the

2. Companies Act 1948, S. 95 (S. 395 of Companies Act, 1985 as amended by 1989 Act)

The second defence against the banker's right under the letter of trust is whether his right fell within Section 95 of Companies Act, 1948.[47] In **Ladenburg & Co v. Goodwin & Ferreira,**[48] the defendants (merchants in Manchester trading with South Africa) obtained advances from the plaintiffs (merchant bankers in London) against shipments made by the defendants to their customers against drafts, bills of lading, invoices, and letter of lien in 1904. The defendants, in a letter, announced that it was not their policy to give a letter of lien, but they were ready to hypothec the shipment as security and the plaintiffs agreed to that suggestion. After the defendants' company went into voluntary liquidation in 1911, a dispute arose between the plaintiffs and the liquidator over the assets of the defendants' company.[49] It was held for the liquidator on the basis that although there are charges on the book debts of the defendant company since they were not registered they are void.

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ordinary course of business as proof of the possession or control of goods" within the exceptions in S. 4 of the Bills of Sale Act, 1878."; and in another part of the judgment he said: "[W]hether these documents intended to be proof of possession and control of the goods in question. Now Bigham, J. has arrived at the conclusion, as appears from his judgment, that the documents described in the letters of lien were intended both as proof of possession and also as proof of control. I am not saying that is not so, but I prefer to take the simpler case of whether they are used as proof of the possession of the goods." [Ibid., pp. 787-88]; see **Re David Allester** [1922] 2 Ch 211, in which similar point was raised and Austbury, J., followed decision made in **Re Hamilton**; Davis, supra (f.n. 6), pp. 199-201; see also Gutteridge, supra (f.n. 3) at p. 218, f.n. 26, which it is said that Austbury, J., did not notice decision in **R.V. Townshend** (1884), 15, Cox C.C. 466; Ellinger's banking law, supra (f.n. 9), p. 554.

[47] S. 93 of Companies Act, 1908; for the situation in Scotland see the rules concerning floating charge, which is affecting heritable and moveable property of companies, introduced in 1961 and now governed by the **Companies (Floating Charges and Receivers) (Scotland) Act 1972.**

[48] [1912] 3 K.B. 275.

[49] Ibid., at p. 280, Pickford, J. put the argument as: "The question which arises in this case is whether the result of transactions between the defendant company and the plaintiffs is that there is a charge on book debts of the defendant company within the meaning of S. 93 of the Companies Consolidation) Act, 1908."; the same judge, in course of his judgment pointed out that "It is said that when the money is paid by the customers to the defendants company or to the liquidator it becomes impressed with a trust in favour of plaintiffs. I am unable to see how this suggested trust could arise unless there had previously been a charge on the money. I think there was a charge on the money which was to be paid for the goods until the money was in fact paid it was a book debt of the defendant company." [Ibid, p. 280]

A similar argument was pointed out in **Re David Allester**[50] but Astbury, J., did not follow the decision in **Ladenburg** and distinguished the instant case on the ground that the bank as pledgee created a trust agency under the letter of trust and as a result he had an especial and independent right over the goods.[51] Moreover, in **Bond Worth**[52] there was a similar argument but taken from a different approach. The facts were that a seller (who supplied synthetic fibre) indicated in his contract with the buyer that risk in the fibre passed to the latter on delivery of the goods but the equitable and beneficial ownership of the fibre was to remain with him until full payment for the fibre delivered had been made, or until its prior resale in which case the seller's beneficial entitlement was to attach to the proceeds of sale. The buyer later became insolvent and receivers were appointed by a debenture holder at a time when the buyer owed the sellers £587,397.

The sellers claimed that by virtue of the retention of title clause in the contract they were entitled to trace their fibre into the stocks of yarn and carpets held or to the proceeds of sale of the carpets in which it had been used. On the other hand, the receivers took out a summons seeking the direction of the court as to whether the sellers had any interest or charge over fibre held by the buyers in the form of the raw fibre, or proceeds fibre. The receiver contended that the only rights conferred on the seller by that retention of title clause were those under a **floating charge** which

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[50] [1922] 2 Ch. 211.

[51] Ibid., p. 218, that the relevent part of his judgment is as follows: "Now in that case [the Ladenburg case] the bank had no pledge or other right in the goods at all before the transaction in question; the transaction was one which notwithstanding its form could not and did not give the bank any right except a charge over the companies book debts, and as Pickford, J., pointed out, it was simply and solely a mortgage or charge on the company's book debts, and as such was avoided by the Act. [...] Here, [...] the bank as pledgee created a trust agency in the company for the purpose of the realization of the bank's security. That trust agency was acknowledged and recorded in the letters of trust are neither bills of sale within s. 93, sub-s.1 (c), nor are they in any sense mortgages or charges on book debts within cluse (c) or any other clause of the section."; Gulteridge, supra (f.n. 11), pp. 219-20; Davis, supra (f.n. 5), pp. 194-201.

[52] [1979] 3 All ER 919.

was void as against other creditors, under S. 95(1) of the Companies Act, 1948 for want of registration.[53] The Court supported the receiver's argument.[54]

1.2. Banks' right to sell goods under a security measure

As discussed earlier, banks by virtue of giving an advance payment under the letter of credit obtain an independent and special right of property over the goods which belongs to the applicant/buyer.[55] If the bank's client cannot pay his debt to the bank, does the bank have a right to sell the goods? Generally speaking, it is accepted that if a certain date for repaying the debt is contained in the contract and the applicant is not able to reimburse the bank in due time, a power of sale is implied in favour of the bank. If there is no such fixed date in the contract the bank is not entitled to exercise its right of sale unless a notice to that effect has been given to the buyer/customer.

In **Deverges v. Sandeman**[56] the defendant, a share broker, as mortgagee sold the plaintiff's shares which were mortgaged to him. The question of law was whether that sale was within the power of the defendant. As a matter of fact there was no express power of sale to the defendant's favour, so the point was whether, given the facts of the case, there was an implied power of sale. The court of first instance held for the defendant and that decision was confirmed by the Court of Appeal on the ground that sufficient notice was given by the defendant. Vaughan

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[53] Section 95(2) of Companies Act 1948 provides: "(c) a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale [...] (e) a charge on book debts of the company; (f) a floating charge on the undertaking or property of the company [...]."

[54] The court gave its support to the receivers argument by deciding that: "On the construction of the contract, the equitable charge in favour of the seller was created by the buyers by way of an implied grant back to the sellers after the whole of the property in the fibre had first passed to the buyers, and not by the sells reserving or excepting to themselves on interest out of the property passing to the buyers. Furthermore, having regard to the buyer's implied authority in the course of their business, the charge could only be construed as a floating charge and not as a specific charge over specific assets, and was in fact a floating charge. Since it was a shifting charge against fluctuating assets which the buyers were free to deal with in the ordinary course of their business." [**Bond Worth** case, supra (f.n. 52), head notes and p. 945 & pp. 953-55]

[55] See **Rosenburg v. International Banking Corpn and Far East Gerhard and Hey Co.** (1923) 14 Ll.L.R. 344 (per Scrutton, L.J.) and relevant discussion in Section A.1.1.2.1 of the present chapter above.

[56] [1902] 1 Ch. 579; see also **Rosenburg**, ibid.

Williams, L.J. distinguished the principles of law dealing with both pledge and mortgage and stated: "In case of pledge, whether of chattels or of stock or shares, a power of sale is implied at law if a day fixed by the contract for the payment of debt; [...] In the case of a mortgage in which there is a fixed day for payment and default in payment, a similar power of sale would seen to arise."[57]

Here no date was fixed by the contract, so turning to that fact it was pointed out that "In case of pledge if no time is fixed, it would seem to be fairly well established that, when a loan is for an indefinite time, the lender may terminate the credit by giving notice to the debtor to pay on a certain day and that upon default in payment on that day the pledgee may sell the pledge."[58]

The reasons for requiring notice as a condition of the implied power of sale is said to be that "The answer is plain - to give the mortgagor a reasonable opportunity to redeem."[59] As pointed out above, the other judges (Sterling, L.J. and Cozens-Hardy, L.J.) in the Court of Appeal were in favour of the defendant since they were of the opinion that sufficient notice had in fact been given to the plaintiffs. However, they shared the view of Vaughan Williams, L.J., that giving a notice to that effect is necessary for an implied power of sale. Sterling, L.J. discussing the general principle of law where a fixed date was set by the contract, agreed with the views saying "If stock is itself made the security for money, and the day appointed for

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[57] Ibid., p. 589; **Tucker v. Wilson**, 1 P. WMS 261; 5 Bro. P.C. 193.

[58] Ibid., p. 589; another distinction between English and scots law is about security over stocks and shares of a company. In that regard it is said: "English law recognises both a **legal mortgage** (i.e. where there is a transfer of the shares to the mortgagee (the lender) and the transfer is registred by the company) and an **equitable mortgage** (i.e. where the share certificate is deposited with the lender, usually accompanied by a "blank" transfer (a transfer signed by the borrower but with the transferee's name left blank so that the transfer may, if necessary, be later completed by the lender and then registred with the company). The English equitable mortgage does not give the lender absolute security, because the borrower is still registered as the holder in the company's register of members and so might fraudulently sell the shares to a third party who would then, by registering his transfer with the company, become, as far as the company would be concerned, the undisputed owner of the shares. [...] In Scotland the validity of blank transfers is doubtful because the Blank Bonds and Trusts Act 1696 declares null "bonds, assignations, dispositions or other deeds" subscribed blank in the name of the person or persons to whom they have been granted." [Emphasis added; Marshall 1983, supra (f.n. 1), pp. 425-26 and 427, paras. 8-97 and 8-108.]

[59] Ibid., p. 590.

payment is passed, the mortgagee may at once proceed to sell the stock, and repay himself principal and interest, without commencing an action of foreclosure."[60] Specifically on the matter under discussion, "what are the rights of a mortgagee when no day has been appointed for payment?", he stated that there was no authority directly relating to the point but he referred to some authorities which related to pledge. The first case was **Ex Parte Hubbard**[61] where Brown, L.J. said: "There is at Common law an authority to the pledgee to sell the goods on the default of the pledgor to repay the money, either at the time originally appointed, or after notice by pledgee."[62]

Another case referred to was **Re Morritt**[63] in which Cotton, L.J. stated: "A contract of pledge carries with it implication that the security may be made available to satisfy the obligation, and enables the pledgee in possession (though he has not the general property in the thing pledged, but a special property only) to sell on default in payment and after notice to the pledgor, although the pledgor may redeem at any moment up to sale."[64]

As to the position of the mortgagee, Cotton, L.J. pointed out that "Where there is no express power of sale given by the mortgage, he has, after default in payment, and after he has given the mortgagor a reasonable time to pay the money due, a power to sell and give a good title to the purchaser, though, of course, the mortgagor has, at any time before sale, a right on payment of the money due, including expenses, to prevent the sale and redeem the chattels."[65]

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[60] Ibid., p. 592.

[61] 17 QBD 698.

[62] **Deverge** case, supra (f.n. 56), p. 593.

[63] 18 QBD 232.

[64] **Deverge** case, supra (f.n. 56), p. 593.

[65] Ibid., p. 593; **Re Morrit**, supra (f.n. 63), p. 233; see also per Fry, L.J. view in **Re Morrit**, where he held in contrast with the majority opinion and said: "that a mortgage (as distinguished from a pledgee) of chattels has, in the absence of statute, no implied power to sell them on default by the mortgagor, even if he has taken possession of them."

In conclusion, Sterling, L.J. gave his view in the following words: "According to those authorities it would seem to me that when no time for payment has been originally fixed, then before the power of sale can be exercised, no notice is to be given to the mortgagor, and default must be made by him in payment after such notice."[66] In the context of the notice no definition was given but it was said that such notice must be in all respect reasonable; and also that "a notice demanding payment of an excessive sum has been held to be bad."[67]

Another point is that bankers have the right to claim against the goods to satisfy advances made by them. However, no right is recognised for holders of drafts drawn against the credit (whether the seller himself or a third person to whom drafts have been negotiated) against a banker in circumstances where a letter of lien is issued by the bank. The reason for this principle is that the banker is not in the position of a trustee. This point was decided in **Banner v. Johnston**,[68] and the issue for consideration was whether the banker was a trustee and therefore obliged to accept every bill which was drawn under the credit. In other words is the banker the only person who is entitled to benefit from the security available under the lien? The House of Lords took a negative view. Lord Cairns stated: "The order to send home the shipping documents, and the conditions annexed to the promise to accept that the shipping documents shall be sent to them are for the protection of the bankers, and not, as it seems to me, in any way for the protection of person who negotiate bills of exchange."[69]

1.3. Grounds against a bank's security

There are grounds in which banks may have lost their rights over the goods: **(1)** "estoppel by conduct" and, **(2)** "Factors Act, 1889, Sec. 2(1)."

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[66] Ibid., p. 593.

[67] Ibid., p. 593; Pigot v. Cubley, 15 C.B. (N.S.) 701.

[68] (1871) LR 5 HL 157.

[69] Ibid., p. 173; Davis, supra (f.n. 5), p. 202.

1.3.1. "Estoppel by conduct"

There are authorities who apparently indicate that a banker by his conduct can damage his right under the security. For instance, in **Moorgate Mercantile Co. Ltd. v. Twitchings**[70] the majority view (of Lord Denning, M.R. and Brown, L.J. in favour of estoppel but Geoffrey, L.J. (dissenting), supported the notion that the plaintiff (a finance company) lost his control over the goods under the rule of "estoppel by conduct". Lord Denning, M.R., said relating to the definition of "estoppel by conduct": "There is no doubt that a buyer of goods can acquire a title by estoppel. This is recognised by S. 21(1) of the Sale of Goods Act 1893, which says: "The buyer acquires no better title to the goods than the seller had unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell."[71] Nevertheless, this decision was reversed in the House of Lords by a majority (three from five) later.[72] Although both views (above) are based on rules of common sense, from a practical point of view it seems that the view adopted by the majority of the Court of Appeal is the better one and it is based on the principle which may acquire more support in the future.[73]

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[70] [1975] 3 All ER 314 (CA) and [1977] AC 890 (HL) reversed the decision of the Court of Appeal.

[71] **Moorgate** case, ibid., p. 323 (CA); in respect of the meaning of "conduct" it is pointed out that: "In applying these principles of properitary estoppel, the owner is estopped, not only by his own conduct, but also by conduct of his agent or any one who is in privity with him." [**Moorgate** case, ibid., pp. 323-24 (CA)]

[72] Ibid., at pp. 917-18 Lord Edmond Davis stated: "I prefer the view expressed by Geoffrey Lane, L.J. ([1976] QB 225, 253) that "HPI, when they give information to a dealer that the car in question is not on their files, are not asserting that no hire-purchase agreement exist in relation to it, but only that no such agreement has been communicated to them. The dealer in the end has to rely on his assesment of the customer's honesty, and if he misjudges it, it is that misjudgment brought about by the customer's dishonesty which is the real and approximate cause of his loss."

[73] A similar point and different view was raised in **Central car Auctions v. Unity Finance** [1957] 1 QB 371; [1956] 3 WLR 1068; [1956] 3 All ER 905 (CA). In that case Denning, L.J. discussed the Doctrine of **estoppel by conduct** but he was not in majority and his view had not been supported by other judges in the Court of Appeal; Berg, Alan, **"Charges over book debts: a reply"**, JBL, September 1995pp. 433-71, at p. 460 pointed out: "If, on the other hand, the bank permits the company, without first obtaining the bank's consent, to make withdrawals from a bloked account into which the bank debt's proceeds are paid it is thought that, depending on the particular circumstances, the bank would become bound by an **equitable estoppel** requiring it to give the company a reasonable period of notice before it could reassert its right to object to withdrawals from the blocked account." [Emphasis added]

1.3.2. Section 2(1) of the Factors Act, 1889

A banker as a pledgee loses his right of pledge if he is subject to S. 2(1) of the Factors Act, 1889.[74] In **Lloyds Bank v. Bank of America**[75] the plaintiff banker paid advances to Strauss & Co. Ltd. (S&C) and as security for such payments under a letter of hypothecation and two other agreements it received documents relating to the goods and an immediate right of sale. Subsequently it chose S&C as its trustee and the latter pledged the documents with the defendants who acted in good faith and without knowing that the transaction was not in order. Then S&C having gone into liquidation, and as a result of a dispute between the banker and the defendant on the ground that they were not the owner of the goods and subject to the Factors Act, 1889, S. 2(1), they, as pledgee with an special interest in the goods pledged, under decided authorities, did not lose their rights under the letter of trust over the goods. In court Porter, J. held for the defendants and his decision was confirmed by

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[74] "2. Powers of mercantile agent with respect to disposition of good, (1) Where a mercantile agent is, with the consent of the owner, in possession of goods or of the documents of title to goods, any sale, pledge, or other disposition of the goods, made by him when acting in the ordinary course of business of a mercantile agent, shall, subject to the provisions of this Act, be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the person talking under the disposition acts in good faith, and has not at the time of disposition notice that the person making the disposition has not authority to make the same."; **the Factors Act 1889, extended to Scotland by the Factors (Scotland) Act 1890.**

[75] Lloyds Bank v. Bank of America [1938] 2 KB 147, pp. 150-51; see also Northern Western Bank v. Poynter, [1895] AC 56 and Re David Allester, [1922]2 CH 211.

the Court of Appeal, but on a different ground.[76] Taking the agency point, it was decided that S&C was "a trust agent for the bank."[77]

1.4. Measure of damages caused by the applicant

If the bank's customer fails to pay the amount of the credit he may be sued by the bank.[78] What is the measure of damages? The case of **Re Ludwig Tillman**,[79] held that Tillman, who because of outbreak of war could not to put the bank in funds, was obliged to indemnify the bank against the amount borrowed by the latter from the Bank of England for the purpose of paying his acceptance.[80] Of course other expenses like charges for opening a credit, legal expenses and interest, if any, must be paid by the applicant for the credit. There is no provision as to this point under consideration in the UCP 500.

1.5. Security measure for the applicant in case of insolvency of the bank

It is suggested that a buyer's right is the same as the others on liquidation in the case of a banker's insolvency where the buyer puts the bank in funds prior to

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[76] Ibid., at p. 162, Wilfrid Greene, M.R., said: "It happens very frequently that the incidents and rights of ownership are divided among two or more hands. One person may have the right to possession, which is one of the rights incident to ownership, and another person may have all other rights incident to ownership. Nevertheless, it is only the two of them who can confer on a third party the ownership of the property in question. It is only by their combining in an assignment that they can confer a good title. I am quite unable to read the word "owner" [in S. 2 of the Factors Act, 1889] as excluding such a case. It seems to me that, where the right of ownership has become divided among two or more persons in such a way that the acts which the section is contemplating could never be authorised save by both or all of them, those persons together constitute the owner."; then he continued: "In the present case, if Lloyds Bank and Strauss & Co., Ltd., had agreed to employ a broker in Mincing Lane, and with the consent of both of them, which was necessary because the bank had the right of possession, these documents had been handed to that broker and thus come into his possession, I can not for one moment doubt that the broker would have been in possession of the documents with the consent of the owner within the meaning of the section, the owner being, for that purpose, the two of them acting in combination." [Ibid., p. 162]; Davis, supra (f.n. 5), pp. 192-93.

[77] Ibid., p. 165; Davis, supra (f.n. 5), p. 193.

[78] Equitable Trust Co. of New York v. Dawson Partners Ltd. (1927) 27 Ll.L.R. 49, 52; Gutteridge, supra (f.n. 11), p. 58 and f.n. 8.

[79] (1918) 34 TLR 322.

[80] Gutteridge, supra (f.n. 11), p. 228 and f.n. 9.

receipt of the proper documents of title from the bank.[81] There is an exemption when the applicant for the credit deposits cash or securities for particular purposes, i.e., to meet the beneficiary's draft. In such a case if the issuing bank becomes insolvent, the buyer is entitled to claim back what he deposited.[82] However, the onus of proof is on the buyer to prove his claim.

Therefore, there must be some proper appropriation in order to show that the money or securities were deposited for a specific reason.[83] Furthermore, such a right belongs only to the person who deposited the securities or cash, namely the applicant for the credit.[84]

2. THE BANK'S RIGHT OF RECOURSE (AS SECURITY MEASURE) AGAINST THE BENEFICIARY

Do banks, as security, have a right of recourse against a beneficiary of a letter of credit? There are three situations in which the issuing bank may look to the beneficiary/seller, namely, (1) insolvency of the applicant for credit, (2) wrongful acceptance of documents presented by the beneficiary, and (3) fraud committed by the beneficiary. In the third situation obviously, as mentioned previously, the bank has a right of action against a fraudulent seller and courts in different legal systems are of the opinion that the beneficiary must not be allowed to benefit from the right provided under the "doctrine of autonomy".[85] Nevertheless, the banker has no right

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[81] Davis, supra (f.n. 5), pp. 62-63.

[82] Farley v. Turner (1877), 26 L.J. Ch. 710.

[83] See Lord Romilly, M.R., decision in Re Barned's Banking Co., Massey's case, (1870), 39 L.J. Ch. 635, that the learned judge distinguished the Farley case, and held that in contrast with the Farley case, in Re Barned [...] the applicant for the credit merely had the right of proff because there is no appropriation of money as it was in Farley case; Davis, supra (f.n. 5), p. 63, f.n. 1.

[84] Banner v. Johanston (1871), L.R. 5 H.L. Cas. 157; Davis, supra (f.n. 5), p. 64 and f.n. 2.

[85] The subject of fraud is considered in Section B.1 of Chapter VII (above); Ellinger, EP, "Documentary letters of credit", Singapore, 1970 [hereinafter referred to as Ellinger], p. 201; Goode, R.M., "Reflections on Letter of Credit- III", Journal of Business of Law, 1980, pp. 443-46, at p. 443 [hereinafter referred to as Goode]; Bank Russo-Iran v. Goordon Woodroffe & Co. Ltd. [1972] The Times, 4 October (an unreprted cases); Edward Owen Engineering Ltd. v. Barclays Bank International Ltd. [1978]1 Ll.L.Rep. 166.

of recourse against a purchaser of the beneficiary's draft as "a holder in due course".[86] But the law may be different in the first two situations. Each will be discussed separately.

2.1. Insolvency of the buyer/applicant for credit: the issuing bank's right of recourse

Does the issuing bank has a right of recourse against the seller/beneficiary when its client becomes insolvent in the case of an irrevocable letter of credit? It is difficult to give a positive response to this question because, first of all, it depends on the type of credit, whether the credit is an acceptance, payment or negotiable one. If the credit is not in the third category, then it is not easy to suggest that the law of negotiable instruments can apply to the other types of credit since such provisions deal only with payment in cash, or where the issued drafts are accepted by the acceptor, i.e. the banker, who does not have a right of recourse against the drawer under the credit's conditions.[87]

If the credit is categorised as a negotiable one there may be support from the law of negotiable instruments but in that situation the banker may lose his right of recourse because, usually, there is a clause in the credit that the banker undertakes to negotiate drafts without using his right of recourse.[88] What would be the solution if there is no such condition in the credit? Even in that situation it is hard to give support to the view that the banker is entitled to look to the seller for the amount which was paid, since the right of the holder of a bill of exchange is different from that of the banker as the holder of a negotiable draft, and under the credit system there is a certain promise by the bank to accept such drafts.[89]

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[86] Goode, ibid., p. 443 and f.n. 3; Guaranty Trust Co. of New York [1981]2 K.B. 623; see also discussions concerning "holder in due course" in Section B.1.2.4., Chapter VII above.

[87] It is said by Ellinger that no right is conferred on an acceptor in Bills of Exchange Act 1882 in England (see Ellinger, supra (f.n. 85), pp. 201-202 & f.n. 86).

[88] Article 9 (a)(iv) and (b)(iv) of the UCP 500; Gutteridge, supra (f.n. 11), pp. 84-85.

[89] Ellinger, supra (f.n. 85), p. 202.

This point has not yet been considered by English courts, but it is clear that under American and French law the banker has no right of recourse against the seller.[90] For instance, in an American case directly dealing with the point it was held that "The general provision of that statute which permits the holder or any subsequent indorser of a negotiable instrument dishonoured to maintain an action therein against the drawer is not applicable in the present case because the drafts here involved specifically state that they are drawn under the irrevocable letter of credit, and by that the bank was required to pay when a draft and other documents specified were presented."[91]

Moreover, by accepting a right of recourse for the banker in case of the buyer's failure, the main purpose of the letter of credit would be destroyed. Therefore, it is not appropriate to suggest such a solution for the problem under discussion.

2.2. Wrongful acceptance of tendered documents

The issuing bank seems to be in much greater difficulty if it wrongfully accepted tendered documents. Since, firstly, by accepting documents presented by the beneficiary the bank agreed that the seller/beneficiary has carried out his obligation under the credit; it will lose its right of recourse, if there is any, against the seller. Secondly, the bank in such a situation failed to carry out its duty under the credit contract, namely, protecting the applicant's interests by controlling tendered documents and to ensure that they are in compliance with terms and conditions stipulated in the credit. Therefore, nobody should suffer from that negligence; it is the bank what should bear all responsibility and any consequent risk.

However, there are suggestions giving some support to the banker's point of view. For instance, it is suggested that the banker is entitled to a right of recourse against the seller based on the doctrine of **"mistake of fact"**.[92] It is also stated by

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[90] Ibid., pp. 202-04.

[91] Bank of East Asia, Ltd. v. Pang 140 Wash. 603, 249, p. 1060 (1926), at p. 1063.

[92] Goode, supra (f.n. 85), pp. 444-45.

another legal writer that "Where the documents, thought apparently what they should be, are in fact not and the beneficiary (not fraudulent) is himself responsible for the discrepancy, the bank should be able to recover the money it has paid against them as paid in **mistake of fact**, unless it has expressly contracted not to have recourse. The mistake is certainly between the payer and the payee and is a mistake as to the correctness of the documents."[93]

In contrast, Professor Ellinger seems to disagree with this opinion[94]; he has accepted the decision of **Bank of New York v. Partola Manufacturing Co.,**[95] where it was held in favour of the defendant seller on the ground that the mistake happened only through the banker's actions and there had been no fraud committed by the seller. In addition there was no mistake of fact on the part of the defendants, because they surrendered the required documents for the amount of the credit. However, the same writer has stated that such a view may find less support in English law.[96]

It is also pointed out by Professor Goode that although the doctrine of "mistake of fact" has found support in both English[97] and American law,[98] such an approach should be rejected in the light of the principle of restitution.[99] The same

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[93] Gutteridge, supra (f.n. 11), p. 85. [Emphasis added]

[94] Ellinger, supra (f.n. 85), p. 207.

[95] 191 App. Div. 424, 181 N.Y.S. 464 (1920); Ellinger, supra (f.n. 85), pp. 204-05.

[96] Ellinger, supra (f.n. 85), at p. 205, f.n. 96 (for referred authorities).

[97] Barclays Bank Ltd. v. W.J. Simms Sons & Cooke (southern) Ltd. [1980]1 Ll.L.Rep. 225; Chase Manhattan Bank N. A. v. Israel-British Bank (London) Ltd. [1979]3 All E.R. 1025.

[98] Fitzgerald v. Title Guarantee & Trust Co., 290 N.Y. 376, 49 N.E. 2d 289 (1943).

[99] Goode, supra (f.n. 85), pp. 444-45, at p. 445 stated: "Yet there are doctrinal difficulties which are not easy to resolve. It is a general principle of the law of restitution that "if A confers a benefit on B under a valid contract, he must seek his remedy under that contract and not in restitution." The restitutionary remedy can therefore be persued only where the mistake is such as to nullify the contract or results in it being set aside. To allow the bank to recover its payment where there is only partial failure of the consideration for the payment would be contrary to principle. Total failure of consideration, which does attract a restitutionary remedy, could only come about as the result of the bank rejecting the documents. But having accepted them the bank surely can not be allowed to change its mind and convert its acceptance into a rejection. This would contravene a separate principle of contract law, that the innocent party can not both approbate and reprobate

writer also for drawn attention to the point that if the banker pays a person (other than the main beneficiary) who purchased his draft in good faith, namely, "holder in due course", the purchaser is immune from liability and the banker is not entitled to sue him. But if payment was made to the original beneficiary of the credit, there are other possible grounds for recovery by the banker. The first solution is for the banker to prove that the seller has a duty of care under the credit operation; by presenting documents which do not fulfil the conditions of the credit, the seller, by that negligence, breaches his undertaking to the banker.[100] Such a defence does not seem very strong because in the first place there is no evidence for it under the credit contract as the contracting parties have no such intention. Secondly, even if it is supposed by implication that the beneficiary is under such a duty, the banker himself has a separate duty of care towards his customer (the buyer) to examine the tendered documents.[101] So, if the banker fails to carry out his duty, he should bear all the risks and responsibilities which may follow. This sort of interpretation of the provisions is nearer both to the present practice of the letter of credit and to a fair solution.

Another possible solution that has been suggested is based on the idea of **breach of warranty** by the beneficiary. It is said "That is no reason why, if the beneficiary chooses to make a tender, he should not be held to warrant that the documents conform to the credit."[102] There is no case in English law to support the view that the seller undertakes any such warranty concerning tendered documents under the irrevocable letter of credit. Nevertheless, the view is expressly supported in Section 5-111(1) of the UCC.[103] There are no similar provisions under the UCP

[...] Having accepted documents in first place, the bank loses its right to reject (in the absence of forgery or fraud) [...]."

[100] Goode, supra (f.n. 85), p. 444.

[101] Article 13 of the UCP 500.

[102] Goode, supra (f.n. 85), p. 445.

[103] See appendix 1 for the text of Section 5-111(1); and for more details concerning the point under consideration see the relevant discussion in Section B.2.2.4, Chapter V (above).

500. The main objection to that suggestion is that by transferring the duty of care from the bank to the beneficiary, the former is freed from its main duty of care in relating to the applicant for credit; then the whole purpose of the credit operation, as a promise for payment, would be destroyed. Moreover, if there is a degree of duty of care on the seller/beneficiary, relating to the documents, it does not extend to remove all of the banker's obligations in relation to the documents.

Consequently, the view that the issuing bank has no right of recourse against the beneficiary of credit is much preferable, also as an opinion has been supported in all major legal systems.

3. THE BANK'S RIGHT OF SECURITY IN RELATING TO A PERSON OTHER THAN THE BANK

The main issue in this part of the study is whether holders of bills of lading (other than a bank) have similar rights over the goods as banks have under such security measures, namely, letters of hypothecation, letters of trust or as a pledgee. In other words, can they stand in the same shoes as a bank against the applicant for credit? As discussed before, nobody other than the bank (issuing or intermediary bank) has any right by way of lien or charge over the goods or to the proceeds of the goods.[104] There are several authorities which support this view. For instance, in **ex parte Dever, in re Suse,**[105] a buyer (J.S. Mussett, carrying on business in London) asked his bank (Messers. W.E. Sibeth [...], who were merchants and bankers in London) to issue a confirmed letter of credit for the seller (W.V. Sentance, carrying business at Shanghai, in China) against drafts drawn by the seller to be accompanied by shipping documents relating to the purchase of tea. The credit was in these terms, "We hereby agree with you and also as a separate

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[104] See **Banner v. Johnson,** (1871) L.R. 5, H.L.C. 157; Gutteridge, supra (f.n. 11), pp. 222-25, where at p. 224, stated: "It was also pointed out in the same case [**Banner v. Johanson**] that the only instance in which a bill-holder could have a claim to goods pledged as security for the bill would be when it was possible to apply the rule in **ex parte Waring** [(1815), 19 Ves. 345], i.e., if the estates of two parties who are liable on the bill are brought under a forced administration and one of the parties holds by way of cover for the bill goods which are still unrealized." [Emphasis and brackets are added]

[105] (1884), 13 Q.B.D. 766.

engagement with the bona fide holders respectively of the bills in compliance with the terms of this credit, that the same be duly accepted on presentation and paid at maturity."[106]

Subsequently, bills of lading and other related documents were discounted by a bank in China which presented them for acceptance through their agents in London. The issuing bank suspended payment and went into liquidation. Afterwards the holders of the bills claimed to be entitled to a lien or charge on the goods and the proceeds of sale. Lindley, L.J. summarised the seller's claim as, "His claim was to have those teas which remained unsold at the date of suspension of payment of Suse & Sibeth applied in taking up the bills, and also to have the proceeds of those teas which had been sold before the suspension similarly applied."[107] As to the goods which were unsold it was decided that there was no problem and the seller was entitled to have the sale proceeds of those goods; but with regard to that part of the goods which were sold before the suspension Lord Lindley stated that the position was different.[108]

In **Brown Shipley & Co v. Kough**[109] in respect of the subject under discussion Fry, L.J., after considering different aspects of the case stated: "I do not think they are intended to transfer any lien, supposing it existed. Nor can I help observing that there would, to my mind, be very considerable difficulty in holding,

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[106] **Ex parte** case, ibid., p. 767-68.

[107] Ibid., pp. 777-78.

[108] Ibid., at p. 778, said: "We do not see our way to hold that Sentance has any equitable right or lien as regards these moneys, or to treat them as subject to any trust, or that he can insist upon having them applied as the unsold teas are applicable."; at p. 776 of the same case, ibid., Cotton, L.J., took a similar position stating: "With regard to the claim of the bill-holders, Mr. Pollard contented that, having regard to the terms of the letter of credit, and to the fact that the bills were drawn with referance to it, each particular bill being drawn to the credit of a particular shipment of tea, a lien or charge on the tea was given to the holder of the bill. I am unable to arrive at that conclusion. Mr. Pollard relied on the decision in **Frith v. Forbes** [4 D.F. & J 409]. That case, however, was decided on its own very special circumstances, and in my opinion, it is no authority in the present case. **Banner v. Johnston** and the cases in the Court of Appeal which have been referred to are much more like the present case. The form of the bill of exchange and of the letter of advice, written at the time by the drawer to the acceptors, did not give the bill-holders any line on the goods."

[109] (1885), 29 Ch. D. 848.

that an instrument at the same moment operated as a bill of exchange and as an equitable assignment."[110]

So, from the above authorities it becomes clear that bankers are the only parties who are entitled to benefit from security measures designed to cover advanced payments; and if a person other than a bank would like to have securities similar to those have been arranged for a bank in English law, he should make proper arrangements when entering into the agreement.

SECTION B: POSITION IN UCP 500

The bank's security has not been considered under the UCP 500. There is only a general provision in Article 14(a) regarding the right of reimbursement of an authorised bank which made payment under credit's condition. Even in that respect no method has been suggested and everything has been left for negotiation between the parties to the credit contract outside the UCP framework. Moreover, it seems appropriate that the subject of insolvency of the bank and its impact on the applicant be addressed by UCP, as presently there is no provision.

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[110] Ibid., at p. 875, he added: "[...] it would require some argument to convince me that the same instrument could have that double operation, because difficult questions would rise. A bill of exchange is a negotiable instrument, taken in the ordinary course of business, free from the equities between the parties. If the same instrument creates the one and the other, does the equitable assignment travel to the hand of every holder of the bill of exchange? Or if not, where does it stop? If it travels into the hands of all the holders of the bill, it is like a bill of exchange free from equities, or is it like an ordinary equitable assignment?"; for another example see Robey & Co.'s Perserverence Ironworks v. Ollier,(1872) LR 7 Ch. 695, the defendants (who paid cash in advance) entered into a joint adventure with Brown for the shipment of maize and it was agreed that the bill which was to be drawn on them by Brown to cover the price of the goods. Bills were drawn for the defendants which were later indorsed for the plaintiffs. Subsequently, Brown failed to carry out his duty and stopped payment. As a result of that failure the defendants refused to accept the bills and sold the goods. The plaintiffs (as third party and holder of bills) commenced an action claiming a lien over the proceeds of sale but his argument was not supported. James, L.J. said: "I am not prepared to say that merely because a bill of exchange purports to be drawn against particular cargo, it carries a lien on that cargo into the hands of every holder of the bill."; similar view was stated by Millish, L.J. as follows: "The indorsement of a bill gives only a right to the bill, and I do not think that any mercantile man would suppose because he saw in the bill the words "which place to account cargo per A" that he was to have a lien on that cargo. A mercantile man who is intended to have a lien on a cargo expects to have the bill of lading annexed; If there is no bill of lading annexed, he only expects to get the security of the bill itself." [See Gutteridge, supra (f.n. 11), at p. 222 for above quotations]

In respect of a bank's "right of recourse", Article 9 of UCP 500 provides that in a negotiable credit banks have no right of recourse against drawers and/or bona fide holders of drafts drawn by the beneficiary. The silence of UCP regarding the other above mentioned points, namely, the buyer's insolvency and the wrongful acceptance of documents by the banks, may itself support the idea that banks have no right of recourse in such situations against the beneficiary of the credit. Nevertheless, one may chose an opposite argument and suggest that banks have a right of recourse in the above situations where other types of credit, namely, sight, deferred, and acceptance credit are used for payment.

CONCLUSIONS

In providing sufficient security for banks in their relation with other parties to a credit contract two issues are of importance: **(1)** having a proper security measures against the applicant; **(2)** having a "right of recourse" against the beneficiary.

The present study clearly points out that, relating to the second issue, although English lawyers' point of view are divided in that respect the preferred opinion, also accepted by the international business community under UCP 500, is that banks would not be able to look to the beneficiary in case of the applicant's insolvency, or wrongful acceptance of documents tendered under the credit arrangement, unless otherwise agreed between contracting parties.[111]

As to the subject of the bank's right of security against the applicant for a credit (the first point above), although depositing sufficient funds by the applicant is the best possible solution from the banker's point of view, it would damage LCs' reputation since the applicant/buyer loses any opportunity to benefit from the system, namely, he is obliged to use his funds before receiving required documents of title or the goods. The second option for bankers is to pledge document(s) of title (bill(s) of lading) as a security for the amount paid under a letter of credit. Such an

[111] For relevant discussion see Section A.2 of the present chapter (above).

option has been accepted by banks as the only reliable security; while it prevents disreputation of the letter of credit system, at the same time it keeps the balance of interest(s) between contracting parties (the bank and its customer (the applicant). In that respect, however, important legal issues would emerge: **(1)** whether the bankers have any special right of property over documents of title presented under the credit arrangement; **(2)** whether they have any power of sale of goods if it is necessary; **(3)** whether their rights under LCs are prior to the applicant/buyer's right of rejection of goods under the sale contract; **(4)** is there any limitation related to the "letter of hypothecation" and "letter of trust"?; **(5)** is there any defence against banks' right of security?; and **(6)** what would be the measure of damages caused by the applicant as a result of failing to pay the advance money paid by the bank?

Concerning the above first and second issues, it has been clarified in the present chapter that the banks' intention is only to secure their advanced payment to their applicants; therefore, they are not interested in becoming owner of the goods as a result of their security arrangement.[112] Because of the pledge transaction, however, bankers have an independent right of property over the goods and a power of selling of goods if the applicant/buyer fail to pay his debt on time; English law supports such an attitude while Scots law takes a different view on the issue.[113]

In respect of the above third issue no decision has been made in English law; for reasons pointed out previously, however, the preferred view is that banks' right of property under the pledge agreement should be safeguarded against the applicant/buyer's right of rejection of goods under the sale contract, as accepted under English law.[114] Regarding the above questions (4 and 5) the answer is positive but not identical under English and Scots law, namely, Section 4 of the Bills

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[112] Sections A.1.1.2 and A.1.1.2.1 (above).

[113] See Section A.1.2 of the present chapter (above).

[114] See relevant discussion in Section A.1.1.2.2 of the present chapter (above).

of Sale Act, 1878 does not apply in Scotland.[115] As to issue number six above, the applicant should be held responsible for the amount of money paid by the bank, charges for opening the credit, legal expenses and interest (if any).[116]

Regarding an applicant's right of security in case of bank's insolvency, it is accepted by English law that the applicant/buyer has the same right as the others on liquidation, unless he proves that his deposits (cash or other securities) are for particular purposes, namely, to meet the beneficiary's draft(s) under LCs; however, the applicant is the only person who is entitled to apply such a right.[117]

Another matter of concern is whether a holder of document of title other than the bank would be able to enjoy from the same right of security provided for banks under a letter of credit transaction in English law. As considered previously,[118] a similar right has not been recognised for a person other than the bank in English law; therefore, bankers are the only parties who are entitled to benefit from such security measures designed to cover their advanced payments under LCs.

In contrast to English law, UCP 500 provides nothing relating to the bank's right of security and legal issues related to it. In order to clarify the position of parties to a credit arrangement relating to bank's security and to prevent further disputes in future, this issue should be addressed by a proper international instrument.

The last three chapters (Chapters VI-VIII) made it clear that UCP as the only internationally accepted provisions relating to LCs only, covers some of the issues relating to that type of payment in international trade; other important legal issues related to such devices have not yet been codified at international level. They are subjects for consideration by the national laws of states. In that respect, it also becomes obvious: firstly, the scope of issues considered by different national law

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[115] For more details see Sections A.1.1.3.3 and A.1.3 of the present chapter (above); as to "letter of hypothecation" and "letter of trust" and their legal nature see Section A, sub-sections 1.1.3 to 1.1.3.2 (above).

[116] See relevant discussion in Section A.1.4 of the present chapter (above).

[117] For relevant discussion see Section A.1.5 of the present chapter (above).

[118] See Section A.3 of the present chapter (above).

(e.g. English and American law concerning the issue of fraud) is not identical; secondly, differences of opinion relating to the same issue between different legal systems exist (e.g. English and Scots law are not identical concerning the bank's right in security). As a result, the present system related to LCs, which is based on a mixture of international customary provisions (UCP) and the national law of a respective state becomes an uncertain and unpredictable system and its reliability may be doubted by business community internationally. Of course, there may always be new issues and no manmade system would be one hundred percent perfect. It is also true that having a code covering all details may not be impossible but it would be impractical; so, there is always a need for national law, namely, to leave details to be considered by courts in different jurisdictions. But, to prevent further disputes between parties to a letter of credit in international trade and to boost the credibility of LCs, a new solid foundation based on mutual interests seems to be necessary. This new platform can be built upon common points existing in different legal systems and particularly in UCP 500. Differences between them would be resolved by a co-ordinated comparative study under the auspices of an international organisation like the United Nations Commission on International Trade Law (UNCITRAL) with the help of other, non-governmental organisations like the ICC. Of course there are practical and legal difficulties which would confront any attempt towards unification of law of LCs, and they should not be underestimated, but such difficulties should not be justified as an excuse to prevent such an effort. To unify the next few chapters are particularly designed to study the future of LCs system under current world trade conditions, in order to examine whether to some extent the situation is ready for having international mandatory uniform rules (in the form of a convention) for LCs.

PART FOUR

THE FUTURE OF

THE LETTERS OF CREDIT SYSTEM

CHAPTER IX

AUTOMATIC DATA PROCESSING

ELECTRONIC DATA INTERCHANGE

The system of documentary letters of credit and its rules and provisions are exposed to a strong pressure from new technology used for transferring data and information[1] as well as from a movement, led by the **United Nations Commission for International Trade Law (UNCITRAL),** towards preparing an international set of standards in the form of a legislative instrument relating to **Standby Letters of Credit (SLCs).**[2] To what extent will the present system remain relevant to LCs, as a paper-based system governed prevailingly by non-mandatory provisions like those of the UCP 500, and how is it going to be affected by technological progress and UNCITRAL's activities? In the light of discussions in the preceding Chapters of the present study it has been shown how documents, particularly transport bills of lading, play an important role in documentary credits operation since they facilitate the purchase of goods and provide a sound security for banks.[3]

How would it be possible to maintain the system at a workable level from a credit applicant's point of view as well from the point of view of banks? Similarly, to what extent would the UNCITRAL's plan for providing an international legislative instrument, instead of present international customary provisions, provide better services for all parties to a letter of credit transaction? These and other relevant questions and issues are the subject of consideration in the present Chapter.

SECTION A: ADP/EDI: GENERAL BACKGROUND

Technological improvements in the field of electronics provide a good opportunity for traders and bankers active in filing LCs to accelerate their activities

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[1] Locher, Gabriel, "Bank Technology Streamlines International Transactions", Business Credit, November/ December 1990, p. 22 [hereinafter referred to as Locher], at p. 22 said: "While the basic terms of letters of credit have remained unaltered for hundered years, technology now allows banks to speed up the process and reduce paperwork. Banks that have invested in the appropriate systems can provide quicker services, lower error rates, prompt status and resolution of problems, better security, and more management information than their counterparts that have not."

[2] This issue is considered in Section A.2 of Chapter X (below) and Section A.2.1.3, Chapter I (above); as to SLCs and their relevant issues see Section B of Chapter I (above).

[3] For more details see discussion concerning bank's securities under LCs in Chapter VIII, Section A.1.1.2 (above) and the role of paper-based documents in international trade in Section B.1 of the present chapter (below).

and reduce operation costs as well as errors which may arise in the course of transacted business.[4] Market acceleration becomes possible by using computers for transferring data and information under terms agreed between contracting parties. A method which provides such a facility is used for **Automatic Data Processing (ADP),** later renamed **Electronic Data Interchange (EDI).**[5] Although still in its infancy, ADP/EDI is becoming a strong area of development affecting trade

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[4] Kozolchyk, Boris, "The paperless letter of credit and related documents of title", Law and Contemporary Problems, Vol. 55, No. 3, Summer 1992, pp. 39-101 [hereinafter it is referred to as Kozolchyk's article], at p. 39 stated: "Computers, telephones, and artificial satellites have made the 24-hour global financial marketplace a reality. At any hour of the day, a trader of goods, services, or financial undertakings can, by using computers linked with telephone lines, microwave dishes, or artificial satellites, engage in transaction to sell, buy, lease, assign, or borrow instantaneously with another trader, no matter how distant. Bank letters of credit and guarantees occupy an important corner of this global marketplace. And while most of letter of credit communications between banks and beneficiaries are still paper-based, communications among banks themselves are in a very large measure paperless."

