

UNIVERSITY OF EAST ANGLIA

NORWICH

LAW SCHOOL

“Documentary Credits and The Problem of the Discrepant Documents”

DISSERTATION / LAW- M56Y

YEAR

2006/2007

This copy of the thesis has been supplied on condition that anyone who consults it is understood to recognise that its copyright rests with the author and that no quotation from the thesis, nor any information derived therefrom, may be published without the author's prior written consent.

Student number

3307824

TABLE OF CONTENTS

Introduction	1
I – GENERAL	1, 2
II- GLOBAL RISKS IN INTERNATIONAL TRADE AND THE DOCUMENTARY CREDIT	3-24
1- Main risks associated with international trade	3-4
(a) <i>Credit risk</i>	3
(b) <i>Country risk</i>	4
(c) <i>Transport risk</i>	4
(d) <i>Exchange risk</i>	4
2- Documentary credits as one of the most common payments method in international trade	5
3- The Legal Status of the Uniform Customs and Practice for Documentary Credits ('the UCP')	6
4- Stages in the Opening of a Documentary Credit	7-9
(a) <i>The contract of sale</i>	8
(b) <i>The application form</i>	8
(c) <i>Notification of Opening of the Credit</i>	8, 9
(d) <i>Realisation of the contract</i>	9
5- Types of Documentary Credit	10-15
(a) <i>Revocable Credits</i>	10
(b) <i>Irrevocable Credits</i>	10, 11
(c) <i>Confirmed Credits</i>	11
(d) <i>Unconfirmed Credits</i>	11, 12
(e) <i>Red clause (or anticipatory) – Green clause Credits</i>	12
(f) <i>Transferable and Non-Transferable Credits</i>	12, 13
(g) <i>Back to Back Credits</i>	13, 14
(h) <i>Revolving or Reinstatement Credits</i>	14, 15
(i) <i>Standby Credits</i>	15

6- Types of Payment Obligation.....	16, 17
7- The Contractual Relationship between the Parties to the Confirmed Documentary Credit.....	17-24
(a) <i>The contract between seller and buyer.....</i>	<i>17-19</i>
i. <i>Time of opening credit.....</i>	<i>18</i>
ii. <i>Duration of credit.....</i>	<i>19</i>
iii. <i>Rejection of goods.....</i>	<i>19</i>
(b) <i>The contract between buyer and issuing bank.....</i>	<i>19-22</i>
(c) <i>The contract between issuing bank and advising bank.....</i>	<i>23</i>
(d) <i>The contract between issuing bank and seller.....</i>	<i>23</i>
(e) <i>The contract between advising bank seller.....</i>	<i>24</i>
III- THE PROBLEM OF DISCREPANT DOCUMENTS AND THE BANK'S LIABILITY UNDER DISCREPANCY OF DOCUMENTS.....	24-38
1- The Duty of Bank in the Examination of Documents.....	24-26
2- The Frequency and Type of Discrepancies.....	26-34
(a) <i>Irrelevant Irregularities of Documents.....</i>	<i>29-31</i>
i. <i>Irregularities irrelevant under the UCP.....</i>	<i>29</i>
ii. <i>Irrelevant variations in the documents.....</i>	<i>29, 30</i>
iii. <i>Irregularities irrelevant according to the court decisions.....</i>	<i>30, 31</i>
(b) <i>Genuine Discrepancies of Documents.....</i>	<i>31-34</i>
i. <i>Discrepancies relevant under the UCP.....</i>	<i>31</i>
ii. <i>Lack of linkage.....</i>	<i>32</i>
iii. <i>Other relevant discrepancies.....</i>	<i>32-34</i>
3- Discrepant Documents, Waiver and Notice.....	34-37
4- Protective mechanisms under discrepant documents.....	37, 38
(a) <i>Payment under reserve.....</i>	<i>37, 38</i>
(b) <i>Payment against indemnity.....</i>	<i>38</i>
IV- CONCLUSION.....	38-40

Bibliography

Brindle, Michael, Cox, Raymond, Waksman, David and Coleman, Richard: **Law of Bank Payments, (London: Sweet & Maxwell, 2004)**

De Rooy, Frans P.: **Documentary Credits (Netherlands: Kluwer Law and Taxation Publishers, 1984)**

Dogan, Vahit: **Uluslararası Ticarette Ödeme Aracı Olarak Akreditif, (Ankara: Seckin Yayinlari, 2005)**

Erdogan, Ihsan: **Akreditif Sozlesmeleri, (Ankara: Nobel Yayin Dagitim, 2000)**

Goode, Roy: **Commercial Law, (London: Penguin Books, 2004)**

Jack, Raymond, Malek, Ali and Quest, David: **Documentary Credits, (London, Dublin, Edinburgh: Butterworths, 2001)**

M.Schmitthoff, Clive: **Select Essay's on International Trade Law edited by Chia-Jul Cheng, (London: Martinus Nijhoff Publishers & Graham/Trotman Ltd., 1998)**

Mugasha, Agasha: **The Law of Letters of Credit and Bank Guarantees, (Sydney: The Federation Press, 2003)**

Mullis, Alastair: **The Documentary Credit Handouts for the Class 'Payments and Finance in International Trade', (2006/2007)**

Mullis, Alastair: **The UCP 600 Rules Handouts for the Class 'Payments and Finance in International Trade', (2006/2007)**

Purvis, Rodney N., Darvas, Robert: **Commercial Letters of Credit, (Sydney, Melbourne, Brisbane: Butterworths, 1975)**

Rowe, Michael: **Letters of Credit, (London: Euromoney Publications, 2nd edition, 1997)**

Schutze, Rolf A., Fontane Gabriele: **Documentary Credit Law throughout the world, (Paris: ICC Publication, 2001)**

Yeni, Coskun: **Uluslararası Ticarette Ödeme Yöntemleri, (Istanbul: Alfa Basım Yayım Dağıtım Ltd. Sti., 2005)**

Introduction

This dissertation gives historical information about international trade and documentary credit. The reasons of why documentary credit is very popular in international trade will be shown. The contractual relationship between the parties to the documentary credit will be analysed. The problem of discrepant documents and the bank's liability under discrepancy of documents will be explained. The dissertation bases on English and Turkish Law. Finally, conclusion will follow.

I – GENERAL

International trade between people and between different ethnic groups has existed and evolved since prehistoric times. A glance at history tells us that one the most important trade routes over the years has been the Silk Road, connecting East and West and, in ancient times, China with the Roman Empire. Many luxury goods, such as silk, jewellery and perfumes, carried along this route. Credit problems no doubt arise when various groups practice commerce with each other. Before the invention of money, trade was carried out by barter.¹

In the middle ages, it was Constantinople and then Genoa, Venice and Florence which were at the heart of western commerce. After the First World War, some changes took place in international trade. Before the war, trade partners could be said to know and trust one other but when the war broke out the old international trade contracts were, to a degree, severed, and firms looked for new trade partners in which the previous patterns of intimacy and trust were absent.² These conditions required on new payment systems.

Documentary credit is one of the most practical payment methods in international trade.

¹ Frans P.De Rooy, *Documentary Credits*, (Netherlands: Kluwer Law and Taxation Publishers, 1984), p. 3

² *Ibid.*, p. 9

The earliest documentary credit was issued by the merchants Alexander Brown & Sons of Baltimore and addressed to Wm. & Jas. Brown of Liverpool.³ “*In this credit the beneficiary is first introduced, after which the text reads: ‘We have also lodged a credit in his favour of 250 pounds sterling, or any part thereof, which he may require’.*”⁴

Modern documentary credit came into existence in the nineteenth century. In 1804, the case of *Robbins. v. Bingham* saw the first American lawsuit related to documentary credit.⁵

In the twentieth century, international trade and finance become more significant. In 1919, the International Chamber of Commerce (ICC) was founded to assist world business by sustaining trade and investment and open markets for goods, services and free capital flow.⁶ The United States of America became a centre of world trade and American banks began to issue documentary credits for their customers. However, initial inexperience led to the acceptance of discrepant documents. In July 1922, the first standard American forms for documentary credit were issued to solve these problems.⁷

The two world wars had significantly affected both international relations and trade, leading to a breach of evolution in international trade. Nevertheless, after the Second World War, some organizations were established by the international community to provide safe economic relations and free international trade. In this period, the General Agreement on Tariffs and Trade (typically abbreviated as GATT) was signed temporarily by 23 countries at Geneva in 1947. It was the first and the most significant leading to today’s World Trade Organization (WTO).

³ Ibid., p. 7

⁴ Ibid.

