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BASICS OF DOCUMENTARY CREDIT AS A TOOL FOR PAYMENT UNDERTAKINGS IN INTERNATIONAL TRADE

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ABSTRACT

This dissertation was written as part of the LLM in Transnational and European Commercial Law, Banking Law, Arbitration/Mediation at the International Hellenic University.

SUMMARY

Documentary credit has historical importance. It has a popular and universal acceptable method of payment in international trading transactions. Numerous uniform international practices have been established and codified for their use. Such uniform international practices are the Uniform Customs and Practices for Documentary Credits. With the advent of technology, “documentary nature of these credits may require certain reversion.

In a nutshell, documentary credit plays a pivotal role in financing international trade and as a result have been described as “the life blood of international commerce”¹, referred to as the quintessential international instruments”².

This paper examines the historically notion of documentary credit, sources of laws and its application. It also entails rights and obligations of parties dealing with documentary credit in transnational commerce, key principles of credit as well as types of credits which can be used during transactional commerce.

Finally, it examines ‘the fraud exception’ rule and how different countries treat this rule according to their different legal systems.

¹ R.D. Harbottle (Mercantile) Ltd v National Westminster Bank Ltd (1978) Q.B. 146 at 155

² Report of the Task Force on the Study of U.C.C. Article 5, An Examination of U.C.C. Article 5 (Letter of Credit), presented to the Letter of Credit Subcommittee of the Uniform Commercial Code Committee of the American Bar Association’s Business Law Section and the U.S Council on International Banking, Inc., reprinted in (1990) 45 Bus.

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(1989)2 Lloyd's Rep 323,330 (Hirst J)

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(1985)1 NSWLR 545, at 550 to 554

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Bank Ltd (1985)2 Lloyds Rep. 554 at 560

APPLICABLE LAWS

ICC DOCDEX Rules

ICC Uniform Customs and Practice for Documentary Credits (2007 revision) (UCP 500)

ICC Uniform Customs and Practice for Documentary Credits (2007 revision) (UCP 600)

ICC Uniform Customs and Practice for Documentary Credits- Electronic Supplement for UCP 600-eUCP

ICC Uniform Customs and Practice for Documentary Credits- Electronic Presentation for UCP 500-eUCP

ICC International Standard Banking Practice (ISBP) for examination of documents under Documentary Credits (ICC publication No 681, 2007)

ICC Uniform Rules for Contract Bonds 1993 (URCB)

National Law

The United Nations Convention on Independent Guarantees

Uniform rules for Demand Guarantee 2010 (URDG 758)

UNICITRAL Model Law on International Credit Transfers, 1992

BASICS OF DOCUMENTARY CREDIT AS A TOOL FOR PAYMENT UNDERTAKINGS IN INTERNATIONAL TRADE

INTRODUCTION

In international commercial transaction, it is essential that the fundamental backbone of successful business commerce is the establishment of efficient risk management. The rationale is that both the seller and the buyer may face certain risks in instances where goods were transported from one country to another reaching frontiers and deliveries. In this case, payment and delivery are separated in time and space.

Some of the risks could be on the side of the seller; he or she may face risk in situations where there are changes on financial status of the buyer after shipment of goods has already been done. This could result to delay in receiving purchase prices or to some extent non-payment. Another risk for the buyer could be, where payment has already been made to the seller upon shipment without finding out whether the goods carries significant risks or not.

Following these significant potential risks of non-delivery, non-payment as well as the difficult factors arising from disparities concerning currencies, legislations, market structure, business culture, risks may be generated as a result of these disparities such as problems of foreign exchange, insolvency, legal and country risks. Thus, merchants came up with a mechanism and established the use of documentary credit otherwise called 'Letters of Credit' which is the most widely used mechanism to reconcile the various economic interests of parties, by eliminating or reducing these risks.

Documentary credit in simple parlance is a way of compliance in which a party concern is obliged to pay the agreed price within the framework of a contract. It is a payment instrument well adapted to the features of

the international commerce since it is capable to overcome the difficulties arising from the international context.³

With the use of documentary credit by the seller and the buyer, it means both the seller and the buyer have agreed on a defined payment terms in which a third trustworthy party which is usually a bank is involve in their relationship. The summary procedure is upon request by the buyer to the bank which is the issuing bank to open a letter of credit in favour of the seller, the bank acts upon the request. The bank undertakes a primary and independent obligation to effect payment to the seller upon fulfillment of certain conditions such as compliance to the specified documents stated on the tendered letter of credit.

This transaction may also involve services of other banks as agents of the Issuing Bank or advising documentary credit to the seller or undertakes a separate obligation to pay the seller. These other banks as agents are the Advising Bank and the Confirming Bank.

³R. de las Heras Ballell Teresa, *Associate Professor of Commercial Law, Universidad Carlos III de Madrid*
2017-2018 Chair of Excellence, CLC, Harris Manchester College Oxford University, "Lectures on Basics of Documentary Credits according to UCP600", *Transnational Commercial Law II*. International Hellenic University, Thessaloniki. 16 &17 March 2019.