[5] UNCITRAL, "B. Working paper submitted to the Working Group on International payments at its twenty-forth session: possible issues to be included in the programme of future work on the legal aspects of EDI: note by the Secretariat, (A/CN.9/WG.IV/WP.53) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XXIII, 1992, pp. 365-82 [hereinafter it is referred to as UNCITRAL Yearbook 1992, WP] at p. 371, pointed out: "The two most recent studies prepared for the Commission on the subject (AC/N.9/333 and A/CN.9/350) make use of the term "EDI". It may be noted that in prior reports to the Commission and in the reports to the Commission and in the reports of the Commission the subject had been considered under the general heading of "automatic data processing" (ADP), which was the term generally used to describe the use of computers for business applications (see AC/N.9/333, para. 7). The change in terminology from ADP to EDI was not intended to introduce a distinction between the transmission and the processing of data to exclude consideration of the issues raised by the transmission of any form of free formatted text or image for commercial purposes. It may be noted, however, that communication of data through EDI inherently supposes a degree of standardization in the form of a predefined syntax used in common by all parties to the EDI relationship so that the data can be read and processed by the computers of both the sender and the recipient of the data." [Emphasis added]; it is also said: "Various suggestions were made as to possible substitute for the term "EDI". Support was expressed in favour of a suggestion to use the term "**electronic commerce**", which was described as sufficiently broad to encompass all existing communication techniques." [Emphasis added; UNCITRAL, "III. ELECTRONIC DATA INTERCHANGE (EDI). A. Report of the Working Group on Electronic Data Interchange (EDI) on the work of its twenty-fifth session (New York 4-15 January 1993)(A/CN.9/373) [Original: English]", UNCITRAL Yearbook, Vol. XXIV, 1993, pp. 191-225 [hereinafter it is referred to as UNCITRAL Yearbook, 1993], at p. 194, para. 20]; see also Strecker, Raymond F., "Automation is still an advantage in global banking services", Information Strategy: The Executive's Journa (IFS), Vol. 7, Iss. 1, Fall 1990, pp. 5-8, where in an abstract to that article it is said: "Although importers and exporters desire quick turnaround, low error rates, and prompt problem resolusion, trade services can be extremely paper and labour intensive. Automated letters of credit and collection processing provide several benefits, including: 1. elemination of paper and labour; 2. faster document handling; 3. the opportunity to innovate delivery mechanisms; 4. support for banks' marketing efforts; and 5. enhancement of banks business reputations."

finance.[6] Because of its evident importance the issue of transferring funds and data by electronic means has been considered in the past three decades by different organisations, national as well as international.[7] In this respect UNCITRAL has shown a special interest and has put the matter for more detailed consideration on its agenda[8] and has accepted the task of coordinating all activities relevant to **Electronic Fund Transfer (EFT)** and EDI.[9]

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[6] Kozolchyk's article, supra (f.n. 4), at p. 39 said: "According to a reliable estimates, seventy-five percent of banks' requests for other banks' issuance, advice, confirmation, or negotiation of credits are sent electronically; the reminder are sent by letter."; see also Jaben, Jan, **"Trade Services Software"**, United States Banker (USI), Vol. 98, Iss. 9, September 1987, pp. 86-89, where in an abstract to that article it is said: "In the past few years, automation has entered the trade services departments of banks because of absolute necessity. There are 5 reasons for doing so which are: 1. to provide more detailed accounting service for customers, 2. to gain better market position, 3. to improve competetive status, 4. to enhance management reporting, and 5. to increase business volume without adding to staff."

[7] International organisations active in the field of Electronic Fund Transfer (EFT) are Economic Commission for Europe and its suborgans ("Working Party on Facilitation of International Trade" and "Inland Transport Committee"), International Maritime Organization (IMO), International Civil Aviation Organization (ICAO), International Rail Transport Committee (CIT), Customs Co-operation Council (CCC), Council of Europe, Organization for Economic Co-operation and Development (OECD), Hague Conference on Private International Law, "Legal Observatory for the European Information Market", International Maritime Committee (CMI)(Sea Waybills Group), and the Committee on International Monetary Law of International Law Association (ILA); and projects concerning to different aspects of ADP can be classified as follow: 1. Efforts relating to the privacy aspect of ADP; 2. Efforts relating to the evidence aspect of ADP; 3. Efforts relating to the substitution of data transmission for written documents; 4. Studies dealing with the use of electronic authentication in place of signature; 5. Efforts in connection with liability which may arise by adopting ADP; 6. Efforts to find solutions through contractual relationships of the contracting parties; 7. Efforts to make necessary changes in rules of any underlying transactions; for other details about ADP see **"An exploration of legal issues in information and communication technologies"** and **"Privacy protection and transboarder data flows"** (papers on legal issues were presented in Symposium on Transborder Data Flaws, held in London from 30 November to 2 December 1983) and the first international conference on **"Paperless trading and the law in the EEC"** by the European Community was held in Brussels on 17-18, March 1986.

[8] UNCITRAL, **"LEGAL ISSUES OF ELECTRONIC DATA INTERCHNGE", Report of the Working Group on International Payments on the work of its twenty-forth session"** (Vienna, 27 January- 7 February 1992)(A/CN.9/360) [Original: English], Yearbook of the United Nations Commission on International Trade Law, Vol. XXIII, 1992, pp. 347-65 [hereinafter it is referred to as UNCITRAL Yearbook, 1992], at p. 347 stated: "The Commission, at its seventeenth session (1984), decided to place the subject of the legal implications of automatic data processing to the flow of international trade on its programme of work as a priority item. It did so after considering a report of the Secretary-General entitled "Legal aspects of automatic data processing" (A/CN.9/254), which identified several legal issues, relating to the legal value of computer records, the requirement of a writing, authentication, general conditions, liability and bills of lading."; see also Patrikis, Ernest T., **"Global EFT Guidelines: What They Can Mean to US Banks"**, Bank Administration, September 1987, pp. 30-31 [hereinafter it is referred to as Patrikis], at p. 31 said: "UNCITRAL, which was established in 1968 by the UN General Assembly, place EFT on its priority list in 1978. It has worked with the UN staff to identify three types of legal issues affecting EFT: those associated with the payments process, those associated with electronic telecommunications and record

Among other organisations active in the field of EDI, the ICC has begun a study about the effect of EDI on provisions related to LCs;[10] and, because of the importance of the issue under consideration, the ICC in cooperation with the UN Economic Commission for Europe (ECE) has undertaken to prepare **Uniform Rules for Communication Agreement (UNCA).**[11] Article 20 (b)(i) of UCP 500 (similar to

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keeping, and those associated with the institutional structure within which an EFT system operates. [...] Harmonization can be gained more easily if implemented before national rules have been set in concrete. If national rules are developed on the basis of the model rules, or indeed, if the model rules are adopted in their entirety as national rules, the opportunity to create greater commercial certaintity accross border may be easily achieved."

[9] UNCITRAL Yearbook 1992, WP, supra (f.n. 5), at p. 369 said: "At its nineteenth session (1986), the Commission had before it a report of the Secretary-General describing the work of international organisations active in the field of automatic data processing (A/CN.9/279). The Commission approved the suggestion contained in the report that it might undertaken leadrship in the coordination of activities in this field by requesting the Secretariat to organise a meeting in late 1986 or early 1987 to which all interested intergovernmental and non-governmental international organisations might be invited. The meeting was held at Vienna on 12-13 March 1987."

[10] **The International Chamber of Commerce (ICC)** in Paris has begun the task of revising its letter of credit rules to accommodate changes in technology, transportation and communications. Included in this review will be an attempt to adapt to the progress and effect of EDI on international trade. By the ICC's own admission, an electronic letter of credit is a long time off; Kozolchyk's article, supra (f.n. 4), at p. 40 said: "Rules do exist, however, for the operation of **the Society for Worldwide Interbank Financial Telecommunications ("SWIFT")**, a banking telecommunications network [...] banks that now send paperless messages to one another adhere universally to **the Uniform Customs and Practice for Documentary Credits ("UCP")**. But the interaction between the UCP and SWIFT rules is not entirely harmonious, and conflicts are similarly apparent between the recently enacted article 4A of the **Uniform Commercial Code ("UCC")** and the practices of banks engaged in prepaying, paying, or reimbursing letters of credit." [Emphasis added; see also p. 42 of the same reference in which it is said: "SWIFT was created in 1973 as a bank-owned, Belgian, not-for-profit cooperative organisation. Its purpose was to facilitate the transmission of bank-to-bank financial transaction messages."]

[11] The draft UNCA is reproduced in ECE document TRADE/WP.4/300 and in ICC document No. 374/1; the first meeting was held at ICC, Paris, on 16-17 Jan. 1986 and representatives of the European Insurance Committee, CCC, International Organisation for Standardisation, UNCTAD, and UNCITRAL were attended on that meeting [ICC Document 374/3]; see also ICC Document No. 470-35/5 where in general statement number 2 it is said: "Members of the Working Group expressed their disagreement with the decision taken by the Commission to disban the EDI-UCP Working Party. They are strongly opposed to the idea of trying to create a new UCP rules applicable both to paper credit paperless credit. They underlined their awareness that for practical reasons and due to legal problems paper documents rules can not be applied to EDI messages. The Group therefore proposed that separate rules should be elaborated by multidisciplinary Working Group. Realising that it is forwarded strategy and not an immediate goal, members ask the Commission to reconsider its decision regarding the EDI-UCP Working Party."; UNCITRAL, "LEGAL ISSUES OF ELECTRONIC DATA INTERCHANGE. Electronic data interchange: report of the Secretary-General (A/CN.9/350)" [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XXII, 1991, pp. 381-97 [hereinafter referred to as UNCITRAL Yearbook, 1991], at p. 387 stated:

Article 22 (c)(ii) of UCP 400, 1983) provides: "[...] banks will also accept as an **original document(s)**, a document(s) produced or appearing to have been produced: **i.** by reprographic, **automated or computerized system** [...]",[12] unless otherwise agreed by parties to the credit arrangement.

"In 1990, the ICC decided to create a "Joint Working Party on Legal and Commercial Aspects of EDI". The mandate given to that Working Party is to study the work undertaken on legal issues by other organisations such as the TEDIS Group, UN/ECE WP.4, UNCITRAL and the International Data Exchange Association (IDEA), with a view to establishing "common position which can then be presented to the relevant governmental and private sector organisations". That Working Party was also created to "monitor EDI developments, providing the impetus to address issues critical to global business practices, through close liasion with other EDI organisations."; UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), at p. 369 said: "The first effort accomplished by the international EDI community to harmonize and unify EDI practices resulted in the adoption of the Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission (UNCID) by the International Chamber of Commerce (ICC) in 1987 (ICC Publication No. 452, 1988). UNCID was prepared by a special joint committee of the ICC in which the following organisations were represented: the United Nations Economic Commission for Europe (ECE); the Custom Cooperation Council (CCC); the UNCTAD Special Programme on Trade Facilitation (FALPRO); the Organisation for Economic Co-operation and development (OECD); the International Organisation for Standardisation (ISO); the Commission of the EEC; the European Insurance Committee; The Organisation for Data Exchange via Teletransmission in Europe (ODETTE) and the secretariat of UNCITRAL." [See also p. 264 of UNCITRAL, "LEGAL ISSUES OF ELECTRONIC DATA INTERCHANGE, "Electronic data interchange: preliminary study of legal issues related to the formation of contracts by electronic means: report of the Secretary-General (A/CN.9/333) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XXI, 1990, pp. 253-65 [hereinafter it is referred to as UNCITRAL Yearbook, 1990]]; UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), at p. 369 said: "Although the first draft of UNCID was based on the idea of creating a model communication agreement, it was found that, due to the differing requirements of various user groups, the creation of a model communication agreement was an impractical objective at such an early stage of the development of EDI techniques. It was therefore decided to create a small set of non-mandatory rules on which EDI user and suppliers of network service would be able to base their communication agreements. UNCID was also incorporated into the United Nations Rules for Electronic Data Interchange for Administration, Commerce and transport (UN/EDIFACT) as part of the United Nations Trade Data Interchange Directory. Although UNCID constituted a limited achievement, it also represented a major step in the development of a legal framework for EDI, both because it furnished a basis for preparing individual communication agreements and because it served as a first effort that could later be used to reach a higher level of reinforcement (see A/CN.9/333, paras. 82-86). [...] The following issues are covered by UNCID: definitions; use of interchange standards; standard of care to be applied by the parties when communicating through EDI; identification and authentication of messages and transfers; acknowledgement of a transfer; confirmation of content of messages; protection of trade data; storage of data. In addition, the introductory to UNCID outlines the following issues to be considered when drafting a communication agreement; liability; situation of third parties; insurance; time within which a receiver should process the data; securecy or other rules regarding the substance of the data exchanged; rules of a professional nature; encryption and other security measures; rules on signature; applicable law and dispute resolution."

[12] Emphasis added.

So, a question, put forward by an expert on documentary credits, asks whether it is possible to have a "documentless documentary credit"?[13] In recent decades, as mentioned above, UNCITRAL has attempted to find proper solutions to technical and legal problems which may arise when applying the new electronic/paper-less system. Of course, the UNCITRAL Commission has focused its efforts on EFT as a wide field covering all technical and legal problems affecting the subject.[14] It has been concluded that ADP/EDI is an essential part of the concept of electronic banking.[15]

The purpose of this part of the present study, after a general background concerning ADP/EDI, is to consider the effect of the new technology on the

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[13] Whebel, B.S., "International trade data interchange systems", from Goode, R.M., "Electronic Banking, the legal implications", published by the Institute of Bankers & Centre for Commercial Law Studies, Queen Mary College, University of London, 1985 [hereinafter it is referred to as Goode], pp. 123-29, at p. 129 [hereinafter referred to as Whebel], stated: "In time, electronic communication possibilities may well lead to the "documentless documentary credit"- to "funds transfer" instruction being held in abeyance in a data bank at the instance of the buyer until specified "goods transfer" instructions are fed in at the instance of the seller, completing the connection and releasing the funds to the seller and the goods to the buyer."

[14] Patrikis, supra (f.n. 8), at p. 31 said: "After several years of work, the U.N. has just published a guide for legislators and attorneys involved in developing EFT regulations. The **"Legal Guide on Electronic Funds Transfers"** identifies 41 legal issues that should be considered in EFT system development, describes the various approaches being used to address them, points out the advantages and disadvantages of each, and suggests alternative solutions." [Emphasis added]; for other relevant articles concerning EFT see Santa Lucia, John S., "Exchange Losses from International Electronic Funds Transfers: Time to Unify the Law", Northwestern Journal of International Law & Business, Vol. 8, 1988, p. 759 and O'Keefe, Brian, "Automated Clearing House Growth in an International Marketplace: The increased flexibility of Electronic Funds Transfer and its impact on the minimum contacts test", University of Pennsylvania Journal of International Business Law, Vol. 15, No. 1, Spring 1994, p. 105; Malaguti, Maria Chiara, "Liability for fraud and mistake in electronic transfers of funds", an article published at p. 63 of the book edited by Carr, Indira and Williams, Katherine, "Computers and law", Intellect, Oxford, England, 1994 [hereinafter referred to as Carr].

[15] Whebie, supra (f.n. 13), at p. 129 said: "Trade data interchange may seem an area somewhat remote from electronic funds transfer but it is an essential part of concept of electronic banking. No one would dissociate funds transfers from documentary cerdits, any more than they would ignore the trade data transfer by means of paper documents."; see also ""Automatic Data Processing" legal value of computer records: report of the Secretary-General (A/CN.9/265)", UNCITRAL publication, Yearbook 1985, pp. 351- 65 and Ian Walden and Nigel Savage, "The legal problems of papperless transactions", J.B.L., March 1989, pp. 102-12 [hereinafter referred to as Walden], at p. 102 regarding to electronic data interchange (EDI) stated: "In simple terms EDI replaces all standared paper business documentation- such as invoices, orders, customs entries or reservations- by standardised electronic messages. The more formal definition is of EDI as "computer-to-computer transmission of data in structured forms" in essence, paperless trading."

documentary credits system as a paper-based method of payment. What advantages and disadvantages does ADP/EDI as a paper-less system offer as against a paper-based system? What legal problems may arise by adopting the new system as far as document(s) are concerned, and what could the ADP/EDI's impact on UCP be, since by adopting the electronic system, the operation of LCs may, in some aspects, be changed?

1. INTRODUCTION, DEFINITION, RELATED PROJECTS

1.1. Introduction

The transfer of funds by methods based on electronic forms of communication, cable, telex and phone, has been used in international trade for over a hundred years and computer-to-computer access may be seen as a modern version of this.[16] For the first time UNCITRAL placed the subject of Electronic Funds Transfer (EFT) as a matter of priority on its agenda at its 11th session in 1978. A draft text on EFT, prepared by the Secretariat, was examined by the UNCITRAL Study Group on International Payment at a meeting held in the Hague in April 1982.[17] A related report stated that as a consequence of EFT, a payment instruction transmitted to or between banks in electronic form rather than through traditional transmission of a paper-based payment instruction, speeded transmission and facilitated the handling of messages, thereby reducing the cost of operation. It was also pointed out that although there may be some EFT systems which are

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[16] Kozolchyk's article, supra (f.n. 4), at p. 82 said: "Facsimile (Fax) transmissions of applications for the issuance of letters of credit and subsequent fax issuance have become quite popular. The fax medium is not paperless, but it combines the speed of a telecommunication with the convenience of paper. Yet fax communications, unlike SWIFT, are not part of a system or network, but are open to anyone with a fax machine and connected telephone line. This explains why the bankers' main concern with faxed letter of credit or application messages is their lack of security. [...] Thus the validity of the signature or of other authentication devices in a fax operative credit instrument cannot reliably established unless the message were subjected to sophisticated enciphering and authentication procedures that are unsuited, as of this writing, for widespread use."

[17] UNCITRAL Study Groupe on International Payments is a consultative body composed of representative of banking and trade institutions [see UNCITRAL, "Electronic funds transfer", UNCITRAL Yearbook, 1982, A/CN.9/221, pp. 272-86 [hereinafter referred to as UNCITRAL Y.B. 1982], p. 273, pars. 1-3 and UNCITRAL Yearbook 1984, p. 118, par. 5]

completely electronic from the entry of data by the originating bank to the processing of data by the recipient bank, most of the systems are based at present on the paper form in connection with the instructions of the bank's customer or when sending a message to another customer. So the term EFT means "equivalent to the term "paper-based funds transfer" in that it describes the medium of communication but does not describe the banking or legal aspects of making the payment."[18] The difficulties which may arise in replacing the traditional paper-based system by electronic messages, particularly for those who are dealing with bills of lading in a letter of credit, were admitted in the report as a problem of great importance to be solved in the future.[19] This issue is considered later below.

1.2. Definition of ADP/EDI

Although the terms **Automatic Data Processing** (ADP) or **Electronic Data Interchange** (EDI) have been widely used in practice to describe the use of computers for business applications in recent years, there is no unified definition for them. This may create some confusion in the legal field.[20] Although existing definitions about EDI differ as to their wording, it is said: "[...] most definitions of EDI contained in existing model interchange agreements seem to rely on a combination

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[18] UNCITRAL Yearbook 1982, ibid., p. 273, par. 7; see also par. 22 of the same reference which is said that payment instruction between two banks can be based through one of three types as: 1. Transmitted directly between two banks; 2. Using services of another bank; 3. In large numbers of payment instructions, using "clearing-house"; the United States Electronic Funds Transfer Act of 1978 in Section 903(6) defines the EFT as following: "The term "electronic funds transfer" means any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or authorise a financial institution to debit or credit an account. Such term includes, but is not limited to, point of sale transfer, automatic teller machines, direct deposits or withdrawals of funds, and transfers initiated by telephone." [See Martine Karmel, **"Procedure and advances: the maintenance of transaction records, proving the state of account in EFT transaction"** Goode, supra (f.n. 13), p. 45.

[19] UNCITRAL Yearbook, 1982, supra (f.n. 17), p. 275, par. 19.

[20] UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), p. 370; it is also said (at the same page of the same reference): "No statutory or case law definition of EDI has, as yet, come to the knowledge of the Secretariat. However, it may be noted that a number of definitions of EDI can be found in working documents from international organisations and are used as a basis for the work of these organisations. For example, the United Nations Trade Data Interchange Directory (UNTDID) published by the United Nations Economic Commission for Europe (TRADE/WP.4/R.721) contains the following definition: "Electronic Data Interchange: the Computer-to-computer transmission of business data in a standard format.""

of two or more of the following elements: the transmission of trade data; between computers; operated by different trading partners; by reference to a standardised syntax or format; through the use of electronic means."[21] For example, the commentary developed by the American Bar Association (ABA) reads as follows: "Electronic data interchange (EDI) is the method by which business data may be communicated electronically between computers in standardized formats (such as purchase orders, invoices, shipping notices and remittance advices) in substitution for conventional paper documents. [...] Technically stated, EDI is the transmission, in a standard syntax, of unambiguous information between computers of independent organisations."[22] On the other hand, the term EDI may interpreted strictly, namely, it covers only interchange rather then processing of transferred data which is an issue independent from transferring data.[23] However, as pointed out previously, UNCITRAL has in its recent reports emphasised that using the term EDI

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[21] See UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), in which at p. 370 pointed out: "Examples of such definition of EDI in model communication agreements include the following: "the interchange of trade data effected by teletransmission"; "the transmission of data structured according to agreed message standards, between information systems, by electronic means"; "the transmission of structured data via electronic communications links between the parties". Wording the same effective can be found in other model communication agreements and commentaries."

[22] UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), p. 370; Commission, "Commission recommendation of 19 October 1994 relating to the legal aspects of electronic data interchange (Text with EEA relevance) (94/820/EC)", Official Journal of the European Communities Legislation, Vol. 37, Part 1, December 1994, pp. 98-117 [hereinafter referred to as Commission], at p. 100 concerning definition of EDI provides: "2.2. EDI: Electronic data intechange is the electronic transfer, from computer to computer, of commercial and administrative data using standard to structure an EDI message."; and at the same page of the same reference about EDI message stated: "2.3. EDI message: An EDI message consists of a set of segments, structured using an agreed standard, prepared in a computer readable format and capable of being automatically and unambiguously processed."

[23] UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), at p. 371 stated: "[...] the preliminary report entitled "DOCIMEL report de base droit" (March 1991), published by the International Rail Transport Committee (CIT), contains the following indication: "It seems that [the term "EDI"] strictly covers the interchange of data but not the processing of these data which is independent from their actual transmission. [...] Another distinction is drawn in a report prepared for the Organisation for Simplification of International Trade Procedures in South Africa (SITPROA), which reads as follows: "Electronic Data Interchange is usually defined as the electronic exchange of machine processable, structured data, formatted to agreed standard and transmitted across telecommunication interfaces directly between different applications running on separate computers. Thus defined, it is clear that EDI does not include facsimile transmissions, electronic mail or other forms of free formatted text or images."

instead of ADP does not mean that there is an intention to introduce a distinction between transmission of data and processing of data.[24]

Regarding the new concept of "Open-EDI" developed by the International Organisation for Standardisation (ISO),[25] it is said that the above terms rely on the following definition of EDI: "The automated exchange of predefined and structured data for some "business" purpose among information system of two or more parties their number being determined by the "business operation" or equivalent concerned."[26]

1.3. EDI and related projects

There have been efforts by organisations other than UNCITRAL and ICC in the field of EDI in order to facilitate the use of EDI and to remove barriers which may cause the unpopularity of the electronic system.[27] A result that has emerged from

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[24] UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), p. 371.

[25] An open-EDI defined as following: "Electronic data interchange among autonomous parties using public and non-proprietary standards aiming towards global interoperability over time, business sectors, information technology systems and data types." [UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), p. 371]

[26] UNCITRAL Yearbook, 1991, supra (f.n. 11), pp. 390-91 (about definition of EDI messages as written documents); see also UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), at p. 371.

[27] For instances look at following projects: 1. **Work undertaken under the TEDIS I programme; A comparative survey of European legislation: the TEDIS study**- It is said: "In 1988, the Commission of the European Communities began to implement the TEDIS (Trade Electronic Data Interchange Systems) programme, which has as one of its purposes the development of an appropriate legal framework for the increased use of EDI in the twelve member States of the European Communities." [UNCITRAL Y.B., 1990, supra (f.n. 11), at p. 256 and UNCITRAL Y.B., 1991, supra (f.n. 11), p. 383]; 2. **Working Party on Facilitation of International Trade Procedures (WP.4)**- It is pointed out: "In March 1990, the Working Party on Facilitation of International Trade Procedures (WP.4) of the United Nation Economic Commission for Europe "requested its rapporeurs on Legal Questions to establish, in cooperation with an ad hoc Group, a detailed action programme on legal aspects of trade data interchange, with indication of priorities and proposals concerning the resources which would be needed to execute the programme. The ad hoc Group will comprise France, Romania, Switzerlan, the United Kingdom, the Uinted States, UNCITRAL, the European Economic Community, and the International Chamber of Commerce. New Zealand will contribute by correspondence to the prepration of the action programme." (See TRADE/WP.4/171, par. 19)." [UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 385]; 3. **International Rail Transport Committee (CIT)** [UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 387]; 4. **International Road Transport Union (IRU)** [UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 388]; 5. **International Maritime Committee (CMI)**- It is stated: "At its thirty-forth Conference (Paris, June 1990), the CMI adopted the text of "The CMI Rules for Electronic Bills of Lading " (see A/CN.9/333, para. 89), hereinafter referred to as the CMI Rules [...] It is recalled in the introduction to those Rules that non-negotiable sea-waybills should be preferred to negotiable bills of lading and that "non-negotiable sea waybills could easily be replaced by messages sent between the interested parties by electronic means." However, it is also noted that the electronic bill of lading would play

the efforts is that there are no coherent and unified legislative instruments in international trade, even among the member states of the European Union.[28] This is also true insofar as courts' decisions are concerned.[29] However, several model law agreements for national as well as international use exist; they have been provided by different organisations active in field of EDI.[30]

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an important function as regards the commodities that are sold in transit." [UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 388]; 6. **The report of the Observatoire juridique des technologies de l'information (France)**- It was reported that: "The French Government mandated a study on the French law of evidence and the manner in which it would need to be modified (or affirmed) in order to accomodate the development of paperless legal relationships. The results of that study were published at the end of 1990 by the Observatoire juridique des technologies de l'information (OJTI) in a report entitled **"Une socie'te' sans papier?"** (hereinafter referred to as OJTI Report)." [Emphasis added; UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 388]; and 7. **The report of the American Bar Association**- It is said: "A study was initiated in 1987 by the Electronic Messaging Services Task Force under the auspices of the American Bar Association (ABA) to examine the effects of electronic commerce upon fundamental principles of contract law and related legal issues. A first report on "Electronic Messaging" was released in 1988 and the final Report on Electronic Commercial Practices, incorporating a Model Electronic Data Interchange Trading Partner Agreement and commentery, was Published in 1990." [UNCITRAL Yearbook, 1990, supra (f.n. 11), p. 259]

[28] Formerly called European Communities; see also UNCITRAL Yearbook, 1990, supra (f.n. 11), at p. 256, relating some of results achieved by TEDIS 1 programme stated: "One of the finding of the study was that, in the European Communities, no country had as yet fully adopted its legislation to meet the especific needs and problems related to the development of EDI. [...] The TEDIS study makes it clear that, although efforts have been made at the national level to solve some of the problems arising from the use of EDI, and more specifically those related to the legal value of computer records, many other problems, typically those of contract making by electronic means, remain subject to traditional rules. Those rules would need to be interpreted, developed and updated by case law or national administrative practice in order to fit with an EDI enviroment."

[29] UNCITRAL Yearbook, 1991, supra (f.n. 11), at p. 389 said: "As regards case law, the OJTI Report notes that very few cases have actually been brought before the courts. It may be recalled that a similar finding was contained in the American Bar Association (ABA) Report on Electronic Commercial Practices discussed in the report submitted to the twenty-third session of the Commission (see A/CN.9/333, para. 44). A reason for the absence of case law may lie in the fact that EDI is currently used mainly between trading partners with a long-term relationship."

[30] UNCITRAL Yearbook, 1991, supra (f.n 11), pp. 389-91, numbered three types of agreements which are as following: 1. **Model agreements prepared for national use:** The "EDI Association Standard Electronic Data Interchange Agreement" (hereinafter referred to as the UK-EDIA Agreement) prepared by the EDI Association of the United Kingdom (2nd Edition, August 1990); The **"Model Electronic Data Interchange Trading Partner Agreement"** (hereinafter referred to as the ABA-Agreement) prepared by the American Bar Association (June 1990); **The model EDI interchange agreement** (hereinafter referred to as the CIREDIT Agreement) prepared by the Centre International de Recherches et d'Etudes du Droit de l'Informatique et des Te'le'communications (France, 1990); **The "Standard EDI Agreement"** (hereinafter referred to as the NZEDIA Agreement) prepared by the New Zealand Electronic Data Interchange Association (New Zealand, 1990); The **"Electronic Data Interchange Trading Partner Agreement"** (hereinafter referred to as the EDICC Agreement) prepared by the EDI Council of Canada (Canada 1990); **The standard interchange agreement** (hereinafter referred to as the Quebec Agreement) prepared by the

Although model rules reflect the different legal systems they have originated from and cover those aspects of EDI which are interesting for parties to electronic transactions, they have one common point, namely, they are of a contractual nature and can be brought into force only by consent of the contracting parties.[31] This can cause uncertainty since contractual provisions are not enforceable against a person not party to a contract.[32] It should also be pointed out that paper document(s) and handwritten signatures,[33] are needed as written evidence in situations involving international payments (letters of credit), and transport (bills of lading);[34] there is

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Ministry of Communications of the Province of Quebec (Canada, 1990); **The draft model interchange agreement** (hereinafter referred to as the **draft SITPROSA Agreement**) prepared by the Organization for Simplification of International Trade procedure in South Africa (March 1991)."; 2. **International model agreements covering the issues of EDI in general:** The draft "TEDIS European Model EDI Agreement" (hereinafter referred to as the draft TEDIS Agreement) prepared by the Commission of the European Communities (December 1990); The **"Model Agreement on Transfer of Data in International Trade"** (hereinafter referred to as the FINPRO/CME Agreement) agreed upon by the Republic of Finland and CMEA Member States (1991)."; and 3. **International model agreements limited to some specific legal issues:** The draft "Guideline Concerning Customs-Trader Data Interchange Agreements and EDI User Manuals" (hereinafter referred to as the draft CCC Guidelines) prepared by the Customs Co-operation Council (March 1990); **The Guidelines for Interchange Agreements** (hereinafter referred to as the ODETTE Guidelines) prepared by the Organization for Data Exchange through Teletransmission in Europe (1990); The **"CMI Rules for Electronic Bills of Lading"** adopted by the International Maritime Committee (CMI) in June 1990.

[31] For instance, see UNCITRAL Yearbook, 1991, supra (f.n. 11), at p. 390, which it is said: "A clear expression of that characteristic is contained in Article 1 of the CMI Rules ("These rules shall apply whenever the parties so agree").

[32] UNCITRAL Yearbook, 1991, supra (f.n. 11), at p. 390, it is said: "That situation raises difficulties where the applicable law would not allow the parties to deviate from provisions of statutory law. However, the main difficulty results from the fact that provisions of contract cannot regulate the rights and obligations of person who are not parties to that contract. Contractual provisions can be appropriate and even necessary to solve the legal issues of communication through EDI within a closed network but they are unlikely to regulate the same issues when they will arise in an open enviroment. Contractual solutions to the legal issues of EDI are therefore to be considered as a first step that can help to resolve many of the present practical difficulties and to better understand the questions that will require the prepration of future legal instruments."

[33] "The analysis was oriented towards these latter requirements, the predominance of writing and handwritten signatures having been identified as a priority matter. It noted that in fields such as transport, methods of payment or the settelment of legal disputes, paper supporting documents were required and represented a major obstacle to the development of EDI." [UNCITRAL Yearbook, 1991, supra (f.n. 11), at pp. 383-84]

[34] UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 384, which is said: "The report concluded that a major barrier to the use of EDI resulted from the need for written evidence essentially in the fields of transport (negotiable bills of lading), payment techniques (cheques, bill of exchange, letter of credit), and the settlement of disputes (though international agreements have solved some of the problems in this area)."; it is

also the "symbolic" function of a bill of lading as a "document of title" in international trade.[35]

2. ADP/EDI: ADVANTAGES AND DISADVANTAGES

Does the application of ADP/EDI provide a better service for traders and help international commerce? To persuade the governments of different states, traders, and organisations involved in international trade to adopt ADP instead of the traditional paper-based systems, a report by the Nordic Legal Committee[36] supports a fundamental change by pointing out that the paper-based system, with many documents as used or required, makes the business operation too complicated and expensive; it is also stated that required documents often contain unnecessary data already found in other documents.[37] It has been assessed that, as a result of such disadvantages, the cost of goods increases by 7 to 10 per cent.[38]

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also pointed out: "This requirement in regard to a contract for the sale of goods is set out in section 2-201 of the Uniform Commercial Code as follows: "A contract for the sale of goods for the price of $500 or more is not enforceable unless there is some writing sufficient to indicate that a contract has been made between the parties and signed by the party against whom enforcement is sought." [UNCITRAL Yearbook, 1990, supra (f.n. 11), p. 259]; and at p. 259 of the same reference also stated: "The report also notes that the United States has ratified the United Nations Convention on Contracts for the International Sale of Goods and that, as a result, no writing is required for contract of sale subject to that Convention."

[35] For more details see the relevant discussion in Section B.1.3 of the present chapter (below).

[36] NORDIPRO special paper No. 1, **"The export contract as a management tool"**, Oslo, March 1978.

[37] The relevent part of the report had summerized by UNCITRAL, in Yearbook 1983 (**"Electronic funds transfer, and legal aspects of automatic data"**, UNCITRAL Yearbook 1983, A/CN.9/242 & A/CN.9/238, p. 34 & pp. 174-88 [hereinafter referred to as UNCITRAL Yearbook 1983]), at p. 177, para. 1 as following: "(a) Too many documents are used or required; (b) Documents are too complicated and often contain both too much and unnecessary data; (c) The same data are repeated in many documents; (d) The movement of essential documents takes too long, and frequently leads to severe delays in securing release of goods at destination."

[38] kozolchyk's article, supra (f.n. 4), at p. 42 said: "An experienced American banker estimated the cost of sending a letter of credit by telex in the early 1980s to be between ten and twenty-five dollars as compared to 17.5 Belgian francs or approximately fifty cents had the same message been sent by SWIFT. This saving was made possible by the adoptation of a method of electronic communication known as Electronic Data Interchange ("EDI"). EDI's application to financial, bank-to-bank messages has lowered costs by requiring that the messages be structured in uniform fasion, including standardized elements for allocation of message space and for the text of the message itself. This emphasis on uniformity and standardization has made it possible for the computers communicating through EDI to exchange and process data without rekeying the data."

It has been suggested, on the other hand, that by using the ADP/EDI system a major economic gain would be achieved and most of the problems would be solved as under the new regime errors would decrease, higher quality in managing trade statistics, nationally as well as internationally, would result and the speed of business activities would be increased while the relevant costs of operations would be lower than the costs of an operation under the paper-based system.[39] To what extent is the above argument correct? There are several factors which make ADP/EDI unpopular; they can be summarised as follows:

1. Firstly, the physical characteristics of the paper document are absent in ADP/EDI. So, a paper document can be used for any type of transaction or any type of business record. Paper is durable and it can be retained for a longer time and it is not easy to remove, alter, or add to its text; any such alterations to a paper record would be normally detected. Moreover, paper-based documents can be sent by post or messenger to distant places. In addition there is no problem of authentication since it can be authenticated by signature or any other legally acceptable means. Lastly, there are other functions concerning the physical nature of a paper-based document. First of all, a document in paper form is a carrier of information so it has an **"informative function."**[40] Secondly, it constitutes good evidence if any

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[39] UNCITRAL Yearbook, 1983, supra (f.n. 37), at p. 177, par. 4 pointed out: "(a) Fewer errors, since data would be transmitted and controlled by machines, thus eleminating errors which often occur through manual transmission of information; (b) Better cash flow management, with consequential financial savings; (c) Availability of data for direct use in trader's own ADP systems, e.g. accounting, stock and production management, and a wide range of inhouse statistics; (d) Higher quality of national and international trade and transport statistics, since these would be based on standardised data governed by exact harmonised definitions; (e) Fewer misunderstandings (through inaccurate transaction) owing to use of international standard data elements and codes; (f) Swifter turn-around of ships in port, since the necessary data would be available before the arrival of the goods"; Walden, supra (f.n. 17), pp. 103-104.

[40] Kozolcyk's article, supra (f.n. 4), at p. 84 said: "The documents usually required by letters of credit have either informational or title-transferring functions. The date in an informational type of document may include the description of the goods, the listing of the terms and conditions of insurance coverage, or the certification of volume, wieght, helth, or quality. Considerable progress has been made on a uniform layout and standardized text for the customs' invoice and possibly other informational documents. The trading nations' adoption of the United Nation's syntax for electronic business and administartive messages (EDIFACT) should make it possible to transmit many of the informational messages cheaply and reliably from beneficiaries' and third parties' place of business to banks."

argument arises between the contracting parties; the **"evidential function"** of a paper document is a matter of importance. Thirdly, some documents are legally accepted as a document of title, such as a bill of lading, so therewith another function of a document, as its **"symbolic function"**[41] is given. As considered later below, the main legal problems concerning ADP/EDI are concerned with the two last functions of a paper document, namely, the evidential and the symbolic character of a paper document.[42]

2. There is no specific law or other authority relating to ADP/EDI; the existing law is associated, to a large extent, with documents issued in a traditional form.[43]

3. Using ADP/EDI needs technical and legal expertise to make the system workable, whereas in the traditional form of payment based on paper there is no necessity for such expertise.[44]

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[41] UNCITRAL Yearbook, 1993, supra (f.n. 5), p. 197, para. 51 (about 11 functions of a writing); UNCITRAL Yearbook, 1983, p. 180, par. 47; Walden, supra (f.n. 15), p. 103; Kozolchyk's article, supra (f.n. 4), at p. 84 stated: "Computers and telecommunications technology has also attempted to incorporate the three main functions of the ocean bill of lading (receipt of the goods, contract of freight, and document of title) into telecommunicated messages. As a result of this technology, several types of paperless bills of lading are currently in use. Most of these bills, however, are just carrier-issued receipts. Only a few of the paper-less bills currently in use can act as documents of title to the merchandise, and fewer qualify as negotiable documents of title. The fact that the negotiable document of title function has not yet been fully incorporated into a paperless bill does not mean that paperless bills have no banking value. A paper-based ocean bill of lading is valiable to banks for both its informational and its document of title functions."

[42] UNCITRAL Yearbook, 1993, supra (f.n. 5), p. 201, paras. 77-79 (about requirement of an original document which constituted an obstacle to the use of EDI); UNCITRAL, **"Automatic data processing, legal value of computer records, reports of the Secretary Genral"**, UNCITRAL Yearbook 1985, A/CN.9/265, pp. 351-67 [hereinafter referred to as UNCITRAL Yearbook 1985], pp. 355-62; see also report of the Secretary-General on 18th session of UNCITRAL in Vienna, 3-21 June 1985, about **"Draft legal guide on electronic funds transfer, chapter one, legal issues raised by EFT"**, pp. 6-7 [hereinafter referred to as legal issues]; Enyon Smart, **"Electronic Banking: An Overview of the legal Implications"**, see Goode, supra (f.n. 13), pp. 1-4.

[43] Talmor, Sharona, **"Technology: Trade partners get hooked up"**, The Banker, February 1994, p. 65 [hereinafter it is referred as Talmor], at p. 66 said: "The fact that there is no international trade finance industry standard for EDI opens a golden opportunity for banks which are now setting up their own standards. The one that comes up with a good product first will gain the competitive edge."; and at p. 67 it is pointed out: "EDI and trade facilitation will prove attractive to banks as the way of the future. But this take a long time; the technology might be here today but a myriad technical, statutory and regulatory details remain to be resolved."; Hoeren, Thomas, **"Electronic data interchange: the perspective of private international law and data protection"**, Carr, supra (f.n. 14), pp. 128-41.

[44] Talmor, ibid., at p. 65 said: "What proved to be difficult in the automation process was that document processing requires a certain level of expertise. Due to complexity and a high number of exceptions it is hard

4. In most countries traditional communication services, such as mail, telephone, telegraph and telex are, to a great extent, well established nationally and internationally. They are often state monopolies in one form or another, a fact that makes the system both more certain and more secure.

SECTION B: LEGAL ISSUES ABOUT ADP/EDI

1. ROLE OF A "PAPER-BASED" DOCUMENT IN INTERNATIONAL TRADE

As previously mentioned, issues relating to functions of documents may arise and should also be considered under ADP/EDI: what is the nature of an electronic transmission? Can such transmission perform similar functions to a document provides under the paper-based system?

1.1. "Informative" function of a paper document

Regarding the importance of the "informative" function of a document and whether ADP/EDI as a paper-less system satisfies parties to an international transaction (like LCs), UNCITRAL has included this issue in a question: "How far is it possible to retain the informative function of paper documents in an ADP-based system in a manner that satisfies the need of parties to achieve the same technical and legal standards as before?"[45] So far as the form and contents of documents are concerned there seems no problem would arise since it is possible to produce electronic documents similar to those used in a paper-based system. In respect of rules, however, there may be legislative texts which may require a paper document. There seems to exist no problem as to the acceptability of an electronic document if

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to model this expertise. There always needs to be manual intervention to ensure that details of the trade are accurate."; and at p. 66 the same writer pointed out: "The first challenge for EDI lies in the modelling the manual complexity that still shrouds trade finance. The second is the installation of the EDI networks in the emerging countries, which are increasingly opening to trade. [...] The final challenge is achievement of an agreement among the key parties involved in trade finance EDI. Agreeing on standards would allow an EDI message to be transmitted irrespective of the communicating parties particular hardware and software, and for the eventual creation of a total EDI enviroment for trade finance."

[45] UNCITRAL Yearbook, 1983, supra (f.n. 37), p. 181, para. 64.

it is accepted that an ADP/EDI document is a perfect document as long as it performs functions similar to those of a paper document.[46]

A question of importance is the meaning of **"signature"** under ADP/EDI: must it be a hand written symbol or can it be made by mechanical or electronic means? To answer that question, firstly, function(s) of a signature should be clarified; secondly, it should be considered whether a signature other than a hand written symbol would satisfy the necessary requirements for a signature. A handwritten signature indicates two things to the recipient of a document: firstly, the source of the document; and secondly, the approval of a person who has authority to approve the contents of an issued document (authenticating party).[47] With regard to these requirements most legal systems permit other types of signature made by stamps, symbol, facsimile, mechanical, and electronic means.[48] As a result, and because of the increasing use of ADP/EDI in international trade, the meaning of "signature" has been expanded in a recent international convention to cover electronic authentication.[49]

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[46] UNCITRAL Yearbook 1983, supra (f.n. 37), at p. 181, para. 69 pointed out: "The validity of such "incorporation clauses" is being discussed in many form and is accepted in most instances. (See Kurt Gronfors, "Cargo Key Receipt and Transport Document Replacement", Gothenburg 1979, pp. 18-19; and E. du Pontavice, "Legal restraints on trade data interchange", ECE document TRAD/WP. 4/R. 116 para. 7 et seq.)" [Emphasis added]; in order to avoid long texts different methods are suggested, such as using an "incorporation clause" in the form of code words such as "carrier's conditions" or "ICC rules"; see also UNCITRAL Yearbook, 1993, supra (f.n. 5), p. 202, paras. 87-88 (about the concept of originality and its connection to the reliability of the information in a document).

[47] UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 357; UNCITRAL Yearbook, 1993, supra (f.n. 5), at p. 199, para. 63 said: It was generally agreed that among the functions of a handwritten signature were the following: to identify a person; to provide certainty as to the personal involvement of that person in the act of signing; to associate that person with the content of a document."