⁵ Ibid.

⁶ International Chamber of Commerce. History, Web at http://en.wikipedia.org/wiki/International_Chamber_of_Commerce#History accessed on 17 June 2007.

⁷ Frans P.De Rooy. *Documentary Credits*. (Netherlands: Kluwer Law and Taxation Publishers, 1984), p. 10

II- GLOBAL RISKS IN INTERNATIONAL TRADE AND DOCUMENTARY CREDIT

1- Main risks associated with international trade

International trade has been growing increasingly in recent years. Merchants enter new markets looking for new trade partners and opportunities. Unfortunately, new markets cover new risks.

When trading internationally one is either a buyer or seller and one must therefore choose payment methods carefully in order to reduce the risks which international trade carries with it.

Four main risks exist in international trade; *a- credit risk, b- country risk, c- transport risk, and d- exchange risk.*

Below are definitions of the above-outlined risks.

a- Credit risk

Credit risk is the most common risk for all trade partners. One of the contract parties, usually the buyer, may fail to pay because of bankruptcy, fraud, incapability or a delayed payment.⁸ This nonpayment can affect a company's flow of cash. It is also difficult to follow trade partners, who may be based in different countries and thus operate in different languages and within different commercial and legal systems. But there are also buyer's risks whereby the seller may not deliver the promised goods or deliver goods of a quality and/or quantity at variance with that stated in the agreement.

⁸ AIB Capital Markets Trade Finance, International Trade Payments in plain English. Web at http://www.aib.ie/servlet/ContentServer?pagename=AIB_CapitalMarkets/CM_Download/cm_d_downl_oa&c=CM_Download&cid=1061217474477&channel=CMFT accessed on 25 June 2007.

b- Country risk

Country risk is also called “political risk” in that the buyer may fail to pay because of governmental circumstances. The reasons of this undesirable condition may be insufficient foreign exchange reserves in the state to pay for imported goods or social unrests like war, revolution and rebellion.

c- Transport risk

Import and export contains transportation risks in that the goods may be lost or damaged while they are transported between the exporter and importer.⁹ Suitable insurance cover may, however, reduce this risk.

Every sales contract should include the definite terms of shipment (known as the ‘incoterms’).¹⁰

d- Exchange risk

This is the risk of a floating exchange rate between the time entered into contact and the time payment is due to be made.¹¹ If the importer enters into a contract in other currency, he or she can cover the risk by using a forward contract or using a foreign exchange option.

Parties of the sale contract in international commercial transactions can reduce the risks to choose correct payment method such as open account, documentary collections, documentary credits and paying in advance. Documentary credits can minimize the risk and is one of the most common payments methods in international trade.

⁹ Ibid., p. 8

¹⁰ Ibid., p. 9

¹¹ Ibid.

2- Documentary credits as one of the most common payments method in international trade

Documentary credit otherwise known as 'letter of credit' or 'documentary letter of credit' or 'commercial letter of credit' is, in brief, a bank promise of payment against presentment of specified documents.

In international trade almost all documentary credits are governed by the International Chamber of Commerce's publication "Uniform Customs and Practice for Documentary Credits ('UCP')".¹² Documentary credit ('credit') is defined by the UCP 600 as:

*"any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank (means: 'the bank that issues credit at the request of an applicant or on its behalf') to honour (means: 'a- to pay at sight if the credit is available by sight payment. b- to incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment. c- to accept a bill of exchange ("drawn") by the beneficiary and pay at maturity if the credit is available by acceptance') complying presentation."*¹³

In other words, documentary credit is payment assurance to the seller by the buyer's bank when the terms and the conditions of the documentary credit are met. They provide assurance to both the exporter and the importer where conditions may be uncertain or there is no previous relation between the parties.

¹² It was first promulgated by the International Chamber of Commerce ('ICC') in 1933 and revised in 1951, 1962, 1974, 1983 and finally 2007 and it is also the most long-standing and successful set of private rules for international trade ever developed. The last of these ('UCP 600') is the current text since the 1st of July, 2007.

¹³ UCP 600, Article 2.

3- The Legal Status of the Uniform Customs and Practice for Documentary Credits ('the UCP')

Article 1 of the UCP 600 states that, "The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no.600, are rules that apply to 'any' documentary credit..." The new UCP is differently from the UCP 500 because of not using apply 'all' documentary credits. There was a discussion that the UCP are mandatory rules and apply to all documentary credits.

However, as the ICC is not a legislative power, the UCP can be seen as the most successful set of private rules for international trade developed so far that cannot be law "*sui generis*".

It is the well-established view in England that the UCP are simply a set of rules having no legal force unless the contract expressly or implicitly provides such a mechanism.¹⁴ In contrast to the English view, there is a discussion of the legal statutes of the UCP. Although some writers in other countries accept that the UCP is a form of code which has its own force without turn on incorporation by sales contract,¹⁵ Professor Boris Kozolchyk explains succinctly in his comparative study, "*The text of the UCP is neither systematic nor comprehensive enough to warrant the legal characterization of code.*"¹⁶

There is no specific provision in the Turkish Commercial Code or Law of Obligation relating to documentary credit and its function.¹⁷ Turkish legal principles on documentary credits reflect Swiss law but are dominated by the UCP.¹⁸ Unlike Anglo-American Law and the UCP, a documentary credit in the meaning of Article 399 of the Law of Obligation is not regarded as a type of credit by Turkish Law.¹⁹

¹⁴ Roy Goode, Commercial Law, (London: Penguin Books, 2004), p. 968

¹⁵ *Ibid.*, p. 969

¹⁶ *Ibid.*

¹⁷ Dogan Vahit, Uluslararası Ticarete Odeme Araci Olarak Akreditif, (Ankara: Seckin Yayinlari, 2005), p. 30

¹⁸ Rolf A.Schutze, Gabriele Fontane, Documentary Credit Law throughout the world, (Paris: ICC Publication, 2001), p. 113

¹⁹ *Ibid.*

4- Stages in the Opening of a Documentary Credit

Table 1. Steps of the Documentary Credit transaction²⁰

1	Applicant (buyer)	The buyer fills in a letter of credit application form and sends it to his or her bank for approval.
2	Issuing bank (buyer's bank)	The issuing bank approves the application and sends the letter of credit details to the seller's bank (advising bank).
3	Advising bank	The advising bank authenticates the letter of credit and sends the beneficiary (seller) the details by post or fax.
4	Beneficiary (seller)	The seller examines the details of the letter of credit to make sure that he or she can meet all the conditions. If necessary, he or she contacts the buyer and asks for any necessary amendments to be made.
5	Beneficiary	Once the seller is satisfied with the conditions of the letter of credit, he or she ships the goods and presents the documents to his or her bankers (advising bank).
6	Advising bank	The advising bank examines the documents against the details on the letter of credit and the International Chamber of Commerce rules. If they are in order, the bank will send them to the issuing bank for payment or acceptance. If the details are not correct, the advising bank tells the seller and waits for corrected documents or further instructions.
7	Issuing bank	The issuing bank examines the documents from the advising bank and if they are in order, pays the money promised or agrees to in the future. If the details are not correct, the issuing bank contacts the buyer for authorisation to pay or accept the documents. If acceptable, the issuing bank releases the documents to the buyer, and pays the money promised or agrees to pay it in the future.
8	Applicant	The buyer receives the documents from the issuing bank and collects the goods. He or she also receives advice about the payment.
9	Beneficiary	The seller receives the payment through his or her bank.

²⁰ AIB Capital Markets Trade Finance, International Trade Payments in plain English. Web at http://www.aib.ie/servlet/ContentServer?pagename=AIB_CapitalMarkets/CM_Download/cm_d_download&c=CM_Download&cid=1061217474477&channel=CMFT accessed on 25 June 2007.

As seen in Table 1, the documentary credit transaction has four main stages; *'the contract of sale'*, *'the application form'*, *'notification of the opening of the credit'* and *'realisation of the contract'*.

a- The contract of sale

The first stage of the documentary credit transaction starts with the sale contract. The buyer and the seller agree that payment is to be made by documentary credit. Actually, the sale contract is separate from the credit but it includes credit obligations and the credit must comply strictly with the sale contract otherwise the seller is entitled to refuse payment under the credit.²¹

b- The application form

In the second stage of the transaction, the importer (the applicant) will apply to a bank (the issuing bank) to open a documentary credit in favour of the exporter (the seller/ the beneficiary) on the terms of the sale contract.²² When the applicant completes the issuing bank's standard application form, he or she has to give clear and precise instructions to his or her bank. The issuing bank is not party to the sale contract, concerning itself merely with the instructions given it by the applicant. When we look at the reverse side of the credit, generally it consists of terms whereby the bank is prepared to grant credit and also the UCP 600.²³

c- Notification of the Opening of Credit

In the third stage of the transaction, the issuing bank will notice the beneficiary of the opening of documentary credit in his favour. Generally, the issuing bank communicates to the beneficiary via another branch of the issuing bank or a correspondent bank which is in the beneficiary's country.