CHAPTER 1

BASICS OF DOCUMENTARY CREDIT

A) DEFINITION OF DOCUMENTARY CREDIT

The definition of documentary credit according to the UCP 600 Article 2 states:

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

“Honour” means:

- a. To pay a sight if the credit is available by sight payment
- b. To incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment
- c. To accept a bill of exchange (‘draft’) drawn by the beneficiary and pay at maturity if the credit is available by acceptance”.

The term UCP means the Uniform Customs and Practice promulgated by the International Chamber of Commerce. It is usually called the ICC Uniform Customs and Practice for Documentary Credits. They are set of rules used to facilitate the flow of international trade when protectionism and nationalism posed serious threats to the world trading system. UCP600 is the sixth revision of rules since its establishment in 1993.

Documentary credit is interchangeably known as Letters of Credit or Banker’s documentary credit. It is one of the oldest and accepted legal instruments used for financing international trade⁴. As a matter of fact, this instrument is widely appreciated which resulted to be considered as the *“Life Blood of Commerce”*⁵.

⁴ A. Hamed, Documentary Letters of Credit, Legal Nature and Sources of Law, Journal of Legal Studies, Vol. 17 issue 31/2016, p. 106-121

⁵ RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd (1978) QB 146, 155 (Kerr LJ); Power Curber International Ltd v National Bank of Kuwait SAK (1981); Lloyd’s Rep394,400 (Griffiths LJ); Hong Kong and Shanghai Banking Corporation v Kloecker & Co AG (1989)2 Lloyd’s Rep 323,330 (Hirst J).

B. HISTORY OF DOCUMENTARY CREDIT

Documentary credit is said to be originated from the French word 'Accreditif', which means the power of doing something.

The word 'Accreditif' comes from a Latin word 'Accreditiwus' which has to do with the notion of trust⁶.

In practice, the usages of documentary credit in international trade could be dated back to the old Egypt and Babylonian banking system. In reliance of some excavations in Babylon provides from 3000 B.C, promissory notes established the promise of payment of the same amount of monies plus interest rate at a specified date. In ancient Greece, banks draw documentary credit to their correspondents as a way of obviating spices transportations in return for payment of accounts⁷. As fear of lack of security in carrying gold and precious items by merchants during their business trips in the middle age's era, they use documentary credits as a means of solving key problems. Another problem is the lack of common trade currencies having the same standard abroad⁸.

Because of the risk of carrying cash when travelling, merchants used cash in exchange for documentary credit at their bank with the ability to cash such monies in another bank at a specified place⁹. Medici Bank used documentary credit during the late 1300s in Italy and Bruges as De Roover puts it¹⁰. Later England became famous and was termed as the outstanding financial center because of the growth of international trade. The British Banking system also became the monopoly in the issuance of documentary credits which orchestrated the use of pound sterling currency in international trade.

Professor Roy Goode defines documentary credit as:

⁶ Garcia RLF 'Autonomy principle of the letter of credit' (2009) Mexican Law Review 72 (Hereafter Garcia RLF (2009))

⁷ Trimble RF 'The Law Merchant and the Letter of Credit', (1948) 61 Harvard Law Review, 1982-86

⁸ Toth. Z, 'Documentary Credits in the International Commercial Transaction with special Focus on Fraud Rule' (2006), 1, Doctoral Dissertation.

⁹ Koudriachov.SA, (2001), *Application of the Letter of Credit Form of Payment in the International Business Transactions*. 10 *Current International Trade Law Journal*. 37

¹⁰ De Roover. R, *Money, Banking and Credit in Medieval Bruges*, 2 *Journal of Economic History* (Suppl.Issue), 1942, p.52

“A money promise which is independent of the transaction that gives it birth and which is considered binding when received by the beneficiary without acceptance, consideration, reliance, or execution of solemn form”¹¹.

The latest version of Uniform Customs and Practices for documentary credit (UCP 600) defines Letters of Credit as:

“An arrangement however named or described, that is irrevocable and thereby constitutes and definite undertaking of the issuing bank to honor the complying presentation that is in accordance with terms and conditions of the credit, the applicable provisions of this rule and international standard banking practice”¹².

In article 2 of UCP 600, *Complying presentations* means, a presentation that is in accordance with terms and conditions of the credit, the applicable provisions of this rule and international standard banking practice.

Kudriachov describes Letters of Credit as:

“One-way abstract transaction, in which the emitting bank cannot reject the execution of its obligation by referring to non-execution of obligations by other parties to the transaction”¹³.

Documentary credit entails a written instrument which is addressed by one party usually the account party to another party requesting that the letter of credit be given to the person in whose favor it is addressed to (the beneficiary) by a bank or a financial institution¹⁴. The long mercantile history of documentary credit involves the utilizing of credit arrangements practically which dated back to the second half of the 19th Century. One of the first lawsuits on documentary credit review is the case of *Rose v Von Mierop and Hopkins (12)*¹⁵.