[48] "The most common form of authentication required by national law remains a signature, which is usually understood to mean the manual writing by an individual of his name or initials. Legal systems increasing permit the required signatures of some or all documents to be made by stamps, symbol, facsimile, perforation or by other mechanical or electronic means. This trend is most evident in the law governing transport of goods, where all the principal multilateral conventions that require a signature on the transport document permit that signature to be made in some way other than by mutual signature." [UNCITRAL Yearbook, 1990, supra (f.n. 11), p. 260]

[49] UNCITRAL Yearbook, 1992, supra (f.n. 8), at p. 357 said: "The Working Group proceeded with a review of the provisions of some multilateral conventions concerning the definition of "signature" and other means of authentication. It was noted that a number of recent international instruments envisaged functional

There is, on the other hand, a tendency to support the idea that there is no need for mandatory requirements of signature in EDI, and the issue of authentication as to the source and contents of an EDI message should be left for parties to a commercial transaction to decide what sort of authentication would be suitable for them.[50] However, in countries where signature is required by law for a particular document, the above mentioned view would cause great uncertainty unless appropriate legislation is provided to cover EDI messages.[51]

Appropriate legislation should consider differences which exist between a hand-written signature and an EDI authentication, as pointed out in a Scandinavian study (Nordipro Special Paper Number 2- Legal Questions of Trade Facilitation): "It

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equivalents to the handwritten signature to be used in the context of electronic transmissions. Those provisions generally provided an extended definition of "signature", such as the following definition found in article 5(k) of the United Nations Convention on International Bills of Exchange and International Promissory Notes: ""Signature" means a handwritten signature, its facimile or an equivalent authentication effected by any other means."; see also Article 22 of UCP 500, mentioned previously; it is also said: "In determining whether a method of authentication was commercially reasonable, factors to be taken into account might include the following: (1) the status and relative economic size of the parties; (2) the nature of their trade activities; (3) the frequency at which commercial transactions took place between parties; (4) the kind and size of the transaction; (5) the status and function of signature in a given statutory and regulatory enviroment; (6) the capability of the communication systems; (7) the authentication procedures set forth by communication system operators; and (8) any other relevant factors." [UNCITRAL Yearbook, 1993, supra (f.n. 5), p. 200, para. 67]

[50] "The Working Group was generally agreed that there existed a need to eliminate the mandatory requirements of signatures in EDI communications. It was also agreed that there existed a need to promote the use of electronic authentication procedures regarding the source and the content of EDI messages, and that such procedures should be adopted to the functions served by an electronic message. Parties should be allowed to determine the nature of such authentication procedures within the relem of commercial reasonableness. Wide support was given to the idea that legislative provisions might be needed to establish the principle of "commercial reasonableness". The Working Group was agreed that the issues raised by the notion of signature, as well as by related techniques such as the digital signature, required close cooperation with other organisations active in the field, both at the technical and at the legal level." [UNCITRAL Yearbook, 1992, supra (f.n. 8), pp. 357-58]

[51] UNCITRAL Yearbook, 1990, supra (f.n. 11), at p. 261 said: "However, the extent to which such methods would receive legal recognition in States where signature is required by law for a particular documents remains a matter of great uncertainty. Where the law has not been interpreted by the courts or other reliable sources so as to consider an electronic form of authentication as a "signature", it is likely that this uncertainty will be overcome only by legislation. A question of consideration is how far such legislation, when specially permitting or requiring authentication to be made by EDI, should require evidence of conformity with an applicable EDI protocol, at least as a condition of attracting a presumption of authenticity, the onous of proof being shifted to the party asserting the authenticity of the message in cases where the requirements of the protocol are not satisfied."

is important to understand the essential difference from the legal angle between a document and automatic data transfer. The ordinary export document retains its identity: a signature on that document will remain there, whether made by an authorised person or not- and even if it is forged. Correction and addition will also show on the document itself. Automated data transfer, on the other hand, by its very nature, has a completely different characteristic. Once fed into the computer the data seem to lose their identity; they are retained in a computer memory and become accessible only by computer programs. Here also there is a legal aspect the problem of regulatory law. Paper-born data is acceptable- but with a known specified format, data content and method of authentication. A corresponding legal acceptability for data produced automatically or electronically may not exist."[52] Lastly, it is pointed out that it is necessary for those who intend to use ADP/EDI to make clear what they mean by **"authentication"**.[53] At present, different techniques are available for the authentication of electronically transmitted documents[54] but one should be aware of the cost of operation.[55]

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[52] Wheble, *supra* (f.n 13), p. 126.

[53] UNCITRAL Yearbook 1983, supra (f.n. 37), para. 71; Walden, *supra* (f.n. 15), pp. 105-6; see also legal issues, supra (f.n. 42), pp. 20-21, issue no. 12 that pointed out, **"Should there be a legal requirement as to the form of authentication necessity in an electronic funds transfer?"** It is commented that: "1. [...] there seems to be no general requirement that a funds transfer instruction must be authenticated; [...] 4. However, it may be thought to be impracticable to specify by law in any meaningfull way the manner in which an electronic funds transfer instruction should be authenticated. In contrast to authentication of a paper-based document, where a reasonably exhaustive list of means of authentication, including signature, could be given if desired, there are innumerable ways to authenticate a message sent by telecommunications. With the rapid development of technology, some current methods of authentication can be expected to become weaker while new and more secure forms of authentication can be anticipated; 5. As a result, it might be thought that any statutory provision concerning that authentication of an electronic funds transfer instruction should do little more than to authorize the use of means appropriate to the type of instruction involved. Questions as to the liability for loss caused by fraudulent or erroneous authentication might be dealt with separately, as might questions as to the party who bears the burden of proof as to whether the authentication was genuine or not."; see also UNCITRAL Yearbook, 1993, supra (f.n. 5), at p. 201, paras. 75 and 76 various suggestions were made relating to the a possible definiton of "authentication".

[54] UNCITRAL Yearbook, 1991, supra (f.n. 11), at p. 393 said: "The issue of authentication of documents is addressed in most model agreements. It may be recalled (see A/CN.9/333, paras. 50 to 59) that the number of techniques have been developed to authenticate electronically transmitted documents. As regards identification of the transmitting machines, telex and computer-to-computer telecommunications often employ call-back procedures and test keys to verify the source of the message. Techniques combining several keys can be used as a means of identifying the operator of the sending machine."; see also

1.2. "Evidential" value of EDI messages

Another function of a paper document is that of the evidential value of such a document in courts. Would an electronic transmission be accepted as good and valid evidence in the eyes of the law? There are major variations in the general law of evidence regarding the validity of a document as evidence:[56] **Firstly**, in many legal systems it is accepted as a principle that all kinds of information relevant to a dispute are allowed to be submitted to the court and it is the court's obligation to accept presented information as good evidence, or to reject it. In the legal systems in question it seems no problem would arise as to the evidential nature of an electronic document.[57] However, variations have existed regarding the exact manner in which an electronic-based evidence is admitted and handled.[58]

UNCITRAL Yearbook, 1990, supra (f.n. 11), at p. 260 pointed out: "Most generally, as regards identification of persons in an EDI context, verification procedures can be based upon one or more of three parameters: what the operator knows (passwords, secret codes), what the operator holds (microcircuit cards) or what the operator is (biometrics). Of the three, biometrics (i.e. the physical characteristics of the operator) is the most exact. Six biometric technologies are currently available: retina scans which record the eye signature of an individual and store it in microprocessor; thumb print or finger print identification systems; hand geometrysystem which measure, record and compare finger length, skin translucency, hand thickness or palm shape; voice verification devices which record voice patterns and inflections; signature verification devices which trace either the static or dynamic characteristics of a person's signature; keystrok dynamics which identify individuals by their typing patterns and rhytmes. All of these biometric products compare the stored templets with fresh patterns or scans to allow or deny access to the secured mechanism."

[55] UNCITRAL Yearbook, 1991, supra (f.n. 11) at p. 393 said: "As concerns the issues of authentication, it is clear that the legal reliability of EDI techniques that high standards be implemented achiveing legal certainty as to the identity of the sender, its level of authorization and the integrity of the message. However, it must be pointed out that the various authentication methods available involve very different costs."; see also UNCITRAL Yearbook, 1992, supra (f.n. 8), at p. 357 it was stated that: "[...] various techniques (e.g., "digital signature") had been developed to authenticate electronically transmitted documents. Certain encryption techniques could authenticate the source of message, and also verify the integrity of the content of the message. It was observed that, in considering whether to employ such authentication methods, attention needed to be paid to the cost involved, which might vary considerably according to the extent of computer processing that was required."

[56] "As regards the law of evidence, the TEDIS study broadly distinguishes between the rules applied to litigation in civil law countries and to litigation in common law countries, and the rules governing the retention of business record for tax and regulatory purposes." [UNCITRAL Yearbook, 1990, supra (f.n. 11), p. 257]; see also UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), pp. 372-73 (about evidential value of EDI messages).

[57] "At its eighteenth session (1985), the Commission had before it a report by the Secretariat entitled "Legal value of computer records" (A/CN.9/265). That report came to the conclusion that, on a global level, there were fewer problems in the use of data stored in computers as evidence in litigation than might have been

Secondly, in some states there is a list of acceptable evidence always required to be in the form of written documents. An electronic document is not accepted as evidence in court, or it might be accepted for clarifying the facts of the case. However, there may not be restrictions about commercial matters as compared with criminal questions in countries adopting such procedures.[59]

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expected." [UNCITRAL Yearbook, 1992, supra (f.n. 8), pp. 347-48]; see also UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), p. 368, UNCITRAL Yearbook, 1991, supra, pp. 393-94 (regarding evidential value of computer records), and UNCITRAL Yearbook, 1990, supra (f.n. 11), p. 258 (about evidence in acconting and tax law); see Commission, supra (f.n. 22), p. 101 provides: "Article 4: Admissibility in evidence of EDI messages- To the extent permitted by any national law which may apply, the parties hereby agree that in the event of dispute, the records of EDI messages, which they have maintend in accordance with the terms and conditions of this Agreement, shall be admissible before the Courts and shall constitute evidence of the facts contained therein unless evidence to the contrary is adduced."

[58] See UNCITRAL Yearbook, 1992, supra (f.n. 8), at p. 353 (about the admissibility of EDI messages as evidence) which is said: "The Working Group commenced its consideration of this item by hearing statements concerning statutory and case law in different legal systems on the question of admisibility of computer records and other forms of electronic-based evidence. This exercise revealed a veriety approaches. In many legal systems, parties to commercial disputes were generally permitted to submit any type of evidence that was relevant to the dispute. Among those countries, however, variations existed as to the exact manner in which electronic-based evidence was admitted and handeled. For example, in some countries specific rules had been established governing the introduction of electronic evidence. Such requirements were aimed at establishing the intelligibility, reliability and creditability of the evidence, focusing specifically on the methods of entry of the information and the adequacy of protection against alteration. Some jurisdictions required expert certification as a condition for introduction of the evidence. In some countries, the procedures for objecting to the introduction of electronic evidence differed from the procedure involved in objecting to other forms of evidence. In quite number of countries in this first general group, when a question arose as to the accuracy or value of the electronic evidence, it was left to the court to weight the extent to which the evidence should be relied upon. The factors to be considered in such an assessment of the quality of electronic-based evidence might include the degree of security in the system that produced the evidence, its management and organisation, whether it was operating properly and any other factors deemed relevant to the reliablity of the evidence."

[59] "The above survey revealed that in most countries a distinction had to be drawn between the admissibility of electronic evidence in judicial proceedings and the acceptance and use of such evidence by administartive authorities. [...]" [UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 354]; see also UNCITRAL Yearbook, 1990, supra (f.n. 11), pp. 257-58 (regarding the issue of evidence in Civil law countries) which relevant parts are quoted below: "The TEDIS study notes that the development of EDI meets legal obstacles in civil law countries due to the uncertain value of a copy, since all computer records and the computer printouts are copies of an original, whether the original is paper document or an electronic message. [...] In those countries where a general rule of civil law (as distinguished from commercial law) is that economic transactions can be proven in litigation only by a writing, there are many exceptions. [...] It must be pointed out that the general requirement of a wrting is considered as an evidentiary requirement of civil law and not of commercial law, where evidence of contracts can be presented to a court in any form. [...] The consequence is that the requirement of a writing does not affect EDI as used for most trading contracts. Since the determination of which rule on evidence applies depends upon the status of the defendant, the rule of civil law applies when a party who is not a merchant is the defendant and the rule of commercial law applies when the defendant is a merchant. In this context, the characterization of the plaintiff as a merchant or as a non-merchant is

Thirdly, in common law countries the general principle is based on oral and adversarial procedures, namely, a witness is able to testify only about matters which he knows personally. So, such procedures give the other side an opportunity to verify statements by cross-examination. Therefore, what he learns from another source, e.g. from another person, a book, etc., is called **"hearsay evidence"**, and it is not automatically accepted as evidence by tribunals. There are many exceptions to this principle; for instance, business records generated in the ordinary course of business may be accepted as evidence even though there may be no individual available to testify from his personal knowledge and memory of the record.[60]

Nowadays, no difficulty seems to exist in accepting electronic documents as evidence. Some common law jurisdictions have accepted computer print-outs as

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irrelevant. [...] Even when the civil law rule applies, in many countries the requirement of a written evidence is considered not to be mandatory. It is therefore generaly possible for the parties to agree beforehand that contracts they enter into will be evidenced by means other than a writing."

[60] UNCITRAL Yearbook, 1990, supra (f.n. 11), at p. 258 (regarding the issue of evidence in Common law countries) said: "The TEDIS study states that in the common law, the rules of evidence that have a direct impact on EDI are the "heresay evidence rule" and the "best evidence rule". According to the hearsay evidence rule, subject to certain exceptions, a document is not admissible as evidence for the purpose of proving the truth of the matters stated in the document. According to the best evidence rule, only the original documents should be presented as evidence. As in civil law countries, there is general agreement that a computer printout is not an original. Both of those rules in their pure form would be serious obstacles to the increasing use of EDI. To overcome them in the United Kingdom, section 5 of the 1968 Civil Evidence Act expressly allowed the use of computer printouts as evidence. [...] The general conclusion of the TEDIS study on evidence in litigation was that, while there were no major obstacles to the development of EDI in civil law countries, and therefore no need for fundamental changes of the rules, the common law countries showed theoretical difficulties which made it necessary to adopt statutory law to meet the need of EDI."; it is also said: "It was reported that, in common law countries, in which an oral and adversarial procedure was generally employed in litigation, emphasis was placed on testimony based on the personal knowledge of witness, thus allowing the opponent an opportunity to verify the statements through cross-examination. In those countries, in which there tended to be more elaborate statutory structure governing the admission of evidence and more limited judicial discretion, secondary sources were generally excluded as "hearsay evidence". In those countries in which computer records and other forms of electronic-based evidence were considered as hearsay evidence, admissibility was nevertheless possible by way of the "business records" exception to the hearsay rule. In order to be able to benefit from this exception, the proponent of the evidence would typically have to demonstrate that the information was complied in the normal course of business and would have to describe the chain of events involving the compilation of the information and leading up to the point when the evidence assumed its current form, so as to ascertain the integrity and reliability of the system producing the evidence. In some cases the testimony of an expert might have to be tendered to certify the reliability of the evidence. Opponents of the evidence would be permitted to present conflicting evidence in written, oral or electronic form." [UNCITRAL Yearbook, 1992, supra (f.n. 8), pp. 353-54]; Hirst, Micheal, "Computers, hearsay and the English law of evidence", Carr, supra (f.n. 14), p. 159.

business records and as exception to the hearsay-evidence rule.[61] In England under Section 5 of the Civil Evidence Act 1968 a computer record is accepted as evidence: "In any civil proceeding a statement contained in a document produced by a computer shall, subject to rules of court, be admissible as evidence of any fact stated therein of which direct oral evidence would be admissible."[62]

1.3. "Symbolic" function of a paper document

Documents like bills of lading, beside having other characteristics of a document (namely informative and evidential functions), are negotiable since they are accepted by law as well as in practice as "document of title."[63] The question is: would an electronic message, which loses its physical character and thus its negotiability, provide the same services (transferring the title of purchased goods to the buyer or provide a good security for bankers who issued LCs) as a paper-based

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[61] UNCITRAL Yearbook 1985, supra (f.n. 42), p. 355, paras. 27-34.

[62] Walden, supra (f.n. 15), pp. 106-7; see also **the Police and Criminal Evidence Act 1984** and **Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission (UNCID) Rules, TRADE/W.P. 4/R. 483 Annex)**, Article 10, which states that contracting parties need to ensure that "a complete log is maintained of all trade data as they were sent and received"; for technical solution look at UNCITRAL Yearbook 1983, supra (f.n. 37), para. 106 in which 6 methods were suggested namely logging, print-outs, passwords, protocols, confirmation and cryptography; and for contractual rules on admissibility of evidence see UNCITRAL Yearbook, 1991, supra (f.n. 11), at p. 392, said: "In earlier days, controversies arose about the validity of privately agreed standards on admissibility of evidence in case of litigation. It now seems to be widely conceded that under both common law and civil law systems, such private commercial agreements on admissibility of evidence are valid or, at least, they are not faced with a general prohibition."; see also UNCITRAL Yearbook, 1993, supra (f.n. 5), at p. 202, para. 92 (for latest view regarding the contractual rule).

[63] "There are considerable problems with regard to the value and status in law of EDI messages and the dematerialization of essential documents in commercial law such as bills of lading, letters of credit; etc." [UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 385]; UNCITRAL Yearbook 1983, supra (f.n. 5), p. 186, par. 128; and "negotiability" is also defined as "the legal effect attached to the possesion and transfer of the original document."; for the relevant Act in English law see **the Carriage of Goods by Sea Act 1992 (COGSA)** and see Faber, Diana, **"Shipping documents and EDI"**, Carr, supra (f.n. 14), p. 83 [hereinafter referred to as Faber], at pp. 90-91, concerning the Act stated: "This Act deals with title to sue and replaces the Bills of Lading Act 1855 in relation to documents issued after 16th September 1992. It covers bills of lading including received for shipment bills but excluding bills which cannot be transferred. It applies to sea waybills which are defined as documents which are not bills of lading but do contain or evidence a contract of carriage by sea and which identify the consignee even in a way which allows the identity of the consignee to be varied after issue. Non transferable bills of lading would probably fall within the definition of sea waybills. The Act also applies to true ship's delivery orders." (for other details related to COGSA 1992, see relevant discussion in Chapter VII, Section A.2.2.3, above); Tettenborn, A.M., **"Transferable and negotiable documents of title- a redefinition?"**, LMCLQ, Part 4, Nov. 1991, pp. 538-42.

bill of lading provides?[64] It is admitted that this matter constitutes a serious obstacle to movement towards a ADP/EDI system.[65] Although there are efforts by different organisations active in the field of international trade to overcome the difficulties and different projects have been examined by organisations, they have not yet achieved any success.[66] To tackle the problem it is suggested that the use of negotiable bills

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[64] "Explanations were given regarding the transfer of title to goods in transit under the "CMI Rules for Electronic Bills of Lading", adopted by the Comite' Maritime International (CMI) in 1990. Those Rules applied if the participating parties so agreed. It was pointed out that an electronic bill of lading, in order to attractive alternative to a paper-based bill of lading, had to fulfil in particular the following functions: to evidence the contract of carriage; to evidence receipt of goods; to provide a right to control goods and the possibility of transferring that right; to secure reliable information concerning the description of the goods; to allow veryfication by interested third parties (e.g., insurers) of information concerning goods; and to allow establishment of a security interest in the goods." [UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 363]

[65] For instance, see UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 358; and Faber, supra (f.n. 63), at p. 89 concerning some of difficulties which may arise regarding the issue of signature of an electronic bill of lading pointed out: "These problems are firstly that banks would not accept them as security for their loans and this would effectively prevent letter of credit sales and amount to a significant obstacle to international trade. Secondly, it would not be possible to pass property in the goods using an electronic bill. Thirdly, the holder of an electronic bill would not be able to establish title to sue the carrier. The forth potential problem concerns the incorporation into the contract of carriage of internationlly recognised rules governing the rights and liabilities of the parties."

[66] Some instances, in respect of a negotiable electronic bill of lading, are as following: 1. <u>"SeaDocs registry limited"</u>- It is quite common in the oil sopt market to sell one oil cargo repeatedly during a trading day to traders in different parts of the globe. SeaDocs Registry Limited (SeaDocs), a London cooperative venture between Chase Manhatan Bank and INTERTANKO (an association of oil tankers), was intended to bring about the telecommunicated negotiation of bill of lading issued in commection with oil shipments. Unfortunately, while SeaDocs was the first serious attempt to fashion a negotiable electronic bill of lading that proved to be technically feasible, it was unsuccessfull and was closed within one year of its inauguration in 1986. [...] Despite its demise, SeaDocs proved that an international, centralized, largely electronic bill of lading was technically feasible. From the standpoint of the paperless letter of credit, its most important lesson was that unlike the DFR, the CKR, and the English sea waybill, SeaDocs' PIN conveyed right to the goods equivalent to those conveyed by a negotiable bill of lading that were enforceable as of the moment of transmission of the approriate messages by SeaDocs." [Kozolchyk's article, supra (f.n. 4), pp. 89-90];

2. <u>"The comite' maritime international's (CMI's) "private key."</u> The rules for the electronic bills of lading adopted in 1990 by the CMI are the most sophisticated attempt to date to regulate open-ended, computerized issuance and negotiation of bills of lading. Unlike the SWIFT rules, the CMI rules can apply to any contracting party willing to abide by them. As optional rules, however, the CMI rules require that the parties to the electronic bill of lading specify the application of the rules in the "master" or in individual agreements. [...] The main feature of the CMI rules is the creation of an electronic bill of lading not by centralized entity such as SeaDocs but by the carrier, which also acts as a registry of negotiations. Accordingly, the CMI electronic bill of lading can be issued by as many as carriers as have the necessary hardware and software, and it can be "endorsed" by as many endorsees as have the same facilities. The device that makes such issuance, endorsement-negotiation, and registration possible is the "private key." The private key, in the words of one of CMI draftsmen, is "akin to single transaction personal identification number. [...] The CMI's private key operative scheme is as follows: (1) upon receiving the goods, the carrier electronically sends to the shipper or the party designated by the shipper a "receipt message" containing the

of lading should be discouraged and other types of transport documents like sea waybills[67] should be used by parties to an international transaction involving a letter

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description of the goods and reservations by the carrier on the state of the goods. (2) The recipient confirms receipt of the message to the carrier, and following this confirmation, the carrier provides him with the private key. (3) Depending upon the specific system in use, the shipper and subsequent holders of the electronic bill of lading receive a password to access the carriers computer network and/or an identification number and a private key. (4) The shipper or subsequent sending party then inputs the electronic address of the carrier-receiving party, and, as with telex messages, each party to the transmission sees the other party's address as the electronic "handshake" takes place. (5) After the security procedures are satisfied and the message is sent, the private key is used by the shipper or subsequent holders to verify the authenticity of the message. Thus, even though a fraudulent sender may know how to access the network and establish a valid identity, he cannot obtain possession of the goods without the use of the private key. [...] Bankers cannot visualize how telecommunications between strangers can be accomplished without incurring a hig risk of fraud. They prefer the security of uniform log-in procedures, message numbering, error choking, encryption, record retention, uniform formats and message self-auditing associated with SWIFT procedures. [...] From a legal standpoint, it is doubtful whether the private key procedure can be function as a negotiable bill of lading. The transferee's rights in the private key procedure depend upon both the issuance of a private key and the transferee's acceptance of the right to control. Yet the transferee's acceptance of the right to control is based upon the information in the receipt message transmitted by the carrier or by someone purporting to the carrier. Accordingly, it is not clear what rights are accepted by the transferee; relying upon fraudulent information, he may have accepted nonexisting rights. Meanwhile, the carrier may issue the private key to the transferee in the belief he has accepted a genuine receipt message. The rights incorporated into the private key, then, depend not only on the lawful acquisition of the private key, but also on the text of the carrier's valid receipt message. And while no carrier would want to be bound by terms and conditions other than those on the receipt message it sent, no transferee would want to pay for an electronic bill whose terms and conditions are other than those he received. The difficulty cannot be overcome by a stipulation that the receipt message and the private key together are the equivalent of a paper-based negotiable bill of lading. For as a rule, the creation of negotiable documents of title is a prerogative reserved solely for the legislature." [Kozolchyk's article, supra, pp. 90-92]; see also UNCITRAL Yearbook, 1992, supra, p. 364, where it is said: "It was noted that mere possession of the currently valid private key was not sufficient to transfer the right to control and transfer. The carrier, in communicating with the holder of the key, would also verify whether the instruction for transfer was given by the person identified by the perivious holder. Such verification of identity would be done by electronic means of authentication in addition to the private key. [...] It was noted that the CMI Rules did not make it possible for two persons to have simultaneous control over goods, one as the owner of the goods and the other as the holder of the security interest in the goods. If a security interest was to be established in favour of a person (e.g., a bank), that person would have to be made the single holder of the right of control and transfer over the goods. A suggestion was made that consideration should be given to a possibility that an owner of goods, while retaining a degree of control over the goods, would establish through EDI a security interest in the goods in favour of a creditor. A related suggestion was to explore the possibility of an electronic transfer of a security interest in goods independently from the transfer of ownership over goods."

[67] Kozolchyk's article, supra (f.n. 4), at p. 85, said: "The sea waybill, the air waybill, and the rail consignment note function as receipt of the goods by the sea, air, and rail carriers and also an informational documents. Unlike document of title, these bill do not have to be presented to the carrier in order to obtain possession of the goods. The consignee of an air, sea, or railroad bill of lading needs only to identify himself to obtain possession. Nonetheless, since these receipts are often needed before the arrival of the goods to expediate their release, they can be transmitted electronically to the consignee [...]." And as long as their layout is uniform and their text is structured and standardized, they can be transmitted to anyone, including customs officials and banks, using the same EDI software.

of credit contract.[68] As to the electronic transmission of the bill of exchange it is similarly suggested that before the adoption of such an electronic document, the following issues should be resolved first: issues related to string contracts (contractual problem), transferability of a document, concepts of possession and of property, and "procedural difficulties."[69] Several theories in connection with legal

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In addition to allowing the ship to unload immediately upon arrival (thereby reducing the time and cost of unloading, processing, and warehousing of the cargo), the sea waybill also allows the consignor to vary his delivery instructions during the carriage. This feature can be useful when buyers suddenly become insolvent or when unfavourable market conditions require re-routing of the cargo."; and the same writer at pp. 85-86 pointed out: "**The Scandinavian Data Freight Receipt.** In 1971, the Atlantic Container Lines (ACL), one of the world's largest container carriers, introduced a sea waybill labeled Data Freight Receipt (DFR) for its North Atlantic shipments. As with the air waybill, the DFR eliminated the need to send paper documents with the shipment. [...] As with air waybill, the DFR was non-negotiable. It acknowledged receipt only for shipment and not for on-board loading."; see also UNCITRAL Yearbook, 1991, supra (f.n. 11), at p. 396, said: "Another view on the questions raised by the documents of title in an EDI context favours the use of non-negotiable transport documents. That view is reflected, for example, in the first draft of a policy statement by the ICC which states that: "Many of the perceived legal "obstacles" to the use of EDI are not true obstacles, rather they are long-standing commercial habits which must be broken if EDI is to be used its maximum advantage [...] One example of a perceived obstacle is found in common misconception that transactions involving negotiable documents represented by signed writings cannot be handled with EDI. They can via the use of non-negotiable electronic messages."; and in the same Yearbook, at p. 396 pointed out: "A commentator on the subject noted that: "Most probably the use of the negotiable transport document would be diminish in the future. Commercial practice will prefer the non-negotiable waybill system or replace transport documents altogether by transferring the relevant information electronically. Be that as it may international commerce will have the same need to transfer the legal rights from sellers to buyers in international contract of sale as previously. Is the only satisfactory solution to elaborate an international convention on transfer of title to goods in transit from one country to another? Most probably those questions will be the focus of attention from now on and during the rest of the present century. " [Ramberg, Jan, **"International Carriage of Goods: Some Legal Problems and Possible Solutions"**, The international Commercial Law Series, Vol. I, 1988]

[68] See UNCITRAL Yearbook, 1983, supra (f.n. 37), at p. 186, para. 129, recommendation No. 12 **"Measures to facilitate maritime transport document procedures"**.

[69] The relevent part of that suggestion is quoted below: "Four legal problems would have to be solved before any attempts were made to introduce the required technological innovations. [...] The characteristic of bills of exchange foreshadow the problems that would have to be solved if they were to be replaced by defferred payment EFTs. The first problem and major one may be described as the contractual problem. Despite its terms and steriotyped text, a bill of exchange embodies a string of contracts. [...] These are not only the contracts between the holder and the persons who have signed the bill in one or another capacity but also contractual relationships substituting between those parties. Basically, each party has a right of recourse against earlier ones if the bill is not met. It is difficult to see how much such a string of contracts can be created by deferred payment EFTs. [...] The second problem regarding the creation of bills by deferred payment EFTs is based on the fact that a negotiable instrument needs to be transferable. This means that it must be of a type that may be indorsed and delivered. [...] The third obstacle to creating bills of exchange by means of deferred payment EFTs is related to the fact that a negotiable instrument constitutes an item of property and not just a string of contracts. This attribute of a bill is reflected by the importance played in respect of it by the concepts of possession and of property. [...] The fourth and last objection may be best

and technical issues have been suggested, but the lack of legal rules, both nationally and internationally, leads to a feeling of insecurity which may hinder further developments.[70]

2. RISKS AND LIABILITY (LEGAL SECURITY)

There are several factors involving risks in an ADP/EDI system in contrast to the paper-based funds transfer, such as non-standardized messages and procedures, reproducing messages, error, and failure of equipment. Consequently, there may be different types of losses, for instance, loss of principal (which may happen by fraud), loss of interest and losses which may arise from exchange rate variations and consequential damages. Therefore, for mitigating such risks the system should adopt, both technically and legally, security measures as a matter of priority and importance. So far as the present study is concerned, issues related to legal security are discussed below.[71]

Legal security

From the legal point of view, methods of security under an ADP/EDI system can be based on administrative instruments, practices and court procedures in order

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called the "procedural difficulties". A bill of exchange has to be presented for acceptance and for payment. If it is dishonoured, the holder has to follow a certain procedure before he can bring actions to enforce his rights against the drawer and the indorsers. He has to sent notice of dishonour and, in the case of a foreign bill, has to effect protest through a notary." [Ellinger, Peter, **"Electronic Funds Transfer as a Deferred Settlement System"**, see Goode, supra (f.n. 13), pp. 38-43]; see also UNCITRAL Yearbook, 1991, supra (f.n. 11), at p. 396, said: "As to whether an electronic system providing negotiability of transport documents can function satisfactorialy on a purely contractual basis, the question arises whether all the persons to whom the title to the goods in transit would currently be transmitted by use of a paper negotiable bill of lading would be willing or able to become parties to a contractual network arrangement that would regulate the rights and obligations of the parties to the transport operation itself. For those parties absent from the network arrangement at least, statutory law or an international convention seems to be needed."

[70] UNCITRAL Yearbook 1983, supra (f.n. 37), pp. 186-7, paras. 130-48; Knut Helge Reinskou, **"Bills of lading and ADP: description of a computerized system for carriage of goods by sea"**, Journal of Media Law a Practice, Vol.2, No.2, September 1981 (about legal approach); Roger Henriksen, **"The Legal Aspects of Paperless International Trade and Transport"**, Copenhagen, 1982 (dealing with technical approach); Cargo Key receipt System and the INTERTANKO Project-sale of Cargo through a clearing house (systems are testing at present).

[71] Regarding technical security a classification has been suggested as covering physical security, organizational security, operational security, and system orientated security. [UNCITRAL Yearbook, 1983, supra (f.n. 37), p. 182, paras. 77-79]

to give a clear picture to the contracting parties as to their mutual rights and duties. Important legal points may arise, for example, to what extent is the sender of a message (as an offeror or acceptor) legally bound if his statement has been unintentionally changed in the transmission or pre-transmission process? What would liability for losses caused by such errors be? What is the responsibility of the intermediary party who is providing the transmission of the message?[72] Generally speaking, it is suggested that liability for damages by a party causing a failure or error in communication should rest with the sender, unless agreed otherwise, under the principle of freedom of contract.[73]

Another question is: which party would have to bear the risk of loss resulting from failure or error in communication? In other words, to what extent is the sender of an electronic message, in case of failure or error caused by the computer, responsible? It is generally accepted that the sender has no liability in such a situation, unless he would have been able to prevent the failure or reduce its consequences.[74] It seems the network operator should be held responsible for any

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[72] UNCITRAL Yearbook, 1983, supra (f.n. 37), p. 182, paras. 81-92; Walden, supra (f.n. 15), at p. 109 said: "With regard to alterations in a message forming the basis of a contract, United Kingdom law states that: "Where corruption occurs, a message may be received in substantially different from the form in which it was transmitted. If this occurs, and neither party is aware of the corruption, the mutual misunderstanding will prevent any enforceable contract from arising."; see also Jonathan Lass, **"Fraud, Error and System Malfunction"** and Robert pennington's paper with similar title [see Goode, supra (f.n. 13), pp. 57-83].

[73] "A suggestion was made that the question of liability and risk might be addressed by a provision along the following lines: "Subject to the agreed procedures for authentication or verification, the risk and liability for any faulty transmission and resulting damages rest with the sender."" [UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 361]

[74] In a comment on a legal question namely "should a bank be free from responsibility for errors or delayed funds transfers caused by failures in computer hardware or software?" it was concluded that: "As a result, a generalized exoneration from liability may be thought not to be justified but that exemption from liability for computer failure might be justified when the bank could not be expected to have prevented the failure or reduced its consequences." [Legal issues, supra (f.n. 42), issue no. 19, p. 27]; there are 41 legal issues concern to EFT and for more detailes, for instances, see **issue no.18** (Should public telecomunications carriers, private data communications services, electronic funds transfer networks and electronic clearing-houses be responsible for losses arising out of errors or fraud in connection with a funds transfer instruction?), **issue no. 20** (Should a bank be liable to its customer for having entered a debit or credit to the account according to the account number indicated on the funds transfer instruction it has received if the name on that account does not correspond to the name given on the funds transfer instruction?), **issue no. 21** (Should the bank or the bank customer carry the burden of proof whether a debit to the transferor's account was authorized by him or occured through his fault?), **issue no.27** (Should either the transferor or the

loss caused by failure of the communication system, although it is said that, in practice, the liability of the operator is restricted.[75] However, it is generally agreed by UNCITRAL's Working Group that parties to an EDI transaction should be free to agree about the level of their liabilities under a contract. Similarly, it is suggested that such a freedom should be limited by a mandatory provision to ensure that the network's liability was not excluded or set at an unreasonably low level.[76]

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transferee recover interest for a delay of a funds transfer?), **issue no.28** (Should either the transferor or the transferee recover exchange losses for delay of a funds transfer?), and **issue no. 29** (Under what circumstances should the bank be liable for consequential damages?).

[75] "It was observed that, in practice, the liability of network operators was to a large measure restricted. In the case of network operators that had a public status (e.g., those that were state-owned, enjoyed a degree of monopoly, or were of special importance to the national economy), the restriction or exclusion of liability was often established in the law or regulation governing the functioning of the network. The responsibility of passive carriers of data (such as telephone, telex or facsimile networks) in particular was low or excluded. In the case of networks that has no such public status, liability restrictions were founded in contracts with users of the communication services. In addition to excluding or placing financial limits on liability, liability restrictions generally concerened the basis of liability and the burden of proff. Liability might be restricted also through rules determining that the operator was liable only for direct loss or loss that the operator could reasonably foresee; for example, when a payment order or an acceptance of a contract offer was not transmitted properly, the liability might be limited to the fee paid for the transmission and to the interest lost because payment was made late." [UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 362]

[76] See UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 362; it is also said: "[...] a provision on liability might be broadly modelled on the approach adopted in article 12 of draft TEDIS Agreement as produced in paragraph 103 of document A/CN.9/350: "Each party shall be liable for any direct damage arising from or as a result of any deliberate breach of this agreement or any failure, delay or error in sending, receiving or acting on any message. Neither party shall be liable to the other for any incidental or consequential damage arisning from or as a result of any such breach, failure, delay or error. The obligations of each party imposed by this EDI agreement shall be suspended during the time and to the extent that a party is prevented from or delayed in complying with that obligation by **force majeure**. Upon becoming aware of any circumstances resulting in failure, delay or error, each party shall immediately inform the other party(ies) hereto and use their best endeavours to communicate by alternative means. [...] Another example as a possible model for a provision on liability was article 16 of the draft SITPROSA Agreement as produced in paragraph 103 document A/CN.9/350 as following: "16.1 The risk and liability for any faulty transmission and the resulting damages rests with the Sender: a. subject to the exceptions described in clause 16.2; b. subject to the condition that the Sender will not be liable for any consequential damages other than those for which he would be liable in the case of a breach of contract in terms of the Main Contract or which have been specifically agreed.

16.2 Although the Sender is responsible and liable for the completeness and accuracy of the TDM [Trade Data Message], the Sender will not be liable for the consequences arising from reliance on a TDM where: a. the error is reasonably obvious and should have been detected by the Recipient; b. the agreed procedure for authentication or verification have not been complied with." [UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 361]; Article 4A of the Uniform Commercial Code (UCC) establishes liabilities for an originator of an electronic credit payment and the originator' bank.

3. FRAUD IN ADP/EDI

Another matter of concern for users of an ADP/EDI system is fraud, particularly with regard to the fact that as paperless, EDI is more insecure and open to fraud.[77] Although using methods like a call back system, private key, electronic signature, and other methods of authentication, mentioned previously, may to some extent prevent the abuse of EDI system, there is always a risk that the system may be intercepted by an unauthorised person. Suggestions have been made for reducing such a risk by: "1. limiting access to terminals and data, 2. segregating functions, 3. encrypting data, 4. using message authentication, and 5. conducting key exchange in a secure environment."[78]

4. TIME OF ESTABLISHMENT OF A PAPERLESS LETTER OF CREDIT

As previously pointed out,[79] in connection with a documentary credit, issues related to the time and place of formation of a contract are important matters since rights and duties of contracting parties as well as issues related to applicable law of

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[77] Rowbotham, Graham; Schwank, Friedrich; Mitchell, Wendy, "EDI, The Practitioner's View: Data and the Documentary Credit", International Financial Law Review (IFL), Vol. 7, Iss. 8, August 1988, pp. 35-38, in an abstract to that article it is said: "The sudden popularity of electronic data interchange (EDI) in the commercial world, the contractual nature of EDI communication, and the fact that it is paperless makes EDI interesting to attorneys. [...] Establishing documentary credits on screen has caused concern among international commercial bankers and financial institutions. One problem is **preventing fraud in the electronic transfer of funds since there are no paper-based supporting documents that are signed.**"; Stuparich, Mark, "Security issues in EFT/EDI", Journal of Cash Management (JCG), Vol. 13, Iss. 1, January/February 1993, pp. 22-24 [hereinafter it is referred to as Stuparich], in an abstract to that article it is pointed out: "In electronic funds transfer (EFT) or electronic data interchange (EDI) transactions, **fraud** can occure through access to unprotected data terminals or disk files, or through interception of data as they are being transmitted over a telephone line."[Emphasis added]

[78] Stuparich, ibid. (abstract).

[79] See relevant discussion in Chapter V, Section B.2.2.2 (above); Kozolchyk's article, supra (f.n. 4), at pp. 52-53, said: "In the light of the speed with which SWIFT messages are communicated and the receiving bank's need to act quickly in response to the electronic request or instruction, the receiving bank must know as of what moment the sender of the message is irrevocably bound. Article 5 of the UCC refers to this event as "establishment" and, almost uniquely, lays down specific rules by which it may be determined- a matter as to which even the UCP are silent."

contract are directly related to them.[80] This is also true in the context of EDI relationships,[81] for which two rules have been suggested as a solution regarding the time of formation of contract, namely, the "receipt" rule and the "dispatch" rule.[82]

According to the dispatch rule, a contract is formed at the moment when the declaration of acceptance of an offer is sent by the offeree to the offeror. According to the receipt rule, a contract is formed at the moment when the acceptance by the offeree is received by the offeror.[83] It has also been suggested by a writer that the

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[80] "Parties to a contract have a practical interest in knowing where and when the contract is formed. When the contract is formed, the parties become bound by the legal obligations they have agreed upon and the contract may start producing effects. In different legal systems, the time when the contract is formed may determine such issues as the moment when the offeror is no longer entitled to withdraw his offer and the offeree his acceptance; whether legislation that has come into force during the negotiations is applicable; the time of transfer of the title and the passage of the risk of loss or damage in the case of the sale of identified goods; the price, where it is to be determined by market price at the time of the formation of the contract. In some countries, the place where the contract is formed may also be relevant for determining the applicable customary practices; the competent court in case of litigation; and the applicable law in private international law (see A/CN.9/333, para. 69)." [UNCITRAL Yearbook, 1991, supra (f.n. 11), p. 395 and UNCITRAL Yearbook, 1990, supra (f.n. 11), p. 262]

[81] "The question of the time and location of the formation of an EDI contract is identified in the TEDIS study as the one which receives the widest variety of solutions within national legislations in the EEC. The same question is addressed by the ABA report and may be regarded as one important issues to be settled in a communication agreement." [UNCITRAL Yearbook, 1990, supra (f.n. 11), p. 263]

[82] "It was noted that when dealing with the issue of time and place of formation of contracts in the context of EDI relationships, two solutions were most commonly found in legal systems (see A/CN.9/333, Paras. 72-74): the receipt rule and the dispatch rule. [UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 359]; for more details see also UNCITRAL Yearbook, 1993, supra (f.n. 5), p. 207, paras. 137 and 147.

[83] "It was recalled that the TEDIS Study on the Formation of Contracts (see AC/N.9/WG.IV/WG.53, Para. 68) contained a chapter on the issue of time and place of formation of contracts. The conclusion of the study were that the receipt rule should be promoted as particularly suitable for EDI. It was observed that the transmission of EDI messages might be initiated in different places, such as a place of business of sender, or the place where the sender held its computer. It was also observed that, during the transmission process, particularly where third party service providers were involved, EDI messages might travel through places that were irrelevant to the underlying commercial contract. It was thus submitted that only the place where the message had been placed at the disposal of the recipient was sufficiently predictable to provide legal certainty, particularly as to the place of formation of a contract. It was also mentioned that the receipt rule was in line with article 18(2) of the United Nations Sales Convention, with the draft Principles for International Commercial Contracts prepared by the International Institute for the Unification of Private Law (UNIDROIT) and with national legislation in a number of states. [...] In the absence of madatory provisions, article 9.2 of the "TEDIS European Model EDI Agreement" prepared by the communication of the European Communities (May 1991) read as follows: "Unless otherwise agreed, a contract made by EDI will be considered to be concluded at the time an place where the EDI message constituting the acceptance of an offer is made available to the information system of the receiver." [UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 359]

establishment of the paperless letter of credit between banks could occur at various times: 1) when the SWIFT message is released to the SWIFT access point; 2) when the message is acknowledged by the receiving bank; and 3) when the receiving bank performs the requested or instructed act.[84] However, in practice, most bankers rightly accept the time of release of the message as the time of establishment of their duty against the recipient bank.[85]

SECTION C: ADP/EDI AND ITS IMPACT ON UCP 500

In the light of previous discussions (above), it has been explained that although under a paper-less method of payment some functions of a document such as "informative" and "evidential" functions are foreseeable, there is an important issue (like the "symbolic" function of a document) which makes an ADP/EDI system incompatible with a paper-based system such as that of LCs, since it provides no security as well as possession of goods for its holder (the bank or the

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[84] Kozolchyk's article, supra (f.n. 4), pp. 52-53; it is also stated by the same writer that: "Other moments of establishment are conceivable, such as when the message actually reaches the recipient's "options" computer (as distinguished from a mere "host" or "depository" computer), when the recipient's operations officers gain knowledge of the existence of the message, or when the message is received by the beneficiary. Yet none of these moments is sufficiently objectively ascertainable to warrant consideration."

[85] See discussion related to the time of establishment of a credit contract in Chapter V, Section B.2.2.2; Kozolchyk's article, supra (f.n. 4), at pp. 52-53, said: "Virtually every American and European Banker interviewed by this writer pointed to the moment of release of the message as the moment when the deemed his liability established vis-a-vis correspondent banks. This moment usually coincides with the time the issuing bank records its liability and any other debits or credits related to the message in question. As a result both of the regulatory requirements and of electronic programs that carry out the bank's issuance of credits and related bookkeeping functions, this recording (also known as "booking") occurs in conjunction with and immediately following release. [...] The SWIFT User Handbook does not state when a credit is established. Instead, these rules assures the issuer that messages not yet "delivered" to the intended recipient can be revoked or canceled."; and at p. 54, the same writer said: "Yet after A released its message of issuance to SWIFT but before the message reached B, A asked SWIFT to revoke or cancel the message of issuance, and SWIFT revoked or cancel it. This revocation or cancellation occured after that moment when bankers feel they are irrevocably bound not only by the their message of issuance, but also with respect to a pre-advised credit. And the consensus among banks and banking lawyers- now expressed in the proposed revision of the UCP- is that a pre-advice irrevocably binds the issuing bank to issue the operative credit instrument "without delay"; see also UNCITRAL Yearbook, 1992, supra (f.n. 8), at p. 358, said: "As regards the issue of revocability of an offer, the Working Group recalled that article 16 of the United Nations Sales Convention provided that an offer could normally be revoked if the revocation reached the offeree before dispatch of the acceptance. While support was given to the idea that such a rule should also be applicable to contracts formed in an EDI context, doubts were expressed as to the workability of such a rule, given the speed of EDI transmission."

applicant for a credit as the case may be). Therefore, there is a need to deal with these issues and, as a result, with the present system of payment based on documents like LCs and its relevant provisions which continue to provide necessary services for users of the documentary credits system. The point that should be underlined is the extent to which the relevant provisions (namely UCP 500) would be affected by ADP/EDI? Generally speaking, articles of UCP 500 related to the definition of the letter of credit and parties to such a transaction (Article 2), the time necessary for checking documents required and presented by the beneficiary as well as the time necessary for accepting or rejecting them by banks (Article 13 (b)) are among aspects that would be the subject of change(s) because of the speed of the EDI system. Moreover, as to the negotiation of a credit it has been pointed out by a writer that under the UCP[86] the procedure stipulated for such a situation is different from what has been accepted under an EDI system at present.[87]

Excepting the above mentioned articles, it seems the rest of UCP's articles would remain unchanged since they are related to principles and practices mostly accepted worldwide by business communities, for instance, the revocability and irrevocability of a credit (Article 6), banks' duties under the "doctrine of autonomy" as well as the "principle of strict compliance" (Articles 3 and 4), transferability of a credit (Article 48), and assignment of proceeds (Article 49) remaining unchanged.[88] A

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[86] See Articles 9 (a)(iv) and 10 (b)(ii) of UCP 500.

[87] Kozolchyk's article, supra (f.n. 4), at pp. 66-67, said: "**Conflicting procedures and definitions.** SWIFT procedured are significantly at odds with procedures set forth for the very same transactions by the UCP. Consider, for example, the negotiation procedures in both sources. The SWIFT User Handbook requires that "the advice to the beneficiary must note each negotiation," and "[t]he negotiation bank must note each negotiation on that advice." In contrast, the UCP requires neither the presentation of the advice at each negotiation nor a notation for each negotiation. This conflict raises a number of troublesome everyday practice questions, such as: (1) Can a confirming-negotiating bank that negotiates a credit subject to the UCP reject a tender of documents that does not contain a hard copy of the credit advice even if such a requirement is not listed among the terms and conditions of the operative credit instrument? (2) Can a bank that has issued a credit subject to the UCP and silent on the need to present the operative credit instrument refuse to reimburse a confirming bank that did not require such an instrument and/or failed to note the negotiation? (3) Is an issuing bank bound to honour such a presentation if the beneficiary bypass the confirming bank and presents the documents directly to it?"