²¹ Alastair Mullis, *The Documentary Credit Handouts for the Class 'Payments and Finance in International Trade'*, (2006/2007), p. 3

²² *Ibid.*

²³ *Ibid.*

The notification is generally given by telex and confirmed by letter. After that, the issuing bank is liable to the beneficiary of transaction.

If the beneficiary is worried about the country risk to the buyer, he or she may ask that the letter of credit be confirmed. With the confirmed letter of credit, the confirming bank will also be liable to the beneficiary. The most important advantage to the beneficiary, which is in the confirmed letter of credit, is that the beneficiary can sue the bank in its own jurisdiction if a payment risk arises.

d- Realisation of the contract

The fourth stage in the transaction is realisation of the credit. In this stage, the exporter ships the goods, provides the shipping documents and presents the documents in accordance with the terms of the credit. According to sub-article 6(d)(ii) of the UCP 600; *'The place of the bank with which the credit is available is the place for presentation. The place for presentation under a credit available with any bank is that of any bank. A place for presentation other than that of the issuing bank is in addition to the place of the issuing bank.'* Essentially, the presentation of the documents made by the exporter's bank and the exporter's bank act like a collecting bank and presents the documents like the beneficiary's agent.²⁴ If the documents are in order, the advising bank (the buyer's bank) will send them to the issuing bank for payment or acceptance. The issuing bank will examine the documents; if they comply with the terms of the credit, the amount promised is paid or payment is agreed for a future date.²⁵

²⁴ Ibid., p. 4

²⁵ Ibid.

5- Types of Documentary Credit

a- Revocable Credits

A Revocable credit is one which can be modified and cancelled at any time without notice to the beneficiary.²⁶ The revocable letter of credits can be revoked by the issuing bank without the applicant's instruction.

Revocable credits are rare in practice because the credit does not provide the seller security for the payment by the banks.²⁷ It can be used by the same group of companies. Equally, this type of documentary credit does not involve a confirming bank because of its relative insecurity.²⁸

b- Irrevocable Credits

Article 3 of the UCP 600 states that, "*A credit is irrevocable even if there is no indication to that effect*".²⁹ An irrevocable credit is revoked only with the acceptance of the applicant, the issuing bank and the beneficiary.³⁰ Article 6 of the UCP 500 provides: "*a- A credit maybe either revocable or irrevocable b- The credit, therefore, should clearly indicate whether it is revocable or irrevocable. c- In the absence of such indication the Credit shall be deemed to be irrevocable.*"³¹ In practice, almost all documentary credits are irrevocable because it gives the seller security for the payment by the banks. The parties' relations under amendments or cancellations are governed by the UCP 600, Article 9 (d).

²⁶ Michael Brindle, Raymond Cox, David Waksman, Richard Coleman, Law of Bank Payments, (London: Sweet & Maxwell, 2004), p. 663

²⁷ Ibid.

²⁸ Coskun Yeni, Uluslararası Ticarete Odeme Yontemleri, (Istanbul: Alfa Basim Yayim Dagitim Ltd. Sti., 2005), p. 26

²⁹ UCP 600, Article 3.

³⁰ Raymond Jack, Ali Malek, David Quest, Documentary Credits, (London, Dublin, Edinburgh: Butterworths, 2001) p. 25, UCP 500, Article 9 (a).

³¹ UCP 500, Article 6.

Excepting the case of a transferable credit, an irrevocable credit cannot be amended or cancelled without the agreement of the issuing bank, any conforming bank or the beneficiary.³² The most significant nature of the irrevocable letter of credit is effective protection for the exporter.³³

c- Confirmed Credits

When a bank issues a documentary credit it mostly does so far from the beneficiary's own country.³⁴ A confirmed letter of credit gives the beneficiary the security of payment in his own country due to fact that the advising or correspondent bank accompanies its own undertaking to that of the issuing bank to pay, accept or negotiate bills.³⁵ The confirmed letters of credit are also irrevocable letters of credit due to the reasons given above. A confirmed credit is always irrevocable; however a credit may be irrevocable without being confirmed.³⁶ If one of the advising banks or correspondent banks adds its confirmation to the letter of credits, it means that they will bear responsibility to the beneficiary in the same way as the issuing bank. According to Article 9 (b) of the UCP 500, confirmation of an irrevocable credit by a confirming bank upon the authorisation or request of the issuing bank constitutes a definite undertaking of the confirming bank in addition to that of the issuing bank to honour documents which conform to the terms and conditions of the credit.

d- Unconfirmed Credits

If the documentary credit is unconfirmed, the advising bank will only be the agent of the issuing bank. The advising bank will only check the documents but will not liable for the credit.

³² Agasha Mugasha, *The Law of Letters of Credit and Bank Guarantees*, (Sydney: The Federation Press, 2003), p. 29, UCP 500, Article 9 (d).

³³ Rodney N.Purvis, Robert Darvas, *Commercial Letters of Credit*, (Sydney, Melbourne, Brisbane: Butterworths, 1975), p. 10

³⁴ Frans P.De Rooy, *Documentary Credits*. (Netherlands: Kluwer Law and Taxation Publishers, 1984), p. 35

³⁵ Raymond Jack, Ali Malek, David Quest, *Documentary Credits*, (London, Dublin, Edinburgh: Butterworths, 2001) p. 30

³⁶ Roy Goode, *Commercial Law*, (London: Penguin books, 2004), p. 959

In confirmed credit, only the issuing bank undertakes the payment obligation to the beneficiary.³⁷ When the advising bank notifies the credit to the beneficiary, it will carry words such as “*This credit does not have our confirmation*”.³⁸ However, an exporter may be led to believe that an unconfirmed documentary credit which is issued by a first class bank provides sufficient guarantee for payment.³⁹

e- Red clause (or anticipatory) – Green clause Credits

Red clause credits – named thus due to the shade of ink – were used in Australia, New Zealand and South Africa for wool trades.⁴⁰ Under a red clause credit, a bank will pay in advance a portion of or the full amount of the credit to the beneficiary in order to specify preshipment documents such as freight charge or packing. Concisely, a red clause credit allows the bank to pay advances to the beneficiary without presentation of documents.⁴¹ Generally, the exporter uses this credit to finance the contract. Under a green clause credit, a bank will also pay the beneficiary in advance but the goods are required to be warehoused in the name of the bank.

f- Transferable and Non-Transferable Credits

Credits are either transferable or non-transferable. According to sub-article 38 (b) of the UCP 600: “*Transferable credit means a credit that specifically states it is ‘transferable’. A transferable credit may be made available in whole or in part to another beneficiary (‘second beneficiary’) at the request of the beneficiary (‘first beneficiary’).*”

³⁷ Coskun Yeni, Uluslararası Ticarette Odeme Yontemleri, (Istanbul: Alfa Basim Yayim Dagitim Ltd. Sti., 2005), p. 27

³⁸ Michael Brindle, Raymond Cox, David Waksman, Richard Coleman, Law of Bank Payments, (London: Sweet & Maxwell, 2004), p. 663

³⁹ Ibid.

⁴⁰ Ibid., p. 671

⁴¹ Rolf A.Schutze, Gabriele Fontane, Documentary Credit Law throughout the world, (Paris: ICC Publication, 2001), p. 20

Transferring bank means a nominated bank that transfers the credit or, in credit available to any bank, a bank that is specifically authorized by the issuing bank to transfer and that transfers the credit. An issuing may be a transferring bank.

Transferred credit means a credit that has been made available by the transferring bank to a second beneficiary.”

The credit can be transferred only if it is specifically stated as “transferable”. When documentary credit is specified as transferable, the beneficiary is able to request the bank to make the credit available in all or in part to third parties.⁴² Transferable credits are generally used by a seller who enters into a contract with the buyer on condition that payment is to be paid under an irrevocable confirmed credit, and whereby he himself is not the physical supplier of the goods but is buying them from a manufacturer that is to be paid under a parallel documentary credit.⁴³

g- Back to Back Credits

Unlike a transferable credit, which is concept a single credit, back-to-back credit is distinct credit from that issued to the seller by the buyer.⁴⁴ A back-to-back credit is issued by the seller’s request to his supplier against the documentary credit which the seller himself received from the buyer.

In *Stach (Ian) Ltd v Baker Bosley Ltd [1958]*, the function of back-to-back credits and transferable credits in such string contracts is explained by Devlin J. as thus:

⁴² Raymond Jack, Ali Malek, David Quest, *Documentary Credits*, (London, Dublin, Edinburgh: Butterworths, 2001) p. 36

⁴³ Alastair Mullis, *The Documentary Credit Handouts for the Class ‘Payments and Finance in International Trade’*, (2006/2007), p.20

⁴⁴ Roy Goode, *Commercial Law*, (London: Penguin books, 2004), p. 1010

“Where, as in the present case, there is a string of merchants’ contracts between the manufacturer or stockist and the ultimate user, the normal mechanism for carrying out the various contracts is the familiar one which was intended to be used in this case: the ultimate user, under the terms of his contract of sale, opens a transferable, divisible credit in favour of his seller for his purchase price: his seller in turn transfers so much of the credit as corresponds to his own purchase price to his seller or, more probably, if his own contract with another merchant also calls for a transferable, divisible credit, procures his own banker to issue bank to bank credit, that is to say, he lodges the credit in his favour with his own banker, who is in turn a issues a transferable, divisible credit for the amount of his purchase price to his own seller; and so on, through the string of merchants, until the banker of the last merchant in the string issues the credit in favour of the actual manufacturer or stockist. The reason why they issue fresh credits is that in banking practice a transferable credit is regarded as transferable once only, and, also as is obvious in this sort of trade, it is desired, naturally enough, by any merchant in the string to conceal from his buyer and his seller who his own customer is.”⁴⁵

h- Revolving or Reinstatement Credits

The UCP 500 and the new UCP 600 does not contain any provision about revolving or reinstatement credits. The revolving credit provides the beneficiary to make various drawings under the credit up to a top amount.⁴⁶ It revolves by value or time upon a given event on a cumulative or non-cumulative basis, either automatically or non-automatically.⁴⁷

⁴⁵ Michael Brindle, Raymond Cox, David Waksman, Richard Coleman, Law of Bank Payments, (London: Sweet & Maxwell, 2004), p. 670

⁴⁶ Rolf A.Schutze, Gabriele Fontane, Documentary Credit Law throughout the world, (Paris: ICC Publication, 2001), p. 19

⁴⁷ Ibid.

Especially, it is particularly useful when the seller and buyer have a previous trade relationship between each other and they have specific quantity of merchandise each month.⁴⁸

i- Standby Credits

The main purpose and the difference of standby letters of credit are to provide security against the non-performance of a party to a contract.⁴⁹

Standby letters of credit do not have their own set of rules and are also subject to the same basic rules contained in the ICC's *Uniform Customs and Practice for Documentary Credits (UCP)*.⁵⁰ Standby letters of credit have developed and are used mostly by banks in the United States which enjoy limited power to issue guarantees.⁵¹ According to the American definition of the standby letter of credit, it is a letter of credit which represents an obligation to the beneficiary on the part of the issuer:

“ - to repay money borrowed by or advanced to or for the account of the account party (customer) or
- to make payment on account of any evidence of indebtedness undertaken by the account party, or
- to make payment on account of any default by the account party in the performance of an obligation.”⁵²

In short, the standby letter of credit can fulfil a very useful function in international trade transactions.

⁴⁸ Frans P.De Rooy, *Documentary Credits*, (Netherlands: Kluwer Law and Taxation Publishers, 1984), p. 45

⁴⁹ Raymond Jack, Ali Malek, David Quest, *Documentary Credits*, (London, Dublin, Edinburgh: Butterworths, 2001), p. 40

⁵⁰ Michael Rowe, *Letters of Credit*, (London: Euromoney Publications, 2nd edition, 1997), p. 205

⁵¹ *Ibid.*

⁵² Frans P.De Rooy, *Documentary Credits*, (Netherlands: Kluwer Law and Taxation Publishers, 1984), p. 51, 52

6- Types of Payment Obligation

A credit must state whether it is available by sight payment, deferred payment, acceptance or negotiation.⁵³ The payment obligation undertaken by the banks arise in four forms. Where the bank undertakes to pay on sight, it stipulates payment is made in cash after the beneficiary receives the documents (the UCP 600, art 7 (a)(i), (ii) and art 8 (a)(i)).

Under a deferred payment, the bank will pay in cash at some deferred date stated in accordance with the terms of the credit (the UCP 600, art 7 (a)(iii) and art 8 (a)(i)). Deferred payment is generally specified in the terms of the credit in this way; "*Payment deferred at 30 days from date of presentation of the following documents.*" Deferred payment credit first came into existence in Japan in the early nineteen fifties.⁵⁴ Japanese importers developed this form because the Japanese banks only issued credits with drafts which drew on sight and refused to issue any more credits in which the drawing of time drafts was stipulated.⁵⁵

In the case of acceptance credits, the beneficiary is asked to draw a bill of exchange (draft) on a bank if the documents tendered meets the terms and conditions of the credit.⁵⁶ If the credit is an acceptance, the draft is to be drawn by the beneficiary on the issuing bank or another drawee bank accepts drafts and pays them at maturity (the UCP 600, art 7 (a)(iv) and art 8 (a)(i)).

The final form of undertaking exists where the credit is negotiable. According to sub article 7 (a)(v) of the UCP 600, "*Provided that the stipulated documents are presented to the nominated bank or to the issuing bank and that they constitute a complying presentation, the issuing bank must honour if the credit is available by negotiation with a nominated bank and that nominated bank does not negotiate.*"

⁵³ UCP 600, Article 6 (b)

⁵⁴ Frans P.De Rooy, *Documentary Credits*, (Netherlands: Kluwer Law and Taxation Publishers, 1984), p. 55

⁵⁵ *Ibid.*

⁵⁶ *Ibid.*, p. 19

The obligation undertaken by the conforming bank is provided by sub article 8 (a)(i); *“Provided that the stipulated documents are presented to the conforming bank or to any other nominated bank and that they constitute a complying presentation, the conforming bank must: honour, if the credit is available by negotiation with another nominated bank and that nominated bank does not negotiate”*.

In such cases, authorized banks which provide for negotiation should specify in the credit.⁵⁷ For instance, *‘restricted negotiable letters of credit’* or *‘freely negotiable letters of credit’* can be used for negotiable letters of credit.

7- The Contractual Relationship between the Parties to the Confirmed Documentary Credit

A confirmed irrevocable credit which is issued in favour of a beneficiary involves at least five different and separate contractual relationships, namely: (1) between buyer and seller (under the contract for the sale of goods); (2) between buyer and issuing bank; (3) between issuing bank and advising bank; (4) between issuing bank and seller; and (5) between advising bank and seller.⁵⁸

a- The contract between seller and buyer

The contract of sale is the first step of the international trade transaction. If there is a clause in the contract calling for payment by documentary credit, the buyer will be under obligation to pay by that method.⁵⁹ Sub article 4 (a) of the UCP 600 states that: *“A credit by its nature is a separate transaction from the sale or other contract on which it may be based.”*

⁵⁷ Coskun Yeni, Uluslararası Ticarete Odeme Yontemleri, (Istanbul: Alfa Basim Yayim Dagitim Ltd. Sti., 2005), p. 33

⁵⁸ Roy Goode, Commercial Law, (London: Penguin books, 2004), p. 978

⁵⁹ Alastair Mullis, The Documentary Credit Handouts for the Class ‘Payments and Finance in International Trade’, (2006/2007), p.41

Actually, there is a relationship between the documentary credit and the contract of sale in that documentary credit is born out of the contract of sale but after that it begins to be separate from its original source.⁶⁰ There is also an applicant/beneficiary relationship under the documentary credits as one of the results of their relationship as buyer and seller under the contract of sale.⁶¹

The opening of the documentary credit in favour of the seller (beneficiary) is an obligation to be undertaken by the buyer (applicant). First, the seller has to wait until buyer fulfilment of the obligation. If the contract of sale provides for an irrevocable credit, the seller is entitled to reject a revocable credit. Equally, if the documentary credit involves payment to be made in a specific currency, the opening of a credit providing for payment in a different currency is deficient.⁶²

(i) Time of opening credit

When the contract of sale states that the documentary credit must be opened by a certain date, the buyer must open the credit at that time.⁶³ Actually, the duty of the buyer is to open a documentary credit in a reasonable time before the beginning of the shipment period. *'Subject to any express provisions in the contract, the seller is entitled to have the letter of credit in his hands within a reasonable time, which, unless otherwise provided in the contract of sale, means no later than the earliest shipping date open to the seller under the contract, and probably a sufficient time before that date to enable him to make the necessary shipping arrangements'*.⁶⁴ If the buyer fulfilled his obligation, the seller will perform his delivery obligation.