[88] For more details about those issues see relevant discussions in Chapter IV (above).

similar conclusion can be drawn regarding those articles of UCP 500 which deal with different types of documents required under LCs (Articles 20-22 and 24-38), except bills of lading (because of their nature as a document of title (Article 23)).

CONCLUSIONS

Generally speaking, new devices and techniques are not free from risks (at least initial) weaknesses and they may create uncertainty and insecurity. The ADP/EDI is not an exception to such a situation. Nevertheless, the mutual co-operation of all interested parties to find solutions for unsolved problems can, as always, be a best prescription. Therefore, as a matter of priority, previously discussed advantages, namely, speed of an electronic system, greater accuracy, and less expensive systems, may motivate the interested parties to coordinate their efforts for improving the system; but such efforts, by governments and all other interested parties at both international and domestic levels, would have to be concentrated on the technical as well as legal aspects of electronic transmission. This may be the only way to provide an electronic/paper-less documentary letters of credit system which could then also be called a "documentless documentary credit".[89] To achieve it several points would have to be clarified from the beginning. For instance, how would an electronic transmission provide a good security for banks as well as a good title and constructive possession over the goods for the applicant for a credit? Moreover, questions related to the formation of contract (such as time and place of establishment of a credit transaction), rights and obligations of contracting parties to EDI, fraud, risks and liabilities under an electronic/ paper-less system, and the "authentication" are other hurdles to be overcome for the widespread use of an ADP/EDI system. By removing these problems from the system, ADP/EDI could become a fact of life in international trade.

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[89] Martino, A.A., "Paperless Trade: Legal and Technical Standardisation Problems", COMPAT 88 [see Walden, supra (f.n. 15), p. 112]; Gronfors, Kurt, "Simplification of document ...", LMCLQ, Vol. 1, 1976, pp. 250-54.

Regarding the application of LCs in the future, an issue of importance may arise: is there any need for banks' services under LCs as mediators between sellers and buyers in the electronic age? In other words, whether ADP/EDI would put an end to the use of LCs and corresponding provisions such as those of UCP 500. Different views regarding this point exist; but the preferable opinion is that, excepting the main reason for establishing the documentary credit system (namely, avoiding distrust between parties to a sale or service transaction), the use of LCs would not be in danger even in an ADP/EDI system.[90] It should also be remembered that the banker's role under LCs is not only as a paymaster, but also as an agent of the applicant for the credit also trusted by the beneficiary. As a result of such a trust between parties to an international transaction (sale/service contract) and because of an established worldwide network of banking systems that carries a valuable banking and trade information, it would not be right to suggest that there is no role for LCs in future international trade markets. As rightly stated by a writer, EDI would change the form of letter of credit transaction but it would not be able to change its underlying commercial function.[91] Therefore, as long as such a commercial function

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[90] Kozolcyk's article, supra (f.n. 4), at pp. 97-99 said: "Two viewpoints are frequently expressed on the future of the electronic letter of credit. The first regards the commercial letter of credit as a dying instrument soon to be replaced by direct electronic or network payment communications directly between buyers and sellers. A second viewpoint maintains that the paper-based letter of credit will be replaced by two types of electronic credit. Type one will be the "default" credit, a credit payable upon certification that the parties did not settle the claimed debt by themselves. [...] second type of credit under which payment will be made by the issuing or confirming bank upon tender not a group of paper documents, but of a single type of EDI message. This EDI message will state that the confirming bank has received, for example, an electronic bill of lading or waybill that on its face conforms with the terms and conditions of the credit, that it has paid or accepted a draft, and that it expects reimbursement. Documents transmitted electronically will not convey title to the goods; they will only acknowledge receipt of the goods and convey other requested information. These documents, therefore, will lack intrinsic value or merchantability. [...] Bernard Wheble [...] in a lecture delivered in Singapore in 1990, [...] predicted that many documents as traditionaly understood will cease to exist in the context of the paperless credit. At the same time, he warned that the replacement of the traditional, paper-based bills of lading may have to continue to be used. He also warned of problems with respect to the presentation of electronic documents other than the bill of lading. Among these problems were the determination of the time and place of presentation, to whom the messages should be addressed, who should be their direct recipient, and whether the "originality" requirements should be preserved. According to Wheble, some of these problems could be resolved by the parties' reliance on UNCID and appropriate user manual. [...] This writer shares Wheble's view of an eclectic (paper-based and electronic) future. In addition, this writer is optimistic about the future of the letter of credit, whether as a paper-based or paperless promise, owing to the fact that distrust among trading partners is now likely to disappear soon. [...]"

[91] Kozolchyk's article, supra (f.n. 4), p. 99.

exists, the need for having relevant rules and provisions like UCP 500 will also exist. Nevertheless, although the general movement toward ADP/EDI on the international level is, for a variety of reasons, proceeding slowly, including the difficulty in getting all parties to such a transaction (namely importers, exporters, banks, transportation companies, and customs brokers) into an electronic loop,[92] it has become clear (as in the present research study) that LCs' provisions (UCP 500) would be affected by an EDI system on grounds related to time (namely, time for checking and deciding to accept or reject documents presented by the beneficiary), definition of a credit transaction and parties to such a contract, as well as issues which are related to fraud, risks and liabilities, and time and place of establishment of a paper-less letter of credit contract.

Another point should also be tackled, namely, how issues about ADP/EDI can be put together with issues related to paper-based LCs? It is reasonable to disagree with the view that issues related to an electronic/paper-less letter of credit should be dealt with separately; having two international sets of standards about LCs would cause uncertainties and would damage the purpose of uniformity in practice as well as law and provisions for stability and for preventing disputes between parties to a credit transaction. It may be pointed out that issues about paper-less LCs are also considered under UCP at an international level by the ICC. It is one of the options, but for reasons discussed in the previous Chapters of the present study, the legal nature of issues (like fraud, time and place of establishment of credit, "authentication" etc.), necessitate comparative studies between different legal systems, for safeguarding the rights of all parties to a credit transaction (the applicant for a credit and the beneficiary). Lack of expertise and costs seem to indicate that it is for the ICC impossible to carry out such comparative studies and the experience of the ICC in the last 60 years seems to support such a view.

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[92] O'Heney, Sheila, "The wired world of trade finance", Bank Management, Vol. 69, No. 2, February 1993, pp. 18-25.

Having an internationally unified set of standards about LCs covering all relevant aspects to the extent it is possible, and at the same time safeguard its simplicity and flexibility, require cooperation between all the interested parties. Governments, international organisations, bankers, traders, lawyers, and scholars from different backgrounds and legal systems would have to work and cooperate closely, with financial as well as political support, in order to achieve the goals of reliability, simplicity and flexibility. Efforts by UNCITRAL towards drafting a uniform law (in the form of a convention) on Standby Letters of Credits (SLCs) and guarantees which would have a serious impact on LCs, are considered in the next part of the present study. However, as to efforts by different organisations to provide a uniform law related to ADP/EDI, none of them have succeeded, because they were based on different purposes and address issues which may cover some but not all relevant issues about ADP/EDI.[93] It must be noted, however, that all model agreements, rules and guidelines mentioned previously are of a contractual nature and can be brought into force only by the consent of the contracting parties. This involves two particular problems; firstly, when the applicable law of the contract prevents the parties to deviate from provisions of statutory law; secondly, when a non-mandatory provision of contract can only regulate the rights and obligations of those persons who are parties to the contract. So, provisions in a contractual form may be appropriate for a closed network of individual EDI communication, but they would not be able to regulate similar issues arising in an open environment. As a result, UNCITRAL has taken the view that the basic rules related to EDI should be unified and a standard communication agreement for use in international trade should be treated as a prime necessity.[94] Such a necessity seems acceptable in

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[93] See UNCITRAL, Yearbook 1991, supra (f.n. 11), at p. 390 said: "Those various model rules take different stands as ragards the legal issues related to the formation of contracts by electronic means that were considered in the perliminary study by the Secretariat (A/CN.9/333). In addition, their structure often reflects the different legal systems they originated from."

[94] UNCITRAL Yearbook, 1992, WP, supra (f.n. 5), p. 367; UNCITRAL Yearbook, 1992, supra (f.n. 8), at p. 350 pointed out: "In favour of work on the legislative level, it was recalled that the mandate given by the Working Group was to consider possible statutiry provisions. It was also stated that statutory provisions, because they would offer detailed guidance, would be more effective tool in assisting States to remove legal

case of letters of credit. It is an issue considered in the next part of the present study.

obstacles to the increased use of EDI. It was observed that, due to a lack of such detailed guidance, the recommendation adopted by the Commission in 1985 (see above, paragraph 2) with a view to establishing legal principles and to providing guidance to national legislators and regulatory authorities for the removal of legal obstacles to the increased use of EDI had resulted in little progress in the removal of those obstacles. [...] It was also agreed that any attempt to design legal rules and principles on EDI should be based on a close observation of commercial practices and aimed at enhancing the use of EDI."; it is also said: "The Commission also took note of the suggestion by the Secretariat to prepare a uniform law on the replacement of negotiable documents of title, and more particularly transport documents, by EDI messages." [UNCITRAL Yearbook, 1992, supra (f.n. 8), p. 349]; see also Locher, supra (f.n. 1), at p. 23 said: "Paperless international trade can not become a reality, however, until a few significant barriers are torn down. First, a truly universal standard for the international interchange of electronic data (EDI) must be developed and accepted within the financial industry and by a host of other service providers. Foreign governments, customs brokers, transporters, and insurance carriers all have their own electronic networks, non of which are currently compatible with those of the financial community. [...] A second obstacle to international EDI appears on the legal front. Many countries prohibit cross-border data exchange, rendering even the most versatile system useless. Finally, whatever standards are decided upon must also be embraced by the entire business world. Even with the architecture in place, EDI will remain an elusive dream unless it is within the means of the common man, or in the case, the middle market company."

CHAPTER X

THE FUTURE OF

THE LETTERS OF CREDIT SYSTEM

SECTION A: INTERNATIONAL REGULATION

1. INTRODUCTION

There have been different views about the unification and codification of the law of international trade at different times.[1] Having a complete and universal unification or codification based on the laws of various nations is a remote hope unless fundamental changes in attitudes about the concept of **"sovereignty"** are agreed and States may envisage partial transfers of national authority to a supranational authority.[2] Furthermore, a successful unification of law requires a strong political desire as well as a real social and economic need for unification between countries participating in such a process.[3] As far as international commerce in general and letters of credits in particular are concerned a certain degree of clarity, stability, and uniformity in the law and practice of international commercial contracts is necessary for their proper functioning internationally.[4]

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[1] For example, see Schmitthoff, C.M.,"The unification of the law of international trade", JBL, 1968, p. 105, once it was commented that "the concept of global and universal code of international trade law introduced into the national laws of all countries of the world is not only unrealistic at the present juncture but might easily become a straitjacket which could slow down the growth of commercial practices and usages and could stifle the continued creation of customary law by international business community."; later, you could read from the same writer that: "The realisation of this aim [i.e. codification of the law of international trade] is not utopian."" [Schmitthoff, C.M., "Commercial law in a changing economic climate", 2nd ed. 1981, p. 30 [hereinafter referred to as Schmitthoff 1981]]; Garro, Alejandro M., "Unification and Harmonisation of Private Law in Latin America", The American Journal of Comparative Law, Vol. 40, No. 3, 1992, p. 578 [hereinafter referred to as Garro]; see also the same journal, at p. 683 for Rosett, Arthur, "Unification, Harmonisation, Restatement, Codification, and Reform in International Commercial Law" [hereinafter referred to as Rosett].

[2] See discussion concerning state's sovereignty in Section B.3.3.4 of the present chapter below; David, Rene', "The International Institute of Rome for the Unification of Private Law", Tulane Law Review, Vol. 8, No. 1, December 1933, pp. 406-16 [hereinafter it is referred to as David], at p. 406 said: "The complete and universal unification of the laws of the various nations is a vain hope which cannot, for one moment, be seriously contemplated. The civilization of the different countries, their living conditions, their customs and traditions, the very ethical principles which social relationships have as their foundation are all diverse; and in this diversity there must correspondingly be as great a difference in public institutions as in the field of private law itself."

[3] Graveson, R.H., "The international unification of law", American Journal of Comparative Law, 16, 1968, pp. 4-12.

[4] Horn, Norbert, "Uniformity and diversity in the law of international commercial contracts", Studies in Transnational Economic Law, Vol. 2, "The transnational law of international commercial transactions",

The diversity of legislation, particularly as regards international transactions, constitutes for traders a considerable and constant source of annoyance. In order to provide some comfort efforts have been made by governments as well as governmental and non-governmental (international) organisations (such as the United Nations Commission on International Trade Law **(UNCITRAL)**,[5] the International Institute of Rome for the Unification of Private Law **(UNIDROIT)**,[6] and the International Chamber of Commerce **(ICC)**[7] regarding different aspects of

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edited by Norbert Horn and C.M. Schmitthoff, Kluwer, 1982 [hereinafter referred to as Horn and Schmitthoff], pp. 3-18, at p. 4 [hereinafter referred to as Horn].

[5] See relevant discussions in Section A.2.1. of the present Chapter (below) and Chapter III, Section A.2.1.3 (above); Horn, ibid, at. p. 18 (for the role of international agencies active in field of international trade law); Herrmann, Gerold, **"The contribution of UNCITRAL to the development of international trade law"**, Horn and Schmitthoff, ibid., pp. 35-50, at pp. 35-37 (creation of UNCITRAL) [hereinafter referred to as Herrmann]; see also Schmitthoff, C.M., **"The Unification of the Law of International Trade"**, JBL, 1968, p. 105, at p. 115 (concerning a need for an international organisation such as UNCITRAL), and **"Progressive Development of the Law of International Trade"**, Report of the Secretary General, UN Doc. A/6396, para. 210 (reprinted in UNCITRAL Yearbook (1968-70), Vol. 1, Part One, II), in which it is said: "The General Assembly of the United Nations, upon the initiative of Hungary, established the new Commission by its Resolution 2205 (XXI) of December 17, 1966. The mandate given to UNCITRAL is described therein as follows, in addition to other provisions on the objectives and methods of work: "The Commission shall further **the progressive harmonisation and unification of the law of international trade** by: (a) Co-ordinating the work of organisations active in field and encouraging co-operation among them; (b) Promoting wider participation in existing international conventions and wider acceptance of existing model and uniform laws; (c) Preparing and promoting the adoption of new international conventions, model laws and uniform laws and promoting the codification and wider acceptance of international trade terms, provisions, customs and practices, in collaboration, where appropriate, with the organisations operating in the field; (d) Promoting ways and means of ensuring a uniform interpretation and application of international conventions and uniform laws in the field of the law of international trade; (e) Collecting and disseminating information on national legislation and modern legal developments, including case law, in the field of international trade; (f) Establishing and maintaining a close collaboration with the United Nations Conference on Trade and Development; (g) Maintaining liaison with other United Nations organs and special agencies concerned with international trade; (h) Taking any other action it may deem useful to fulfil its functions." [Emphasis added]

[6] The International Institute of Rome for the Unification of Private Law was created on October 3, 1924, and was formally established on May, 1928; Dolzer, Rudolf, **"International agencies for the formulation of transnational economic law"**, Horn and Schmitthoff, supra (f.n. 4), p. 61, at pp. 71-72 (UNIDROIT) [hereinafter referred to as Dolzer]; Bonell, M.J., **"Unification of Law by Non-Legislative Means: The UNIDROIT Draft Principles for International Commercial Contracts"**, The American Journal of Comparative Law, Vol. 40, No. 3, 1992, p. 617 [hereinafter referred to as Bonell].

[7] For discussions relevant to the ICC see Chapters I (Section B.2.1) and III (Section A.2.1.2) above; Rowe, Micheal C., **"The contribution of the ICC to the development of international trade law"**, Horn and Schmitthoff, supra (f.n. 4), p. 51 [hereinafter referred to as Rowe], at p. 51 pointed out: "The International Chamber of Commerce (ICC) is a non-governmental organisation, representing business internationally. Its contribution to the development of international trade law arises from three main areas of activity: the

international sale transactions from the early years of the twentieth century, especially in the last three decades.[8] Such efforts indicate a real need for a more unified set of standards for those involved in international trade contracts although several obstacles would have to be dealt with first in order to achieve a true unification in international trade and commercial law.[9]

As pointed out in previous parts of the present thesis (Chapters IV and V) rules and provisions related to the documentary letters of credit (namely UCP 500 and Article 5 of the UCC in the USA) are affected, sooner or later, by activities sponsored by UNCITRAL[10] as well as national organisations like the Commission

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development of standard rules and procedures aimed at trade facilitation in its brodest sense; co-operation and contacts with other organisations interested in the same subjects; the organisation of seminars and research projects on business law topics."

[8] For instances, look at ICC Pub. No. 500 (UCP 1993), and the Convention on International Bills of Exchange and Promissory Notes published by UNCITRAL; see also Patrikis, Ernest T., "Global EFT guidelines: what they can mean to US banks", Bank Administration, September 1987, p. 30 [hereinafter referred to as Patrikis], at p. 30 said: "UNCITRAL is now in the final stages of drafting a uniform law on international Bills of Exchange and International Promissory Notes- a convention which sets out model legal rule that individual nations can adopt to bring a dgree of standardization to the international payments system. This has been lengthy and difficult task because it has involved the harmonization of Anglo-American law with European Continental law; it is no simple matter to reach agreement on issues where long-established commercial laws and practices differ."

[9] See relevant discussion in Section B.3.3 of the present chapter below; David, supra (f.n. 2), at pp. 413-14 pointed out some of problems which may arise when there is an effort for unification of international law. He stated: "The unification of law encounters grave obstacles: the first and principal one is the state of confusion in which all branches of the law find themselves, and for some of these an immediate eventuality of unification must be disregarded. [...] A second obstacle created by the existence of already existing juridical literature. [...] A third obstacle in the path of unification is created by the antagonism of legislators, viewing with animosity this consequent withdrawal, by international agreements, of their power to make and unmake the internal law of their respective countries according to their ideas. [...] Finally, the interested merchants and manufacturers naturally view with rancour any legislative innovations, whether of internal or international character, in view of their attachment to the laws with which they are already familiar and to the customs and practices which they helped to create."; Garro, supra (f.n. 1), at pp. 610-11; it is said by another writer that, "Unification of international trade law can be acheived through the adoption of uniform normative texts such as conventions and model laws. But the efficacy of a uniform text can be diminished as a result of divergencies in interpretation and application by judges, arbitrators and practitioners. This problem will never be completely resolved while there remain different legal systems and traditions: the ultimate solution, unattainable for the forseeable future, would be the creation of some international court able to make definitive ruling for the uniform operation of uniform laws." [Fisher, Geoff, "UNCITRAL Gives International Trade Law CLOUT", Australian Business Law Review, Vol. 21, October 1993, p. 362 [hereinafter referred to as Fisher], at p. 362]

[10] Fisher, ibid., at p. 362 said: "The United Nations Commission on International Trade Law (UNCITRAL) is establishing a system for collecting and disseminating information on arbitral awards and court decisions

for the revision of Article 5 of the UCC in the USA.[11] These efforts, however, involve no fundamental changes of principles accepted under the documentary credit system.[12] For instance, as noticed in discussions related to the Electronic Data Interchange (EDI), principles like **"doctrine of autonomy"** and **"the principle of strict compliance"** remain enforceable.[13]

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rendered on UNCITRAL Conventions and model laws. The system, styled **CLOUT** (case-law on UNCITRAL texts), is intended to enhance awareness of UNCITRAL legal texts and promote their uniform interpretation and application. [...] Given the acronym of **"CLOUT"** [...] the system is intended to promote international awareness of UNCITRAL legal texts and the uniform interpretation and application of those texts. A draft User Guide for the CLOUT system has been prepared by the UNCITRAL Secretariat, outlining the nature of the system and its method of operation."; Maurer, Virginia G., **"The United Nation Convention on Contracts for the International Sale of Goods"**, SYR. J. Int'l L. & Com., Vol. 15:361, 1989, p. 361, at pp. 361-62 said: "The United Nations Convention on Contracts for the International Sale of Goods (CISG) was drafted by the United Nations Commission on International Trade Law (UNCITRAL) at the Vienna Conference in 1980. [...] The Convention represents a major effort at unification of international trade law across economic, legal, developmental, and political barriers. The gole of Convention is to reduce the uncertainty inherent in contracting for the sale of goods among international traders who do not understand or accept one another's substantive trade law. Reducing uncertainty in trade law should reduce the cost of international transactions and promote efficient world trade. To this end, the treaty establishes a common body of national law for certain international sales transactions. It also provides a common basis for interpreting contract provisions, and it provides substantive law for "filling the gap" left by the contract drafters. In addition, the CISG addresses the choice of law problems that vex drafters of international sales contracts."

[11] Boss, Amelia H. and Fry, Patricia B., **"Divergent or parallel tracks: International and domestic codification of commercial law"**, Business Lawyer, Vol. 47, Iss. 4, Aug. 1992, pp. 1505-1515. In an abstract to that article it is pointed out: "Activities are currently under way on the international level lending to the creation of an International Uniform Commercial Code. The first step was the drafting and signing of the United Nations Convention on Contracts for the International Sale of Goods. The current development of the emerging international code is taking place when the US Uniform Commercial Code (UCC) is undergoing tremendous scrutiny and revision. The challenge facing commercial lawyers is to harmonise the activities that are occurring on the domestic and international levels in order to assure that the events occurring on both levels fulfil the purposes of commercial codification: 1. to simplify, clarify and modernise the law, 2. to remit the continued expansion of commercial practices through custom, usage, and agreement of the parties, and 3. to make uniform the law among various jurisdictions. Specific areas where progress in domestic and international codification seem to parallel include sales, letters of credit, secured financing, payment systems, and documents of title."; The American Law Institute, **"UNIFORM COMMERCIAL CODE REVISED ARTICLE 5, LETTERS OF CREDIT (with amendments to Articles 1, 2, and 9), Proposed Final Draft (April 6, 1995)"**, Submitted by the Council to the members of The American Law Institute for Discussion at the Seventy-Second Annual Meeting on May 16, 17, 18, and 19, 1995 [hereinafter referred to as PFD]; for more details concerning revision of Article 5 of the UCC see relevant discussions in Chapter V (above).

[12] As to principles applied to LCs see relevant discussions in Chapters II (Section B.1), VI and VII (above).

[13] See Section C of Chapter IX (above).

Nonetheless, beside other changes relevant to issues like the time of establishment of a credit contract, fraud, banks' security, etc.,[14] a need for a fundamental change as to the present legal form of existing provisions about LCs (UCP 500), namely, changing its legal status from an **international customary instrument** to an **international legislative instrument**, is required more than ever for business communities in international trade. The UCP 500 is non-mandatory and covers issues which parties to a credit transaction need to know when dealing with LCs; however, many issues relevant to the legal aspects of LCs have been, deliberately, left untouched by the ICC.[15] As a result of such shortcomings existing under UCP 500, on the one hand, and because of the importance of issues like fraud, banks' rights of security and conflicts of law on the other a trend towards a **uniform law** has been started, for many years, in order to provide more unified and mandatory rules about standby letters of credit (SLCs) and bank guarantees (BGs).[16]

The first step in that direction are the activities of UNCITRAL involving a serious review of the rules and provisions about SLCs and BGs since 1988.[17] As a

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[14] See relevant point in Chapters V (Section B.2) to VIII (above).

[15] For shortcomings of the UCP see Section B.3 of Chapter XI (below).

[16] UNCITRAL, "B. Stand-by letters of credit and guarantees: report of the Secretary-General (A/CN.9/301) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XIX, 1988, pp. 46-61 [hereinafter referred to as UNCITRAL Y.B., 1988], at p. 48, para. 8 said: "The topic of this report as outlined above has been with the Commission since its inception, albeith with varying scope and emphasis, first on bank or contract guarantees and later on stand-by letters of credit. Pursuant to a request by the Commission at its frst session in 1968 (A/7216, para. 29), the secretariat submitted to the second session a perliminary study of guarantees and securities as related to international payments (A/CN.9/20 and Add.1). Ter. years later, the secretariat submitted a preliminary study on stand-by letters of credit (A/CN.9/163), following a decision by the Commision at its eleventh session in 1978 to include in its programme of work as a priority topic "Stand-by letters of credit, to be studied in conjunction with the International Chamber of Commerce" (A/33/17, paras. 67(c)(ii)a, 68 and 69). The wording of the topic indicates what has been a recurrent feature in the Commission's previous involvement, namely co-operation with ICC."

[17] UNCITRAL Y.B. 1988, ibid.; UNCITRAL, "IV. STAND-BY LETTERS OF CREDIT AND GUARANTEES, A. Report of the Working Group on International Contract Practices on the work of its twelfth session (Vienna, 21-30 November 1988) (A/CN.9/316) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XX, 1989, pp. 182-200 [hereinafter referred to as UNCITRAL Y.B., 1989]; for other relevant materials look at below bibliography for UNCITRAL's Yearbooks, 1990-93.

result of such continuous efforts a draft convention has been prepared for consideration and deliberation by member states participating in a Working Group established for such a task in 1993.[18] Although the work of the UNCITRAL Working Group has not yet reached its final stage and it is related only to issues about SLCs and BGs and not traditional letters of credit (LCs), it indicates the importance of the matter, namely, concerning a real need for more harmonious provisions regarding SLCs in the international trade community. Such a necessity is so obvious in the case of LCs[19] that, as a result, it has been suggested that the future "uniform law" (UL) should be extended to issues which are also of matter of importance for traditional commercial letters of credit.[20] This is another indication that the

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[18] UNCITRAL, "II. GUARANTEES AND STAND-BY LETTERS OF CREDIT, A. Report of the Working Group on International Contract Practices on the work of its eighteenth session (Vienna, 30 November-11 December 1992) (A/CN.9/372) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XXIV, 1993, pp. 139-154 [hereinafter referred to as UNCITRAL Y.B., 1993, part A], at p. 140, para. 7 stated: "The Working Group, which was composed of all States members of the Commission, held its eighteenth session at Vienna, from 30 November to 11 December 1992. The session was attended by representetives of the following States members of the Working Group: Argentina, Austria, Bulgaria, Canada, Chile, China, Czechoslovakia, Ecuador, Egypt, France, Germany, Hungary, Iran (Islamic Republic of), Japan, Kenya, Mexico, Morocco, Nigeria, Poland, Russian Federation, Saudi Arbia, Spain, Thailand, United Kingdom of Great Britain and Northern Ireland, United States of America and Uruguay."

[19] For more details see Section B of the present chapter below.

[20] UNCITRAL Y.B., 1989, supra (f.n. 17), at p. 195, para. 125 said: "After deliberation, the Working Group was agreed that the uniform law should focus on independent guarantees, including stand-by letters of credit, and that it should be extended to traditional letters of credit where that was useful in view of their independent nature and the need for regulating equally relevant issues."; similarly pointed out: "In view of this latter question of possible scope of any uniform law, this note, while focussing on guarantees and stand-by letters of credit, takes into account some special issues of commercial letters of credit (e.g. relationship between issuing and confirming bank, deferred payment credit). The considerations on most of the more general issues (e.g. principle of independence, applicable law) would apply to guarantees and stand-by letters of credit as well as commercial letters of credit, although solutions might differ in detail." [UNCITRAL, "B. Working papers submitted to the Working Group on International Contract Practices at its twelft session. 1. Standby-by letters of credit and guarantees: review of ICC draft Uniform Rules for Guarantees: note by the Secretariat (A/CN.9/WP.II/WP.62) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XX, 1989, pp. 200-205 [hereinafter referred to as UNCITRAL Y.B., 1989, part two], p. 203, para. 3]; moreover, it is said: "It was noted, however, that the uniform law might also apply to some aspects of documentary credits, in which case reference to a confirming bank would be expected." [UNCITRAL, "IV. GUARANTEES AND STAND-BY LETTERS OF CREDIT, a. Report of the Working Group on International Contract Practices on the work of its thirteenth session (New York, 8-18 January 1990) (A/CN.9/330) [Original: English]", Yearbook of the United Nations Commission on International Trade Law, Vol. XXI, 1990, pp. 227-238 [hereinafter referred to as UNCITRAL Y.B., 1990], p. 231, para. 43].

international trade community has reached a stage where more unified rules are essential for business activities under the present circumstances of world trade and LCs provisions are not an exception, any more.[21]

In brief, step(s) should be taken, so far as legal matters are concerned, in order to provide more uniformity in the worldwide application of LCs. Moreover, by providing a more reliable and predictable set of standards for LCs, from an international legal point of view, the credibility of the documentary letters of credit could possibly be improved and their importance compared with other methods of payment like bills of exchange,[22] promissory notes, and cheques could be recognised worldwide;[23] and, at the same time in this way, another part of the jigsaw (namely, the international law for sale contracts) could be completed.[24]

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[21] For other reasons see relevant discussions in Section B.2 of the present chapter and Section A.3.2 of Chapter XI (below).

[22] The basis of the law of the negotiable instruments in the United Kingdom is the Bills of Exchange Act 1882, which has been adopted as the basis of the law in the United States of America, and the former British Dominion, as well as in other countries which are, or were, members of the British Commonwealth of Nations (see Hedley, W., **"Bills of Exchange and Banker's Documentary Credit"**, Lloyd's of London Press Ltd., 1986, at p. 4 and foot note 1 said: "The law relating to bills of exchange had developed through the usage of traders from about the 14th century into a body of law called the "Law Merchant". This body of law was only lightly touched on by Parliament, until it was codified by the Bills of Exchange Act 1882. [...] The law of Scotland differs in one or two important aspects; for instance ss. 98 and 100 of the Act 1882."); the 1882 Act contains special sections (ss. 76-82) relating to cheques. In addition, there is the Cheques Act 1957, passed in order to eliminate the necessity for indorsement of cheques and other orders to pay; the United States equivalent of the BEA Act 1882 is Article 3 of the UCC dealing with commercial paper governing laws relating to negotiable instruments (NI), part 7 thereon, section 3-701, of the UCC on Advice of International Sight Draft covers Letters of Advice of International Sight Draft and, therefore, international aspects of the BOE and NI.

There are wide differences between the laws of the United Kingdom on the one hand and, on the other hand, those of the Continent of Europe, certain South American countries and Japan whose laws are founded on the League of Nations Conventions Number 3313 and 3314 (Uniform Law and Conflicts of Law) relating to Bills of Exchange and Promissory Notes, date June 7, 1930, and Numbers 3316 and 3317 (Uniform Law and Conflicts of Law) relating to Cheques, dated March 31, 1931."

[23] **The United Nations Convention on International Bills of Exchange and International Promissory Notes (CIBN)** (approved by UN General Assembly, December 9, 1988; cite as 28 ILM 170, 1989) [UN Document A/43/820 of November 21, 1988, pp. 2-42]; the UN Convention on International Bills and Notes (CIBN) should be regarded as part of a series of projects which attempts to provide unification of international commercial law. Prior conventions prepared by UNCITRAL include the Convention on Contracts for the International Sale of Goods (19 ILM 671, 1980), ratified by the United States in 1986, and by 16 other nations to date. Other such treaties include: **The Conventions on International Lease Financing and on International Factoring** [27 ILM 931, 1988] prepared by the International Institute for the Unification of Private Law (UNIDROIT), the final text of which were adopted by a Diplomatic Conference at Ottawa in May 1988]; Reisman, Albert F., **"A Uniform International Law: Financing and**

A question may arise whether an effort towards a uniform law for LCs would provide a better ground for safeguarding the interests of parties to a credit transaction and for preventing abuse of the documentary credit system? In order to give an adequate response to this question, it is necessary to review, first, what has been done by UNCITRAL then to consider whether the international trade community is ready for accepting such a change, namely, by adopting a uniform law for LCs; and if the answer is positive, then what type of legal instrument (e.g. a "model law" or a "convention") would provide a sound and reliable future solution for unifying the law of LCs in international trade. The present chapter will correspondingly deal in two sections with **(1)** UNCITRAL's activities: background reasons, latest deliberations, and whether these amount to an effort in the right direction; and **(2)** the socio-economic situation of the commercial world and international trade at present: does a more integrated and barriers-free situation exist from the commercial, economic, and social points of view? If so, does such a situation require more co-operation between trading partners; and how such a need should be dealt with? The remaining issues are considered in Chapter XI in two sections: **(1)** international legal instruments available for serving such a purpose:

Factoring of Transnational Accounts Receivable", The Secured Lender, Vol. 48, No. 6, Nov/Dec 1992, p. 6, at the same page said: "On May 28, 1988, the final text of the UNIDROIT Convention on International Factoring (IFC) was approved at a diplomatic conference in Ottawa, Canada without dissent by representatives of fifty-five nations."; and at p. 12 of the same reference pointed out: "Export factoring of transnational sales on open account terms offers an alternative to traditional letter-of-credit financing arrangements and may provide a reasonable accommodation for the expectations of both the exporter and the importer."

[24] The United Nations Convention on Contracts for the International Sale of Goods (CISG) was drafted by the United Nations Commission on International Trade Law (UNCITRAL) at the Vienna Conferrence in 1980; as it became effective from January 1, 1988, and 11 nations have ratified it. The United Kingdom was represented on the Working Group, at UNCITRAL and at the Vienna Conference; but, it has not signed or acceded to the Convention. Previous experiences in the field of international trade and commerce have included the Uniform Law on International Sale of Goods and the Uniform law on the Formation of Contracts for the International Sale of Goods; parallel to these developments, on the international shipping and transport scene there have been the United Nations Convention on the Combined Transport Document 1980, The United Nations Convention on Carriage of Goods by Sea which seeks to replace the International Convention for the Unification of Certain Rules of Law Relating to the Carriage of Goods by Sea 1924 as revised by the Convention Concerning Certain Rules Relating to Carriage of Goods by Sea 1968.

"customary" and "legislative" instruments, advantages and disadvantages of each one of these methods; and **(2)** unification/codification of law of LCs at an international level.

2. UNCITRAL'S ACTIVITIES

2.1. General background

UNCITRAL's decision to include in its work programme, as a priority, the topic of the Standby letters of credit (SLCs) goes back to 1978.[25] SLCs have been used in the USA for many years and have been introduced for the first time under Articles 1 and 2 of the UCP 400 (1983) by the International Chamber of Commerce (ICC); a similar policy has been followed in UCP 500 (1993). Since UNCITRAL has begun a study related to SLCs, it is worth to consider the relevant issues (like background, definition, function, classification, similarities of SLCs with and differences from the traditional letters of credit (LCs)) as well as bank guarantees (BGs) in order to find more about SLCs, their importance in international trade, and practical difficulties (like fraud) which may arise as a result of using them. In that respect, see the relevant discussion in Chapter III (above).

In brief a standby letter of credit is accepted worldwide as a device which is similar, in principle, to traditional commercial letters of credit (LCs);[26] therefore, SLCs' provisions may be said to be the same as for LCs. This view has been formally accepted by the International Chamber of Commerce (ICC) for more than a decade[27] and supported by courts in the United Kingdom[28], as well as in the

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[25] For details concerning UNCITRAL's activities about SLCs see Chapter III, section A.2.1.3 (above); Bergsten, Eric E., "A new Regime for International Independent Guarantees and Standby Letters of Credit: The UNCITRAL Draft Convention on Guaranty Letters", The International Lawyer, Vol. 27, No. 4, Winter 1993, p. 859 [hereinafter referred to as Bergsten]; UNCITRAL, "Reports of the United Nations Commission on International Trade Law on the work of its twenty-eight session, 2-26 May 1995, General Assembly Official Records- Fifteen Session Suppliment No. 17 (A/50/17)", United Nations, New York, 1995.

[26] See Chapter III, Section B.1 (above).

[27] See Articles 1 and 2 of UCP 400 (1983) and UCP 500 (1994); similarly, look at UNCITRAL Y.B., 1988, supra (f.n. 16), at p. 53, paras. 51, and 53 to 56 which is pointed out: "The international rules most commonly referred to in stand-by letters of credit are the Uniform Customs and Practice for Documentary Credits. While this practice developed under previous versions of UCP, the 1983 revision (ICC Publication

USA,[29] while concerning the BGs the law is not identical in these countries.[30] Referring to such a clear fact, it has been suggested by the WG that the future studies should include issues related also to LCs.[31]

No. 400, reproduced in annex II to A/CN.9/251) now specifically covers stand-by letters of credit. [...] No rules or guidelines are offered for determining which of the articles of UCP are in fact applicable to a stand-by letter of credit and, if they are applicable, to what extent. The answer has to be sought by examining the purpose and scope of each provision and then judging its suitability for this functionally different type of credit. While questions of applicability may be easily answered at a general level, there remains a considerable amount of uncertainty when it comes to concrete issues. [...] Generally applicable are, for example, the general provisions and definitions set forth in articles 1 to 6, the rules on the form and notification of credits (articles 7 to 14) and the imposition or exclusion of liabilities and responsibilities of banks (article 15 to 21). Of these provisions, article 3 and 6 are of particular relevance to stand-by credits in that they establish and underline the independence or autonomy of the letter of credit. As an important complement, article 4 provides that "all parties concerned deal in documents, and not in goods, services and/or other performances to which the documents may relate"; the refrence to services and performances as well as goods reflects the wide coverage of UCP, including its extension to stand-by credits. [...] In general, the provisions that would not be applicable include those on transport documents, insurance documents and commercial invoices (articles 22 to 42), which are geared to the traditional documentary credit in a sales transaction. However, those provisions may be relevant to a stand-by letter of credit operating as a secondary payment (see above, para. 30). [...] The miscellaneous provisions of UCP(articles 43 to 53) combine applicable and non-applicable rules. This may happen even within one and the same article; for example, article 44 deals with partial drawings that may occur in stand-by operations and with partial shipments that are unlikly to occur. In respect of a number of these articles, no certainty exists as to whether they are applicable to stand-by letters of credit. To mention only one example, the question has arisen (and is currently before the ICC Commission on Banking Technique and Practice) whether subparagraph a) of article 47 governing the period of time for presentation of documents and their refusal after the expiry date is applicable to a stand-by letter of credit."; for a different view see Schmitthoff, C.M., **"The New Uniform Customs for Letters of Credit"**, JBL, 1983, p. 193, at p. 195 in which the late Professor Schmitthoff was of the view that the UCP 1983 Revision should never have been extended to include standby credits.

[28] **Edward Owen Eng. Ltd. v. Barclays Bank Int'l**, [1978]1 QB 159, pp. 170-171 (CA); Bergsten, supra (f.n. 25), at p. 866 said: "In the fundamental case in the United Kingdom, **independent guarantees**, labelled as **performance bonds or performance guarantees**, were said by the Court of Appeal to be "virtually promissory notes payable on demand" and furthermore, **"the performance guarantee stands on a similar footing to a letter of credit."**" [Emphasis added]

[29] Bergsten, supra (f.n. 25), p. 864, f.n. 22 and 23.

[30] Horn, Norbert, **"Securing international commercial transactions: standby letters of credit, bonds, guarantees and similar sureties"**, Horn and Schmitthoff, supra (f.n. 4), p. 275 [hereinafter referred to as Horn's article], at p. 279 pointed out: "American banks do not issue guarantees because they are not expressly authorised to do so by federal and state banking laws and prevailing authority concludes that issuing guarantees would thus be **ultra vires** the banks. British banks, on the other hand, issue such a guarantees including those to pay "on first demand."; and at the same page continued: "In the common law of both the United States and Great Britain, a guarantee is a **"secondary obligation"** securing an underlying debt and depends upon conditions and defences in the underlying contract. British common law recognises, in addition, a surety which creates a primary obligation independent from the underlying contract, which is termed **"indemnity"**."]Emphasis added]; for more details see Harfield, H., **"Bank credits and acceptances"**, 5th ed., 1974, pp. 154-55 [hereinafter referred to as Harfield]; Williams, K.P., **"On demand**

It seems that the view accepted by the WG is important for the following reasons: firstly, the view is emphasised that SLCs are similar to LCs as to principles and comparable functions. Therefore, they should be governed by the same rules and provisions. Secondly, it is indicated that rules and provisions about LCs are not adequate to deal with different legal issues (e.g. fraud, bank's security, applicable law, and so on) which may arise in the wake of international letter of credit transactions;[32] therefore, there is a real need for providing a uniform law in this respect too.

2.2. Analysis of the UNCITRAL's stand concerning SLCs

Although in the light of what has been submitted previously (Chapter III), it becomes obvious that SLCs have more similarities with LCs rather than BGs (namely similarities in principles, operations and relevant rules as well as provisions which are accepted by British and American courts as well as by international business communities like the ICC),[33] UNCITRAL has preferred to study SLCs

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and conditional performance bonds", JBL., 1981, p. 8 [hereinafter referred to as Williams], and JBL, 1978, p. 58; Border Nat'l Bank v. American Nat'l. Bank, 282 F. 73, 75 (5th Cir. 1992).

[31] UNCITRAL Y.B., 1989, supra (f.n. 17), at p. 195, para. 125: as to rules of interpretation it is suggested that, "the uniform law, assuming that it would cover commercial letters of credit, should accord priority to UCP, as referred to in almost every letter of credit, over any inconsistent provision of the uniform law. Such a rule of priority could refer to party autonomy or to universal customary law, if an express mention of UCP appeared undesirable. It was noted in reply that the suggestion related to the issues that had been discussed earlier, namely, the possible limits to party autonomy and the advisability of avoiding conflicts between the uniform law and UCP (see, in particular, above, paragraphs 60, 66-67). It was stated that both issues were of continuing importance throughout the prepration of the uniform law and that the suggestion of according general priority to UCP could thus not appropriately be decided upon at the current stage of the preparatory work." [UNCITRAL Y.B., 1990, supra (f.n. 20), p. 237, para. 101]; on the other hand, see UNCITRAL Y.B., 1993, part A, supra (f.n. 18), at p. 142, para. 33, said: "An alternative suggestion was not to reference any typical purpose but to list those independent undertakings that should not be covered. Examples of such undertakings include insurance contracts and, especially, commercial letters of credit, which the Working Group again decided not to cover in the draft Convention, without thereby precluding consideration at a later statge as to the appropriateness of the finally agreed provisions for commercial letters of credit."

[32] See Section B.3, Chapter XI (shortcomings of the UCP 500), below.

[33] See foot notes 27-29 (above); Horn's article, supra (f.n. 30), at p. 282 stated: "Standby letter of credit as [...] **an independent and primary obligation of the bank** [...] **is an offspring of traditional commercial letter of credit**, which has been in worldwide use for years and is governed by the Uniform Customs and Practices for Documentary Credits [...] and by the Uniform Commercial Code. The standby letters have been created **as a substitute for guarantees** which, as mentioned, are ultra vires American Banks. [...] letters of credit create a primary obligation on the bank, independent of the underlying commercial transaction and its

beside BGs. A point which should be noticed is: for what reason(s) did UNCITRAL adopt such a view? The reason for it is said to be their common operational legal character and functional equivalence[34] and UNCITRAL has taken the view that there are more difference between SLCs and LCs than BGs.[35] This view is in contradiction with the facts, as admitted even by the Commission, namely in national law SLCs and LCs are treated similarly.[36] Therefore, for reasons pointed out above and elsewhere (Chapter III, Section B above) it is more preferable that rules and provisions related to SLCs and LCs be studied together and one international set of standards govern both of them[37] because, by adopting a

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conditions and defences. **Standby letters share this quality.**" [Emphasis added]; Section 5-105(1)(a) and Section 5-114 of UCC (1972 version).

[34] "The view was expressed that the stand-by letter of credit should be dealt with clearly separately from the independent guarantee because of its different functional origin. The prevailing view, however, was in favour of a joint treatment in view of their common operational legal character and functional equivalence." [UNCITRAL Y.B., 1990, supra (f.n. 20), p. 229, para. 14]; see also previous notes and UNCITRAL Y.B. 1993, part a, supra (f.n. 18), p. 140, para 13.