⁶⁰ Frans P.De Rooy, *Documentary Credits*, (Netherlands: Kluwer Law and Taxation Publishers, 1984), p. 67

⁶¹ *Ibid.*

⁶² Mullis Alastair, *The Documentary Credit Handouts for the Class 'Payments and Finance in International Trade'*, (2006/2007), p. 42

⁶³ *Ibid.*, p. 49

⁶⁴ *Ian Stach Ltd. v Baker Bosley Ltd.* [1958] 2 QB 130 as cited in Goode Roy, *Commercial Law*, (London: Penguin books, 2004), p.980

(ii) Duration of credit:

According to sub article 6 (d)(i) of the UCP 600: “A credit must state an expiry date for presentation. An expiry date stated for honour or negotiation will be deemed to be an expiry date for presentation.” If the credit does not contain an expiry date, the seller will reject the credit.

(iii) Rejection of goods:

Regardless of whether the documents are accepted under a documentary credit or not, the buyer can reject the goods themselves if the goods do not conform to the contract of sale.⁶⁵

b- The contract between buyer and issuing bank

There is a banker and customer relationship between buyer and issuing bank. Under the documentary credit transaction, the terms of the contract are set out in the issuing bank’s standard application form, which is also incorporated by the UCP, and the buyer is required to fill in and sign the form.⁶⁶

In *United City Merchants (Investments) LTD v. Royal Bank of Canada [1983] 1 AC 168*, at 182 Lord Diplock defined the contract between issuing bank and applicant for the documentary credit as: “*the contract under which the issuing bank agrees to issue the credit and either itself or through a confirming bank to notify the credit to the seller and to make payments to or to the of the seller (or to pay, accept or negotiate bills of exchange drawn by the seller) against presentation of the stipulated documents; and the buyer agrees to reimburse the issuing bank for payments made under the credit. For such reimbursement the stipulated documents, if they include a document of title such as a bill of lading, constitute a security available to the issuing bank.*”⁶⁷

⁶⁵ Goode Roy, *Commercial Law*, (London: Penguin books, 2004), p.981

⁶⁶ Ibid.

⁶⁷ Mullis Alastair, *The Documentary Credit Handouts for the Class ‘Payments and Finance in International Trade’*, (2006/2007), p. 80

If the issuing bank agrees to issue the documentary credit, it must comply with the instructions which are given by the buyer/applicant in the application form. The issuing bank is liable to ensure that the documentary credit issued to the seller complies strictly with the instructions of the credit and that payment, acceptance or negotiation is effected on tender of documents which completely comply with the terms of the credit.⁶⁸

If payment is not made by the issuing bank and made by the advising bank or by some other bank authorized to negotiate under an open negotiation credit, the issuing bank will be liable for the errors and omissions of the bank due to its agent through article 37 of the UCP 600.⁶⁹

If the documentary credit is not honoured⁷⁰, the issuing bank is liable to indemnify the buyer against to the seller.⁷¹ Sub article 37 (d) of the UCP 600 provides that 'the applicant shall be bound by and liable to indemnify a bank against all obligations and responsibilities imposed by foreign laws and usages.'

The banks' other obligation under article 14 (a) of the UCP is that need only examine a presentation to determine, on the basis of the documents, whether or not the documents appear at face value to constitute a complying presentation. According to article 34 of the UCP 600, the bankers are responsible for the documents, whether they comply with the terms of the credit or not, and for the application form but they are not responsible for their sufficiency, genuineness or legal effect: '*A bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document, or for the general or particular conditions stipulated in a document or superimposed thereon; nor does it assume any liability or responsibility for the description, quantity weight, quality, condition, packing, delivery, value or existence of the goods, services or other performance represented by any other document, or for the good faith or acts*

⁶⁸ Goode Roy, Commercial Law, (London: Penguin books, 2004), p.981

⁶⁹ Ibid.

⁷⁰ UCP 600, Article 2

⁷¹ Goode Roy, Commercial Law, (London: Penguin books, 2004), p.982

*or omissions, solvency, performance or standing of the consignor, the carrier, the forwarder, the consignee or the insurer of the goods or any other person.*⁷²

When an issuing bank determines that a presentation of the documents by the seller is complying with the terms of the credit, it must honour the agreement.⁷³ If the issuing bank determines that a presentation does not comply with the terms of the credit, it may refuse to honour or negotiate⁷⁴ or it may in its sole judgement approach the applicant for a waiver of the discrepancies.⁷⁵

In light of article 16 of the UCP 600, as an alternative to rejecting the documents, the bank will waive the breach or accept the documents under reserve. There is no English case law at all on the acceptance of documents by the bank under reserve and thus no guide to the measure of damages.⁷⁶

The UCP includes some provisions which exempt the banks from liability for several matters beyond their control:

Article 35 of the UCP 600 Disclaimer on Transmission and Translation

“Banks assume no liability or responsibility for the consequences arising out of delay, lost in transit, mutilation or other errors arising in the transmission of any messages or delivery of letters or documents, when such messages, letters or documents are transmitted or sent according to the requirements stated in the credit...”

⁷² UCP 600, Article 34

⁷³ UCP 600, Article 15 (a)

⁷⁴ UCP 600, Article 16 (a)

⁷⁵ UCP 600, Article 16 (b)

⁷⁶ Goode Roy, Commercial Law, (London: Penguin books, 2004), p.983

Article 36 of the UCP 600 Force Majeure

“A bank assumes no liability or responsibility for the consequences arising out of the interruption of its business by Acts of God, riots, civil commotions, insurrections, wars, acts of terrorism, or by any strikes or lockouts or any other causes beyond its control...”

Article 37 of the UCP 600 Disclaimer for Acts of an Instructed Party

“a. A bank utilizing the services of another bank for the purpose of giving effect to the instructions of the applicant does so for the account and at the risk of the applicant.

b. An issuing bank or advising bank assumes no liability or responsibility should the instructions it transmits to another bank not be carried out, even it has taken the initiative in the choice of that other bank...”

Article 35 protects the bank from liability for consequences arising from delay, loss or mutilation of messages during the transmission of any messages or delivery of letters of documents. It also protects banks in respect of errors in translation or interpretation of technical terms and may transmit credit terms without translating them.

Article 36 protects the banks from liability for consequences arising out of several force majeure events. It does not protect the bank in respect of its own negligence as in article 35.⁷⁷

Under article 37, ‘an issuing bank that utilises the services of a correspondent bank does so at the buyer’s risk and account and assumes no liability if the instructions it transmits not be carried out even if the issuing bank has taken the initiative in choosing the correspondent’.⁷⁸

⁷⁷ Mullis Alastair, *The Documentary Credit Handouts for the Class ‘Payments and Finance in International Trade’*, (2006/2007), p. 92

⁷⁸ *Ibid.*

c- The contract between issuing bank and advising bank

Documentary credit to be issued by the issuing bank may directly to the seller, but generally it will arrange for notification by another bank, which is called the 'advising bank', in the seller's country.⁷⁹

The relationship between the issuing bank and the advising bank is like a principal and agent.⁸⁰ When the issuing bank is not concerned with the beneficiary directly, there is an agreement between the issuing bank and a correspondent bank (an advising bank, a negotiation bank or conforming bank) under which the advising bank undertakes to act with the instructions of the issuing bank and the issuing bank undertakes to reimburse or remunerate the advising bank for its services.⁸¹

d- The contract between issuing bank and seller

Under letter of credit transactions, the main function of the issuing bank is to undertake payment after the presentation of documents. Under the contractual relationship between the beneficiary and the issuing bank, the beneficiary provides the terms of the credit and the issuing bank guarantees the payment to the beneficiary.

Article 15 of the UCP 600 states that; "*When an issuing bank concludes a presentation as compliant, it must honour the agreement*". If the presentation does not comply with the credit, the issuing bank has different options open to it.⁸² First of all, it can take information from its customer to waive the discrepancies; after that it may reject or accept the documents or it may pay either under reserve or under indemnity to the seller.⁸³ A wider discussion of discrepant documents will feature in part three.

⁷⁹ Goode Roy, Commercial Law, (London: Penguin books, 2004), p.957

⁸⁰ Ibid., p. 984

⁸¹ The Issuing Bank's Duty under Letter of Credit Transaction, Web at <http://www.hllawyers.com/law-en-publications/law-en-publications-4.htm> accessed on 19 July 2007.