[35] "By its function and purpose, the stand-by letter of credit differes considerably from the traditional commercial letter of credit or documentary credit and is equivalent to independent bank guarantees and similar indemnities. [...] As regards stand-by letters of credit, it is often doubtful whether a given provision of the law on letters of credit is applicable, i.e. appropriate in view of the special nature and purpose of the stand-by letter of credit. As regards guarantees, uncertainty arises from the fact that the autonomy or independent nature of the undertaking is not yet recognised in full and firmly established in all jurisdictions." [UNCITRAL Y.B., 1988, supra (f.n. 16), p. 57, paras. 91 and 92]

[36] "Stand-by letters of credit and guarantees (or bonds), while functionally equivalent or at least similar, differ as to their legal treatment for the formal reason that the stand-by letter of credit is a letter of credit. Thus, the laws and rules governing documentary letters of credit would generally be applicable to stand-by letters of credit. [...] For guarantees and bonds, the legal framework is different. As discussed below (Part II, B), it is characterized by a varied development of national laws, in particular case law, towards recognizing the independent (non-accessory) legal nature of the guarantee and by attempts to prepare uniform rules." [UNCITRAL Y.B., 1988, supra (f.n. 16), p. 47, para. 5]

[37] It is a sensitive issue in the USA; for instance, it is recorded that: "At its eighteenth session (A/CN.9/372), the Working Group [...] had before it draft rules on stand-by letters of credit as proposed by the United States of America (A/CN.9/WG.II/WP.77). It was noted that those draft rules were based on the assumption that independent guarantees and stand-by letters of credit would be dealt with in separate parts of the future Convention. It was agreed that the need for such treatment in separate parts could appropriately be determined only when it was clear which, and how many, provisions should be applicable exclusively to bank guarantees or to stand-by letters of credit. The Working Group thus focused its discussion on the draft articles prepared by the Secretariat, with special attention to the question whether a given rule was appropriate for both types of undertakings or for only one of them." [UNCITRAL, **"C. Report of the Working Group on International Contract Practices on the work of its nineteenth session (New York, 24 May-4 June 1993) (A/CN.9/374 and Corr.1) [Original: English]"**, Yearbook of the United Nations

different approach (as accepted by the UNCITRAL), a new area of conflict of laws would emerge between UCP 500 and the future set of standards provided by UNCITRAL. In other words, the international business communities would be faced with two sets of standards for SLCs, namely a first one (UCP published by the ICC) would treat them like LCs while under a second type (the future UNCITRAL's set of standards) SLCs would be accepted as being similar to BGs.[38] Although there may be similar provisions about SLCs in both sets of standards, there would also be distinctions between them, as something in contradiction with the task of UNCITRAL, namely, providing a more unified front regarding an international payment system.[39] So, a question may arise: what could be the solution of the UNCITRAL Commission in order to prevent the emergence of such a problem? As far as the ICC is concerned it has announced its' disagreement with the present trend adopted by the UNCITRAL since the ICC is more in favour of treating SLCs and LCs together and separate from BGs;[40] it seems, therefore, it is possible to

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Commission on International Trade Law, Vol. XXIV, 1993, pp. 175-189 [hereinafter referred to as UNCITRAL Y.B., 1993, part c], p. 176, para. 7 and UNCITRAL Y.B., 1993, part a, supra (f.n.18), p. 140, para. 13]; for a different view see Buckley, Ross p., "THE 1993 REVISION OF THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS", Geo. Wash. J. Int'l L. & Econ., Vol. 28, 1995, p. 265 [hereinafter referred to as Buckley], at pp. 299-300 pointed out: "The principal weakness in this approach of the ICC is that the fraud Exception needs to be more expeansive for guaranty letters and standby credits than for trade-related documentary credits because fraud is so much easier to engineer in the guaranty or standby situation. With a trade credit, a number of parties usually need to contribute to the documents to be presented to trigger payment. With a standby credit or guaranty letter, payment is usally triggered by the certificate of only one party, so a fraud is much easier to effect." [Emphasis added]

[38] A similar confusion would be arise concerning BGs; for instance, Buckley, ibid., at p. 299, referred to such a matter and said: "The ICC, on the other hand, has promulgated the Uniform Rules for Demand Guarantees, and has chosen to leave standby credits to be regulated by the UCP."; ICC Pub. No. 458, "Uniform Rules for Demand Guarantees", 1992; see relevant discussions in Chapter III, Section A.2.1.2 (above).

[39] See foot note 5 (above) for paragraph (a) of the UNCITRAL's mandate.

[40] ICC, "ICC's opinion on UNCITRAL's draft convention on independent guarantees and stand-by letters of credit", a document published by the ICC, about the UNCITRAL's sessions held in New York, 9th-20th January, 1995 that in its foreword pointed out: "On November 1988, the ICC was given the opportunity to make a presentation to UNCITRAL's Working Group on Independent Guarantees and Stand-by Letters of Credit, on the ICC's Uniform Rules for Demand Guarantees. At that time, the ICC's representative raised the concern of potential duplication of effort, and perhaps conflict of application between the ICC's Rules and UNCITRAL's Convention or Model Law on Stand-by Credits and Guarantees." [Emphasis added]; in that respect see also ICC, "ICC's Second Opinion on UNCITRAL's

suggest that the ICC remove SLCs from the ambit of the UCP as a solution and that reconciliation should be effected between the ICC and the UNCITRAL concerning their different approaches about SLCs,[41] but as a remote possibility under the present circumstances. In treating this point different approaches may be envisaged, as follows.

One solution for overcoming the above difficulty is to extend the scope of standards to cover issues related to LCs under the future uniform law. This idea, as pointed out above, was noted by the UNCITRAL Commission, but because fundamental distinctions exist between LCs and BGs (namely, under LCs banks' undertaking is primary and is independent from an underlying contract while it is not so under BGs), different views were submitted during discussions in the Working Group and a final decision on that issue was left for later sessions. Another solution for tackling the above mentioned problems is to treat SLCs and LCs together (because of their similarities), completely separate from BGs. As to the question under consideration, there are four possibilities before the Commission, as follows: **(1)** it may be decided by the Commission that the future set of standards should be limited to issues relevant to SLCs and BGs; **(2)** it may be decided that beside SLCs and BGs, issues related to LCs be covered by the future set of standards; **(3)** the view suggested by the American delegation, namely, that issues related to SLCs and BGs should be studied separately and different sets of standards should be prepared for them would be accepted by the Commission; and **(4)** it may be accepted by the Commission that both SLCs and LCs are similar to each other and hence they should be treated separately from BGs.

It seems that both the first and the second possibilities would solve part of the problem but, at the same time, would cause more confusion and conflicts of

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Draft convention on independent guarantees and stand-by letters of credit", a document published by the ICC, about the UNCITRAL's sessions held in Vienna, 2-26 May 1995 (Document A/CN.9/408, 15 February 1995).

[41] Buckley, supra (f.n. 37), at p. 299 said: "An even more effectious solution would be to remove standby credits from the ambit of the UCP." [Emphasis added]

laws between parties to an international sale transaction. Firstly, as mentioned above, because of two sets of standards SLCs (one under UCP and the other one under UNCITRAL's standards), business communities would be confused about SLCs and their legal nature and purposes. Secondly, by having two sets of standards about one instrument, a different treatment as well as a different body of rules and provisions would emerge in different parts of the world of commerce; this would in total contrast to UNCITRAL's effort, at present, namely, for providing a uniform set of standards about SLCs and BGs under the title of "guaranty letters".[42]

The third of the above cited possibilities would, on the other hand, provide more certainty since it would be based on a reality accepted by the business communities, namely, SLCs as being something different from BGs and thus treating them differently. However, such a solution would still be subject to the same critique, namely, it would not solve the problem of conflict of laws arising by having, as mentioned above, two sets of standards about SLCs. Moreover, under such a suggestion only issues about SLCs would be considered but LCs' issues, which include the larger and more important part of documentary letters of credit system as an international method of payment, would be left untouched.

The above mentioned fourth possibility, in contrast to the other three approaches, would open a new direction for the Commission in order to reach its goal satisfactorily. After a decision by the Commission that SLCs and BGs should be dealt with separately (with a possibility under 3 above), it would be vital for the UNCITRAL Commission in its final consideration to take the view that the scope of uniform law should not be limited only to SLCs and issues related to traditional commercial letters of credit should also be included in any future international set of standards about documentary credits. By doing so any cause of confusion and conflict of laws would be, on the one hand, removed from the beginning and, on the other, a more complete, reliable, and predictable set of standards regarding documentary letters of credit (for both LCs and SLCs) would emerge in order to help

[42] UNCITRAL Y.B., 1993, part A, supra (f.n. 18), pp. 140-41, paras. 17 to 19.

international business communities. Similarly, by adopting such an approach UNCITRAL would be able to fulfil its task successfully by presenting a more acceptable and unified set of standards regarding documentary letters of credit.

As to what the final form of the future uniform law should be, namely, whether in the form of a "model law" or "convention", this is an issue on which the Working Group has not reached any decision, and as has left the issue for further consideration at a later stage. This issue is discussed in a later part of the present study. Prior to that, it is necessary to have a further discussion regarding the socio-economic situation of the international trade world at present. This is the issue considered in the next section below.

SECTION B: NEED FOR UNIFICATION OF THE LAW RELATED TO LCs

1. INTRODUCTION

As shown in section A of the present Chapter, the activities of the United Nations Commission on International Trade Law (UNCITRAL) relating to preparation of a draft convention on standby letters of credit (SLCs) and bank guarantees (BGs), the scope of such a convention, and its possible impact on existing rules and provisions affecting documentary letters of credit (LCs), particularly Article 5 of UCC in the USA and UCP 500, clearly indicate the readiness of the trading and commercial communities around the world to consider possible further integration between different national laws on SLCs and BGs. To what extent is the current situation of the world of commerce ready for another change, namely, considering possible uniformity in international law related to LCs? In that respect reference is made to the meaning of unification, available techniques for achieving the unification/ codification of the law on documentary credits, and obstacles which may endanger the uniformity of international rules; but before that, the current condition of the world of commerce is considered below.

2. THE WORLD OF COMMERCE; CURRENT CONDITIONS

2.1. Historical background

"For ever since men began to organize their common life in political communities they have felt the need of some system of rules, however rudimentary, to regulate their intercommunity relations",[43] and as ever, people living in different parts of the globe have similar basic needs like procuring food, clothes, housing, health, education, etc. It is obvious that no community is able to produce all its needs alone and it is essential for each community to establish some sort of exchange and trading relationship with other communities. This involves the buying and selling of goods and of services and having commercial and trade relations between countries as an old type of co-existence between human communities around the world.

With the rise of modern states in Europe in the 16th and 17th centuries, governments have invested authority and power in ruling and providing law and order.[44] While borders were drawn by new states in Europe and political developments concerned national interest and sovereignty for each state,[45]

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[43] Brierly, J. L., "THE LAW OF NATIONS, AN INTRODUCTION TO THE INTERNATIONAL LAW OF PEACE", Oxford, 6th ed., 1963, p. 1 [hereinafter referred to as Brierly].

[44] See Brierly, ibid., at pp. 1-6, for origin of international law and rise of modern state in Europe and role of feudalism and church in that respect.

[45] For more details about the doctrine of sovereignty see Brierly, supra (f.n. 43), at pp. 7-23; and at pp. 8-9 of the same reference it is said: "[...] a new theory of the nature of state, **the doctrine of sovereignty**. This was first explicitly formulated in 1576 in the **De Republica** of Jean Bodin, and since sovereignty has become the central problem in the study both of the nature of the modern state and the theory of international law [...] The essential manifestation of sovereignty (**primum ac praecipuum caput majestatis**) he thought, is the power to make the laws (**legem universis ac singulis civibus dare posse**), and since the sovereign makes the laws, he clearly cannot to be bound by the laws that he makes (**majestas est summa in cives ac subditos legibusque solute potestas**)." [Emphasis added]; at p. 126 of the same reference about the meaning of "state" said: "A state is an **institution**, that is to say, it is a system of relations which men establish among themselves as a means of securing certain objects, of which the most fundamental is a system of order within which their activities can be carried on."; and as to the meaning of territorial sovereignty it is said by the same writer that: "At the basis of international law lies the notion that a state occupies a definite part of the surface of the earth, within which it normally exercises, subject to the limitations imposed by international law, jurisdiction over persons and things to the exclusion of the jurisdiction of other states. When a state exercises an authority of this kind over a certain territory it is popularly said to have **"sovereignty"** over the territory [...]." [Emphasis added]

promoting the identity of each state as well as the effectiveness of governmental authority, other functions were forcing states to maintain mutual relations. One such factor has been, not least, the role of businessmen and traders from different states in keeping doors open for relations between different countries.[46] This holds also in our time. European states have accepted, as a principle, the notion of co-operation with each other and such acceptance has promoted the rise of international law (public and private) in general, and international commercial law in particular.[47]

A similar process has happened in Britain. For instance, before the time of Lord Justice Mansfield (1756) commercial law was international in real sense, namely, the laws and practices concerning the commercial law in London, Paris and Venice were much the same;[48] but Lord Justice Mansfield integrated the commercial laws and practices into common law and created a systematic body of commercial law since the sphere of commercial law was extended from foreign to domestic trade[49] and commercial law was regarded as a kind of natural law of

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[46] Brierly, supra (f.n. 43), at pp. 6-7 stated: "[...] among these causes may be mentioned (1) the impetus to commerce and adventure caused by the discovery of America and the new route to the Indies; (2) the common intellectual background fostered by the Renaissance; (3) the sympathy felt by co-religionist in different states for one another, from which arose loyalty transcending the boundaries of states; and (4) the common feeling of revolution against war, caused by the savagery with which the wars of religion were waged. All these causes co-operated to make it certain that the separate state could never be accepted as the final and perfect form of human association, and that in the modern as in the medieval world it would be necessary to recognize the existence of a wider unity."

[47] Brierly, supra (f.n. 43), p. 7; and the same writer pointed out some definition regarding states' relations to each other as following: "Contractual engagements between states are called by various names- treaties, conventions, pacts, acts, declarations, protocols. Non of these terms has an absolutely fixed meaning; but a **treaty** suggests that the most formal kind of agreement; a **convention** or a **pact** generally, but not always, an agreement less formal or less important; an act generally means an agreement resulting from a formal conference and summing up its results; a **declaration** is generally used of a law-declaring or law-making agreement, e.g. the Declarations of Paris or London, but such agreements are equally often called **conventions**, e.g. the Hague Conventions; **protocol** is a word with many meanings in diplomacy, denoting the minutes of the proceedings at an international conference, an agreement of less formal kind, or often supplementary or explanatory addendum to another treaty, e.g. the Geneva Protocol of 1924, so called because intended to amend the Covenant." [Emphasis added]

[48] Baker, **"The law merchant and the common law before 1700"**, Cambridge Law Journal, 1979, p. 295, concerning the nature of commercial law at the time of Sir Edward Coke (1552-1632).

[49] Schmitthoff, C.M., **"Modern trends in English commercial law"**, Sartryck ur (Tidskrift av Juridiska Foreningen i Finland) 1957, Haft 6, reprinted in the **"Clive M. Schmitthoff's selected essays on**

mankind by the same Lord Justice.[50] Such integration, however, caused a situation in which commercial law lost its international character and was completely absorbed by English common law. In that respect, commercial law moved from the level of international, universal, cosmopolitan custom into the orbit of the national law of England[51] until it finally became part of it in the 18th century.[52]

2.2. New age of co-operation between states: Moving from international private law towards transnational commercial law

As different conditions exist in different countries as to living standards, customs and traditions, ethical values, public institutions as well as private law have not been uniform between states; and different legal systems have emerged.[53] This

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international trade law", edited by Chia-Jui Cheng, Martinus Nijhoff Publishers, 1988, p. 5 [hereinafter referred to as Schmitthoff' s article 1957].

[50] In one of his judgements L.J. Mansfield said: "The mercantile law, in this respect, is the same all over the world. For from the same promises, the same conditions of reasons and justice must universally be the same." [Pelly v. Royal Exchange Assurance Co., (1757), Burr. 341, at p. 347.]

[51] Schmitthoff's article 1957, supra (f.n. 49), at p. 6 referred to such a matter by saying that "Historically, commercial law was absored by the common law. Originally, commercial law in Western Europe was distinctly the law, or more recently the usage or practice, of a class people, namely of cosmopolitan merchants who frequented the fairs and pots of various European countries, usually carrying their wares with them."

[52] That developments was not restricted to England but occured everywhere in the 18th and 19th centuries when the national state became a reality." [Schmitthoff's article 1957, supra (f.n. 49), at p. 6]; Goldstajn, A., "The new law merchant reconsidered", in Schmitthoff, C.M., "Law and international trade", 1973, p. 171 [hereinafter referred to as Goldstajn], at p. 174 said: "Before the 19th century the movement for the unification of law took, for example, on the national level that every country attempted to reduce the variety of local and regional customs. One of the best example in this field is Britain "Where a common law (Commune Ley) was imposed upon the whole kingdom in the Middle Ages." [Emphasis added]; Lando, Ole, "Principles of European Contract Law: An Alternative to or a Precursor of European Legislation?", The American Journal of Comparative Law, Vol. 40, No. 3, 1992, p. 573, at p. 574 (concerning the situation in France, Italy, and Germany)[herinafter referred to as Lando].

[53] Megrah, Maurice, "A uniform code for documentary credit practice?", International and Comparative Law Quarterly, Vol. 8, Jan. 1959, p. 41 [hereinafter referred to as Megrah 1959], at p. 42 concerning the difficulties of unification of international law many years ago pointed out: "A more fundamental reason for lack of unification, however, may be the basically different systems of law. Broadly speaking, the legal systems of the western world in this respect fall into two groups; the law of British Commonwealth is at bottom the common law of England, virtually unwritten, whereas those of European and south American countries are largely codified and derive from very different beginnings. It cannot have been expected, therefore, that the two sides would find it easy to come together, even if the question of unification in the case of negotiable instruments law had been urgent, which probably it was not." [Emphasis added]

was the situation until the early years of the 20th century when co-operation between states began to improve the law of international trade.[54] Such an effort, however, was not successful in unifying international commercial law in a real sense, namely, as a law which is understood and applied similarly everywhere. Reasons for this related partly to gaps between industrial and non-industrial countries concerning their strength in economy and trade and partly because of the increasing role of states in regulating their international affairs from a national point of view mostly based on national rather than international interests. So, a large part of international law, at the time formed upon mutual interests between two or more states, left issues of differences to be solved by rules of conflict of laws. Therefore, the possibility that a similar issue would be decided differently in different jurisdiction was high. This was the status of international private law until 1950s.

2.2.1. Transnational commercial law (lex mercatoria)

After the Second World War several factors were the cause for the birth of a new branch of international law called **transnational law**, which is not a branch or part of public international law; it derives its authority from the sovereign power of national law givers.[55] There are reasons for the rise of a new age of lex mercatoria, as follows.

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[54] For instance see Chapter I, Section B.1 (history of LCs) above, and early efforts concerning the unification of law of bills of exchange, promissory notes and cheques in 1930s.

[55] If we look at the various systems of national law, we note that they essentially consist of two types of legal rules; (1) some of them are **mandatory in charachter**, such as criminal law, family law and so forth, i.e. to be accepted by the people affected by them, whether they like them or not; and (2) the others are **optional**, for example: contract law. Of course there are mandatory rules in the law of contract, e.g. public policy, but it is mostly governed by the principle of the autonomy of the parties' will or as it is called the principle of freedom of contract in common law countries. However, this is the area in which a transnational law of international trade has developed and can be evolved. This is essentially founded on a parallelism of action in the various national legal systems. The aim of this parallelism of action is to facilitate the conduct of international trade by establishing **uniform rules or law** for it. Another aim of this parallelism, which is of great importance to international trade, is a far-reaching **reduction of the national rules of conflict of laws** and their substitution by a uniform, worldwide legal system of international trade regulation; **transnational law of international trade** in the **broadest sense** has been defined by Professor Jessup as "all law that regulates actions or events that transcends national frontiers. [Jessup, **"Transnational Law"**, 1965, p. 2; see also Jessup, **"The concept of transnational law"**, Columbia J. Transnational L., Vol. 3, 1964]; Schmitthoff, C.M., **"Nature and evolution of the transnational law of commercial transaction"**, Horn and Schmitthoff, supra (f.n. 4), pp. 19-31 [hereinafter referred to as Schmitthoff 1982], at p. 19 stated: "One of the outstanding features of legal development in all trading countries of the world is the general acceptance

2.2.1.1. Economic integration

Reconstruction plans for countries with economies and social infrastructures damaged as a result of the Second World War (1939-1945), economic prosperity, and higher oil prices are some of reasons why more contacts and co-operation between different states have increasingly developed in recent decades.[56]

2.2.1.2. Technological advances

As a result of unprecedented progress in science and technology the world has become a smaller place. Mass production of industrial and agricultural goods calls for larger markets and improved means of distribution. Furthermore, technological improvements in the field of transportation and communications, e.g., Electronic Data Interchange (EDI) have accelerated the growth of international transactions in recent decades.[57]

2.2.1.3. Birth of new states

New states have emerged as a result of independence movements in 1960s and 1970s; as a result, many third world countries have become responsible and important partners in international commerce. With the changing political map of the world on the one hand, and economic integration of the world on the other international trade has expanded to new markets. New independent states, looking

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of common principles in the law relating to international commercial transaction. This development has been described as the emergence of a transnational law of international trade, a new lex mercatoria. I have attempted to examine the theoritical basis of this development in my **commercial law in changing economic climate** and the practical aspect of it in **Schmitthoff' s export trade [7th ed. 1980], the law and practice of international trade**." [Emphasis and bracket added]; Horn, supra (f.n. 4), pp. 11-16; for more details concerning transnational law or lex mercatoria see relevant discussion in Section B.3.1 of the present chapter below.

[56] Schmitthoff 1982, ibid., p. 20; Horn, supra (f.n. 4), at p. 4 concerning the opening of new markets said: "Important new markets for technology have been opened in **oil-exporting countries** since the remarkable increase in bargaining strength and income of the OPEC countries in the 1970s. Another remarkable development is in international financial markets. Starting with the rise of the so-called **eurocapital market** in the mid-1960s, new international capital and new financial markets with their centres in Europe and, later, in Asia, have developed." [Emphasis added]; Langen, E., **"From private international law to transnational commercial law"**, The Comparative and International Law Journal of Southern Africa, 1969, p. 314.

[57] As to EDI and its relevant issues see Chapter IX (above).

for a fairer and equitable system of international trade law, and their bargaining power[58] as well as their attitude towards playing an active role in international trade[59] have been effective causes of changes.

2.2.1.4. Role of formulating agencies

It is not always true that differences existing in international law are exclusively the result of states. In many instances, divergences existing between different countries, at least as far as private law is concerned, have not been generated by the absolute character of state sovereignty but the absence of international institutions to co-ordinate the work of different legislators relating to international private law. This may be the cause of uncertainty since some national legislators have been unaware of each other's existence.[60] Since the early decades of the current 20th century efforts have been made by governments to remove obstacles and prepare the way for harmonising and possibly unifying sets of standards regarding issues related to international private law. The establishment of

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[58] See Horn, supra (f.n. 4), at p. 5 said: "The rise of the **OPEC cartel** has dramatically changed the bargaining power of OPEC member countries. In this case, the old rule that a technology recipient country is normally in a weaker bargaining position, is no longer true. At the same time, the banllance of payment and international debt position of many oil-importing countries has dramatically deteriorated." [Emphasis added]

[59] "A large number of commercial transactions with third world countries are concluded and carried out with **governmental agencies** as parties. In many of these countries, **special legislation on foreign trade** and, in particular, on the transfer of technology, prescribes the precise terms of the contracts for these transactions. In addition, in many cases **public bidding procedures** are instituted, which leave foreign contractors no freedom to bargain over the contractual terms. Instead, national legislation and the administrative practice of the authorities involved decide on the contractual patterns, unless special circumstances lead to special arrangements." [Emphasis added; Horn, supra (f.n. 4), p. 6]; Wallace Jr, Don, **"International agencies for the formulation of transnational economic law: a comment about methods and thechniques"**, Horn and Schmitthoff, supra (f.n. 4), p. 81 [hereinafter referred to as Wallace], at p. 81 concerning the role of states in modern societies stated: "As the law develops [...] the line that once existed between traditional bodies of private law and public law begins to blur and vanish. The **state** enters the market place. In the case of developing countries, the government takes a paternalistic interest in the law regulating transactions with its private subjects." [Emphasis added]; Dolzer, supra (f.n. 6), at p. 80, referred to the same issue; Schmitthoff 1982, supra (f.n. 55), at p. 25 referred to the role of states in those countries of state-planned economy and stated: "They are in a stronger position than market economies to achieve the unification of legal regulation because trade between them is governed by a measure of **state** direction unknown in the market economy countries." [Emphasis added]

[60] David, Rene', **"The International Institute of Rome for the Unification of Private Law"**, Tulane Law Review, Vol. 8, No. 1, December 1933, pp. 406-16 [hereinafter referred to as David], at p. 406.

the League of Nations, and then of the United Nations[61] and its relevant agencies and organisations like the UNCITRAL[62] are good examples of the willingness and readiness of states for more co-operation regarding public as well as private international affairs. Similar efforts are being made by non-governmental organisations like the ICC; its work deals mainly with issues related to private international affairs.[63]

2.2.1.5. Role of legal scholars

Beside organisations and institutions which are active in the field of international law, the role of legal scholars (lawyers and academics) should not be underestimated[64] since their efforts have a decisive impact on any movement towards unification and codification of law at an international level, in two ways: (1) in the drafting and negotiating process a common understanding between legal experts all over the world creates a sound platform for a common international

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[61] Horn, supra (f.n. 4), at p. 18 pointed out: "A number of international organisations and institutions of varied legal status are active today in the elaboration and definition of uniform legal rules and patterns of international commerce. These activities are aimed either at the prepration of new international "legislation", such as the UN Convention on Contracts for the International Sale of Goods, or are aimed at the promulgation of standard rules and clauses." [Emphasis added]; Ademuni-odeke, "The United Nations Convention on International Bills of Exchange and Promissory Notes", JBL, May 1992, pp. 281-90 [hereinafter referred to as Ademuni]; Lookofsky, J.M., "Loose ends and contracts in international sales: problems in the harmonisation of private law rules", The American Journal of Comparative Law, Vol. 39, 1991, pp. 403-416 [hereinafter referred to as Lookofsky]; Feltham, J.D., "The United Nations Convention on Contracts for the International Sale of Goods", JBL, 1981, p. 346 [hereinafter referred to as Feltham]; Schlechtriem, Peter, "From the Hague to Vienna- Progress in Unification of the Law of International Sales Contracts?", Horn and Schmitthoff, supra (f.n. 4), p. 125.

[62] International payments is one of the three classic topics selected by the Commission at its first session in 1968; concerning UNCITRAL's activities concerning SLCs and BGs see relevant discussions in Sections A.2.1.3 (Chapter III) and A.2 (present chapter) above.

[63] For more details about ICC's activities look at discussions in Chapter III (above); Rowe, Micheal C., "The contribution of the ICC to the development of international trade law", Horn and Schmitthoff, supra (f.n. 4), p. 51 [hereinafter referred to as Rowe], at p. 51 said: "The International Chamber of Commerce (ICC) is a non-governmental organisation, representing business internationally. Its contribution to the development of international trade law arises from three main areas of activity: the development of standard rules and procedures aimed at trade facilitation in its brodest sense; co-operation and contacts with other organisations interested in the same subjects; the organisation of seminars and research projects on business law topics."

[64] Lando, supra (f.n. 52), at p. 577; Garro, supra (f.n. 1), at pp. 610-11.

understanding of legal issues and related interests; **(2)** once a codified text have been agreed upon internationally, its uniform application in practice requires another co-operation, namely, a common understanding of legal terms and principles accepted in the code. Without these elements, therefore, any efforts concerning the unification of international law would be futile and meaningless; as a writer has rightly pointed out "A common language for lawyers is needed."[65] Fortunately, this fact has been recognised for many years and in that respect international lawyers have become more active and have participated effectively in a number of projects connected to the unification of private international law through existing international organisations like UNCITRAL, UNIDROIT, and the ICC.

In the above circumstances, co-operation between traders have increased internationally and as a result a new age of lex mercatoria has begun.[66] While the modern lex mercatoria seeks to find its place in international trade there is a difference between the new and old eras, namely, states play an important role for shaping the transnational law at present, something which cannot be denied and is a fact of life in modern societies. This was not so in the era of old lex mercatoria (15th to 18th centuries).

Parallel to the expansion of international trade in recent decades, disputes arise in international business relations and a need for a more unified international set of standards becomes obvious. Although having a completely universal or unified law for diverse international trade relations seems impossible, at least for the foreseeable future,[67] facts of daily life also point to the need for greater uniformity

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[65] Horn, supra (f.n. 4), at p. 18; for further details see relevant discussion in Section B.3.3 of the present chapter (obstacles to unification of law) below.

[66] see Lando, supra (f.n. 52), at p. 578 (concerning the interest of international arbitrators in development of lex mercatoria).

[67] David, supra (f.n. 60), at p. 406 said: "The complete and universal unification of the laws of the various nations is a vain hope which cannot, for one moment, be seriously contemplated. The civilization of the different countries, their living conditions, their customs and traditions, the very ethical principles which social relationships have as their foundation are all diverse; and in this diversity there must correspondingly be as great a difference in public institutions as in the field of private law itself." Boss, Amelia H. and Fry, Patricia B., "Divergent or parallel tracks: International and domestic codification of commercial law", Business Lawyer, Vol. 47, Iss. 4, Aug. 1992 [hereinafter referred to as Boss], pp. 1505-1515.

regarding rules of international private law;[68] delay in that respect causes uncertainty and higher costs as serious inconveniences between parties to international transaction.[69]

3. UNIFICATION OF LAW: MEANING; TECHNIQUES; OBSTACLES

3.1. Meaning of unification of law

Law can only exist in a society. International law or the "law of nations" is not an exception to a "society of nations" which exists as a prior condition to any discussion on international law; but having a society of nations is one condition among others for having a unified and codified law. In order to achieve "unification" or "codification" of law in any sphere of international affairs, other factors should also be considered. For instance, there must exist a strong feeling and desire for justice and equality,[70] deep respect for law, order, responsibility and co-operation,[71] and a

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[68] For instance, see discussion concerning the UNCITRAL's activities in Section A of the present chapter above.

[69] For example see Kozolchyk, Boris, "Towards New Customs and Practice for Documentary Credits: The Methodology of the Proposed Revision", Commercial Law Annual, 1993, pp. 371-408 [hereinafter referred to as Kozolchyk 1993], at p. 394 concerning discrepancies of documents presented under LCs and the cost effect of them said: "The growth in the number of discrepancies is a universal phenomenon. SITPRO, an English trade facilitation agency, recently conducted a survey which found that as many as 50% of the first tenders of documents contained discrepancies. Similar surveys conducted by this writer among American and German bankers placed the percentage as high as 75%." [Emphasis added]; and at p. 399 of the same reference above pointed out: "AS a result of the distrust created by the banking practices and judicial decisions described above, **the cost of processing an ordinary documentary credit has risen more than tenfold in less than 10 years in the United States.**" [Emphasis added]; Buckley, supra (f.n. 37), at p. 271; for other details see relevant dicussion in Section B.3.2 of Chapter XI (below).

[70] Kozolchyk, ibid., at p. 382 connecting to the role of banks in connection to LCs said: "[d]istance between traders and financial intermediaries accentuates the need for cooperation, and cooperation is best insured by reciprocity. Accordingly, an issuing bank wishing to participate regularly in the international letter of credit business must not only treat the confirming, advising and negotiating banks fairly [...] but must also be willing to advise, confirm and negotiate its correspondents' credits. Indeed, the fact that today's issuer is tomorrow's confirmer, adviser or negotiator reinforces the need for equal treatment." [Emphasis added]

[71] Briefly, supra (f.n. 43), at p. 42 said: "Modern science has given us vastly increased facilities and speed of communications, and modern commerce has created demands for the commodities of other nations which even the extravagances of modern economic nationalism are not able to stifle. If human affairs were more wisely ordered, and if men were clearer-sighted than they are in seeing their own interests, it might be that this interdependence of the nations would lead to a strengthening of their feelings of community. [...] Some sentiment of shared responsibility for the conduct of a common life is a necessary element in any system of law; and the strength of any legal system is proportionate to the strength of such sentiment."

vision that order and not chaos is the governing principle of the world in which mankind has to live as nations and governments. It is obvious that a single world society or community can be at present more a dream than something that be made into reality. This is not the issue for consideration in the present study. The point for discussion is whether unification or codification of private law under the current situation of the world, namely, as a society of nations, is something possible and useful. In that respect some basic questions should be raised.

3.1.1. The practical interest of unification

Life is complicated and human foresight is limited, so it is not possible for law (national or international) to be complete and as a set of rules and standards. Human societies are moving forward and there are always new situations which fall outside all already formulated rules. Is there then any practical interest in talking about the international unification of law? Generally speaking, it is accepted by lawyers that law cannot and does not refuse to solve a problem simply because it is novel. To deal properly with new situations one way is to refer to new principles being outside the area of existing law, which may be denied to exist while actually existing. It would be, moreover, not reasonable to argue that because existing law needs changes it is not practical to work for the unification or codification of law. A first result which progressive unification of law may achieve is harmonisation and codification of law and of general principles for providing a background for dealing with future problems.[72] If no such efforts had been made in the past, and none is undertaken in our time, society would face more difficult situations not only in relation to the future but also in relation to inherited problems.[73] So, a fear of revising law because of expectedly new situations in the future does not justify the claim that there is no need or practical interest to work for unification or codification

[72] Unification and harmonisation of law are not identical. Harmonisation is less ambitious; it aims only at the approximation of the fundamental principles of the various national law but leaves undisturbed national divergencies in matters not regulated by the harmonising law.

[73] Lando, supra (f.n. 52), at pp. 574-75 (need for harmonisation of European laws).

of the law existing between nations for the purpose of states' mutual understanding for coordinated action towards more certainty, predictability, and reliability on law operative between parties to an international transaction.[74]

The complexity and shortcomings of current private international law are due to a number of reasons. Firstly, mostly national legal systems exist, at present, in the world. They vary even if they have roots, respectively, in the same sources, for example, in civil law, common law, socialist law, and islamic law. Moreover, they take very little notice of each other in details as well as in practice while claiming to share common roots and principles.[75] Secondly, in international disputes it is an accepted procedure to use domestic tools to solve questions essentially international and, although complicated, foreign national law could be used. To apply uncritically a national system of law, however correctly interpreted by a judge, to an international legal relationship is not a satisfactory solution. National systems of law are not designed for the regulation of complex international relations. It is desirable that these should be governed by an international system, uniformly understood and applied by courts, national or international, requested to consider such relations.[76] Thirdly, the technique normally applied by states to solve

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[74] Horn, supra (f.n. 4), at p. 4 said: "International commerce based on **freely negotiated contracts** is still the driving force of international economic co-operation and prosprity. **Clarity, stability and perhaps a growing degree of uniformity in the law and practice of international commercial contracts** are a prerecuisite for the functioning and further development of international commerce." [Emphasis added]

[75] Herrmann, Gerold, **"The contribution of UNCITRAL to the development of international trade law"**, Horn and Schmitthoff, supra (f.n. 4), pp. 35-50 [hereinafter referred to as Herrmann], at p. 42 concerning the role of UNCITRAL in resolving differences exist between different legalsystems regarding the issue of international payment stated: "The primary objective of unification in this field is to find, or lay, some common ground between two major systems: the civil law system, as shaped by the Geneva Conventions of 1930 and 1931 providing Uniform Laws for Bills of Exchange and Promissory Notes (ULB) and for Cheques (ULC), and, on the other hand, the common law system, as represented by the United Kingdom Bills of Exchange Act 1882 (BEA) and the United States Uniform Commercial Code (UCC). This is not an easy task if one looks at the basis disparities in concepts and in solutions to particular issue, for example, forged documents."

[76] David, Rene', **"THE LEGAL SYSTEMS OF THE WORLD, THEIR COMPARISON AND UNIFICATION"**, International Encyclopedia of Comparative Law, Chapter 5, The International Unification of Private Law, Vol. 2, J.C.B. Mohr (Paul Siebeck), Tubingen Mouton, the Hague, Paris, Oceana Publication Inc., New York, 1971 [hereinafter referred to as David's legal system 1971], at pp. 13-14 said: "By contrast, it would be inconvenient for each court to have to apply different sets or rules for international and for internal relations. [...] And to classify a relationship as international or internal is far from simple, for

international disputes, namely **conflict of law** itself is a source of complexity because of the current state of private international law with its diversity and corresponding uncertainty. For instance, in any international dispute the first question to respond should be: what is the applicable law of transaction? The answer will vary from national to national law and, the same legal situation may be treated differently by the national laws of different states. The diversity of legal systems is not only complicated but may also be considered to be unjust.

It is also important to remember that a mere similarity in terms is not sufficient for uniformity in law. Also only part of a problem may be solved by using different and sometimes contradictory terms about the same legal notion in different legal systems. The argument for the unification of private international law is that the same legal issue should be interpreted in a similar way by judges in different legal systems.[77]

In conclusion, it is preferable to refer to private international law as a better source of support and solutions for parties to an international transaction instead of having different national laws on an issue truly international in nature; formalized international law or a unified worldwide accepted law should be considered. National judges may have truly international rules anchored in their respective languages in familiar terms, but based on the same principles applicable to international

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not every international element can reasonably be said to require submission of the transaction to international law."

[77] Gutteridge, H.C., "A Comparative View of the Interpretation of Statute Law", Tulane Law Review, Vol. 8, No. 1, 1933, pp. 1-20 [hereinafter referred to as Gutteridge 1933], at p. 2 said: "Uniformity in law, as Professor Beutel has pointed out, means more than a "mere similarity of wording." Unless unification is accompanied by a similarity of judicial interpretation, it may well become a pretence and be "a mere hollow shell" which fails to serve any useful purpose."; in order to solve the problem of different interpretation of law by judges the same writer at p. 2 of the same reference stated: "The task of clearing the ground, with a view to scientific investigation of this problem, involves a close consideration of the following matters: 1. An estimate of the extent to which the technique of judicial interpretation varies in the different legal systems; 2. The extent to which differences in the structure of legal institutions may affect the wight to be attached to judicial interpretation in different countries; 3. The difficulties in the international sense which may arise from the necessity of the enactment of the same law in several different languages."; Beutel, "The necessity of a new Technique of Interpreting the N.I.L.", 6 Tulane Law Review 1, 2 (1931).

transactions.[78] As previously pointed out, a need is felt for the preparation of a uniform law about standby letters of credit (SLCs) and bank guarantees (BGs).[79] A similar need has also emerged for rules relating to traditional letters of credit (LCs).[80]

3.1.2. The concept of unification

What does unification mean? Different meanings can be presented.

1. A first meaning of unification is that the actual rules of law are unified between different countries so that the same problem can have the same solution in every country. This definition is widely accepted by international organisations in charge of the unification of law, for example, UNCITRAL and UNIDROIT. As a result of such an understanding different model laws or international conventions have been drafted. However, the methods used for them are not the only ones for the unification of law. Beside establishing rules other possibilities such as the establishment of concepts, standards, and methods exist as elements for creating law. For having good law it is necessary to consider various factors such as the ones mentioned above. As pointed out by a writer, "to separate law from its "infrastructure of concept", to look at it without considering the methods which influence its presentation, is to lose touch with reality."[81] Therefore, there is the

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[78] Gutteridge 1933, ibid., at p. 15 said: "A uniform law owes its existence **ex hypothesi** to a desire to abolish differences between various systems of municipal law." [Emphasis added]

[79] For instance see UNCITRAL Y.B., 1989, supra (f.n. 17), at pp. 194-195, para. 122 which was pointed out: "The Working Group recalled the preliminary deliberations by the Commission as reflected in the report on the twenty-first session: "While some doubts were expressed as to the practical need and usefulness of such a uniform law, there was wide support for the view that successful work in this direction was desirable in view of the practical problems that could only be dealt with at the statutory level. The Commission was aware of the difficulties inherent in such an effort relating to fundamental concepts of law, such as fraud or similar grounds for objections, and touching upon procedural matters. Nevertheless, it was felt that, in view of desirability of legal uniformity and certainty, a serious effort should be made."; see also p. 200, paras. 174 and 175 of the same reference above.

[80] UNCITRAL Y.B., 1989, supra (f.n. 17), at p. 195, para. 125 said: "After deliberation, the Working Group was agreed that the uniform law should focus on independent guarantees, including stand-by letters of credit, and that it should be extended to traditional letters of credit where that was useful in view of their independent nature and the need for regulating equally relevant issues."; for more details see discussion about UNCITRAL's activities in Sections A.2 (present chapter) and Section A.2.1.3 (Chapter III) above.

[81] David's legal systems 1971, supra (f.n. 76), p. 35, para. 88.

possibility of gaining a degree of unification by harmonising the concepts, methods, and presentation of different legal systems without adapting identical legislative texts in different countries. Such a broad meaning of unification has supporters and its advantage is its flexibility since under it just principles are agreed upon under a convention and states are free in implementing them in a way which seems to them to be formally most appropriate. Another advantage of such a formula is its simplicity since there is no need to find words/terms which would be identical in all legal systems; the same meaning would be understood by different parties to an international transaction governed by an international adopted convention.

Nevertheless, the disadvantage of such a method appears in its lesser efficiency, namely, in a dispute a concept of law described by different names could probably cause confusion among businessmen in their daily communications using different terms for the same concept of law. Therefore, beside agreeing upon the concept underlying a given legal rule and its relevant principles as anchored in a convention, it may be more preferable to agree on identical terms to prevent any possible confusion in daily practice.[82]

2. The second meaning of unification of law concerns the question whether the legal rules in question have their roots in one national law in preference to other national laws or whether a new rule is being established to govern particular legal relations. In other words, whether unification of international private law means the **unification of conflict rules** or **unification of substantive rules**. Which one of these methods would have more advantages?[83] Generally speaking, a direct agreement on the substantive rules applicable to a certain relationship instead of agreement on the choice of national law would offer a better solution to the problem

[82] "Codification" of international law involves the setting down, in a comprehensive and ordered form, of rules of existing law and the approval of the resulting text by a law determining agency. The process in international relations has been carried out by international conferences and by groups of experts whose drafts were the subjects of conferences sponsored.

[83] For details concering different types of unification of rules see relevant discussion in Section A.4, Chapter XI (below).

of unification of law: **(1)** there is no need to consider in an international dispute which national law should be applied; **(2)** by applying the same rule everywhere judges would not face the problem of unfamiliarity of another legal system and this would accelerate procedures and the adoption of just conclusions; the parties would be more certain that their particular relations would receive the same treatment under different legal systems. Moreover, a judge would have a more positive attitude towards such a uniform law accepted as part of his national law; and **(3)** another advantage of a substantive law for international transactions would be that international issues could be treated open mindedly and international problems would be seen from an international perspective rather than from a narrow national view. National systems of law, by contrast, generally take little account of problems peculiar to international relationships. As rightly pointed out by a writer, "to require the application of these systems (national systems of law)- by merely unifying the conflict rules- is to refer to systems of law which are ill adapted to these transactions."[84] The only difficulty is that it is not always easy, in practice, to reach worldwide agreement over a new set of standards, partly because of a feeling that the new rules may put their national interest at risk, and partly because of costs in terms of time and money. In conclusion, the preferable approach for the unification of law would be the unification of substantive rules. Insofar as such a formula is not possible to apply, the method, namely, the unification of conflict of laws could be mobilised. In order to achieve a better and more functional result in the unification of law, the former substantive law approach should always be complemented by the latter method.

3.2. Methods and techniques of unification

Once it has been accepted, in principle, that the unification of international private law is desirable and necessary, the question can be addressed as to what can be done to attain it? Methods and techniques exist and they are available for

[84] David's legal system 1971, supra (f.n. 76), p. 38, para. 97.

discussion in the international community to promote progress towards the unification of law.

3.2.1. Legislation

One of the techniques envisaged for the unification of law in international affairs is **international legislation**. One advantage of this approach is the speed with which legislative provisions can modify the law, owing to the mandatory nature of rules which legislation makes enforceable. This may suggest giving priority to the legislative unification of law over other available methods.

3.2.2. Practice (freedom of contract and trade usages)

Opponents of "legislation" argue that it is not the only method for unification of private international law. In addition, it generates less flexible rules when revision is needed for improvement parallel to advancing technologies, for example, in transportation and communications, and new issues are to be addressed in daily practice. It is important to consider also other techniques for the unification of law, namely, practices by those involved in international transactions and trade usages. In other words, parties to an international contract should be free to negotiate terms and conditions most suitable to the needs of their respective relationships. The notion of **freedom of contract** is not a strange one and modern legal systems have accepted it and to some degree issues related to contracts have been left to be agreed by the interested parties. To what extent is the practice of contracting parties capable of constituting a factor tending to unify the law?

Parties to a contract are free and capable of fixing, according to their needs and capacity, details of their transaction, for example, prices, date and place of delivery, type of delivery, quality and quantity of the object(s) of the contract, insurance, method of payment. Other points concerning the applicable law of contract, appropriate forum, and methods for dispute settlement to a large extent are left by most legal systems to the contracting parties' agreement. All the above points affecting contracts are related to the rights and duties of persons parties to a contract; they could be the cause of disputes, confusion and uncertainty if they are

not precisely agreed upon and included in the contractual text of the transaction. For resolving such disputes, normally reference is made to general principles of law and if the contract is not subject to any international legal rules, it is decided by the national law of one state in accordance with the **theory of conflict of laws**. The will of parties to an international transaction covers only details of the deal and is limited to those issues which are not affected by the rule of law and public order. This is valid both in international as well as internal trade relations. Diversity of practices and trade usages and modifications or developments may also be elements of instability, not favourable for the unification of law, compared with the relative advantages of legislation, for example, in the form of an international convention.

There are some principles of law which have originated from long term, popular, lawful and worldwide practice and usage in a particular trade: **custom**, accepted even in international law as a source of international law.[85] Nonetheless, custom does not match the speed, predictability and certainty promoted by legislation/ codification in dealing with the problems of unifying the law. Some points relating to terms such as ***international customary instrument*** and ***international legislative instrument***, their advantages and disadvantages are put forward in the next part of the study (Chapter XI).

3.3. Obstacles to the unification of law

Although governmental and non-governmental international organisations have invested much effort in clarifying and improving all branches of law, there are still issues which cause difficulty and are to be faced when efforts are made to prepare a suitable atmosphere for establishing a uniform law. These obstacles put at risk any efforts relating to the desirable unification of international rules. Some of those obstacles are considered below.

3.3.1. Routine and prejudice

[85] See Article 38 of the Statute of International Court of Justice (ICJ); and Section A, Chapter XI (below).