⁸² Goode Roy, Commercial Law, (London: Penguin books, 2004), p.985

⁸³ Ibid., p. 986

e- The contract between advising bank seller

When the advising bank does confirm the credit, there is a contractual relationship between the advising bank and the seller. If the advising bank adds its own confirmation to the credit, the credit is honoured by the advising bank.

This undertaking is given by the principal of the advising bank, not as agent for the issuing bank.⁸⁴

III- THE PROBLEM OF DISCREPANT DOCUMENTS AND THE BANK'S LIABILITY UNDER DISCREPANCY OF DOCUMENTS

When documents are presented to a bank for payment under a documentary credit transaction, the bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.⁸⁵ Article 13 of the UCP 500 contained an obligation which included the bank's duty to examine documents with reasonable care; the new UCP 600, however, does not expressly contain the phrase 'reasonable care'. Additionally, according to sub-article 14 (b) of the UCP 600, banks have only five banking days to accept or refuse documents. The five-day maximum period of examination of documents does not depend on any upcoming expiry date or latest date for presentation.

1- The Duty of the Bank in the Examination of Documents

The aim of the bank's examination of documents is to see whether the documents appear at face value to meet the requirements of the credit.⁸⁶

⁸⁴ Ibid.

⁸⁵ UCP 600, Article 14 (a) and according to article 2 of the UCP 600: complying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.

⁸⁶ Mullis Alastair, *The Documentary Credit Handouts for the Class 'Payments and Finance in International Trade'*, (2006/2007), p. 117

The duty of the bank in the examination of documents is provided in article 14 (a) of the UCP 600;

“banks must examine a presentation to determine, on the basis of the document alone, whether or not the documents appear on their face to constitute a complying presentation”.

According to article 2 of the UCP 600; “*Complying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.*”

In the Turkish Law of Obligations, banks must examine the documents as agents.⁸⁷

If the documents comply on their face with the terms of the credit, it must honour. Article 15 of the UCP 600 provided that;

“a. When an issuing bank determines that a presentation is complying, it must honour.

b. When a conforming bank determines that a presentation is complying, it must honour or negotiate and forward the documents to the issuing bank.

c. When a nominated bank determines that a presentation is complying and honours or negotiates, it must forward the documents to the confirming bank or issuing bank.”

In *Glencore International AG v Bank of China* [1996] 1 Lloyd’s Rep 135, at 148 Bingham MR interpreted the role of the banker in documentary credit transactions as follows:

⁸⁷ Turkish Law of Obligations, article 390, (BK. 390/1)

“The parties to these transactions (buyers, sellers, issuing and advising banks) are seasoned professionals, not inexperienced consumers. The banks are not required to familiarize themselves with any of the infinitely various terms, conventions or esoteric understandings of the sales transactions themselves: their role is limited to the demanding, but essentially clerical, task of scrutinizing the documents tendered under the credit to establish that they conform to the terms of the credit. Banks, rightly jealous of their reputation in the international marketplace, are generally careful not to refuse payment on grounds of nonconformity unless the non-conformity is clear. Practice is generally governed by the Uniform Customs and Practice for Documentary Credits (“the UCP”), a code of rules settled by experienced market professionals and kept under review to ensure that the law reflects the best practice and reasonable expectations of experienced market practitioners.

When Courts, here and abroad, are asked to rule on questions such as the present they seek to give effect to the international consequences underlying the UCP.”⁸⁸

In Turkish law, according to sales contract, the buyer must pay the purchase consideration and is liable to receive the goods.⁸⁹ When the sales contract includes payment method of documentary credit, the issuing bank (on behalf of the buyer) should examine the documents which were presented by the seller whether or not they comply with the terms of the credit and application form.⁹⁰

2- Frequency and Type of Discrepancies

There are various discrepancy situations existing in documentary credit transactions.

⁸⁸ Ibid., p. 119

⁸⁹ Turkish Law of Obligations, article 208 (BK.208)

⁹⁰ Erdogan Ihsan, Akreditif Sozlesmeleri, (Ankara: Nobel Yayin Dagitim, 2000), p. 78

In the United Kingdom, statistics on the failure rate of the presented documents are available⁹¹ from Midland Bank in conjunction with SITPRO.⁹² A report on the use of export letters of credit 2001/2002 shows that, due of discrepancies; approximately 50-60 % of documents tendered under documentary credit were rejected on first presentation.⁹³

At a rough estimate, every year the UK loses 113 million pounds through non-compliant documents being presented under letters of credit.⁹⁴ The first edition of the Midland Bank/SITPRO research includes 1,215 sets of documents tendered over a random three-week period in 1983.⁹⁵ The second edition of this research includes 1,143 presentations in 1986.⁹⁶

The failure rate of first presentations in 1983 was 49.0 percent and in 1986 51.4 percent; some documents, however, were accepted in the second presentation.⁹⁷

In 2003, when the ICC authorized the ICC Commission on Banking Technique and Practice (Banking Commission) to begin a revision of the UCP 500, the failure rate increased to 70 percent.⁹⁸ This failure rate included not only rejections due to discrepant documents, but also included rejections due to 'credit expired', 'late shipment' and 'late presentation'.⁹⁹

On the 11 April 2003, SITPRO's letter of credit report, which surveyed several banks, explained top ten discrepancies leading to rejection of documentary credits and the responsibilities of the parties. Table 2, shows the SITPRO's fundamental discrepancies below.

⁹¹ M.Schmitthoff, Clive, *Select Essay's on International Trade Law* edited by Chia-Jul Cheng. (London: Martinus Nijhoff Publishers & Graham/Trotman Ltd., 1998), p. 431

⁹² The Simplification of International Trade Procedures Board (SITPRO) is an independent organisation sponsored by the British Overseas Trade Board (B.O.T.B).

⁹³ SITPRO, *Report on the Use of Export Letters of Credit 2001/2002*, Web at <http://www.sitpro.org.uk/reports/lettcredr/lettcredr.pdf> accessed on 11 July 2007.

⁹⁴ *Ibid.*

⁹⁵ M.Schmitthoff, Clive, *Select Essay's on International Trade Law* edited by Chia-Jul Cheng. (London: Martinus Nijhoff Publishers & Graham/Trotman Ltd., 1998), p. 432

⁹⁶ *Ibid.*

⁹⁷ *Ibid.*

⁹⁸ Mullis Alastair, *The UCP 600 Rules Handouts for the Class 'Payments and Finance in International Trade'*, (2006/2007), p. 1

⁹⁹ M.Schmitthoff, Clive, *Select Essay's on International Trade Law* edited by Chia-Jul Cheng. (London: Martinus Nijhoff Publishers & Graham/Trotman Ltd., 1998), p. 432

Table 2. Top Ten Discrepancies Leading to Rejection of Documentary Credits and the Party with the Responsibility for the Error is given.¹⁰⁰

Discrepancy	Reason	Responsibility
Inconsistent data	Different information between the different documents.	Exporter
Absence of documents	Documents required by the letter of credit are missing	Exporter
Other	Other documentation reasons not specifically noted	Exporter; any third party e.g. PSI company, carrier
Late presentation	Documents presented later than 21 days after shipment or after the number of days stipulated in the letter of credit	Exporter
Carrier not named and signing capacity	The name of the carrier on the airway bill is missing or not signed on behalf of the carrier	The transport provider
Incorrect data	Information on the set of documents is not in conformity with the letter of credit	Exporter
Letter of credit expired	Documents presented after the letter of credit has expired	Exporter
Incorrect goods description	The goods description on the documents differs from that on the letter of credit	Exporter
Incorrect or absence of endorsement	The bills of lading, insurance certificate or bill of exchange not endorsed by the exporter or other party	Exporter or insurance company
Late Shipment	Goods shipped after the last date given for shipment	Exporter/carrier

Under letter of credit transactions, which have been described by English judges as 'the life blood of international commerce', a failure rate of about between 60-70 percent on first presentation of documents is alarming.¹⁰¹

¹⁰⁰ SITPRO, Report on the Use of Export Letters of Credit 2001/2002. Web at <http://www.sitpro.org.uk/reports/lettcredr/lettcredr.pdf> accessed on 11 July 2007.

¹⁰¹ M. Schmitthoff, Clive. Select Essay's on International Trade Law edited by Chia-Jul Cheng. (London: Martinus Nijhoff Publishers & Graham/Trotman Ltd., 1998), p. 432

The legal arrangement of discrepancy situations can be arranged into two groups; (a) irrelevant irregularities of documents and (b) genuine discrepancies of documents.¹⁰² However, these arrangements of discrepancies cannot be definite categorization for all discrepancy situations.

a- Irrelevant Irregularities of Documents

Irrelevant irregularities of documents can be sub-divided into three groups.