Merchants, manufacturers, bankers, lawyers, and judges constitute a principal difficulty when dealing with any projects for the unification of international law. For their convenience, they stick to rules and methods, for the settlement of disputes, which belong to the past or even may constitute a main cause for the disparity of international law. For instance, the theory of **conflict of laws** has been accepted as the only suitable method for solving problems posed by international legal relations and it is applied by those who support it. While such a method would not be useless, as discussed previously, in resolving an international dispute, it is not the most suitable method for the unification of law, because its weakness is its reference is to national law and cannot provide a solid rock for international law in its true meaning. International law and international rules should originate from an international rather than national interest, for safeguarding impartiality as well as fairness in practice.[86] Routine and prejudice are thus recognised as barriers on the way to any projects for the international unification of law.[87]

3.3.2. Different substantive rules

In international relations between individuals (private international law), states decide how to regulate such relations, without necessarily considering what other states do. The result is that the same international relationship may be treated differently in different states, in the light of national rules of private international law differing from jurisdiction to jurisdiction. The substantive rules governing particular types of legal relations differ from country to country. Again, the question of unification arises in order to find proper solutions to difficulties generated by different substantive rules resting on different ideas of justice. Admittedly, differences between two substantive rules may also be purely accidental and may offer different

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[86] See relevant discussions in Sections B.3.1 of the present chapter (above) and A.4 of Chapter XI (below).

[87] David's legal system 1971, supra (f.n. 76), at p. 25, para. 62 said: "For more than 100 years they have been used to thinking that the problems concerning international relationships between individuals should be regulated by means of the conflict of laws theory. They unhesitatingly approve all the efforts made to arrive at an agreement between the various states on the conflict rules to be applied in such a case. But they have the greatest difficulty in conceiving that the theory of conflict of laws might not be the only suitable method of solving the problem posed by international legal relations."

solutions. Each of them could be equally well adopted, with one country choosing one and another state a second. In such a situation unification may have a better chance while still being not easy.

3.3.3. Different techniques

Differences between legal systems are due not only to the diversity of ideas of justice, but are also connected with the variety of techniques, concepts, and the vocabulary used at lawyers' disposal.[88] When considering the possibility of having an international unification of the law, into account should also be taken the fact that the interpretation of rules by judges/lawyers and methods used by them may be different from legal system to legal system. The function of legislation, custom, and case-law are not everywhere the same.[89]

3.3.4. State sovereignty

Another obstacle for the unification of law, sometimes playing a great role, is that states see the issue of unification of law as a threat to their sovereignty.[90] This is, to some extent, true but what can be done when an international matter requires uniformity in practice? It is not, therefore, wise to suggest that states should pay no attention to an international problem and leave their sovereign subjects without a proper legal protection. So, it is more preferable that for a higher goal states should abandon part of their sovereign powers of making law and transfer it to an agreed international body in order to deal properly with the issue of law making at an international level.

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[88] Lando, supra (f.n. 52), at p. 575 concerning the European Communities (now Union) pointed out: "The 12 Member States have nine languages and at least 13 legal systems, some of which are very different from each other." [The number of Member States is 15, at present, and it would be increased if the Eastern European countries application for joining the Union will be accepted.]]

[89] See discussion concerning the role of legal scholars in unification of international law in Section B.2 of the present chapter (above).

[90] Garro, supra (f.n. 1), at p. 588 said: "In Latin America, efforts to deal with unification have been traditionally frustrated by chauvinistic perspectives of sovereignty."; David, supra (f.n. 2), p. 414.

CONCLUSIONS

After considering the above obstacles for unification it may be asked: how is it possible to find a solution to overcome the existing problems? It is important to remember that the purpose of unification or codification of international law is to find common solutions to common cross-frontiers problems. This does not, however, mean that all differences between different legal systems have to be overcome, anyhow something impossible to achieve in the foreseeable future. It may not happen at all. It is, therefore, vital to ask what is meant by the unification of law in order to avoid further confusion and be in harmony with the realities of daily affairs. In that respect, progress can be achieved by getting rid in the first place of routine and prejudice, and showing clearly that unification or codification is not an attack upon national sovereignty; in that respect the role of legal scholars are vital both in a primary process towards preparing a uniform law and after it, namely, for a common understanding and approach concerning the interpretation of rules and principles agreed upon in the uniform law.

Regarding the diversity of national economic, social, and political structures, and divergent ideas of justice, it could be argued that these differences do not prevent the existence of private legal relations at an international level, but these situations constitute one more reason for seeking the road to unification. A similar argument could be used when taking the variety of techniques and the interpretation of law by judges and lawyers. Furthermore, the current condition of the world of commerce, as considered above (Section B.2), as well as the UNCITRAL's activities concerning the first convention about SLCs and BGs (Section A.2 above) confirm a need for a more progressive unification of international trade law, in general, and of the law for LCs in particular. The role of states in modern societies in an era of economic integration and rise of transnational law (new lex mercatoria) is something that should not be underestimated.[91] States in our time, regardless of their political,

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[91] Horacio A. Griger Nao'n, "The UN Convention for the International Sale of Goods", Horn and Schmitthoff, supra (f.n. 4), p. 89 [hereinafter referred to as Horacio], at p. 123 about the UN Convention on International Sale of Goods (Vienna Convention, 1980) and its impact on the issue of freedom of contracting parties said: "[p]arties do not possess an unlimited metaphysical and abstract ability to regulate their

economic and religious differences, are under pressure from their commercial and banking communities to play an active role in international markets[92] for an intensive co-operation with each other in order to keep the global market open for easy and peaceful transfer of goods, services and technology in a fair balance of interests. Lastly, it is essential to involve businessmen and their trade or professional associations in discussions on unification while ideas are still in their formative stage. To consult them only when a draft set of rules has been formulated is too late, because by that time the ideas of the law maker may have been channelled down a particular track from which it would be difficult to depart.

On balance, how can a formula be agreed upon in the certainty that it will lead to a result of uniform situations in different legal systems? The international unification of law has potential objectives provided its true significance, its objects, and its different options are grasped by all the interested parties involved in an international relationship. To achieve the international unification of law is not to demand that two or more legal systems should be completely merged and replaced by a single system. Unification can be much more concrete by being capable of being much more modest.

As far as UCP 500 is concerned, it deals with the question of unification of law. In the text of UCP 500 and the concept of letters of credit, different relationships in transactions, and the rights and duties of parties to an international transaction, to

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economic and commercial relations- this was more fitting in the nineteenth century for powerful merchants and businessmen who required wide freedom in their underpopulated world to achieve full exploitation of natural resources and development of productive forces. The regulation devised by the Convention establishes clear and prudent limits to the autonomy conferred upon the contracting parties within the general context of international trade relations. In other words, the parties can only choose between the Convention's provisions and the rules made applicable by national conflicts rule." [Emphasis added]

[92] Horn, supra (f.n. 4), at pp. 4-5 referred to the role of banks in modern societies and said: "[t]he international banking system has substantially expanded and the banking infrustructure of many developing countries has reached a level similar to that of industrialised countries. International commerce largely depends on the functioning of this international banking network which provide the necessary payment and credit facilities." [Emphasis added]

some extent, are considered.[93] However, the relevant point about UCP 500, insofar as the unification of law is concerned, is its non-mandatory structure; it is in form of an international customary instrument.[94]

Another question concerns the reason(s) why no effort has yet been undertaken regarding the preparation of a uniform law about LCs. To invest effort in work for the unification/ codification of LCs' law in international trade corresponds to a marked desire by all interested parties (bankers, applicants for credits and beneficiaries) and international commercial communities and organisations (such as ICC and UNCITRAL) for having a uniform law. It is vital to deal with the (above mentioned) obstacles which usually prevent any movement towards unification and codification of any aspect of private international law. If something seems difficult there is no reason to turn our back on it; it is indeed a task for those who are best equipped to undertake such a challenge and find a proper solution for it. In that respect, documentary credit operations because of their central role in international trade require special attention, namely, they need to be governed by rules which are clear, certain, and predictable. This is something which seems the current existing laws around the world are inadequate to provide as proper response. Unification/ codification of law of LCs and relevant issues are considered in the next chapter below.

[93] For shortcomings of the UCP 500 see the relevant discussion in Section B.3 of Chapter XI (below) and Chapters V-VIII (above).

[94] This issue is considered in more details in Section B.2 of Chapter XI (below).

CHAPTER XI

LEGAL INSTRUMENTS FOR THE UNIFICATION OF LAW OF DOCUMENTARY LETTERS OF CREDIT

SECTION A: LEGAL INSTRUMENTS FOR UNIFICATION AT THE LEVEL OF INTERNATIONAL LAW

International conventions and international custom are two important sources,[1] among other sources of modern international law quoted in Article 38 of the Statute of the International Court of Justice (ICJ).[2] In the light of what has been said previously (Chapter X, Section B.3.2), international legislation in the form of conventions may still be the best formula for unification of private international law as an "international legislated law".

1. TECHNIQUES AVAILABLE FOR INTERNATIONAL LEGISLATION

How can international legislation be established? There are three possibilities.

1.1. Supranational legislation

For providing a genuine international legislation, an international legislative body has to exist. It could act as supranational authority underwhich states could

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[1] Brownlie, Ian, "PRINCIPLES OF PUBLIC INTERNATIONAL LAW", Clarendon Press, Oxford, 3rd ed., 1979 [hereinafter referred to as Brownlie] at p. 1 said: "It is common for the writers to distinguish the formal sources and the material sources of law. The former are those legal procedures and methods for the creation of rules of general application which are legally binding on the addressees. The material sources provide evidence of the existence of rules which, when proved, have the status of legally binding rules of general application." [Emphasis added]; see also pp. 1-2 of the same reference regarding the real meaning of formal and material sources as far as international relations are concerned.

[2] "Article 38 of the Statute of International Court of Justice (ICJ) direct the Court to apply: "(a) International conventions, whether general or particular, establishing rules expressly recognized by the contesting States; (b) International custom, as evidence of a general practice accepted as law; (c) The general principles of law recognized by civilized nations; (d) Subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law. [...] This provision shall not prejudice the power of the Court to decide a case ex aequo et bono, if the parties agree thereto." [Emphasis added]; Article 59 provides: "The decision of the Court has no binding force except between the parties and in respect of that particular case."; Brierly, J.L., "THE LAW OF NATIONS, AN INTRODUCTION TO THE INTERNATIONAL LAW OF PEACE", Oxford, 6th ed., 1963 [hereinafter referred to as Brierly], at pp. 351-52 stated: "The Permanent Court of International Justice was created by a treaty, generally called the "Statute" of the Court, in 1921, Under the Charter of the United Nations it is now replaced by the International Court of Justice, but the Statute of the new Court, which forms part of the Charter, is identical with that of the old, except for a few and very important changes." [Emphasis added]; Brownlie, ibid., at p. 4 said: "In general Article 38 does not rest upon a distinction between formal and material sources, and a system of priority of application depends simply on the order (a) to (d), and the reference to subsidiary means." [Emphasis added]

give up their sovereignty within certain limits for the purpose of international legislation. They would delegate the exercise of their legislative sovereignty to create international rules binding upon participating states. The unification of law through international legislative instruments could be made upon ratification, directly applicable at national level. The limitations of using such an approach are obvious above all at a technical level. A good pioneering example for the application of the proposed approach is, at present, **the European Union** which to some degree has achieved the application of uniform law by the 15 member states. However, for full integration of laws between the member states a long way still remains to be covered, for while the exercise of more sovereign competencies would have to be given up in favour of the Union.

1.2. International Convention

The second formula available for having a unified and codified body of rules between different states concerns the use of an **international convention**.[3] Under it states would not delegate the exercise of any of their sovereign powers to a supranational authority. Instead their representatives, gathered usually under auspices of an international governmental organisation like the agencies of the United Nations, and after full consideration of issues subject to inclusion in a convention, would prepare a draft convention for ratification by all participating states. In order to make the convention effective as part of the law of states participating in the preparation of the convention, precise agreement would be reached on adherence to the convention. The advantage of this second formula, compared with the above indicated first method, is obvious: no threat arises as to

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[3] David, Rene', "The legal systems of the world, their comparison and unification", International Encyclopedia of Comparative Law, Chapter 3, Sources of Law, Vol. 2, London, 1984 [hereinafter referred to as David's legal systems 1984], at p. 159, para. 306 said: "International sources of law are of two kinds. The classic, and more usual, is the international convention, bilateral or multilateral: two or more states agree that a particular type of legal relation with a foreign element and involving their nationals, will be regulated in a particular way if brought before their courts. These days there is also another kind, the unions [...] In the first case the rules governing international relationships are laid down directly by states themselves, in the exercise of their sovereignty, without any transfer of their sovereign prerogative. In the second case, on the other hand, certain sovereign prerogatives are transferred to the new organisation." [Emphasis added]

the sovereignty of states concerned. As a result governments may be inclined to use the method of unification through conventions. Moreover, conventions could be used with great flexibility, namely, as multilateral, regional or universal conventions.

1.3. Model law

A third method which may be used in the unification of parts of legal systems concerns the drafting is that of the model codes or laws. State representatives or experts would collaborate in the drafting of texts and in recommending them to governments to adopt them. However, this would go no further than recommendation. It would be for the authorities in each state to decide if and to what extent they would take notice of, approve and give effect to the recommendations.

The method of model laws offers an advantage: it does not affect the essence of state sovereignty. However, the method at the same time has, when compared with the formula of adopting conventions, an obvious weakness. Under the model laws states may not be under the same pressure to move towards unification of laws while the adoption of model laws into domestic law may be restored. Therefore, achieving unification of law through the method of convention may be more practical than theoretically ideal model laws.

1.4. Concluding remarks

For what has been said above it is clear that among the different suggested methods for the unification of law through international action the formula of international conventions may be the best practical solution for progress towards the unification of private international law under present circumstances in the world.

2. INTERNATIONAL CUSTOM

One argument for unification of private international law suggests that, instead of international legislation in the form of conventions it is more suitable to use another method based on international custom accepted as a source of international law under Article 38 of the Statute of International Court of Justice

(ICJ).[4] Regarding the point as to which method provides the best solution for the unification of private international law, it is necessary to consider, first of all, the concepts of **international commercial customs** and **international conventions,** then, to discuss which one of the methods would provide better conditions for tackling the question under consideration.

2.1. Meaning of a commercial custom

The word **commercial custom** means the habitual behaviour of businessmen in a business society or commercial community. These words in their legal sense require more than mere habit or usage,[5] namely, a habit or usage establishing some obligation(s) for those who follow it and, somehow, to be related to the idea of justice. The obligation in question originates from responsibilities accepted by parties involved in a business transaction. Similar rules apply at the level of an international commercial customs, they are practices, usages or standards of particular business formulated or endorsed by international agencies such as the International Chamber of Commerce (ICC).[6] In order to have much of international commercial custom accepted as a source of law, mentioned previously, according to the meaning of the Article 38 of the Statute of ICJ several conditions must be met.

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[4] See foot note 2 (above).

[5] Brownlie, supra (f.n. 1), at p. 5 said: "Although occasionally the terms are used interchangeably, "custom" and "usage" are terms of art and have different meanings. A usage is a general practice which does not reflect a legal obligation, and examples are ceremonial salutes at sea and, apart from a recent convention, the giving of customs exemption to the personal baggage of diplomatic agents." [Emphasis added]

[6] David, Rene', "THE LEGAL SYSTEMS OF THE WORLD, THEIR COMPARISON AND UNIFICATION", International Encyclopedia of Comparative Law, Chapter 5, The International Unification of Private Law, Vol. 2, J.C.B. Mohcr (Paul Siebeck), Tubingen Mouton, the Hague, Paris, Oceana Publication Inc., New York, 1971 [hereinafter referred to as David's legal system 1971], pp. 97-99; Brownlie, supra (f.n. 1), at pp. 5-6 stated: "The material sources of custom are very numerous and include the following: diplomatic correspondence, policy statements, press releases, the opinion of official legal advisors, official manuals on legal questions, e.g. manuals of military law, executive decisions and practices, orders to naval forces, etc., comments by governments on drafts produced by the International Law Commission, state legislation, international and national judicial decisions, recitals in treaties and other international instruments, a pattern of treaties in the same form, the practice of international organs, and resolutions relating to legal questions in the United Nations General Assembly. Obviously the value of these sources varies and much depends on the circumstances." [Emphasis added]

2.2. Elements of customs

Several conditions are to be met for practices, usages or habits in a particular area of business to be accepted and equated to international custom and then to govern relations between parties participating in a transaction. Firstly, the business community practising a custom must consider it as a **legal custom**; it means that such a custom is compatible with the notion of justice. If a dispute arises between parties to an international transaction such a custom is capable of application for resolving the dispute.[7] Secondly, a custom must not be opposed to what has been accepted as **reasonable standards or principles**. Thirdly, in order to accept a practice or usage as custom in international trade it is necessary that it is practised or used for a **reasonably long period of time**. Different suggestion have been made for the length of time necessary for a custom to become legally relevant, e.g., 40 years. There is, however, no certainty as to the length of time; much depends on the importance of the practice or usage and its relation to idea of justice, its reasonableness, and its popularity among those dealing with it.[8] The element of duration must be supported in addition by two other elements, namely, uniformity and generality of the practice. Uniformity means a substantial consistency in the practice, and not necessarily complete uniformity; the generality of a practice means

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[7] Brownlie, supra (f.n. 1), at p. 8 regarding to that point stated: "The Statute of the International Court refers to "a general practice accepted as law." Brierly speaks of recognition by states of a certain practice "as obligatory" [p. 61], and Hudson requires a "conception that the practice is required by, or consistent with, prevailing international law." [Quoted in Briggs, p. 25] Some writers do not consider this psychological element to be a requirement for the formation of custom, but it is in fact a necessary ingredient. The sense of legal obligation, as opposed to motives of courtesy, fairness, or morality, is real enough, and the practice of states recognizes a distinction between obligation and usage." [Emphasis added]

[8] David's legal system 1984, supra (f.n. 3), pp. 101-102; see the same reference that at para. 184 said: "[...] the custom concerned must have been followed for a particular period of time, e.g., 40 years. In English law there is a rule namely a Statute of 1265 established that, in order to have the character of an immemorial custom required by the common law, and thus to be obligatory, the custom must have existed since 1189, when King Richard the Lionheart came to the throne of England."; for a different view see Brownlie, supra (f.n. 1), at p. 6 said: "Provided the consistency and generality of a practice are proved, no particular duration is required: the passage of time will of course be a part of the evidence of generality and consistency. A long practice is not necessary, and rules relating to airspace and the continental shelf have emerged fairly quick maturing of practice. The International Court does not emphasize the time element as such in its practice."

that it is applied in a substantial number of states, without meaning universality of practice.

Beside the above theoretical necessities, those who allocate a particular role for custom in society may argue that although statutory law plays, at present, a leading role, it cannot always fully refer to the notion of justice; but it could be conferred that as a result of the complexity of modern societies custom in many instances is replaced by statutes which play a great role in modern societies.[9] However, for defending custom and its importance as a source of law beside a desire to preserve its role it is vital to uphold the notion of justice, reasonableness of the custom, and practice during a period of time during which a corresponding custom emerged. Obviously, to preserve a custom the society too in which a custom is practised must also be preserved.

3. INTERNATIONAL CONVENTIONS V. INTERNATIONAL CUSTOMS

In the light of what has been said above a question may arise: which of convention or custom is preferable for the codification/unification of private international law? In answering the question reasons for and against each of them should be considered.

3.1. Arguments for international commercial customs

Supporters of international custom argue that one of advantages of custom against conventions is its **non-mandatory nature**. It is based on the autonomy of parties to an international transaction; therefore, international custom applies only if it is agreed upon and adopted by the party interested in a contract. Another argument in favour of custom is that it does not affected a **state's sovereignty**. As

[9] Brierly, supra (f.n. 2), at p. 58 said: "The only class of treaties which it is admissible to treat as a source of general law are those which a large number of states have concluded for the purpose of either of declaring their understanding of what the law is on a particular subject, or of laying down a new general rule for future conduct, or of creating some international institution. Such treaties are the substitute in the international system for legislation, and they are conveniently referred to as "law making"; their number is increasing so rapidly the "conventional law of nations" has taken its place beside the old customary law and already far surpasses it in volume." [*Emphasis added*]

considered previously[10] states are anxious not to lose their legislative powers in their international relations with other states, in the sphere of both public and private international law. Custom, therefore meets such a requirement and as a result meets no objection by states as well as parties to an international transaction. The third reason for preferring international custom instead of conventions for the unification of private international law is its **flexibility** when change is needed. With respect to progress in technologies and developments relevant to international contracts (such as multimodal transportation, communication facilities and electronic data interchange),[11] parties to international transactions look for provisions which meet the needs related to a particular type of business; custom with its non-mandatory nature provides a good basis for flexible responses to daily problems. If it was not possible for international commercial communities to deal with their legal problems within a short time, they would suffer losses and relations in the area of international trade would be damaged.

In agreement with what has been said above, it seems sound to argue that, nonetheless international custom would not be able to satisfy all the conditions for which unification/ codification of international private law may be desirable. Firstly, practices and usages of a particular branch of business can be something less than custom. For the emergence of international custom it is necessary that a given practice or usage in a particular area of trade satisfies such conditions as agreement with the idea of justice and acceptance, and practise during a particular period of time. Therefore, it is not easy to accept any practice or usage affecting a particular area of business as a custom; custom should not be confounded with and replaced by common (non-legal) practices or usages. Moreover, it is not always arguable that custom is always more flexible than conventions when changes are

[10] See Chapter X, Section B.3.3.4 (above).

[11] As to EDI see Chapter IX (above); see also Chapters I (Section B.2.1) and IV (concerning UCP 500 and reasons for its revision in the past) above.

needed.[12] To review a convention and improving its contexts may sometime take less time if the conditions necessary for such a change are favourably supported by an international organisation enjoying the support of states and having adequate financial resources.

Regarding the parties' autonomy and their freedom to agree upon issues which concern their needs, a point should be clarified in order to avoid confusion: To what extent are parties to an international contract free as to the terms and conditions of their transaction? It is obvious that their freedom is not unconditional or unlimited. For instances, they are not allowed to make a transaction with the enemies of their countries, and they may not agree upon conditions which are against the public order.[13]

On the other hand, when the adoption of a **convention** for the unification of law is suggested this does not mean that details of a contract should also be regulated by the convention and parties to an international transaction should lose their autonomy. It is not practical to envisage a convention dealing with all details related to international transactions. However, principles of law essentially for a more reasonable international contract may be codified. In this respect it seems that custom and conventions have to some extent similarities since both of them limit the autonomy of the parties to an international contract. The difference between them is that conventions are codified principles with mandatory power underlying them as a necessary element for the unification of private international law.[14] A unified law involves more sacrifice when individuals as well as states consider it parallel to, for

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[12] Schmitthoff, C.M., "Nature and evolution of the transnational law of commercial transaction", Studies in Transnational Economic Law, Vol. 2, "The transnational law of international commercial transactions", edited by Norbert Horn and C.M. Schmitthoff, Kluwer, 1982 [hereinafter referred to as Horn and Schmitthoff], pp. 19-31 [hereinafter referred to as Schmitthoff 1982], p. 25.

[13] For the relevant discussion see Section B.3.2.2, Chapter X (above).

[14] Schmitthoff 1982, supra (f.n. 12), at p. 23 said: "If it is intended to provide obligatory rules of international application, the adoption of an **international convention** and its subsequent introduction into municipal law is the only method to give effect to measures aimed at achieving international uniformity [...]." [Emphasis added]

example, sovereignty. As already stated above,[15] modern societies with their complexities are different from primitive societies; they require more elaborate systems of law to master problems, with more certainty, predictability and uniformity. In that respect a customary system of law seems would never be adequate to the challenges of modern societies.

3.2. Arguments for international conventions

Those who favour international conventions as the best solutions for the unification/ codification of law in modern society argue as follows:

1. Conventions are particularly suitable to establish mandatory rules of law.[16] Such mandatory rules may accelerate unification and may provide a better situation for co-operation between parties to an international transaction as under conventions individuals as well as states would have to take more responsibility in their conduct in accordance with more uniform standards of law as vital for modern societies if they are interested in improving their relations with each other.

2. Social as well as economic developments after the Second World War have emphasised the importance of closer relations between states. Unprecedented progress in science and technology have in recent decades created a situation in which the world has become a smaller place and international borders so far as trade and commerce are concerned have become hindrances. Other conditions such as sharing natural resources, mass production of industrial, agricultural and cultural goods, communications technology, and global population increase have promoted closer relations between states.[17] As a result, states and their populations are more than ever mutually dependent and progressive integration between different societies has taken place. In order to prevent chaos, uncertainty and

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[15] Section B.2 of Chapter X (above); see also Section A.3.2 of the present chapter (below).

[16] Megrah, Maurice, "A uniform code for documentary credit practice?", International and Comparative Law Quarterly, Vol. 8, Jan. 1959, p. 41 [hereinafter referred to as Megrah], at p. 45 said: "It is sometimes thought that the **customs** have the force of law, but this is placing them too high." [Emphasis added]

[17] For other details see relevant discussion in Chapter X, Section B.2 (above).

confusion, the elaboration of law is becoming an essential need for shaping international relations and safeguarding the interests of all who are parties to international transactions.[18]

3. It is rightly argued that irrespective of different political, ideological, and economic systems existing in different countries in our time, legal techniques used to solve issues related to international trade are the same everywhere. They are based on general principles anchored in common sense and have been recognised and respected by many nations.[19]

4. The role of states in codifying customary law derived from the law merchant of the Middle ages (**lex mercatoria**)[20] and the **modern lex mercatoria**[21] particularly from international conventions related to international sale transactions as well as to efforts made by the European Union are noteworthy. Regarding the role of states, one may rightly argue that the codification by states of old lex

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[18] Schmitthoff, C.M., "COMMERCIAL LAW IN A CHANGING ECONOMIC CLIMATE", Sweet & Maxwell, London, 2nd ed., 1981 [hereinafter referred to as Schmitthoff 1981], p. 18.

[19] Professor A. Goldstajn said:"The law governing trade transaction is neither capitalist nor socialist; it is a means to an end, and therefore, the fact that the beneficiaries of such transactions are different in this or that country is no obstacle to the development of international trade. The law of international trade is based on the general principles accepted in the entire world." [See Schmitthoff 1981, ibid., p. 18]

[20] Schmitthoff 1981, supra (f.n. 18), at p. 2 (f.n. 3) said: "What is lex mercatoria? The law merchant of the middle ages, also called the lex mercatoria, was not law in the same sense as, e.g. the law of property or the rules of equity. The ordinary courts of the land did not normally cognisance of it. It consisted mainly of general customs and usages which more often that not were handed down by word of mouth and implicity accepted by the merchants in their daily dealings, though in some instances, particularly as far as the law of the sea was concerned, code existed which were not, however, formulated by authoritative bodies. Often these mercantile customs were vague and ill-defined. In brief, the law merchant of the middle ages was not law in the formal sense, but it was law in wider sense in which the term is used here."; and at p. 5 of the same reference it is said: "In France the incorporation of the law merchant in the national law was accomplished by legislation, and in England by judicial precedent."

[21] Schmitthoff 1981, supra (f.n. 18), at p. 21 said: "The new lex mercatoria is very different from the medieval one. It differs, in particular, in two aspects. First, international characters to be reconciled with the concept of national sovereignty on which the world order is still founded. Secondly, while the growth of the medieval lex mercatoria was haphazard and unplanned, developing from usage to custom and then to law, the modern lex mercatoria is the deliberate creation of formulating agencies and is expressed in international conventions or model laws or in documents published by such bodies as the International Chamber of Commerce."; for other details concerning lex mercatoria or transnational law see relevant discussion in Section B.2, Chapter X (above).

mercatoria has put up a barrier to the integration of the law of international trade since the efforts of the states have been based on national rather than international interests.[22] However, as pointed out previously,[23] it is not reasonable based upon what has been said to conclude that states should not play a role in the unification of international law since such a suggestion does not fit with the reality of modern societies at present. A better argument would be to encourage states in more co-operation with each other for further progress towards a more unified/codified international law. In that respect, and from a practical point of view, conventions would be better instruments for legal reform today for providing harmony between law and these needs of modern life, involving social responsibility, legal protection of the economically weaker and growing international co-operation.

There are in addition certain conditions while should also be regarded as important if conventions are to retain their usefulness. For instance, after adopting a convention it is necessary to provide for adequate control of a convention probably by the draftsmen of the convention. A similar concern should be prevail as regards the interpretation of a convention by different legislative powers in different countries.[24] It is not sufficient to have a binding text; it is very important how its effectiveness is kept through proper interpretation and application.[25]

4. SUBSTANTIVE UNIFICATION V. CONFLICT OF LAWS UNIFICATION

There are two ways of including rules on international legal relationships in a convention: **(1)** Unification of conflicts laws stating which national law, by common

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[22] Schmitthoff 1981, supra (f.n. 18), p. 6; for the relevant discussion see Chapter X (above).

[23] See Section B.2 of Chapter X (role of states) above.

[24] Schmitthoff 1982, supra (f.n. 12), at p. 23 said: "[t]he initial uniformity may be lost by subsequent amendments which may be adopted by some states and not by others. Even if there are no subsequent amendments, the uniform character of an international convention intended to have obligatory character in the legislation of the adopting states may impaired by the general practice to allow reservations to signatory or acceding states."

[25] David's legal system 1971, supra (f.n. 6), pp. 89 (para. 233) and 93 (para. 244).

accord, would govern a particular legal relationship. This method as already stated, is the most favoured solution for the unification in the sphere of international law since it is in perfect harmony with the idea that law making is an eminently national phenomenon, without effects on national sovereignty. **(2)** The second way for creating a convention is to replace all national laws relevant to a certain legal relationship by new uniform rules. It involves the unification of law through the unification of substantive law. Some of the advantages of this second method have been previously discussed:[26] national law is frequently ill-suited to govern legal relationships of an international nature for the obvious reason that a state when laying down national rules considers national rather than international interests. Moreover, it is not always easy to agree over one national law for defining an international legal relationship. As a result of such an inherent difficulty conventions based on the unification of conflicts of laws have made only a slow and difficult contribution to the developments of international law.

When deciding which one of the above indicated methods should be preferably adopted one should carefully consider the circumstances of each particular legal relationship since both formulas have their advantages and disadvantages. When national views differ profoundly as to one particular issue and it is difficult to reach an agreement over a substantive rule, the method of unifying conflict of laws would be helpful. Regarding commercial issues, however, it seems the best method for the unification in the sphere of international law would be the method of unification of substantive law (for reasons pointed out above).

SECTION B: UNIFICATION OF THE LAW OF DOCUMENTARY LETTERS OF CREDIT

An author has rightly pointed out that "the commercial letter of credit is one of the most efficient and inexpensive methods that has yet been devised for facilitating the exchange of goods. Its efficiency and economy can be retained and increased

[26] See the discussion concerning the meaning of unification in Section B.3.1, Chapter X (above).

only if disputes and misunderstandings are kept to a minimum."[27] For increasing the sufficiency of documentary credits in international trade, standardization of forms and practices have long been recognised by international commercial communities and bankers.[28] However, there are different views regarding the advantages and disadvantages of standardisation of points relevant to documentary credits. For instance, it is argued that the flexibility of documentary credits is an important feature of the method of payment in international trade and any type of uniformity which undermines it would harm the system's credibility in international trade.[29] Harfield, in another part of his book has indicated that there are problems related to achieving a complete uniformity of practices dealing with documentary credits.[30] In respect of the appropriate method for the unification of the law of documentary credits, Harfield concludes that **"consensual regulation"**, for the time being, would provide the necessary condition for the uniformity of practices relating to documentary credits while at the same time safeguarding its flexibility.[31] Should

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[27] Harfield, H., "Bank credits and acceptance", New York, 5th ed., 1974 [hereinafter referred to as Harfield], p. 195.

[28] For a historical background look at Section B.1, Chapter I (above) and Harfield, ibid., at pp. 196-202 for early works as well as various national regulations regarding documentary credits. For instances, at p. 196 of that reference it is said: "The advantages to be gained from standardization have long been recognized. The Bankers' Magazine of August, 1917, contained an article by J.P. Beal, which bore the title, "Utility of Letters of Credit in the Export Trade- a Plea for Standard Forms"; and as to effect of national regulation at p. 202 of the same reference it is pointed out that: "The great importance of the various national regulations lies in the fact that they opened the way by which the ultimate goal of an international standardized commercial letter of credit practice might be realized." [Emphasis added]

[29] Harfield, supra (f.n. 27), at p. 203 said: "Clearly, the achievement of complete uniformity at the price of substituting rigidity for flexibility would do more harm than good."; Rosett, Arthur, "Unification, harmonisation, Restatement, Codification, and Reform in International Commercial Law", The American Journal of Comparative Law, Vol. 40, No. 3, September 1992, p. 683 [hereinafter referred to as Rosett].

[30] "There are two problems [...] First, there is not, in fact, absolute uniformity of practice among bankers throughout the world or, frequently, even in a given locality. Nor is there a complete uniformity of the responsibilities which commercial credit bankers assume under the law of various countries. [...] The second problem is quiet different one. This relates to the method by which the lack of uniformity may be dispelled. Here the problem focuses not so much upon agreement as to the use of words, but upon agreement as to responsibilities and, even more important, as to the method by which any agreement shall be expressed." [Harfield, supra (f.n. 27), p. 203]

such an argument, put forwarded many years ago, be adopted for the needs of a modern society? From the last quotation of the Harfield's book (above) it becomes clear that the same writer was unhappy with the existing law of LCs in international trade and was looking forward to a day that LCs' operation governed by the same law worldwide. Such a desire seems, at present, stronger than 20 years ago and the current situation of the world of commerce, more than ever, calls for a uniform law concerning LCs.[32] However, to achieve such a goal it is important to know more about the only international source of law about LCs, namely, UCP 500, its legal nature and shortcomings as follows.[33]

1. EXISTING INTERNATIONAL SOURCE ABOUT LCs

The Uniform Customs and Practice for Documentary Credits (UCP) lays down a set of standards applicable to issues related to documentary letters of credit (LCs) and standby letters of credit (SLCs) as the most popular methods of payment in international trade.[34] UCP 500 is, at present, the only existing source of international rules relevant to LCs and SLCs and banks in many countries handle

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[31] "[a]t least until such time as businessmen and bankers in every portion of the world are governed by the same law, it seems clear that the only hope for a degree of uniformity which will not interfere with the flexibility of the commercial credit device lies in the adoption of consensual regulations. Uniformity in the field of commercial credits can come only through the development of a common understanding among those who do the business, who commence with a broad base of common practice and understanding, and who are in a position, because of their intimate connection with and dependence upon the business, to expand the area of agreement not only with respect to the existing practices, but also so as to incorporate and set on a firm footing whatever sound new practices may be developed." [Emphasis added; Harfield, supra (f.n. 27), pp. 203-204]

[32] See the relevant discussion in Section B.2, Chapter X (above).

[33] For the relevant discussion see Section B.2, Chapter I and Chapter IV (above).

[34] See the relevant discussions in Chapters I, III, and IV as well as ICC Publication No. 500 (UCP 1993); Harfield, supra (f.n. 27), pp. 205-225 (about forms) and pp. 225-27 (about UCP), and pp. 227-28 (for historical background of UCC); Kozolchyk, Boris, "Towards New Customs and Practice for Documentary Credits: The Methodology of the Proposed Revision", Commercial Law Annual, 1993, pp. 371-408 [hereinafter referred to as Kozolchyk 1993], at p. 373 and f.n. 5 said: "The reason why the UCP inspired such widespread observance is not hard to surmise: It is the living law of documentary credits. By "living law", I mean a law that not only adjudicates disputes but also governs every aspect of the every day "healthy" (unlitigated or undisputed) letter of credit transaction. [...] The living law character of the UCP contrasts with the litigational character of Article 5 of the United States Uniform Commercial Code."; as a comparison between UCP 500 and Article 5 of the UCC see the relevant discussions in Chapter V (above).

documentary credits under it. As a document it has been subject to several revisions since 1933 by the international Chamber of Commerce (ICC).[35] As a result of the popularity of UCP among business communities around the world and ICC's constant efforts to keep the provisions on line with latest improvements in the field of communication technology and transportation as well as the needs of commercial communities to solve problems which arise during the operation of LCs and SLCs, the Uniform Customs and Practice for Documentary Credits has been accepted as the only set of standards internationally applied to documentary credits. What type of source of international rules is the UCP 500?

2. THE LEGAL NATURE OF UCP 500

It is obvious, in the light of the above research, that UCP is not international legislation in the form of a convention or model law. Whether it is a source of international rules in the form of international custom has been a matter of dispute between writers.[36]

1. One view suggests that UCP is a set of provisions based on practice and usages related to documentary credits. It is, therefore, not a set of international customary standards and should be categorised as **contractual provisions** agreed by parties to a letter of credit transaction.[37] Reasons for supporting this view are

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[35] For more details see Section B.2 of Chapter I (above).

[36] Dolan, John F., "WEAKENING THE LETTERS OF CREDIT PRODUCT: THE NEW UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS", RDAI/IBLJ, N. 2, 1994, pp. 149-177 [hereinafter referred to as Dolan], at p. 151 said: "It is not clear whether the Uniform Customs are in the nature of a contract term or are, as their name implies, evidence of trade usage. To some extent, the distinction matters. If the customs function as a contract-term, courts should construe them strictly against the bank issuers that incorporate them. If they are evidence of trade usage, the party relaying on them should prove that they are indeed usage and not an attempt by banks to mask efforts to protect themselves at the expence of commercial parties and of the letter of credit product itself."; see also foot notes 12 and 13 at p. 173 of the same reference for different views regarding the issue under consideration. It is also pointed out by the same writer that: "For want of a better description, this article differentiates the role of Customs as one in the nature of a term incorporated into the credit by the will of the drafter, usually the credit issuer, (a "contract term") or one in the nature of a trade usage that binds banks with international departments, members of trade." [Dolan, the same reference above, at p. 151]

[37] Dolan, ibid., at p. 152 said: "Formerly, the ICC made the claim that the Uniform Customs were trade usage. [...] UCP 500, however, eschews that claim, providing in Article 1 that the parties must incorporate the Uniform Customs expressly. This change may reflect the decision of the ICC's Commission on Banking Technique and Practice to treat the Uniform Customs as a contract term rather than as trade usage or it may

several. Members of the ICC Banking Commission on Banking Technique and Practice as well as members of the Working Group appointed for drafting UCP 500 are large banks with international departments.[38] Moreover, it is rightly pointed out that beneficiaries as well as applicants for LCs do not have a fair share of representation, therefore, their views have received inadequate support when drafting UCP.[39]

Another reason for supporting the above view is the non-mandatory nature of the UCP 500 as it provides clearly under Article 1 of its provisions: "The Uniform Customs and Practice [...] shall apply to all Documentary Credits [...] where they are incorporated into the text of the Credit. They are binding on all parties thereto, unless otherwise expressly stipulated in the Credit."[40] Therefore, if parties to a credit contract do not expressly agree upon UCP under their contract the provisions do not apply to their relationship. The concept of international custom, as discussed previously,[41] concerns also trade usages and practices which can normatively lead to new practices and can be accepted as a source of international law with mandatory effects, even in the absence of an express agreement about them, and

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reflect a realization that courts of some important states will not treat the Uniform Customs as anything else,"; see also foot note 18 at p. 174 of the same reference.

[38] Dolan, supra (f.n. 36), at p. 152 said: "Participants in the ICC Commission are generally selected by trade groups in states that are members of the ICC. The U.S. representatives to the Commission are chosen by the U.S.C.I.B. Although there are more than 11000 commercial banks in the United States, the U.S.C.I.B. counts less than 400 of them as members. Many nonmembers of the U.S.C.I.B. issue commercial letters of credit, however; and virtually every bank, large numbers of the thrift and insurance industries, and other financial institutions issue standby letters of credit, which UCP 500 purports to cover; and although the standby is largely a domestic product, it too finds application in international dealings. In short, the drafters of the Uniform Customs represented only one segment of the broad letter of credit industry."; see also p. 153 of the same reference for a similar point.

[39] Buckley, Ross p., "THE 1993 REVISION OF THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS", Geo. Wash. J. Int'l L. & Econ., Vol. 28, 1995, p. 265 [hereinafter referred to as Buckley], at p. 267 stated: "The UCP is a set of standard terms **drafted by bankers for bankers**. The very parties that documentary credits are designed to serve, exporters and importers, are not directly represented at the drafting table." [Emphasis added]; Dolan, supra (f.n. 36), pp. 154-55.

[40] See ICC Publication No. 500 (UCP 1993).

[41] Section A.2.1 of the present chapter above.

they could be recognised as enforceable with regards to relationships between parties to a transaction while it would be governed by them. In that respect, it is said that UCP 500 does not reflect such authority.[42] Moreover, the title chosen for the provisions by the ICC, namely, **"The Uniform Customs and Practices for Documentary Credits"** itself upholds the view that, at least, UCP is not totally about customs; part(s) of it are about unified practices as something different from customs.[43] Therefore, supporters of the above view conclude that UCP 500 should be treated as **contractual** rather than as **international custom** provisions.[44]

2. As opposite view is based on the fact that UCP 500 contains the only provisions related to documentary credits recognised by most banking communities and commercial centres worldwide.[45] The popularity of the provisions beside its application for a long period of time, namely, more than 60 years (from 1933 when

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[42] Dolan, supra (f.n. 36), at p. 154 stated: "There is a second problem with the claim that UCP 500 is trade usage. Trade usage is a regularly observed practice in the trade. UCP 500 sometimes codifies such regularly observed practice but sometimes serves as positive law legislating new practices. To that extent, UCP 500 does not reflect trade usage. The trade usage concept is broad enough to encompass trade codes, which can legislate new practices, but trade codes are only binding when they are "agreed upon by merchants."

[43] Ellinger, E.P., **"The Uniform Customs and Practice: a brief review of their salient points"**, JBL, January 1994, p. 28 [hereinafter referred to as Ellinger 1994], at p. 32 pointed out: "One interesting decision on documentary credits is **Royal Bank of Scotland v. Cassa di Risparmio delle Province Lombard** [Unreported, decision of January 21, 1992, CA]. Here the Court of Appeal held that a confirming bank's action for reimbursement ought to be instituted in New York, where reimbursement was expressly made due in the credit. Rejecting an argument to the effect that the specific term ought not to be considered in isolation but be read together with the provisions of Article 21 of the UCP [1983 Revision], their lordships considered the general question of inconsistencies between the UCP and an express term of contract. Mustill L.J. pointed out that the UCP did not constitute an independent Code or source of law but, merely a set of customs and practice by which merchants might wish to be bound. His Lordship concluded, on this basis, that where a specific term, such as the place of reimbursement, was expressly stated in the credit, there was no need to refer, in addition, to the UCP. In such a case, the express term in question took precedence over the relevant provisions of the UCP. [...] However, according to earlier authority, this principle applies in documentary credit case only where the letter of credit manifests a clear intention to exclude the respective provision of the UCP. Otherwise, the clause in question and the relevant provision of the UCP have to be read together with a view to reconciling them if possible." [Emphasis added]; for an earlier authority see **Forestall Mimosa Ltd. v. Oriental Credit Co.** [1986]1 WLR 631.

[44] Dolan, supra (f.n. 36), p. 155.

[45] In the USA issues about documentary credits are gathered under Article 5 of The Uniform Commercial Code (UCC) which is accepted by most states in the USA and there are some distinctions between UCC and UCP. For more details see the relevant discussions in Chapters I (Section B.2.3) and V (above); Harfield, supra (f.n. 27), pp. 227-28.

the first revision of UCP was published by the ICC) leave no doubt that the provisions correspond to previously considered elements, required for an **international custom**, namely duration, popularity of a practice or trade usage among those who are practising them, and its relation to the idea of justice. If there is no reference to UCP in a documentary credit transaction or nothing opposing to what is expressly stipulated under the same contract, courts of different jurisdiction will, under proper circumstances, look at UCP as an international document which lays down rules of international custom as well as practices relevant to documentary credits.[46]

Both of the above views have supporters, but for reasons considered previously it seems the former view is preferable. Nevertheless, even if it is accepted that UCP can stand as an international source of law in form of a "customary" instrument, there are other issues which undermine the creditability of UCP internationally as a set of standards for unification of the law of documentary credits.

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[46] Ellinger, E.P., "The Uniform Customs and Practice for Documentary Credits- the 1993 Revision", LMCLQ, Part 3, August 1994, p. 377 [hereinafter referred to as Ellinger], at pp. 382-83 said: "Article 1 continues to treat the UCP as a set of standard terms and conditions applicable to documentary credits and standby credits by incorporation. Notably, though, Gatehouse, J's decision in **Harlow and Jones Ltd. v. American Express Bank Ltd.** [1990]2 Ll.L.R. 343, indicates that, in view of the universal adoption of the Code by banks all over the world, it would, as a matter of business practice, apply to a documentary credit even if it was not expressly incorporated therein. It is true that Gatehouse, J's decision related to the Uniform Rules for Collection and not the UCP. But, as the UCP has attained a considerable greater degree of acceptance in international banking than the Uniform Rules for Collection, the ruling ought to apply even more decisively to this Code. It can, therefore, be assumed that the UCP applies to a documentary credit unless expressly excluded." [Emphasis added]; Buckley, supra (f.n. 39), at p. 268 referred to this point and said: "The U.S. Council on International Banking has said that, "[w]hile the UCP is partly standard contract language, it is also recognized by the markets and the courts throughout the world as the **de facto law** which defines and regulates the interlocking relationships [involved in documentary credits]." [Emphasis added]; and at the same page (f.n. 15) it is said: "As Professor Dolan has said, "[t]he drafters of the Uniform Customs consistently have protested that the Uniform Customs are not law, but they cannot deny that the customs may have the force of law."; Dolan, John F., "**The law of letters of credit**", 2nd ed., 1991, pp. 4-19.