(i) Irregularities irrelevant under the UCP

First, the UCP include some provisions which sanction the acceptance of irregular documents and these provisions can be applied by the beneficiary, provided that the credit was issued subject to the UCP.¹⁰³ For example, a credit referred a shipment of 100 tons of iron but the beneficiary shipped only 97 tons and this is reflected in the bill of lading and the invoice. If the documentary credit does not specify that the quantity of goods must not be reduced, this deficiency is within the tolerance approved by sub-article 30 (b) of the UCP 600; "*A tolerance not to exceed 5% more or 5% less than the quantity of the goods is allowed, provided the credit does not state the quantity in terms of a stipulated number of packing units or individual items and the total amount of the drawings does not exceed the amount of the credit.*"¹⁰⁴

(ii) Irrelevant variations in the documents

Secondly, irregularities relevant to commercial invoices may cause problems.¹⁰⁵

¹⁰² Ibid., p. 433

¹⁰³ Ibid.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid., p. 434

While the bill of lading is commercially the most significant document in the sense that it enables the buyer to take delivery of the goods, the commercial invoice is the lead document from the bank's perspective in that it describes the goods in respect of which the presentation is made and states the price that is being claimed.¹⁰⁶ Sub-article 18 (c) of the UCP 600 stipulates that the description of the goods, services or performance in a commercial invoice must correspond with that appearing in the credit.

For instance, the credit may provide '20 cm pipe-cutting machinery' and the invoice relate to 'two 20 cm pipe-cutting machines.'¹⁰⁷ The bank may accept the invoice despite of the trivial discrepancy. On the other hand, if the credit states to 'two machines' but the invoice refers only 'machinery', the bank should reject the documents because 'machinery' may comprise one machine.¹⁰⁸

(iii) Irregularities irrelevant according to the court decisions

Thirdly, the documents or one of them are obviously irregular but the courts regard the irregularity to be irrelevant.¹⁰⁹ In *Golodetz & Co. Inc. v Czarnikow-Rionda Co. Inc. The Galatia* [1980] 1 W.L.R 495¹¹⁰, the contract was made for the sale of sugar c. and f. from Kandia in India to Iran. When the vessel was partly loaded, fire broke out on the ship and a large quantity of the sugar was damaged by the fire itself as well as the water. The damaged sugar was discharged and these events were recorded on the bill of lading.¹¹¹

The bank which had confirmed the credit refused to take up the bill of lading on the ground that it was not clean.

¹⁰⁶ Mullis Alastair, *The Documentary Credit Handouts for the Class 'Payments and Finance in International Trade'*, (2006/2007), p. 152

¹⁰⁷ M.Schmitthoff, Clive, *Select Essay's on International Trade Law* edited by Chia-Jul Cheng, (London: Martinus Nijhoff Publishers & Graham/Trotman Ltd., 1998), p. 434

¹⁰⁸ *Ibid.*

¹⁰⁹ *Ibid.*, p. 435

¹¹⁰ *Ibid.*

¹¹¹ Commercial Laws, Enforcement and Remedies, Web at <http://www.commerciallaws.org/frame/caselaw.html> accessed on 30 August 2007.

The Court of Appeal refused the appeal because this event had come into existence after the goods were loaded in good condition at the time of the shipment.

The Court preferred the legal view to the commercial view, according to which every bill, which includes a notation or clausung, is directly to be regarded as a claused bill.¹¹²

b- Genuine Discrepancies of Documents

If we classify the genuine discrepancies of documents, first discrepancies can be discrepant documents due to non-compliance with UCP provisions. Secondly, there can be the discrepancies due to absence of linkage between the documents to be treated. Thirdly, there can be cases of genuine discrepancies, which we will now examine.¹¹³

(i) Discrepancies relevant under the UCP

First, if the credit is subject to the UCP, the presented documents must satisfy the conditions deemed in this document.¹¹⁴ It is true that the many provisions of the UCP start with the phrase 'unless otherwise stipulated in the credit'. If this is not the case the bankers test the conformity of documents to the terms of the credit by direct reference to the articles of the UCP.¹¹⁵ For example, according to the sub-article 19 (a) of the UCP 600; "*A transport document covering at least two different modes of transport, however named, must appear to indicate the name of the carrier and be signed by the carrier or a named agent for or on behalf of the carrier, or the master or a named agent for or on behalf of the master.*" If the transport document fails to indicate the name of the carrier or is not signed by the carrier, the banker will reject the documents.

¹¹² M.Schmitthoff, Clive, Select Essay's on International Trade Law edited by Chia-Jul Cheng, (London: Martinus Nijhoff Publishers & Graham/Trotman Ltd., 1998), p. 436

¹¹³ Ibid., p. 437

¹¹⁴ Ibid.

¹¹⁵ Ibid.

(ii) Lack of linkage

Secondly, the documents in the presentation must be consistent with one another. If the documents are not properly linked together, there will be a genuine discrepancy.¹¹⁶ If there is an uncertainty between the documents, for example, one of them refers to goods other than those specified, the bank will reject the documents or accept them under a protective mechanism.

Sub-article 18 (c) of the UCP 600 states that *'the description of the goods, services or performance in a commercial invoice must correspond with that appearing in the credit.'*

In the case of *Banque de l'Indochine et de Suez S.A. v J.H. Rayner (Mincing Lane) Ltd.* [1983] Q.B. 711,¹¹⁷ the parties entered into a contract for the sale of sugar which was to be carried in a vessel named The Markhor. When the beneficiary presented the documents, the bank claimed that there were some discrepancies, one of them being: *'Certificates of weight, quality, packing and certificates for origin and E.U.R. 1 certificate can not be related to the remaining documents or to a letter of credit.'* This rejection was related to an absence of linkage between the documents in the credit. Finally, the bank had paid 'under reserve'.¹¹⁸ The second issue will be appeared later. Certificate of origin referred that the sugar was carried in vessel named 'm.v. Markhor or substitute' and it was another reason for the absence of linkage.

(iii) Other relevant discrepancies

Thirdly, there are other genuine discrepancies in tendered documents. In *Panchaud Freres S.A. v Etablissement General Grain Co.* [1970] 1 Lloyd's Rep.53,¹¹⁹ the credit provided for shipment in June/July.

¹¹⁶ Ibid., p. 438

¹¹⁷ Ibid.

¹¹⁸ Ibid.

¹¹⁹ Ibid. p.440

The advising bank was tendered with two conflicting documents. The bill of lading dated on 31st of July and a loading certificate referring to that loading took place between the 10th and 12th of August.¹²⁰

This case shows a genuine discrepancy between the stipulation of the credit and tendered documents. Finally, the bank should reject them.

Further, In *Bank Melli Iran v Barclays Bank DCO* [1951] 2 Lloyd's rep 367¹²¹ Bank Melli issued a documentary credit which was confirmed by Barclays Bank.

The credit was issued as evidence of the shipment of 100 new Chevrolet Trucks. The invoice presented provided '100 "one ton" Chevrolet trucks in new condition ex site at [Belcele] near Antwerp, Belgium....40,000 pound' and a government certificate referred to '100 new, good Chevolet M6 4 X 4 trucks from the USA under a contract with subject company.' The confirming bank accepted the documents, and paid the seller. McNair J held that both documents were defective and could be rejected.¹²²

In *Credit Agricole Indosuez London Brunch v Credit Suisse First Boston, Zurich* [2001] Lloyd's Rep Bank 218 Morison J explained that a provision in the credit stating that '*transport documents were "to be accepted as presented" did not override either an express provision in the credit as the time by which presentation had to be made, or, in the absence of such a stated period, the 21 day period*' (Article 43 of the UCP 500).¹²³ The judge held that '*the period of time for presentation was fundamental and if a bank could not be satisfied without further inquiry that the documents were tendered during the specified period, then the tender was a bad one and should be rejected.*'¹²⁴

¹²⁰ Ibid.

¹²¹ Mullis Alastair, *The Documentary Credit Handouts for the Class 'Payments and Finance in International Trade'*, (2006/2007), p. 125

¹²² Ibid.

¹²³ Ibid., p. 144

¹²⁴ Ibid.