3. SHORTCOMINGS OF UCP AS AN INTERNATIONAL SOURCE OF LAW

3.1. Repudiating UCP

It has been from time to time queried whether UCP does not have a true regulatory value by setting out customary standards in international trade. Beside the point discussed above, it has been always argued that the ICC, as a private and non-governmental international organisation, has no authority to impose its own points of view upon any parties to an international sale transaction. Thus it is always possible to repudiate the provisions; such a possibility opens the door for applying different sets of standards for documentary credits and, as a result, uncertainty may arise regarding any hope for the worldwide unification of laws of documentary credits.[47] The problem becomes deeper when different rules are accepted as appropriate solutions for issues of documentary credits under the national or federal laws of a country as it has happened in the USA.[48]

3.2. Bargaining power and its impact on law making

It is always important to note whether a rule or set of standards have originated from a notion of justice or, by contrast, it is based on safeguarding the interests of a particular group against the interests of another group, with an affecting to bargain and lay down rules or standards fit even if not always just. There may be reasons for doing so; a particular profession may be better equipped for drawing up the **"law of the profession"**.[49] Such a danger has always been the

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[47] Megrah, supra (f.n. 16), at pp. 43-44 said: "The Uniform Customs and Practice for Commercial Documentary Credits [...] is partly obligatory- in that no licence or discretion is allowed- and partly permissive. [...] (b) being partly permissive and not obligatory, does not provide that practice shall be uniform."

[48] See discussion related to Article 5 of the UCC in the USA in Chapter V (above); David's legal systems 1984, supra (f.n. 3), p. 178, para. 343.

[49] David's legal systems 1971, supra (f.n. 6), at p. 57, para. 145 said: "One danger in general conditions of business or standard- form - contracts drawn up by trade organisations is that they might be, or risk being considered, "one sided bargains". There are two reasons for this. Usually, standard - form - contracts are drafted by professional associations of national character, and it is to be feared that they will be excessively favourable to the trade interests of a particular nation. It is also to be feared that they may be favourable to

subject of discussions regarding UCP[50] and the ICC's main concern, like other private organisations, has been to safeguard the interests of its members.[51] Such a way of proceeding usually prevents further progress towards unification and codification of international law in general, and of particular rules on business aspects such as documentary credits.[52]

The requirement that provisions related to documentary credits should be fair originates from the fact that issuing banks' practices are expected to be accepted by parties to a documentary credit transaction; those parties are other banks and third parties as applicants for credits or beneficiaries entrusted the bank. If they reach

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the interests of a particular group which, being more concentrated or better organised, is in a better position to formulate the "law of the profession" as it thinks fit." [Emphasis added]

[50] For instance see Article 7(c) of UCP 1983 (ICC Publication No. 400) provided: "In the absence of such indication the credit shall be deemed to be revocable." That attitude raised many questions by other parties to a credit contract as to its justification which those objections leads, finally, to change of Article 7(c) above under the new version of UCP (Article 6(c) of UCP 500 provides: "In the absence of such indication the Credit Shall be deemed to be irrevocable."; for other examples look at the relevant discussions in Chapter IV, Section B.I (above); Ellinger, supra (f.n. 46), at p. 385 said: "One of the most sensible changes in the new Revision is to be found in Art. 6, which has replaced Art. 7 of the 1983 Revision. [...] Article 7(c) of the old Revision, under which such a credit was deemed to be revocable, was regarded as out of date; it was left unchanged in 1983 mainly due to pressure from certain isolated National Committees. The extent to which the old provision was out of touch with reality is evidenced by the fact that standby credits, which did not incorporate the Code, and which failed to include an express indication, were usually treated by the courts as irrevocable."; for more details see **West Virginia Housing Association Development Fund v. Sroka** (1976) 415 F. Supp. 1107, **Benjamin's Sale of Goods**, 4th ed., sec. 23-047, and **Giddens v. Anglo Produce Co. Ltd.** (1923) 14 J.I.L.R. 230.

[51] Dolan, supra (f.n. 36), at pp. 170-71 said: "Often it makes sense for banks to fashion UCP rules in a way that externalizes costs. [...] By externalizing costs they can best handle, banks do themselves no favour; they weaken their letter of credit product. In UCP 500, the bankers have fashioned provisions that arguably respond to perceived convenience not exigency and arguably hurt rather strengthen the letter of credit product. Commercial parties (buyers, sellers, lenders, and borrowers, the parties that pay banks to issue, advise, confirm, and execute the letter of credit) may prove unwilling to accept such provisions. Court, moreover, may see them as adhesion terms in bank created rules that will catch commercial parties unaware. If UCP 500 is a contract term, as this paper suggests it often is, courts may well deny banks the questionable benefits of some UCP provisions. Well advised commercial parties, moreover, may choose to delete offensive UCP provisions from the credit they purchase. The narrowing of the estoppel provision in Article 14(e) is one such provision."; see also pp. 171-72 of the same reference concerning the point under consideration.

[52] David's legal systems 1971, supra (f.n. 6), at p.57, para. 145 pointed out: "So, the great trade organisations have sometimes operated as a brake on the progress of the international unification of law; entirely satisfied with their own "clausal law", they feared that international conventions or uniform laws would threaten their privileges."

conclusions that their rights would be at risk as a result of unfair provisions, they will stop using services provided under documentary credits.[53] Beside the marketplace fairness of provisions related to documentary credits they have to be also acceptable under various legal systems since bankers are subject to different legal systems.

Although bankers have tried not to be self-interested,[54] there are articles in UCP 500 that, as mentioned above, undermine the tenets accepted for documentary credits, namely the principle of independence, neutrality, integrity and care by bankers as paymaster. For instance, in respect of the principle of strict compliance[55] it is a fact that although most of documents presented by beneficiaries are not in accordance with the terms of credit contract,[56] they would envisage no objection(s). However, falling market prices of purchased goods or services provide

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[53] Kozolchyk 1993, supra (f.n. 34), at pp. 381-82 said: "In order to formulate industry-wide customary law, the JWD [JWD means Joint Working Groups for the preparing draft for the revision of ICC 400] had to assess not only the efficiency of the competing practice, but more importantly their **fairness**. If the issue were merely one of efficiency, each type of bank could prove that its practice entailed the highest profits and lowest operational costs. **Fairness**, on the other hand, required the acceptability of the practice in question to other banks and third parties who as applicants and beneficiaries entrusted their monies, goods and services to the banks. [...] The need to treat the role of key banks and third parties as interchangeable follows from an essential feature of long distance trade and finance: distance between traders and financial intermediaries accentuates the need for cooperation, and cooperation is best insured by reciprocity. Accordingly, an issuing bank wishing to participate regularly in the international letter of credit business must not only treat the confirming, advising and negotiating banks fairly (in the marketplace sense of fairness just discussed) but must also be willing to advise, confirm and negotiate its correspondents' credits. Indeed, the fact that today's issuer is tomorrow's confirmer, adviser or negotiator reinforces the need for equal treatment."[Emphasis and the meaning of JWD are added]; see also f.n. 17 at p. 381 of the same reference for some important articles about fairness and f.n. 20 at p. 384 for examples suggested for change of the UCP 400.

[54] "A practice was self interested when it promoted the interest of the issuing bank, advising, confirming, negotiating, remitting or paying banks over those of the applicants and the beneficiaries." [Kozolchyk 1993, supra (f.n. 34), p. 388 and f.n. 27]; and at p. 389 of the same reference it is pointed out that: "Given the essential role of marketplace fairness in this revision, the only acceptable self-interested practices were those which banks universally regarded as essential for their ability to continue in the letter of credit business."

[55] See the relevant discussion in Chapters II (Section B.1) and VI (above).

[56] "The growth in the number of discrepancies is a universal phenomenon. SITPRO, an English trade facilitation agency, recently conducted a survey which found that as many as 50% of the first tenders of documents contained discrepancies. Similar surveys conducted by this writer among American and German bankers placed the percentage as high as 75%." [Kozolchyk 1993, supra (f.n. 34), p. 394, f.n. 31]

a good opportunity for bankers to reject in bad faith tendered documents.[57] This has generated distrust between bankers and other parties to a credit transaction and, as a result, it is said that "the cost of processing an ordinary documentary credit has risen more than tenfold in less than 10 years in the United States."[58]

3.3. Legal issues related to documentary credits

UCP 500 deals mainly with customs and practices relevant to LCs and SLCs; issues like fraud,[59] right of security of parties to a letter of credit,[60] electronic data interchange (EDI),[61] time of establishment of a credit,[62] conflicts of law,[63] bank insolvency,[64] banks obligation to the applicant[65] and so on,[66] are not considered

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[57] About bad faith bankers see Kozolchyk 1993, supra (f.n. 34), p. 389 and f.n. 28; and at p. 395 of the same reference it is said: "The need to recognise the functional equivalence of certain documents **in Equitable Trust** illustrates that the determination of strict compliance is not a mechanical process. If it were, we could do away with human document checkers; optical scanners could do a much better job of detecting misspellings, transpositions of letters or absences of statements. Because some discrepancies are fatal and others are simply irrelevant, the checking of documents calls for direction and good banking judgment." [Emphasis added]

[58] Kozolchyk 1993, supra (f.n. 34), p. 399.

[59] See Chapter VII, Section B.1 (above).

[60] Chapter VIII (above).

[61] See Section A of Chapter IX (above).

[62] Chapter V, Section B.2.2.2 (above).

[63] As to issue of governing law of LCs and its potential difficulties see Buckley, supra (f.n. 39), pp. 300-301 and Schmitthoff 1982, supra (f.n. 12), p. 22; Morse, C.G.J., **"Letters of credit and the Rome Convention"**, LMCLQ, 1994, p. 560 [hereinafter referred to as Morse], at p. 560 pointed out: "**The Rome Convention on the Law Applicable to Contractual Obligations 1980** was implemented in the United Kingdom in the Contracts (Applicable Law) Act 1990. The provisions of the Convention apply to contracts entered into after 1 April 1991. The relatively well settled **choice of law** rules for contracts which had been developed in the common law will now be increasingly supplanted by a European Community treaty. Mance, J's recent decision in **Bank of Baroda v. Vysya Bank Ltd.**[[1994] 2 Ll.L.R. 87] is, thus, of more than passing interest in that it appears to be the first reported English decision which has had to consider the application of the Convention." [Emphasis and the date of case are added]

[64] See Section B.2.2.5, Chapter V (above).

[65] Chapter V, Section B.2.2.1 (above).

[66] For other examples see relevant discussions in Chapters IV-VIII (above); Buckley, supra (f.n. 39), pp. 297-98.

under UCP.[67] The reason for adopting such a policy by the ICC beside financial expenses and professional interests is the complexity of the above mentioned issues particularly their legal aspects[68] requiring legal expertise and more co-operation between states as well as individuals for promoting a mandatory set of international standards.[69] For instance, as to the governing law of LCs, the ICC Working Group took the view that such a legal issue cannot be addressed in the UCP since the ICC cannot legislate national law.[70] This point was criticised by a writer on the ground that a choice of law provision in the UCP would be no different than any other express choice of law provision in any international contract;[71] so, it does not an automatic substitute for national law. Further, the UCP as pointed out previously,[72] has been accepted as the only existing uniform rules for LCs in most of countries. Therefore, including provisions concerning the governing law of LCs in the UCP would provides more certainty as far as application of LCs is concerned. A different policy, in contrast, would cause confusion and uncertainty since parties to a

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[67] Rendell, Robert S., "New ICC rules impact letters of credit", International Financial Law Review, Vol. 12, Iss. 11, Nov. 1993, pp. 33-35 [hereinafter referred to as Rendell], where it is emphasised while the UCP 500 is a comprehensive set of guidelines dealing with all aspects of letter of credit practice, it does not address every issue that may arise in a letter of credit transaction.

[68] Kozolchyk 1993, supra (f.n. 34), at p. 376 said: "As a rule of traffic calculated to resolve quickly and extra judicially controversies created by the issuing and confirming bank's improper rejection, Article 16 **[UCP 1983, ICC Publication No. 400]** was not able to handle questions such as "What effect does the seriousness or incurability of a discrepancy have upon the bank's duty to send a notice of dishonour to the beneficiary?" or "Does a beneficiary have a duty to mitigate the damages claimed from the issuing bank even though the claim is limited to the face amount of the credit?" These are typically litigational questions which banks are neither authorised nor equipped to answer and consequently are out of place in living law rules." [Emphasis added]

[69] Kozolchyk, Boris, "Letters of Credit", International Encyclopedia of Comparative Law, Chapter 5, Vol. 9, 1979 [hereinafter referred to as Kozolchyk], at p. 15 pointed out that "the draftsmen of the UCP had a realistic and modest goal. The intent was not to codify all the relevant rules of law, customary or otherwise, but rather to compile international banking customs and other rules that facilitate banking functions."

[70] ICC, "UCP 500 & UCP 400 Compared", ICC, Pub. No. 511, at p. 2.

[71] Buckley, supra (f.n. 39), pp. 300-301.

[72] See Section B.1 of the present chapter (above).

credit transaction would be left defenceless[73] and unsecured. Each procedure for revision of the UCP regardless of consuming time and money requires a certain period of time that commercial communities would be able to familiarise themselves with new provisions.[74]

For reasons already mentioned[75] and because there is no indication that the ICC will change its policy of the last 60 years, the only proper solution for a unification of the law of documentary credits would be **international legislation in the form of a convention**. However, several points should be taken into consideration:

1. Although unification or codification of the law at an international level would provide a better law, would remove uncertainties and fill up existing lacunae and, as a result, would provide a clearer and easily ascertainable set of international standards, it is also true that a convention like any other codes provides solutions only for the problems related to the subject of the convention. No code ever does or can attain a higher purpose for the simple reason that it is never possible to foresee all the situations to which a code will have to be applied. Even if there is a possibility of doing so there may still be reason(s) making such an approach undesirable since it may be assumed to be a threat to the right of freedom of parties to a contract as well as to national sovereignty.[76]

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[73] For instance see Buckley, supra (f.n. 39), at p. 303 concerning the problem of fraud as well as other shortcomings of UCP 500 and a need for international concern stated: "The difficulty with leaving these issues to national law is that, except in the United States, such cases come so rarely before the courts that there are very little opportunities to develop a coherent body of rules. The Anglo-Australian common law on documentary credit fraud is sketchy at best, and yet the incidence of fraud in credit transactions is not exceptionally low. The ICC International Maritime Bureau, while acknowledging the absence of statistics on the problem, has stated, that "there can be little doubt that each year [frauds] net their perpetrators hundereds of millions of dollars."

[74] See Buckley, supra (f.n.39), at p. 265 said: "It has been suggested that developments in the use of electronic data interchange (**EDI**) will cause the next revision to be made in less than ten years time." [Emphasis added]

[75] See Sections A.1, A.3, and B.3 of the present chapter (above).

[76] Briefly, supra (f.n. 2), at p. 79 said: "It would not be desirable to give the law a form so detailed and precise as to exclude the need for adopting it to new situations by the ordinary processes of judicial interpretation."

2. As considered previously,[77] any process of unification or codification of the law at the international level will face many difficulties which must not be underestimated. It is important to remember that those difficulties may vary because of the nature of materials on which draftsmen have to work, namely, the state of the law before its codification. If existing international rules regarding a particular issue are on the whole well settled, the work of draftsmen becomes more difficult for the improvement of the law because of they would face a psychological barrier when mobilizing public opinion for supports behind proposals for international legislation. A good example for such a situation is the state of existing international law about documentary credits. While UCP 500, in the whole, is a success, and to some extent relevant custom and practices of documentary credits in international trade are unified under such provisions there are other matters about documentary credits that, as discussed above, require to be unified internationally. However, the success achieved under UCP provides a barrier to the further development of the law of documentary credits. Work achieved by the ICC must be appreciated but this does not mean that the law of documentary credits has reached to its optimum level and there is no room for further improvements. The present research study has tried to point out those areas that require more action towards unification of the law of documentary credit in international trade; and the ICC as ever should be ready to accept a greater share of responsibility and more positive and active role towards preparing the first draft convention on the documentary credits.[78]

3. Another matter of concern is the degree of readiness of different governments for co-operation with each other for undertaking their share of responsibilities for preparing the unification of international law and implementing their agreements thereto. The unification or codification of international law

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[77] See Chapter X, Section B.3.3 (obstacles to unification of law) above.

[78] "The international codifier could not limit his attention to the form of the law; he would inevitably be concerned throughout with its substance. He would have to choose between competing rules, to fill up gaps on which the law is uncertain or silent, and to give precision to abstract general principles of which the practical application is unsettled." [Brierly, supra (f.n. 2), pp. 79-80]

becomes a reality when political decisions can be taken by governments. This is an important step for any efforts made for the unification of international law. In order to makes governments ready to take political decisions without any hesitation it is vital to show them that they would gain more stability in their relations with each other as well as their nations would face less difficulties in their international transactions with each other. This is a very delicate and at the same time essential matter for any government to take proper decisions safeguarding its national as well as international interests. An inevitable task is faced by modern states because the role of governments as a result of new technological developments in industry and transport has changed and the present condition of the world is making the economy of every country ever more sensitive to what happens in other countries. The need for closer relations between different countries has greatly increased the sphere of state activities at the expense of that of private individuals, and this has involved in international business between governments much that was formerly only the concern of private individuals.[79]

Therefore, any preparatory efforts for the unification of international law should provide necessary conditions so that governments do not need to fear to be asked to bind themselves to a rule of law which will oblige them to disagree with it later, or reach the conclusion that they were neglected during the preparation of the uniform law and their points of view were not properly noticed by the body established for preparatory studies.[80]

4. There is no central organ for the enforcement of international legislation and the creation of any such executive power is still a very distant prospect because of differences exist regarding different aspects of society, namely culture, religion,

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[79] "States are no longer separate units in such matters as commerce, labour, art, morals, inventions, health; and slowly and as yet very imperfectly they are being compelled to recognize that they cannot be altogether separate units in the political or economic fields." [Brierly, supra (f.n. 2), p. 104]; for other details see the relevant discussion in Section B.2, Chapter X (above).

[80] For a recent experience concerning unification of law at the international level see discussions relevant to UNCITRAL's activities in Chapters III (Section A.2.1.3.) and X (Section A.2) above.

social, economic and legal systems.[81] That absence, however, should not be interpreted in a way that each state takes international law into its hands and acts irrationally and leads the rule of law in a direction it thinks fit for enforcing its own rights. It is, therefore, important that any international legislation provides a proper method for dispute settlements between the interested parties to an international transaction.[82]

CONCLUSIONS

There are in the mind of lawyers always questions on the subject of unification and codification of the law of international trade; for instances, are we existing, at present, in a more integrated and barrier-less situation from a commercial, economic, and social point of view? If it is so, does such a situation require more co-operation between trading partners? And, how such a need should be dealt with? Dealing with these questions requires a good knowledge and understanding about the social, economic, and legal structure of modern societies and the role of states regarding their legislative power in such societies.

As a society becomes more complex, the legislative power of government as to national affairs as well as judicial decisions made by courts begin to form a legal system with a coherent and better known judicial practice. As a result of such a trend the role of custom(s) has decreased in importance as a source of law; however, flexibility and adaptability to circumstances are the qualities advanced in favour of customary law. A similar conclusions can be drawn regarding international communities, as a large society. The growth of a new custom is always a slow process, and the nature of international society makes it particularly slow in the international sphere. The progress of international law, on the other hand, has come

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[81] See the relevant discussion in Section A.1.1. of the present chapter (above).

[82] For more information about different methods available for settlement of a dispute in international affairs such as arbitration, or judicial settlement (Good offices, mediation, and conciliation) see Brierly, supra (f.n. 2), pp. 346-357.

to be more and more bound up with that of the law-making treaty. This is an important development for the unification of international law and shows the desire of different states for more co-operation for safeguarding the interests of their citizens in international affairs. Nevertheless, the difference between **international customary law** and **international legislation**, as pointed out by a writer, "is not one between uncertainty and certainty in formulation, but merely between a greater and a lesser degree of uncertainty."[83]

The advantage of having international relationships governed by sources of law which are themselves of an international nature is obvious. The question for consideration is: can a coherent body of rules governing international trade be provided? The use of international conventions, under the present circumstance of the international community, would eliminate objections which might arise out of concern to preserve national sovereignty. Moreover, they provide more certainty, predictability, and reliability as to rules of international nature, leading to a more advanced and fair set of standards regarding international relations.

As to the option of regulating international private law either by the method of **conflict of laws** or by the formula of **substantive law**, the question contains considerable flexibility and both are appropriate in their own fields. The conflict of laws method is to be preferred in all fields where national views differ profoundly as to the substantive rules to be applied, but the other formula for the unification of international private law is more suitable in fields such as commercial law, where it seems conceivable that agreement might be reached on substantive rules, and in situations where it is often questionable whether regulation by a particular national law is appropriate.

In respect of the unification of the law of documentary credits, as also considered previously[84], issues related to LCs and SLCs are unified, to some extent, under UCP 500 (non-mandatory provisions collecting custom and practices

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[83] Brierly, supra (f.n. 2), p. 62.

[84] See Sections A.2.1 (Chapter II) and B.1 of the present chapter (above).

about documentary credits) by the ICC. However, a decade of active letters of credit litigation, conducted in many parts of the world, has exposed the weakness of the UCP 1983 (ICC Publication No. 400) which was led to the revision of UCP 1994 (ICC Publication No. 500). Although the new version of UCP constitutes a much improved and better drafted codification of custom and practices related to documentary credits than any earlier version of the UCP,[85] there are still issues in which UCP 500 requires another revision in the future.[86] Moreover, the international credibility of UCP as a source of international customs under Article 38 of the Statute of International Court of Justice (ICJ) is doubtful for reasons discussed previously.[87] Therefore, there is a need for the unification of the law of documentary credits in the form of an international convention. This is due to the legal character of issues which are not covered under UCP, including the changing socio-economic conditions of nations, and need for a new lex mercatoria, all requiring more co-operation between states.[88] as well as different interested parties to a letter of credit transaction.[89] In addition, as to harmonisation of law in international trade law, it is

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[85] For instance see Buckley, supra (f.n. 39), pp. 288-93 (changes clarifying banking practices), and p. 294 (concerning changes in favour of the beneficiary).

[86] For more details look at relevant discussions in Chapters IV-VIII and Section B.3.3 of the present chapter above; Ellinger, supra (f.n. 46), at p. 402 referred to issues like the governing law of LCs, arbitration that needs to be added in the next revision of the UCP; Dolan, supra (f.n. 36), at p. 149 said: "[t]he latest version of the Uniform Customs may contain misguided attempts to protect banks from problems in the letter of credit transaction that they are better equipped to face." and the same writer at p. 155 of the same reference pointed out: "UCP 500 has weakened the credit product in order to fashion rules that protect banks at the expense of the commercial parties."; Buckley, supra (f.n. 39), at pp. 212-13 said; "**The real weakness of the UCP lies in what it does not address**- the obligations of confirming and advising banks to the applicant, the rights of an applicant against a bank that proposes to pay on documents which are forged or otherwise fraudulent [...] These are some of the issues of real concern to international traders which, without guidance from the UCP, are unlikely to be resolved with sufficient certainty in the next decade." [Emphasis added]

[87] See Sections A.3 and B.2 of the present chapter (above).

[88] See the relevant discussions in Section B.2 of Chapter X (above); Kozolchyk 1993, supra (f.n. 34), at p. 406 referred to such important matter and said: "The time for uniformity and standardisation could not be more propitious. Ours is truly a global financial marketplace. Because of computers, telephones and artificial satellites, traders of goods, services or financial undertakings can at any hour of the day sell, buy, lease, assign, or borrow instantaneously to or from another trader no matter how far away. Documentary credits occupy an important and special corner of this global marketplace."

been rightly pointed out by a writer that: "Harmonization can be gained more easily if implemented before national rules have been set in concrete. If national rules are developed on the basis of the model rules, or indeed, if the model rules are adopted in their entirety as national rules, the opportunity to create greater commercial certainty across border may be easily achieved."[90]

This necessity can also be supported by other international efforts made towards the unification of private international law, with particular reference to the recent **United Nations Convention on International Bills of Exchange and International Promissory Notes** (approved by UN General Assembly, December 9, 1988) and **the UNCITRAL Draft Convention on Guaranty Letters** (UN Document A/CN.9/372, 21, 1993 (a new regime for international independent guarantees and standby letters of credit)).[91] Moreover, national experience(s) can be a great help for the unification of the law of documentary credits.[92] For instance, Article 5 of the Uniform Commercial Code (UCC) in the United States of America deserves more attention. As pointed out by a writer, "Article 5 of the UCC has three outstanding merits namely it is modern in spirit, pragmatic in treatment, and comprehensive. In addition the Code would accelarate and advance the pace towards international unification in four ways: **(1)** by reducing the traditional common law resistance to codification; **(2)** by presenting many common law principles in a

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[89] Buckley, supra (f.n. 39), at p. 267 took the view that "[t]he UCP will be best served in the future by a broader representation of interested parties in its revision process. This view is taken with some appreciation of the real difficulties inherent in securing agreement between bankers and lawyers from different nations, cultures and legal systems, and the understandable reluctance of the ICC to add further parties and perspectives to the process."

[90] Patrikis, Ernest T., "Global EFT guidelines: what they can mean to US banks", Bank Administration, September 1987, p. 30, at p. 31.

[91] For relevant discussions see Chapters III (Section A.2.1.3.) and X (Section A.2) above.

[92] Documentary letters of credit have rarely received any statutory treatment in the legislation of countries. The U.K., for instance, has no specific statute on it. The only common law country that has legislative enactment on credits is the United States. This is contained in Article 5 of the U.S. Uniform Commercial Code (UCC). Article 5 is the only legislation which treated LCs comprehensively. For more details about Article 5 of the UCC see relevant discussions in Chapters I (Section B.2.3) and V (above).

statutory form; **(3)** by formulating novel solutions to many troublesome problems in international trade law; and **(4)** by serving as an example of a successful unification of the laws of many different jurisdictions."[93]

Lastly, courts' decisions as well as doctrinal views should also be taken into account since they have been important in the development of the law of credits and have been influential in the formulation of the UCP. It should also be remembered that they play an important role in interpreting provisions in cases of confusion and dispute.[94] Their role for a greater unification of the law of documentary credits, namely, in the form of an international convention are even more vital. They are a solid rock for efforts towards the unification of international law; without such elements the future of any movement in that direction would be at risk. As rightly stated by a writer many years ago, "so long as the juridical concepts of one country remain unassociated or even unaware of the jurists and customs of another country, no true unification can ever be effected between the legislative enactments of these two countries."[95]

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[93] Schmitthoff 1981, supra (f.n. 18), p. 15.

[94] For the relevant discussion (role of legal scholars) see Section B.2, Chapter X (above).

[95] David, Rene', "The International Institute of Rome for the Unification of Private Law", Tulane Law Review, Vol. 8, No. 1. December 1933, pp. 406-16, at p. 415.

CHAPTER XII

CONCLUSIONS

Letters of credit (LCs)[1] and attach issues have fascinated legal scholars because their important role as mechanisms of payment in international trade. Different questions have from time to time arisen in concerning different aspects of the system, namely, questions on parties to a letter of credit transaction and their relationships with each other, on documents and their roles in operation of the system, on principles and their effect upon rights and duties of contracting parties, and on **rules and provisions related to LCs at an international level**. The present thesis is based on an endeavour to find an answer to the last off the above question; a set of international standards concerning the law of LCs, which would respond to the needs of commercial communities throughout the world of commerce at present and in the future. In that respect several questions needed to be clarified: **(1) What is the present system of law related to LCs?; (2) Would such a system be adequate to provide a uniform law concerning LCs?; and (3) If not, what would be a possible replacement for the present system?**

Before considering these questions it is necessary to remind that the scope of the present study is limited to UCP 500 and English common law; of course, relevant issues in American law (like Article 5 of the UCC and case law) as well as Scots law are also considered.

SECTION A: LETTERS OF CREDIT: CURRENT SITUATION

1. IMPORTANCE OF LCs IN CURRENT CONDITIONS IN THE WORLD OF COMMERCE

Technological improvements[2] and the emergence of new markets (the European Union, the unification of Germany, and the break up of the Soviet Union) in recent years, all point to increasing opportunities for international trade. In that respect, parties to an international sale contract (namely, seller(s) and buyer(s)) need to consider the complexities of dealing with overseas trading partner(s), e.g.,

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[1] It is also called "**documentary letters of credit**" or "**banker's commercial letters of credit**".

[2] Developments related to the telecommunication, transportation (combined and multi-modal transporting of goods), and information technology such as Automatic Data Processing (**ADP**) or Electronic Data Interchange (**EDI**); for further details about ADP/EDI see Section A, Chapter IX (above).

the mechanism of payment; this has always been treated as one of the important issues by all interested parties, as a proverb says: **"A sale remains a gift unless it is paid for."** A question then is: What financing methods are provided for controlling and monitoring international trade transactions? One of the methods of payment available at present[3] are **letters of credit (LCs)**.

Letters of credit have been used[4] to provide a fair and fast method for arranging the payment for goods and services purchased or sold in international as well as domestic trade.[5] The importance of LCs, mostly issued by banks[6], is due to reducing payment risks for both importers and exporters involved in international trade[7]; this provide a system of payment against **"document of title"**.[8] The letters of credit will continue to be the most important method of financing international trade between individual buyers and sellers, if, with objectivity and diligence, the parties to the international transaction can avoid the problems associated with the system.[9]

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[3] Current import-export financing methods include promissory notes and guarantees, payment against delivery of document of title, documentary letters of credit, open account operates on trust, collections, foreign credit insurance, export factoring arrangements, and cash in advance.

[4] See history of LCs in Chapter I, Section B.1 (above).

[5] For definition, function, and operation of LCs in international trade see Section A, Chapter II (above).

[6] There is a distinction between Article 2 of the Uniform Customs and Practices for Documentary Credits (UCP), 1993, International Chamber of Commerce (ICC) Publication No. 500 [hereinafter referred to as UCP 500], and Section 5-102 of Article 5 of the Uniform Commercial Code (UCC) in the USA [hereinafter referred to as UCC), which under the latter, a credit may also be issued by a person other than a bank; see relevant discussion in Section B.1.1.2 of Chapter V (above); and for other differences between UCP 500 and UCC see the same chapter.

[7] See Chapters II (Section B (principles operated under LCs)), VI (the principle of strict compliance) and VII (doctrine of autonomy); some other reasons for using LCs are: 1. In some countries (e.g. South East Asia countries) tradition plays a major role in business transactions. In such countries LCs may simply be the way business done; 2. The central bank of the buyer's country may require that the buyer open an LC. This enables such a country to control their foregin exchange requirements.

[8] For details see relevant discussions in Chapters II (Section B.1 (principle of strict compliance)), VI, VII (Section A.2 (letters of credit and carriage contract)), VIII (Section A.1.1.2 (Banks take shipping documents as a pledge)), and IX (Section B.1 (role of a paper-based document in international trade)).

[9] Some of potential problems with LCs are delays in the honouring of some letters by banks, revocation of agreements by some banks (see articles 6 and 8 of UCP 500), insolvency on the part of certain banks, fraudulent actions by seller or invalid signatures on the necessary documents, and bankruptcy of the buyer;

2. RULES AND PROVISIONS

Issues related to LCs were not discussed for the purpose of a possible unification or codification at international level until 1933[10]. In that year, the first edition of the **Uniform Customs and Practice for Documentary Credits (UCP)** was published by the International Chamber of Commerce (ICC) at its 7th Congress held in Vienna[11]; and it has been revised five times within 60 years between 1933 and 1993[12]. The UCP, at present, is the only body of provisions concerning LCs accepted at international level;[13] as such it is mostly accepted as

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For more details see Chapters VI-VIII (above) and relevant discussion in Section B of the present chapter (below).

[10] Before 1933 some individual efforts were made at national level by different countries, e.g., in 1920 the USA, 1923 Germany and Greece, 1924 France and Norway, 1925 Italy, Czechoslovakia, and Sweden, 1926 Argentine, 1928 Denmark, 1930 Netherlands; Ellinger, E.P., **"The Uniform Customs- their nature and the 1983 revision"**, LMCLQ, 1984, pp. 578-606 [hereinafter referred to as Ellinger 1984]; for more details see Chapter I (history of LCs) above.

[11] ICC, Brochure No. 82; it is necessary to mention that there was another attempt for international standardisation in 1929 Congress of the ICC, held in Amsterdam, but it was not successful; Ellinger 1984, ibid, p. 579.

[12] ICC, Publications No. 151 (UCP 1951), No. 222 (UCP 1962), No. 290 (UCP 1974), No. 400 (UCP 1983), and No. 500 (UCP 1993); some of reasons caused for revisions above by the ICC are: to achieve uniformity, to improve the capability of the UCP with regard to developments in methods of transportation and communication, the need to recognize appropriate documents, and the need to accept new types of credits such as standby letters of credit and deferred payment credits. The New version of the UCP published in May, 1993, but came into effect on January 1, 1994, is ICC Publication No. 500. Although the 1983 Revision of the UCP (ICC Publication No. 400) was, in most regards, considered satisfactory, the need for a new revision had been apparent for a number of years. To start with, voluminous litigation in different parts of the world exposed certain weaknesses in some of the 55 articles of UCP 400. In addition, the many queries referred to the Banking Commission of the ICC by banks puzzeled by or feeling dissatisfied with certain provisions of the 1983 Revision indicated that the need for further work on the Code was felt throughout the banking community at large. UCP 500, incorporates a number of important changes that will affect the way in which banks administer letters of credit. The changes include: (1) A presumption that credits are irrevocable (Article 6(c)); (2) A new time period within which banks must examine documents (Article 13(b)); (3) A new standard for examination of documents (Article 13(A)); (4) A special rule for non-documentary conditions (Article 13(C)); (5) The addition of new transportation documents (Articles 24 (non-negotiable sea waybill), 25 (charter party bill of lading), 27 (air transport document), 28 (road, rail or inland waterway transport documents), and 30 (Transport documents issued by freight forwarders)). UCP 500 applies to all types of documentary credits issued by banks, including commercial letters of credit and standby letters of credit law. It reaffirms the 2 basic principles of letters of credit and practice, the independence and the principle that banks deal only with documents, not with underlying performance. UCP 500 recognises 4 different roles for banks: issuing bank, advising bank, confirming bank, and nominated bank; for more details regarding UCP 500 see Chapters IV-VIII and Section B of Chapter XI (above).

[13] For relevant discussions see Chapters I (Section B.2), and XI (Section B.1) above.

being customary in nature[14]. There are no other rules, except UCP 500, internationally accepted for LCs.

In the United Kingdom (UK) the UCP, beside court cases,[15] is the only available source related to letters of credit. There is no particular Act of Parliament regarding LCs.[16] The situation is different in the United States of America (USA), namely, rules relating to LCs, beside court cases, were codified in Article 5 of the Uniform Commercial Code (UCC).[17] The UCC, in contrast to the UCP which is customary/ contractual in nature,[18] is a legislation at national level.[19] It is, therefore, mandatory in nature, and its rules concern mainly national rather than international aspects of issues related to LCs.[20] Article 5 of the UCC, however, is subject to revision in order to create rules for standby letters of credits (SLCs) and to decide how to blend UCC provisions on letters of credit with **international legal rules**, given the widespread international use of letters of credit.[21] Generally

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[14] The opposite view argued that the UCP is in contractual nature rather than the customary nature; Article 1 of the UCP 500, the same as previous versions of the UCP, supports the view above, namely, the UCP is enforceable if it is agreed by contracting parties; Dolan, John F., **"Weakening the letters of credit product: the new Uniform Customs and Practice for Documentary Credits"**, International Business Law Journal, No. 2, 1994, p. 149 [hereinafter referred to as Dolan]; for more details see Chapter XI, Section B.2 (above).

[15] The last 10-15 years have seen an increasingly amount of litigation regarding letters of credit. The four main areas where LCs disputes are most often litigated are: **(1)** Wrongful dishonour, **(2)** Court injunctions and the fraud exceptions, **(3)** Wrongful honor, and **(4)** Wrongful draw claims, bankruptcy disputes, and presentment warranties. Wrongful dishonour disputes are those in which an issuer has examined the presented documents, decided that the presentment does not comply with the LC's requirements, and refused to pay; White, Brian, **"Pain or payment- The truth behind letters of credit (part 1)"**, Banking World (Journal), Vol. 7, Iss. 12, December 1989, p. 50.

[16] See Section B.2.2, Chapter I (above).

[17] Regarding Article 5 of the UCC and its relevant points see Chapters I (Section B.2.3) and V (above).

[18] See Chapter XI, Section B.2 (legal nature of UCP 500) above.

[19] Chapter V, Section A.2.1 (above).

[20] Section A.2.2, Chapter V (above).

[21] In a report by a special task force on the study of Article 5 of the Uniform Commercial Code (UCC) pointed out there has been a need and desire to revise Article 5 to accompany the increasing role of letters of credit in the world economy. Some of proposed changes are related to wrongfull dishonour (the beneficiary's presented papers must strictly comply with what the letter requires), the rule of strict compliance (regarding the letter's expiry deadline), and the 1990 cases involving the UCC Article 5-114(2) fraud exception (focused on the definition of fraud); Byrne, James E, Dolan, John F., Miller, Fred H.,

speaking, at present, **a mixture of International Commercial Customs (UCP 500) and national rules apply to LCs in international commercial transactions.**

2.1. UCP 500

As pointed out above, the practical issues related to the current LCs system are dealt with by the ICC which, to some extent, has succeeded in unifying a part of customary/ contractual standards applicable to LCs in international trade under the UCP[22] while it covers some but not all issues related to LCs such as fraud.[23] As to the UCP 500, it contains a number of disclaimers which protect banks dealing in letters of credit (namely Articles 16 (disclaimer on the transmission of messages), and 18 (disclaimer for acts of an instructed party)). These disclaimers appear to be rather harsh from the point of view of the applicant.[24]

2.2. National law

Regarding issues not covered by the UCP (mostly legal in nature), there are no uniform rules applicable in international trade. Related issues have been treated under national laws (cases, (e.g. in the UK) as well as rules (like Article 5 of UCC in the USA), if any). As to the merits of national laws of states, the main objection to them is that issues of international character are considered by a national rather

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Taylor, Dan, Bergsten, Eric E., Herman, Gerold, Burman, Harold S., and Wheble, Bernard, "An examination of UCC Article 5 (Letters of Credit)", Business Lawyer (BLW), Vol. 45, June 1990, pp. 1521-1643; for more details concerning differences between UCP 500 and Article 5 of the UCC and suggestions for revision of Article 5 see Chapter V, Section B (above).

[22] For issues relevant to UCP 500 see Chapter IV (above).

[23] For other examples see above Chapters V (Section A.2 (issues considered only under Article 5 of the UCC)), VI (the principle of strict compliance), VII (particularly Section B.1 (fraud)), VIII (Bank's right of security under LCs), and IX (ADP/EDI), and relevant discussions concerning a need for revision of UCP 500 (below).

[24] For relevant discussions see Section B.1 of Chapter IV (above); as to examples related to beneficiaries and banks see the same reference and relevant discussions about practical interests of new system for LCs (below).

than an international instrument.[25] This situation may generate different views about one and the same issue related to LCs.[26]

In such a state of diversity a question arises: **What is the future of the letters of credit system?** Is the present system (**a mixture of international customary/ contractual and national law**) satisfactory in promoting reliability and legal certainty as well as coping with arising disputes at the outset of the 21st century; or is there a real and practical necessity for changing the present system, namely, by unifying issues concerning LCs and codifying them within an **international legislative instrument in the form of a convention**? It is important to keep in mind that a convention has also its limitations, and it is not possible or practical for a convention to contain all details related to LCs; there might be, therefore, a choice between international customs and international conventions. In other words, **would it be in the interest of the letters of credit system itself and participant parties to such international transactions that the existing system (namely, a mixture of international customs and national law) be replaced with a new system (namely, a mixture of international convention and national law)?** To answer this question the following may be said.

SECTION B: LETTERS OF CREDIT: EXISTING PROBLEMS

The present thesis pointed out that most disputes in the international arena are due to the reasons considered below.

1. ISSUES RELATED TO UCP 500

Lack of clarity of UCP 500 regarding the principle of strict compliance and doctrine of autonomy. Its meaning and exceptions,[27] particularly on fraud and related issues, have received much attention by courts in different jurisdictions.[28] It

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[25] For more details see relevant discussions in Chapters X (Section B.3.1 (meaning of unification of law)) and XI (Section A.3.2 (argument for international conventions)) above.

[26] For instance, look different attitude accepted concerning the issue of fraud in British and American legal systems; for further details see Section B.1 of Chapter VII (above).

[27] See relevant discussion in Chapters VI and VIII (above).

[28] See Chapters VI and VII (above).

is also said that the UCP 500 should be subject to further revision because it contains articles that would damage its reputation as a fair and just system (namely Articles 16 and 18).[29] There are also points related to each one of parties to LCS (namely the applicant for a credit, the beneficiary, and banks). They should be clarified in a future revision of UCP 500.[30]

2. UCP 500 AND ARTICLE 5 OF THE UCC: DIFFERENCES

In respect of other possible grounds for the further development of the international law of LCs, a comparison between Article 5 of the UCC and UCP 500 makes obvious that the UCC's coverage of issues related to LCs would be helpful in providing a more clarified set of international standards concerning LCs either as an international customary instrument (like the UCP) or in the form of an international regulation (like a convention).[31] Further, differences between the UCP and the UCC uphold the view in favour of unification of law of LCs; so, as to the above mentioned sources a harmonisation between them, as a mid-term action, seems inevitable.[32]

3. NATIONAL LAWS: DIFFERENCES

It is not difficult to show that national laws are not identical. For instance, in the case of LCs it becomes clear that the sources of law related to LCs are different both in the UK and in the USA while they share a common legal tradition (common law).[33] This is also true regarding particular issues concerning LCs; for instance, fraud and related matters, namely, the scope of fraud and the beneficiary's knowledge of fraud committed by a third party have received different treatment by

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[29] See Chapter IV, Section B.1 (above).

[30] Look at Section B of Chapter IV (above) and relevant discussions about practical intersets of new system of law for LCs (below).

[31] For details see above Chapter V, particularly Sections B.1.3 (issues concerning bank-customer relationships), B.2.1 (rules concerning LCs in general), and B.2.2 (rules concerning parties to a credit transaction such as right of applicant for amendment of a credit (Sub-section B.2.2.1), time of establishment of a credit (Sub-section B.2.2.2), and insolvency (Sub-section B.2.2.5)).

[32] See the relevant discussion in Section D.2 of the present chapter (below).

[33] For details see Chapter I, Section B.2 (sources on standards and rules of LCs) above.

courts in the UK and the USA.[34] A similar conclusion could be drawn to a lesser degree between English and Scots law concerning the issue of the bank's right of security.[35] Such a diversity of law of LCs exists even within a particular jurisdiction such as American law. For instance, as pointed out previously, UCP 500 and Article 5 of the UCC which are two different sources of law connected to LCs (with distinct aspects) are applied by different states in the USA.[36]

4. NEW ISSUES IN THE INTERNATIONAL SPHERE

Further, developments related to electronic data interchange (EDI)[37] as well as a draft convention suggested by the UNCITRAL regarding standby letters of credit (SLCs) and bank guarantees (BGs)[38] open new dimensions for participants to a letter of credit transaction in a future system. As indicated previously, the future of international trade lies in closer relations between states and parties interested to international trade transactions since technological developments and current situation of the commercial world are overcoming frontiers.[39]

Generally speaking, therefore, issues concerning LCs which require further consideration could be classified into three categories: **(1) Issues covered by the UCP;**[40] **(2) Issues not covered by the UCP but which could be included within**

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[34] For details concerning fraud see Section B.1, Chapter VII (above).

[35] For relevant discussions see Chapter VIII (above).

[36] For relevant discussions see in Chapters I (Section B.2.3) and Chapter V (above).

[37] See Chapter IX (above).

[38] For issues concerning SLCs and BGs See Chapters III (Section A.2.1.3) and X (Section A.2 (UNCITRAL's activities)) above.

[39] For more details see Section B.2, Chapter X (the world of commerce condition) above.

[40] For examples of this type of issues see Chapters IV [Section B (issues related to the applicant for a credit such as the bank's position on transmission of messages (Sub-section 1.1) and disclaimer for acts of the issuing bank as an instructed party (Sub-section 1.2); issues concerning the beneficiary such as amendment or cancelation of a revocable credit (Sub-section 2.1), late negotiation (Sub-section 2.2), and so on; and issues related to banks like incorporation of the UCP in the credit (Sub-section 3.1), instructions to issue or amend credits (Sub-section 3.2), insolvency of an advising bank (Sub-section 3.6), etc.)], and V [Section B.1 (issues related to the legal nature and scope of provisions (Sub-section 1.1), issues concerning bank-customer relationship (Sub-section 1.3), and issues connected to bank-beneficiary relationship (Sub-section 1.4)].

its provisions;[41] and **(3) Issues of particular legal complexity and needing expertise, deliberately kept out of the scope of the UCP by the ICC.**[42]

It becomes obvious that the root of the problems related to LCs and the main reason for the existence of numerous cases should be sought in a lack of clarity of law on LCs in international trade, and that the UCP, as the only existing source of law in the form of international commercial custom, cannot accommodate the needs required in modern society due to an inadequacy in coping with disputes (in the past)[43] and, surely, in the future, unless something is done. Consequently, a need for unification/ codification of law of LCs would seem to be inevitable.[44]

SECTION C: OPTIONS FOR UNIFYING THE LAW OF LCs

In order to tackle the problem of disparity in the law of LCs at an international level, there are different options (considered below) for improving the documentary credit system.

1. REVISION OF UCP 500

Revising the UCP would make possible to respond to new situations and parties to LCs transactions would benefit, more than ever, when applying a payment system. This suggestion, based on safeguarding the present system of

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[41] For instance see Chapter V [Section B.2 (rules concerning LCs in general like meaning of document, list of definitions, formal requirements and signing, and consideration (Sub-section 2.1), rules concerning parties to a credit transaction such as right of applicant for amendment of a credit, time of establishment of a credit, and insolvency of each one of parties to a letter of credit transaction, namely, banks, beneficiaries, and applicants for a credit (Sub-section 2.2)].