Under English law, a bank is able to reject documents presented under documentary credit in reliance on the most trivial of discrepancies.¹²⁵ Furthermore, an English court has to consider whether it would be against the principle of good faith to allow the bank to rely on discrepancies to refuse payment under a documentary credit; in the above case, the judge was applying Swiss law.¹²⁶

3- Discrepant Documents, Waiver and Notice

As we have seen, according to article 14 of the UCP 600, banks must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.

Article 14 of the UCP 600 (article 13 of the UCP 500) concentrates on three aspects of duty for the banks; "(a) the basic duty to examine the documents on their face, (b) the time allowed to the banks to examine the documents and (c) linkage/consistency between the documents tendered."¹²⁷

The phrase "with reasonable care" which was used in the UCP 500, has been taken out.¹²⁸ However, I believe the bank is still under duty to examine the documents with reasonable care.

When the banks receive the documents from the presenter, they shall each have a maximum of five banking days following the days of presentation to determine if a presentation complies (Article 14 (b) of the UCP 600). If the presentation complies with the terms of the credit, the bank must pay (Article 15 of the UCP 600). However, if the banks determine that a presentation does not comply, it may refuse to pay or negotiate (Sub-article 16 (a) of the UCP 600).

¹²⁵ Ibid., p. 172

¹²⁶ Ibid.

¹²⁷ UCP 600, Booklet. Web at

http://www.reedsmith.com/db/documents/UCP600_Booklet_Complete.pdf accessed on 25 July 2007

¹²⁸ Ibid.

The procedure to be followed by the banks according to the discrepant documents, waiver and notice is mentioned in article 16 of the UCP 600:

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

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

c. When a nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank decides to refuse to honour or negotiate, it must give a single notice to that effect to the presenter.

The notice must state:

- i. that the bank is refusing to honour or negotiate; and*
- ii. each discrepancy in respect of which the bank refuses to honour or negotiate; and*
- iii. a) that the bank is holding the documents pending further instructions from the presenter or;*
b) that the issuing bank is holding the documents until it receives a waiver from the applicant and agrees to accept it, or receives further instructions from the presenter prior to agreeing to accept a waiver; or
c) that the bank is returning the documents; or
d) that the bank is acting in accordance with instructions previously received from the presenter.

d. The notice required in sub-article 16 (c) must be given by telecommunication or, if that is not possible, by other expeditious means no later than the close of the fifth banking day of presentation.

e. A nominated bank acting on its nomination, a conforming bank, if any, or the issuing bank may, after providing notice required by sub-article 16 (c) (iii) (a) or (b), return the documents to the presenter at any time.

f. If an issuing bank or a confirming bank fails to act in accordance with the provisions of this article, it shall be precluded from claiming that the documents do not constitute a complying presentation.

g. When an issuing bank refuses to honour or a confirming bank refuses to honour or negotiate and has given notice to that effect in accordance with this article, it shall then be entitled to claim a refund, with interest, of any reimbursement made.”

As we seen above, under the Article 16 of the UCP 600, if the bank determines that a presentation does not comply, it may approach the applicant for a waiver of discrepancies in five banking days or if the bank decides to reject the documents, it must give a single notice to the presenter and the notice laid down in Sub-article 16 (c) of the UCP 600.

Furthermore, the notice must be given by telecommunication or, if that is not possible, by other expeditious means.¹²⁹

In summary, the bank has a duty to check the documents on their face whether they comply with the terms and the conditions of the credit under article 14 of the UCP 600. After the examination of documents, if the bank determines that a presentation is complying, it must pay under the article 15 of the UCP 600. On the other hand, if the bank determines that the presentation does not comply with the terms of the credit, it may refuse to pay or ask the buyer to waive the discrepancies under article 16 of the UCP 600.

¹²⁹ UCP 600, Sub-article 16 (d).

Generally, buyers do waive and banks rely on the waiver of the buyer and sometimes accept discrepant documents under protective mechanisms such as 'payment under reserve' and 'payment against indemnity'.

4- Protective mechanisms under discrepant documents

The banks sometimes accept discrepant documents under reserve or against indemnity.

a- Payment under reserve

If the discrepant documents are not vital, the bank will pay the beneficiary under reserve.¹³⁰ Payment under reserve generally exists when there is a reliance relationship between the bank and the beneficiary.¹³¹ The meaning of reservation was considered in *Banque de l' Indochine et de Suez S.A. v J.H. Rayner (Mincing Lane) Ltd.* [1983] Q.B. 711. When the beneficiary tendered his documents to the Banque de l' Indochine, the bank found some discrepancies but paid the beneficiary under reserve. Afterwards, the documents were sent to the issuing bank, which refused them.

The Banque de l' Indochine then reclaimed from the beneficiary, who refused to repay.¹³² In the court of first instance, Parker J. decided that "if a payment had been made under reserve that payment could be reclaimed if *the payment was made under reserve because of the discrepancies alleged by the confirming bank and the issuing bank rejected the documents on the ground of at least one of these discrepancies and if the discrepancies in the documentation were a valid reason in law for rejecting documents.*"¹³³

¹³⁰ Frans P.De Rooy. *Documentary Credits*. (Netherlands: Kluwer Law and Taxation Publishers, 1984),

p. 151

¹³¹ *Ibid.* p. 155

¹³² *Ibid.* p. 152

¹³³ *Ibid.*

The Banque de l' Indochine appealed against this last argument and the court of appeal decided: "*The effect of the payment from the confirming bank to the sellers being made 'under reserve' was that the sellers were obliged to repay the money to the confirming bank on demand if the issuing bank rejected the tendered documents on its own initiative or on the buyers' instructions for the same reasons that the confirming bank had originally rejected them.*"¹³⁴

Kerr LJ. added to this explanation: "*The commercial reality of the situation is that, while holding opposing views, both the bank and the beneficiary hope that, whichever of them is right, the issuing bank and the buyer abroad will raise no objection to the documents. It is therefore with this hope uppermost in its mind that the confirming bank agrees to pay but only 'under reserve'.*"

Consequently, payment under reserve is one of the protective mechanisms for the banks which the beneficiary would bind the repay the money on demand if the issuing bank rejected the documents on its own initiative or on the buyers instructions.

b- Payment against indemnity

If the intermediary bank does not know the beneficiary or the amount of the credit is very large, the bank will prefer to pay the beneficiary only against the signed indemnity.¹³⁵ The indemnity should note the discrepancies and under which conditions the beneficiary agrees to repay if the documents are rejected because of the indicated discrepancies.

IV- CONCLUSION

Documentary credit is a vital point of international trade transactions. Every day, a great many firms enter into sale contracts with one other and agree on payment method by documentary credit.

¹³⁴ Ibid.

¹³⁵ Ibid., p. 155

Documentary credit has universal uniform rules through the ICC's "Uniform Customs and Practice for Documentary Credits ('UCP')", which still remain the most successful set of private rules for international trade thus far.

One of the most important problems of documentary credit transaction is the discrepant documents presented to the banks and the banks liability against the payment or rejection. As mentioned above, under letter of credit transactions, which have been described by English judges as 'the life blood of international commerce', a failure rate of about between 60-70 percent on first presentation of documents under documentary credit is alarming. However, the method of documentary credit is still very popular in international trade.

Banks have different alternatives when they find discrepant documents, such as approaching the applicant for a waiver of discrepancies or accepting the discrepant documents under reserve or against indemnity. In asking why banks reject discrepant documents, one can answer with the simple truism that banks wish to avoid personal liability.¹³⁶

Turkish local courts and court of appeal generally apply UCP in documentary credit transactions because Turkish laws do not include specific provisions on documentary credits and dominated by the UCP. Equally, the courts in the United Kingdom also respect the international standards of documentary credit transactions.¹³⁷ The principle of strict compliance is acknowledged by the English courts. In *English Scottish and Australian Bank v Bank of South Africa* (1922) 13 LL L R 21, Baillache J stated:

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

¹³⁶ M.Schmitthoff, Clive, *Select Essay's on International Trade Law* edited by Chia-Jul Cheng, (London: Martinus Nijhoff Publishers & Graham/Trotman Ltd., 1998), p. 447

¹³⁷ Rolf A.Schutze, Gabriele Fontane, *Documentary Credit Law throughout the world*, (Paris: ICC Publication, 2001), p. 119

the accompanying documents are in accord with the credit as opened."¹³⁸

Finally, when the banks received discrepant documents, they generally seek for waiver from the buyer. The main reason for doing this is because of the documentary credits are an instrument of 'payment' and the buyer need shipping at the earliest possible date.

¹³⁸ Mullis Alastair, *The Documentary Credit Handouts for the Class 'Payments and Finance in International Trade'*, (2006/2007), p. 127