[42] For details see Chapters VI [Section A (legal issues related to the principle of strict compliance), and Section B.1 (exception(s) to the principle of strict compliance)], VII [Section A (legal issues related to the doctrine of autonomy like LCs and its connection to the sale contract (Sub-section 1) as well as a carriage contract (Sub-section 2) and Mareva injunctions (Sub-section3)), Section B (fraud (Sub-section 1), illegality (Sub-section 2), and contractual agreement for unenforceability of the doctrine of autonomy (Sub-section 3)], VIII [the bank's right of security under LCs against the applicant for a credit (Section A.1) and the beneficiary (Section A.2)], and IX [Section B (legal issues about EDI such as role of a paper-based document in international trade (Sub-section 1), risks and liability from legal point of view (Sub-section 2), fraud in EDI (Sub-section 3), and time of establishment of a paperless letter of credit (Sub-section 4)].

[43] For relevant discussions see Chapters IV-IX, X (Section B (need for unification of law of LCs)), and XI (Sections A.3 (international conventions v. international commercial customs) and B (unification of the law of LCs)) above.

[44] See above Chapters X (the future of the letters of credit system) and XI (legal instruments for unification of law of LCs) for relevant discussions.

LCs (mixture of international commercial customs and national law) is the easiest option and a short-cut solution that could be useful particularly for issues fall within the above mentioned first and second categories; the greater advantage of such a solution is that it keeps the international side of the system (UCP 500) in its place. Consequently, the flexibility of the system would be preserved.[45] There are, however, disadvantages concerning the above suggestion, as follows.

Firstly, the above mentioned third type of issues (Section B.4 of the present chapter above), of particular importance from bankers' point of view as well as other parties to a letter of credit transaction[46], would be left again at the mercy of a particular national law, something as considered previously, totally unjustifiable under the current conditions in the world of commerce.[47] Secondly, concerning the two first types of issues (Section B.4 of the present chapter above), the experience of last 60 years (1933-1993) clearly upholds the view that the ICC, as a non-governmental organisation financed mostly by bankers, would not show any interest in changing its approach to issues related to LCs, in order not to limit the power of banks in controlling the provisions in the foreseeable future.[48] Thus, this solution would not provide sufficient ammunition for a sound effort towards the unification of law of LCs at an international level.

2. INTERNATIONAL LEGISLATION IN THE FORM OF A CONVENTION

Another option for supporters of the unification of law of LCs is a **convention**: a legislative instrument prepared by an international governmental

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[45] See relevant discussion in Section A.3.1 of Chapter XI (arguments for international commercial customs) above.

[46] See the relevant discussion in Section B.3.3 of Chapter XI (legal issues related to LCs) and f.n. 42 of the present chapter (above).

[47] See the relevant discussion in Section B.2 of Chapter X (above).

[48] In that respect see relevant discussions in Sections B.3.2 of Chapter XI (bargaining power and its impact over law making) and B.3.3.1 of Chapter X (obstacle to unification of law:rutine and prejudice) above.

organisation like UNCITRAL.[49] The mandatory nature of a convention to some extent would generate a lesser flexibility of rules[50] but its advantages, beside the share of responsibility and co-operation accepted by different governments, would be those factors which are decisive in the success of any movement for unifying the law of international trade in our time, since, as far as international trade is concerned, states play an active role either directly (by engaging themselves in large and important contracts connected to their national interests) or indirectly (by passing necessary laws in order to safeguard the interests of their subjects in international transactions); this is a fact, so the role of states in modern times is something which cannot be denied easily.[51] As far as the flexibility of the system is concerned, techniques could be applied in order to preserve the necessity of such a convention, for instance, by providing adequate resources and sufficient funds for an intense co-operation between different participants (international organisations as well as individuals) and agreement to the revision of the rules (wholly or partly) after a certain period of time, as decisive factors which would eliminate the rigidity of any rules and preserve their flexibility.[52]

The present option, namely, having a convention for LCs, could be achieved in two ways: **(1)** It would only cover those issues which are not covered by the UCP, either because of the policy by the ICC or because of the legal nature of them; **(2)** The convention would include all issues relevant to LCs, namely, issues considered under the UCP as well as others left undecided by the ICC, namely, categories 2 and 3 (Section B.4 above).

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[49] For other techniques available for international legislation like supranational legislation and model law, their advantages and disadvantages see relevant discussion in Chapter XI, Section A.1 (above).

[50] See relevant discussions in Chapters V (Section A.2.2) and XI (Section A.3) above.

[51] For the relevant discussion see Sections B.2, Chapter X (the role of states concerning the new age of lex mercatoria) and A.3.2 of Chapter X (argument for international conventions) above.

[52] See also point No. 5 in Section D.3 of the present chapter (below).

2.1. A convention for issues not covered by UCP 500: A narrow approach

This procedure would solve part of the problems under consideration and unify a part relevant to legal aspects of LCs; the advantage of such a narrow approach, mainly connected to the separation of customs and practices from legal issues, would gain the support of those who are advocating the importance of flexibility in the system and its provisions (supporters of the first option above). Such an approach, however, could be the cause of an immediate instability, namely, by creating a situation with two sets of international standards relevant to LCs, which might overlap, since, it is difficult to imagine that the new set of standards would not have any common point or similarities with the old one (UCP 500). The situation in the USA, namely, accepting two sets of standards for LCs (UCP and Article 5 of the UCC) is good evidence for rejecting such an idea.[53] So, by accepting the approach suggested above, the next step would be the point of selecting one of them as governing the law of LCs, something which has happened in the USA; the same could logically arise in the narrow approach above. This would mean swimming against the main stream and would damage the purpose of the unification of law, namely, providing a more stable, predictable, and clarified situation for parties to an international letter of credit transaction.

Further, the narrow approach towards a convention, as suggested here, would require a new effort for the harmonisation of existing sources of law.[54] This has been perhaps the motive behind some of the changes concerning UCP 500 and a draft suggested for the revision of Article 5 of the UCC, namely, to provide more harmony between the given set of standards.[55] A similar argument was

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[53] For more details concerning differences between UCP 500 and Article 5 of the UCC see Chapter V (above).

[54] For more details see Section B.3.1 of Chapter X (meaning of unification of law) above.

[55] For instance Article 6(c) of UCP 500 ("In the absence of such indication the Credit shall be deemed to be irrevocable." and Section 5-108(b) of the Proposed Final Draft (PFD) for revision of Article 5 of the UCC supported the view accepted under Article 13(b) of the UCP 500 (banks "have reasonable time, not to exceed seven banking days following the day of receipts of the documents") are two example in that direction; for more details see Chapter V, Sections B.1.2.2. (silence as to revocability and irrevocability of a

rightly made by the ICC concerning UNCITRAL's activities regarding a draft convention on standby letters of credit and bank guarantees[56], on the ground that a new set of standards about SLCs by UNCITRAL would lead to confusion and disparity of law concerning SLCs and BGs in international trade.[57]

As a result of what has been said above, it seems that accepting the above suggestion (narrow approach) would cause uncertainty and could be a waste of time and resources.

2.2. A convention for all issues related to LCs: A wide approach

The above suggested second procedure, namely, providing a convention including all types of issues (legal, customs and practices) related to LCs, could be the most sensible approach for solving the problems of dis-unified law of LCs at an international level. Moreover, by achieving such a goal the present status of the international side of the system (UCP 500) as an international source of law would be improved from an international customary/contractual instrument to that of an international legislation; as a result, the existing differences of opinion regarding the legal nature of the UCP, from an international law point of view (namely, whether it is international custom or its force is derived from contractual transaction) would be ended.[58] Another ground for supporting a convention (in a wide approach) is connected to the fact that the laws relevant to an international sale of goods contract and other mechanisms of payment, like bills of exchange, promissory notes, cheques, and factoring were codified in the form of convention at an international level;[59] and as pointed out previously, the law of SLCs and BGs would be in the same direction (convention). Therefore, there is no justification for the

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credit) and B.1.4.1 (time allowed for honour or rejection of documents) above, and appendix 2 for the text of Section 5-108(b) below.

[56] For more details concerning SLCs and BGs see Chapter III (above).

[57] See relevant discussions in Chapters III (Section A.2.1 (historical background)) and X (Section A.2 (UNCITRAL's activities) and its conclusions) above.

[58] For relevant discussion see Section B.2 of Chapter XI (above).

[59] See Conclusions to Chapter XI (above).

view that LCs and their importance as mechanisms of payment in international trade require no uniformity in the form of a convention as far as law is concerned;[60] no uniformity means less attention to safeguarding the interests of parties to such transactions; in other words, the credibility of the credits system would be undermined at the international level. Having a convention would lead to lesser disparity and divergent law, a fairer system in which the interests of the different parties to LCs' transactions would be more balanced,[61] and the certainty and predictability of the system would be increased.

The wide approach above would also be in harmony with the current conditions of world of commerce, namely, the new age of lex mercatoria (international transactions). As discussed previously[62] we are living in an era where geographical frontiers no longer prevent the movement of goods and services between different parts of the globe, for reasons of technological improvements as well as changes related to social, economic, and political conditions in most countries in the last decades (particularly after the Second World War ending in 1945).

For reasons mentioned elsewhere[63] it is obvious that there is a fundamental distinction between the old and new ages of lex mercatoria, namely, earlier states and their authority as law making factors in modern times starting in the 16th-17th centuries). Although in the current new age of lex mercatoria geographical boundaries as well as race, religion, nationality, political, social, and economic differences are to a great extent affected, still an effective element exists which could prevent any efforts towards the unification of the law of international trade; it would be the role of states to administered necessary laws required by the interests

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[60] For further details see relevant discussion in Chapters X (Sections B.2 and B.3.1) and XI (Section A.3.2 (arguments for international convention)) above.

[61] For relevant discussion see Chapter XI, Section B.3.2 (bargaining power and its impact over law making) above.

[62] See relevant discussion In Section B.2, Chapter X (above).

[63] See Chapters XI (Section A.3 (international convention v. international customs)) and X (Section B.2) above.

of this subjects, in our case the business communities. This circumstance has played an important role for shaping international law, at present as well as in the past, and no one can deny it. A state's power of law making, with dividing boundaries, causes divisions and disagreements between states if applied improperly. In contrast, a reasonable approach towards the application of state authority would provide conditions for more co-operation and, as a result, unification of the law of international trade would be promoted as witnessed through some of the conventions sponsored by UNCITRAL in recent years. In that respect, international traders who always call for more uniformity regarding their international business activities could pressure their respective governments to play a more active role in international co-operation. The current situation leaves no room for a policy of non-cooperation between states and commercial communities throughout the world.

In order to achieve uniformity in international trade law, in general, and the law of LCs in particular, different views concerning the role of states in the unification of international law should be distinguished. There are those who are of the opinion that in the new age of lex mercatoria parties to an international transaction should be free to agree what is suitable for their contract, knowingly or unknowingly refusing to accept the (above mentioned) existing fact that the role of states in modern societies, could provide a situation indirectly the cause of non-cooperation policies; in other words, damage the purpose of unification of the law of LCs at an international level. Instead, a positive approach towards the role of states in modern societies, namely, recognising their law making power and encouraging more co-operation and accepting a greater share of responsibility towards unification of international law, as well as law of LCs, would help remove the final obstacle to the unification/ codification of international law.

SECTION D: ACTIONS REQUIRED FOR THE UNIFICATION OF LAW OF LCS

Any serious attempt for the unification/codification of law of LCs would require several actions, as follows.

1. SHORT TERM ACTION: FURTHER REVISION OF UCP 500

The UCP, as a successful experience in the field of international commercial customs, requires further revision in order to safeguard its position as an international source relating to LCs. This would be done in a manner that would **(1)** restore the credibility of the provisions as a fair and just set of standards by changing those sections of the provisions unjustifiably supporting banker's interests; **(2)** clarify those parts of the provisions which affect the banks' relationship with their customers, namely, the applicant for a credit or the beneficiary (examples have been mentioned previously and in Chapter IV, Section B (above)).

2. MID-TERM ACTION: HARMONISATION BETWEEN THE UCP AND ARTICLE 5 OF THE UCC

In order to provide more harmony between existing sources of law and before any revision of the UCP in the future, a joint working group (selected by UNCITRAL/ICC) should be established in order to find grounds for more harmonisation between the UCP and Article 5 of the UCC. The result of such a pilot study would be used for the next stage of unification of the law of LCs (as considered below). Although separate attempts have been made by draftsmen of the revision of UCP 500 and Article 5 of the UCC (as mentioned previously) still intensive work is required in order to fill the gaps between them.[64] For instance, a sharp difference between the UCP and its counterpart is related to the scope of provisions; the UCP does not cover LCs which might be issued by other business institutions (like building societies) than banks. An international set of standards should be flexible in order to cover such types of LCs.[65]

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[64] For a detailed comparative study between UCP and Article 5 of the UCC see relevant discussions in Chapter V (above).

[65] For more information concerning the point under consideration see Section A.1.1.2 of Chapter V; as to other examples such as fraud and the applicant right for amendment under the credit see Section B.2 of the same chapter (above); regarding the new draft suggest for revision of Article 5 of the UCC particularly the issue of governing law of LCs/ choice of law (Section 5-116 of new draft) see appendix 2 (below).

3. LONG TERM ACTION: A DRAFT CONVENTION FOR LCs

The next stage towards unification/ codification of law of LCs requires a wide range of comparative studies between different legal systems for establishing common grounds concerning different aspect of LCs leading to a first draft convention on letters of credit. A convention requires a strong political desire to accelerate activities towards the unification or codification of law, and it does not emerge unless the necessity of having a uniform set of standards concerning LCs at international level, its advantages and possible disadvantages are explained in such a manner that the interested parties to LCs transactions would reach the conclusion that their interests would be safeguarded better than through the present system (a mixture of international customs and national law). In this respect the following suggestions might be helpful.

1. A joint co-operation between UNCITRAL and the ICC would accelerate the transfer of information and prevent any diversion of the law of LCs as it would happen in the case of SLCs and BGs. Moreover, the ICC by offering its support, experience and financial resources, would play a decisive role in shaping the first convention about LCs, as it has done in the case of the UCP.

2. Experience connected to Article 5 of the UCC in the USA as a pilot project would be a great help for dealing with relevant issues as well as for preventing different sets of standards at international and national levels. A similar precaution should be taken regarding the UCP. Furthermore, as pointed out by the present study the UNCITRAL's stand concerning SLCs and BGs could cause uncertainty and would need to be revised.[66]

3. UNCITRAL could start a general study in field of fraud, security, law governing LCs, insolvency, as done in the case of electronic data interchange (EDI).[67] Similarly, the ICC could continue its study regarding UCP 500 and highlight issues for revision. The present study has been limited to common law (UK and to

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[66] See Chapter X, Section A.2 (above).

[67] See relevant discussion in Chapter IX (above).

some extent USA); a comparative study between common law and civil law could disclose more differences and a need for the unification of law of LCs.

4. After such preparatory studies, the results achieved could be consolidated in one code, with possible issues based on legal, customs and practices classified in separate sections.

5. The practical side of the system could be kept open for necessary revisions after a certain period of time (e.g. based on the ICC's experience after 10 years). This would to some extent help preserve the flexibility of the new system and remove any objection in that respect. It would be possible since in the case of the UCP many of its provisions have been left unchanged or have undergone minor and/or stylistic changes.[68] This could be extended to the whole system if necessary.

4. THE PRACTICAL VALUE OF THE NEW SYSTEM

Generally speaking, the need for unification is something that a reasonable lawyer would agree with; the question is how to achieve it? There is no dispute about the principle, but about its form. Further, having a convention would not be enough; it should also be supported by business communities and be workable. In other words, what are the practical and relevant advantage for banks, applicants for credits and beneficiaries to change the present system?

4.1. Common interests

Regarding the above question different benefits which could be achieved as a result of the unification of law of LCs would be: **(1)** improving the legal status of the law of LCs from international customs to international legislative instruments; in that respect, another chain in the series of conventions related to international trade law would be completed. This would remove at the same time the grounds for a distinction between national laws, on the one hand, and national and international existing sources of law (UCP 500 and Article 5 of the UCC) on the other; **(2)** clarification of the law would provide certainty, predictability and reliability; this would lead to less confusion and disputes between contracting parties and save the

[68] See relevant discussion in Section A, Chapter IV (above) and tables 1 and 2 (below).

time and financial resources of individuals, private and/or public sectors; **(3)** the new system would provide a much fairer system in which interests of different parties (banks, applicants for credit, and beneficiaries) would be better balanced (for instances see below).

4.2. Particular interests

4.2.1. Applicants

Beside the above issues concerning applicants having common interests with other parties, there are issues particular to applicants such as: **(1)** revision of Articles 16 (as to banks' disclaimer concerning transmission of a message) and 18 (regarding a disclaimer for acts of issuing bank as an instructed party) of UCP 500, **(2)** right of applicant to amendment of a credit, **(3)** other possible exceptions to the doctrine of autonomy (like illegality and consent of parties for unenforceability of the doctrine), and **(4)** bank's insolvency. The new system would provide a fairer system as far as the applicants are concerned.

4.2.2. Beneficiaries

Advantages of the new system of law, compared with the present system, for beneficiaries beside those above common grounds, are related to: **(1)** preserving the rights of beneficiaries in connection with any amendment or cancellation of revocable credits by issuing banks, **(2)** late negotiation, **(3)** rectifying non-conforming documents, **(4)** meaning of "any cause beyond their control", **(5)** transferable credit, **(6)** bank's insolvency, and **(7)** exceptions to the principle of strict compliance (*like de minimis rule, fairer interpretation of rules and customs* approved by a respective court, waiver and ratification). Surely the beneficiaries' interests would be in a better balance under the new system.

4.2.3. Bankers

Banks' position related to, **(1)** the principle of strict compliance (its contents and relevant exceptions), **(2)** the doctrine of autonomy (its connection with underlying contracts such as sale and carriage contracts as well as Mareva injunctions, and relevant exceptions such as fraud, illegality, and consent of parties

for unenforceability of the doctrine),[69] **(3)** the right of security against the applicants and right of recourse (as security measures) against the beneficiaries, **(4)** EDI and its impact upon their relationship with other interested parties (potential risks and liabilities for banks from a legal point of view, fraud in EDI, and time of establishment of a paperless letter of credit), **(5)** the insolvency of applicants and/or beneficiaries and how it affects the banks' interests under LCs operation, **(6)** the applicable law of LCs, **(7)** the method of incorporation of the UCP in the credit and related issues, **(8)** instructions concerning issue or amendment of a credit, **(9)** legal structure of a second confirmation, **(10)** meaning of teletransmission, **(11)** insolvency of advising bank, **(12)** meaning of "similar credit", and **(13)** assignment of the benefit of a credit, would be considered under the new system. In that regard, as submitted in the present study, bankers would stand on a more reliable platform, namely, facing international legislation rather than different national laws.

CONCLUSIONS

Regarding the three questions pointed out at the beginning of the present Chapter (**(1)** What is the present system of law related to LCs?; **(2)** Would such a system be adequate to provide a uniform law concerning LCs?; and **(3)** If not, what would be possible replacement for the present system?), it becomes obvious that the present system of LCs (a mixture of international custom and national law) needs to be replaced with a new system (a mixture of international convention and national law) in order to respond adequately to the needs of modern societies, now and in the future. Novelty is always difficult but it is necessary; every period requires solutions matching its needs. Consequently, there is no justification for a disparity in the laws of LCs by having different sources of law at international and national levels.

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[69] See Buckley, Ross P., "THE 1993 REVISION OF THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS", The George Washington Journal of International Law and Economics, Vol. 28, 1995, p. 265, at p. 309 (f.n. 312) pointed out that there was a suggestion for adding the issues relevant to fraud to the UCP, but it was not accepted by draftsmen of the UCP 500. This is another evidence which supports the view that the ICC has no interest to consider such issue under the UCP.

The UCP has promoted a common understanding and therewith uniformity in business transactions between trading states regarding international commercial customs and practices affecting LCs; an international commercial "legislative" text would also provide a greater understanding between parties involved in an international contract, as far as transnational legal issues of LCs are concerned. Similarly, as it has been sensible to have codified provisions regarding LCs and efforts have been made to codify customs and practices related to LCs from the early years of the 20th century[70] it would also be sensible, for reasons mentioned above in the present thesis, to have the **unification of the law of LCs in the form of an international convention** at the beginning of the 21st century.

[70] See Chapter I, Section B.1 (history of LCs) above.

APPENDICES

1: ARTICLE 5 OF THE UCC

UNIFORM COMMERCIAL CODE: ARTICLE 5- LETTER OF CREDIT

Section 5-101. Short Title

This Article shall be known and may be cited as Uniform Commercial Code-Letters of Credit.

Section 5-102. Scope

(1) This Article applies

(a) to a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; and

(b) to a credit issued by a person other than a bank if the credit requires that the draft or demand for payment be accompanied by a document of title; and

(c) to a credit issued by a bank or other person if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled.

(2) Unless the engagement meets the requirements of sub- section(1), this Article does not apply to engagements to make advances or to honour drafts or demands for payment, to authorities to pay or purchase, to guarantees or the general agreements.

(3) This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this Article.

Section 5-103. Definition

(1) In this Article unless the context otherwise requires

(a) "Credit" or "letter of credit" means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this Article (Section 5-102) that the issuer will honour drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be either revocable or irrevocable. The engagement may be either an engagement to honour or a statement that the bank or other person is authorised to honour.

(b) A "documentary credit" or a "documentary demand for payment" is one of honour of which is conditioned upon the presentation of a document or documents. "Document" means any paper including document of title, security, invoice, certificate, notice of default and the like.

(c) An "issuer" is a bank or other person issuing a credit.

(d) A "beneficiary" of a credit is a person who is entitled under its terms to draw or demand payment.

(e) An "advising bank" is a bank which gives notification of the issuance of a credit by another bank.

(f) A "confirming bank" is a bank which engages either
that it will itself honour a credit already issued by another bank or that such a credit will be honoured by the issuer or a third bank.

(g) A "customer" is a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank's customer.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Notation of Credit".	Section 5-108.
"Presenter".	Section 5-112(3).

(3) Definitions in other Articles applying to this Article and the sections in which they appear are:

"Accept" or "Acceptance".	Section 3-410.
"Contract for sale".	Section 2-106.
"Draft".	Section 3-104.
"Holder in due course".	Section 3-302.
"Midnight deadline".	Section 4-104.
"Security".	Section 8-102.

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

Section 5-104. Formal Requirements ; Signing

(1) Except as otherwise required in sub-section (1)(e) of section 5-102 on scope, no particular form of purchasing is required for a credit. A credit must be in writing and signed by the issuer and a confirmation must be in writing and signed by the confirming bank. A modification of the terms of a credit or confirmation must be signed by the issuer or confirming bank.

(2) A telegram may be a sufficient signed if it identifies its sender by an authorized authentication. The authentication may be in code and the authorized naming of the issuer in an advice of credit is a sufficient signing.

Section 5-105. Consideration

No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms.

Section 5-106. Time and Effect of Establishment of Credit

(1) Unless otherwise agreed a credit is established

(a) as regards the customer as soon as a letter of credit is sent to him or the letter of credit or an authorized written advice of its issuance is sent to the beneficiary; and **(b)** as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance.

(2) Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be modified or revoked only with the consent of the customer and once it is established as regards the beneficiary it can be modified or revoked only with his consent.

(3) Unless otherwise agreed after a revocable credit is established it may be modified or revoked by the issuer without notice to or consent from the customer or beneficiary.

(4) Notwithstanding any modification or revocation of a revocable credit any person authorized to honour or negotiated under the terms of the original credit is entitled to reimbursement for or honour of any draft or demand for payment duly honoured or negotiated before receipt of notice of the modification or revocation and the issuer in turn is entitled to reimbursement from its customer.

Section 5-107. Advice of Credit; Confirmation; Error in Statement of Terms

(1) Unless otherwise specified an advising bank by advising a credit issued by another bank does not assume any obligation to honour drafts drawn or demands for payment made under the credit but it does assume obligation for the accuracy of its own statement.

(2) A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as thought it were its issuer and acquires the rights of an issuer.

(3) Even though an advising bank incorrectly advises the terms of a credit it has been authorized to advise the credit is established as against the issuer to the extent of its original terms.

(4) Unless otherwise specified the customer bears as against the issuer all risks of transmission and reasonable translation or interpretation of any message relating to a credit.

Section 5-108. "Notation Credit"; Exhaustation of Credit

(1) A credit which specifies that any person purchasing or paying drafts drawn or demands for payment made under it
must note the amount of the draft or demand on the letter or advice of credit is a "notation credit".

(2) Under a notation credit

(a) a person paying the beneficiary or purchasing a draft or demand for payment from him acquires a right to honour only if the appropriate notation is made and by transferring or forwarding for honour the documents under the credit such a person warrants to the issuer that the notation has been made; and

(b) unless the credit or a signed statement that an appropriate notation has been made accompanies the draft or demand for payment the issuer may delay honour until evidence of notation has been procured which is satisfactory to it but its obligation and that of its customer continue for a reasonable time not exceeding thirty days to obtain such evidence.

(3) If the credit is not a notation credit

(a) the issuer may honour complying drafts or demands for payment presented to it in the order in which they are presented and is discharged pro tanto by honour of any such draft or demand;

(b) as between competing good faith purchasers of complying drafts the person first purchasing has priority over the subsequent purchaser even though the later purchased draft or demand has been first honoured.

Section 5-109. Issuer's obligation to its customer

(1) An issuer's obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility

(a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or

(b) for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others; or

(c) based on knowledge or lack of knowledge of any usage of any particular trade.

(2) An issuer must examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit but unless otherwise agreed assumes no liability or responsibility for the genuiness, falsification or effect of any document which appears on such examination to be regular on its face.

(3) A non-bank issuer is not bound by any banking usage of which it has no knowledge.

Section 5-110. Availability of Credit in Portions; Presenter's Reservation of Lien or Claim

(1) Unless otherwise specified a credit may be used in portions in the discretion of the beneficiary.

(2) Unless otherwise specified a person by presenting a documentary draft or demand for payment under a credit relinquishes upon its honour all claims to the documents and a person by transferring such draft or demand or causing such presentment authorizes such relinquishment. An explicit reservation of claim makes the draft or demand non-complying.

Section 5-111. Warranties on Transfer and Presentment

(1) Unless otherwise agreed the beneficiary by transferring or presenting a documentary draft or demand for payment warrants to all interested parties that the necessary
conditions of the credit have been complied with. This is in addition to any warranties arising under Article 3, 4, 7, and 8.

(2) Unless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment under a credit warrants only the matters warranted by a collecting bank under Article 4 and any such bank transferring a document warrants only the matters warranted by an intermediary under Article 7 and 8.

Section 5-112. Time Allowed for Honour or Rejection; Withholding Honour or Rejection by Consent; "Presenter"

(1) A bank to which a documentary draft or demand for payment is presented under a credit may without dishonour of the draft, demand or credit

(a) defer honour until the close of the third banking day following the receipt of the documents; and

(b) further defer honour if the presenter has expressly or impliedly consented thereto.

Failure to honour within the time here specified constitute dishonour of the draft or demand and of the credit [except as otherwise provided in subsection (4) of Section 5-114 on conditional payment].

Note: The bracket language in the last sentence of sub-section (1) should be include only if the optional provisions of Section 5-114(4) and (5) are included.

(2) Upon dishonour the bank may unless otherwise instructed fulfil its duty to return the draft or demand and the documents by holding them at the disposal of the presenter and sending him an advice to that effect.

(3) "Presenter" means any person presenting a draft or demand for a payment for honour under a credit even though that person is a confirming bank or other correspondent which is acting under an issuer's authorization.

Section 5-113. Indemnities

(1) A bank seeking to obtain (whether for itself or another) honour, negotiation or reimbursement under a credit may give an indemnity to induce such honour, negotiation or reimbursement.

(2) An indemnity agreement inducing honour, negotiation or reimbursement

(a) unless otherwise explicitly agreed applies to defects in the documents but not in the goods; and

(b) unless a longer time is explicitly agreed expires at the end of ten business days following receipt of the documents by the ultimate customer unless notice of objection is sent before such expiration date. The ultimate customer may send notice of objection to the person from whom he received the documents and any bank receiving such a notice is under a duty to send notice to its transferor before the midnight deadline.

Section 5-114. Issuer's Duty and Privilege to Honour; Right to Reimbursement

(1) An issuer must honour a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honour of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7-507) or of a security (Section 8-306) or is forged or fraudulent or there is fraud in the transaction

(a) the issuer must honour the draft or demand for payment if honour is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which make it a holder in due course (Section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a security (Section 8-302); and

(b) in all other cases as against its customer, an issuer acting in good faith may honour the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honour.

(3) Unless otherwise agreed an issuer which has duly honoured a draft or demand for payment is entitled to immediate reimbursement of any payment made under the credit and to be put in effectively available funds not later than the day before maturity of any acceptance made under the credit.

[**(4)** When a credit provides for payment by the issuer on the receipt of notice that the required documents are in the possession of a correspondent or other agent of the issuer

(a) any payment made on receipt of such notice is conditional, and

(b) the issuer may reject documents which do not comply with the credit if it does so within three banking days following its receipt of the documents; and

(c) in the event of such rejection, the issuer is entitled by charge back or otherwise to return of the payment made.]

[**(5)** In the case covered by subsection (4) failure to reject documents within the time specified in sub-paragraph (b) constitutes acceptance of the documents and makes the payment final in favour of the beneficiary.]

Note: Subsections (4) and (5) are bracketed as optional. If they are included the bracketed language in the last sentence of Section 5-112(1) should also be included.

Section 5-115. Remedy for Improper Dishonour or Anticipatory Repudiation

(1) When an issuer wrongfully dishonours a draft or demand for payment presented under the credit the person entitled to honour has with respect to any documents the rights of a person in the position of the seller (Section 2-707) and may recover from the issuer the face amount of the draft or demand together with incidental damages under Section 2-710 on seller's incidental damages and interest but less any amount realized by resale or other use or disposition of the subject matter involved in the transaction must be turned over to the issuer on payment of judgment.

(2) When an issuer wrongfully cancels or otherwise repudiates a credit before presentment of a draft or demand for payment drawn under it the beneficiary has the rights of a seller after anticipatory repudiation by the buyer under Section 2-610 if he learns of the repudiation in time reasonably to avoid procurement of the required documents. Otherwise the beneficiary has an immediate right of action for wrongful dishonour.

Section 5-116. Transfer and Assignment

(1) The right to draw under a credit can be transferred or assigned only when the credit is expressly designated as transferable or assignable.

(2) Even though the credit specifically states that it is nontransferable or nonassignable the beneficiary may before performance of the conditions of the credit assign his right to proceeds. Such an assignment is an assignment of an account under Article 9 on Secured Transactions and is governed by that Article except that

(a) the assignment is ineffective until the letter of credit or device of credit is delivered to the assignee which delivery constitutes perfection of the security interest under Article 9; and

(b) the issuer may honour drafts or demands for payment drawn under the credit until it receives a notification of the assignment signed by the beneficiary which reasonably identifies the credit involved in the assignment and contains a request to pay the assignee; and

(c) after what reasonably appears to be such a notification has been received the issuer may without dishonour refuse to accept or pay even to a person otherwise entitled to honour until the letter of credit or advice of credit is exhibited to the issuer.

(3) Except where the beneficiary has effectively assigned his right to draw or his right to proceeds, nothing in this section limits his right to transfer or negotiate drafts or demands drawn under the credit. Amended in 1972.

See appendix for changes made in former text and the reasons for change.

Section 5-117. Insolvency of Bank Holding Funds for Documentary Credit

(1) Where an issuer or an advising or confirming bank or a bank which has for a customer procured issuance of a credit by another bank becomes insolvent before final payment under the credit and the credit is one to which this Article is made applicable by paragraphs (a) or (b) of Section 5-102(1) on scope, the receipt or allocation of funds or collateral to secure or meet obligations under the credit shall have the following results:

(a) to the extent of any founds or collateral turned over after or before the insolvency as indemnity against or specifically for the purpose of payment of drafts or demands for payment drawn under the designated credit, the drafts or demands are entitled to payment in preference over depositors or other general creditors of the issuer or bank; and

(b) on expiration of the credit or surrender of the beneficiary's rights under it unused any person who has given such funds or collateral is similarly entitled to return thereof; and

(c) a charge to a general or current with a bank if specifically consented to for the purpose of indemnity against or payment of drafts or demands for payment drawn under the designated credit falls under the same rules as if the funds had been drawn out in cash and then turned over with specific instruction.

(2) After honour or reimbursement under this section the customer or other person for whose account the insolvent bank has acted is entitled to receive the documents involved.

2: PROPOSED FINAL DRAFT FOR REVISION OF ARTICLE 5 OF THE UCC

UCC ARTICLE 5
April 6, 1995 DRAFT

SECTION 5-101. SHORT TITLE.

This Article may be cited as Uniform Commercial Code- Letters of Credit.

SECTION 5-102. DEFINITIONS.

(a) In this article:

(1) "Advisor" means a person who, at the request of the issuer, a confirmer, or another advisor, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amend.

(2) "Applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(3) "Beneficiary" means a person who under the terms of a letter of credit is entitled to have its complying presentation honoured. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(4) "Confirmer" means a nominated person who undertakes, at the request or with the consent of the issuer, to honour a presentation under a letter of credit issued by another.

(5) "Dishonour" of a letter of credit means failure timely to honour or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(6) "Document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion (i) which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in Section 5-108(e) and (ii) which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(7) "Good faith" means honesty in fact in the conduct or transaction concerned.

(8) "Honour" of a letter of credit means performance of the issue's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honour" occurs

(i) upon payment,

(ii) if the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment, or

(iii) if the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(9) "Issuer" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

(10) "Letter of credit" means a definite undertaking that satisfies the requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honour a documentary presentation by payment or delivery of an item of value.

(11) "Nominated person" means a person whom the issuer (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse.

(12) "Presentation" means delivery of a document to an issuer or nominated person for honour or giving of value under a letter of credit.

(13) "Presenter" mean a person making a presentation as or on behalf of a beneficiary or nominated person.

(14) "Record" means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form.

(15) "Successor of a beneficiary" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

(b) Definitions in other Articles applying to this article and the sections in which they appear are:

"Accept" or "Acceptance"	Section 3-409
"Value"	Sections 3-303, 4-211

(c) Article 1 contains certain additional general definitions and principles of construction and interpretation applicable throughout this article.

SECTION 5-103. SCOPE

(a) This article applies to letters of credit and to certain rights and obligations arising out of transaction involving letters of credit.

(b) The statement of a rule in this article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.

(c) With the exception of this subsection, subsection (a) and (d), Sections 5-102(a)(9) and (10), 5-106(d), and 5-114(d), and except to the extent prohibited in Sections 1-102(3) and 5-117(d), the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

(d) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

SECTION 5-104. FORMAL REQUIREMENTS.

A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or

(ii) in accordance with the agreement of the parties or the standard practice referred to in Section 5-108(e).

SECTION 5-105. CONSIDERATION.

Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation.

SECTION 5-106. ISSUANCE, AMENDMENT, CANCELLATION, AND DURATION.

(a) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.

(b) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provided that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(c) If there is no stated expiration date or other provisions that determines its duration, a letter of credit expires one tear after its stated date of issuance or, if none is stated, after that date on which it is issued.

(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued.

SECTION 5-107. CONFIRMER, NOMINATED PERSON, AND ADVISER.

(a) A confirmer is directly obliged on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer.

(b) A nominated person who is not a confirmer is not obliged to honour or otherwise give value for a presentation.

(c) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obliged to honour or give value for a presentation. An advisor undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.

(d) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (c). The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies.

SECTION 5-108. ISSUER'S RIGHTS AND OBLIGATIONS.

(a) Except as otherwise provided in Section 5-109, an issuer shall honour a presentation that, as determined by the standard practice referred to in subsection (e), appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in Section 5-113 and unless otherwise

agreed with the applicant, an issuer shall dishonour a presentation that does not appear so to comply.

(b) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of the its receipt of documents:

(1) to honour,

(2) if the letter of credit provides for honour to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation, or

(3) to give notice to the presenter of discrepancies in the presentation.

(c) Except as otherwise provided in subsection (d), an issuer is precluded from asserting as a basis for dishonour any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(d) Failure to give the notice specified in subsection (b) or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonour fraud or forgery as described in Section 5-109(a) or expiration of the letter of credit before presentation.

(e) An issuer shall observe standard practice of financial institutions that regularly issues letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(f) An issuer is not responsible for:

(1) the performance or nonperformance of the underlying contract, arrangement, or transaction,

(2) an act or omission of others, or

(3) observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (e).

(g) If an undertaking constituting a letter of credit under Section 5-102(a)(b)(10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(h) An issuer that has dishonoured a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(i) An issuer that has honoured a presentation as permitted or required by this article:

(1) is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;

(2) takes the documents free of claims of the beneficiary or presenter;

(3) is precluded from asserting a right of recourse on a draft under Sections 3-414 and 3-415;

(4) except as otherwise provided in Section 5-110 and 5-117, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and

(5) is discharged to the extent of its performance under the letter of credit unless the issuer honoured a presentation in which a required signature of a beneficiary was forged.

SECTION 5-109. FRAUD AND FORGERY.

(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).

SECTION 5-110. WARRANTIES.

(a) If its presentation is honoured, the beneficiary warrants:

(1) to the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in Section 5-109(a); and

(2) to the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to the augmented by the letter of credit.

(b) The warranties in subsection (a) are in addition to warranties arising under Articles 3, 4, 7, and 8 because of the presentation or transfer of documents covered by any of those articles,

SECTION 5-111. REMEDIES.

(a) If an issuer wrongfully dishonour or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonour or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain

specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. [*] The claimant is not obliged to take action to avoid damages that might be due from the issuer under this subsection. If, although not obliged to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(b) If an issuer wrongfully dishonours a draft or demand for payment presented under a letter of credit or honours a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages [*], less any amount saved as a result of the breach.

(c) If an adviser or nominated person other than a confirmer breached an obligation under this article or an issuer breaches an obligation not covered in subsection (a) or (b), a person to whom the obligation is owed may recover damaged resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection and subsections (a) and (b).

(d) An issuer, nominated person, or adviser who is found liable under subsection (a), (b), or (c) shall pay interest on the amount owed thereunder from the date of wrongful dishonour or other appropriate date.

(e) Reasonable attorney's fees and other expenses of litigation may [**] be awarded to the prevailing party in an action in which a remedy is sought under this article.

(f) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

[*] At its meeting on October 21, 1994, the ALI Council voted to disapprove this provision disallowing consequential damages. At its meeting on May 15, 1995, the Council will consider a recommendation by its ad hoc Committee that it reverse that position and accept the text recommended by the Drafting Committee.

[**] The ALI Council's ad hoc Committee strongly recommended to the Drafting Committee that "may" be changed to "must". The Drafting Committee has agreed to propose to the Nation Conference of the Commissioners on Uniform State Laws that "may" be changed to "must". The Executive Committee of NCCUSL has so recommended to the Commissioners.

SECTION 5-112. TRANSFER OF LETTER OF CREDIT.

(a) Except as otherwise provided in Section 5-113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(b) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) the transfer would violate applicable law; or

(2) the transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other within the standard practice referred to in Section 5-108(e) or is otherwise reasonable under the circumstances.

SECTION 5-113. TRANSFER BY OPERATION OF LAW.

(a) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its statute as a successor.

(b) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (e), an issuer shall recognize a disclosed successor of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in Section 5-108(e) or, in the absence of such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(c) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(d) Honour of a purported successor's apparently complying presentation under subsection (a) or (b) has the consequences specified in Section 5-108(i) even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of Section 5-109.

(e) An issuer whose rights of reimbursement are not covered by subsection (d) or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under subsection (b).

(f) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

SECTION 114. ASSIGNMENT OF PROCEEDS.

(a) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft, or other item of value paid or delivered upon honour or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(b) A beneficiary may assign its rights to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(c) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(d) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds, but consent may not be unreasonably

withheld if the assignee possesses and exhibits the letter of credit an presentation of the letter of credit is a condition to honour.

(e) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(f) Neither the rights recognised by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 or other law.

SECTION 5-115. STATUTE OF LIMITATIONS.

An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the [claim for relief] [cause of action] accrues, whichever occurs later. A [claim for relief] [cause of action] accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

SECTION 5-116. CHOICE OF LAW.

(a) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in Section 5-104 or by a provision in the person's jurisdiction whose law is chosen need not bear any relation to the transaction.

(b) Unless subsection (a) applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address is indicated in the person's undertaking. If more than one address indicated, the person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate judicial entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(c) Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this article would govern the liability of an issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in Section 5-103(c).

(d) If there is conflict between this article and Article 3, 4, 4A, or 9, this article governs.

(e) The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (a).

SECTION 5-117. SUBROGATION OF ISSUER, APPLICANT, AND NOMINATED PERSON.

(a) An issuer that honours a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extend as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(b) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligation owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (a).

(c) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of :

(1) the issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(2) the beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(3) the applicant to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(d) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (a) and (b) do not arise until the issuer honours the letter of credit or otherwise pays and the rights in subsection (c) do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse.

TABLES

1. TABLES RELATED TO THE UCP 500

1.1. TABLE OF CONCORDANCE BETWEEN UCP 500 AND UCP 400

UCP 500	UCP 400	UCP 500	UCP 400
1	1	26	25
2	2	27	NEW
3	3,6	28	NEW
4	4	29	30
5	5,13,22(a)	30	25(d),26(c)
6	7	31	28,32,33
7	8	32	34
8	9	33	31
9	10	34	35,36,37
10	11	35	38,40
11	12	36	39
12	14	37	41
13	15,16(c)	38	42
14	16(a,b,c)	39	43
15	17	40	44
16	18	41	45
17	19	42	46
18	20	43	47
19	21	44	48
20	22	45	49
21	23	46	50
22	24	47	51,52,53
23	25,26,27,28	48	54
24	NEW	49	55
25	25(c),26(c)		

1.2. TABLE OF CONCORDANCE BETWEEN UCP 400 AND UCP 500

UCP 400	UCP 500	UCP 400	UCP 500
1	1	29	23(b-d)
2	2	30	29
3	3(a)	31	33
4	4	32	31(ii)
5	5(a)	33	31(ii)
6	3(b)	34	32
7	6	35	34
8	7(a)	36	34(e)
9	8	37	34(f)
10	9	38	35(a,b)
11	10	39	36
12	11	40	35(c)
13	5(a.ii)	41	37
14	12	42	38
15	13	43	39
16	13,14	44	40
17	15	45	41
18	16	46	42
19	17	47	43
20	18	48	44
21	19	49	45
22	5(b),20	50	46
23	21	51	47(a,b)
24	22	52	47(c)
25	23,26,30	53	47(d)
26	23	54	48
27	23(a.ii)	55	49
28	31		

2: TABLE RELATED TO THE ARTICLE 5 OF THE UCC

2.1. TABLE OF DISPOSITION OF SECTIONS IN FORMER ARTICLE 5

ARTICLE 5 SECTION	REVISED ARTICLE 5 SECTION
5-101	5-101
5102(1)	5-103(a)
5-102(2)	Omitted (inherent in 5-103(a) and definitions)
5-103(3)	5-103(b)(first sentence omitted)
5-103(1)(a)	5-102(a)(10); 5-106(a); 5-102(a)(8)
5-103(1)(b)	5-102(a)(6) ("Document"); 5-102(a)(14) ("Record"); "Documentary" draft or demand not used
5-103(1)(c)	5-102(a)(9)
5-103(1)(d)	5-102(a)(3)
5-103(1)(e)	5-102(a)(1)
5-103(1)(f)	5-102(a)(4)
5-103(1)(g)	5-102(a)(2) ("Applicant" rather than "Customer")
5-103(2)	Omitted as not applicable
5-103(3)	5-102(b)
5-103(4)	5-102(c)
5-104	5-104 and 5-102(6) and (14)
5-105	5-105
5-106(1)	5-106(a)
5-106(2)	5-106(b)
5-106(3)	5-106(b)
5-106(4)	5-106(b)
5-107(1)	5-107(c)
5-107(2)	5-107(a)
5-107(3)	5-107(c)
5-107(4)	Omitted as inadvisable default rule
5-108	Omitted (as outdated)
5-109(1)	5-108
5-109(2)	5-108
5-109(3)	Omitted (all issuers required to observe standard practices)
5-110(1)	Omitted (covered in definitions and comments)
5-110(2)	Omitted (covered in definitions and comments)

(Continue-next page)

ARTICLE 5 SECTION	REVISED ARTICLE 5 SECTION
5-111(1)	5-110(a)
5-111(2)	5-110(b)
5-112(1)	5-108(b) and (c)
5-112(2)	5-108(h)
5-112(3)	5-102(a)(12)
5-113	Omitted (covered by other contract law)
5-114(1)	5-108(a)
5-114(2)(a)	5-109(a)(1)
5-114(2)(b)	5-109(a)(2)
5-114(3)	5-108(i)
5-114(4), (5)	Omitted, were optional
5-115(1)	5-111
5-115(2)	5-111
5-116(1)	5-112
5-116(2)	5-114
5-116(3)	5-113, 5-114
5-117	Omitted (covered by other law)

2.1. TABLE OF NEW PROVISIONS

(Provisions which were not included in former Article 5 and subjects not addressed in former Article 5)

SUBJECTS	REVISED ARTICLE 5 SECTION
"Successor to a beneficiary"	5-102(15)
Non-variable terms	5-103(c)
Independent principle	5-103(d)
Unstated expiry date	5-106(c)
Perpetual letter of credit	5-106(d)
Preclusion of unstated deficiencies	5-108(c)
Standard of practice	5-108(e)
Independence of obligation	5-108(f)
Non-documentary condition	5-108(g)
Standards for issuing injunction	5-109(b)
Transfer by operation of law	5-113
Statute of Limitation	5-115
Choice of law	5-116
Subrogation	5-117

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