¹¹ Goode.R, ‘Abstract Payment Undertakings’ in Peter Cane and Jane Stapleton (eds), *Essays for Patrick Atiyah* (OUP 1991).

¹² Article 2, UCP 600

¹³ Supra note 8

¹⁴ J. D. Lipton, *Documentary Credit Law and Practice in the Global Information Age*, *Fordham International Law Journal*, Vol.22 issue 5/1998, Article 3, p. 1972, Langerich R. ‘Documentary Credits in Practice’, (2000) p. 105 -106

¹⁵ Mc Curdy. W, ‘Commercial Letters of Credit’ (1992), *Harvard Law Review*, 53

For the purpose of understanding certain terminologies, the UCP 600 according to Article 2 has defined:

“Advising bank- means the bank that advises about the credit at the request of the issuing bank.

Beneficiary means the party in whose favor a credit is issued.

Confirming bank means the bank that adds its confirmation to a credit upon the issuing bank’s authorization or request.

Issuing bank means the bank that issues a credit at the request of an applicant or on its own behalf”.

C. VARIOUS INTERESTS IN INTERNATIONAL TRADE

The balancing of bank payment undertakings in international trade has at least three sets of interests; that is the Beneficiary’s interest, the Applicant’s interest and the Issuing bank’s interest. The beneficiary needs to be assured in advance that payment will be done or upon condition that the benefit of payment undertaking is entirely on the presentation of documents which is independent of the established transaction.

The second set of interests is that of the applicant. That is the party at whose request the demand guarantee or interest is issued. In this case the applicant normally wishes to be ensured that only payment is made against a defined or specified document believed to have met the requirement of bank guarantee or credit, failure to which the applicant may refuse to pay for the documents. In any situation of demand guarantee, he needs to be accorded with at least some safeguards in the event there is abusive call on the guarantee. Primarily, demand guarantee is used for the assurance of non-monetary performance. One of the main differences between documentary credit from demand guarantee is that, in demand guarantee there is reduction of loss incurred if the transaction does not go to plan, while documentary credit ensures that a transaction continues. Distinctions between documentary credit and demand guarantee are further highlighted in chapter 5.

The issuing bank has another set of interests. The bank also has its own interest to protect. Its primary responsibility is to ensure that the

beneficiary stipulates the form of payment it will accept. The rationale is to ensure that the bank is not exposing to excessive risk. In this case, three basic conditions should be met to protect the bank: The first condition is that there must be certainty of duration; secondly, commencement and finally the amount or maximum amount of the bank's liability¹⁶. These conditions must be in the terms and conditions of the credit. The issuing bank does not want to be concerned with external transactions since banks deal with documents only and not in services or goods.

In addition, the principle is that the engagement which is established by the issue of documentary credit is independent to the transaction. Bank is not able to make sure that the genuineness of document and signatures in which it must be given the right to pay against document after reasonable evaluation as to the genuineness of such documents to be in conformity with the credit.

1. DOCUMENTARY CREDITS: THE CONTRACT OF SALE AS THE CENTRAL CONTRACT

Typically, the contract of sale determines the payment method, the type of credit to be issued which would include negotiation or acceptance, payment, confirmed or unconfirmed. The seller or beneficiary may reject a credit issued which is not in conformity with the contract. The bank, in which the buyer has instructed for the issuance of the credit, must follow the requirements stipulated in the contract of sale agreed between the seller and the buyer, and there has to be correspondence of the resulting credit to the buyer's instructions as he is the applicant for the credit¹⁷.

2. THE ROLE OF BANKS IN INTERNATIONAL TRADE FINANCE

Traditionally, banks play significant role in international trade transactions. A typical example would be where the seller is in one

¹⁶ G. Roy, K. Herbert, and M. Ewan, *Transnational Commercial Law: The different interests*, Oxford University Press, 2015, p. 323

¹⁷ G. Roy, K. Herbert, and M. Ewan., *Transnational Commercial Law: International Bank Payment Undertakings, Documentary Credit: the contract of sale as the central contract*, Oxford University Press, 2015, p. 329

country and the buyer in another country, and goods are ordered by the buyer from the seller where in such instances both parties do not enjoy cordial business relationship, and each party wishes to ensure that the commitment of another is clearly stipulated by an undertaking from a third party which is the bank's role.

Theoretically, parties could also choose to agree that the buyer pays on the spot and shall collect the goods from the seller's place of business or his warehouse in transactions involving the international sale of goods using sea transit.

However, in practice it is rare seeing such agreements. From a general point of view, there are possibilities for the buyer to allow the seller to arrange shipment of goods but there must be an assurance of payment from the buyer. Now to make things easier and trust-built, arrangement of exchange of payment instrument against documents through the banking system is one of the effective ways used in international trade transaction. This creates assurance that the buyer will actually pay the seller upon receiving the demanded goods as stipulated in the contract of sale.

A typical example for parties to have some forms of protection is where the seller is in Spain and the buyer is in the Gambia, the seller's bank in Spain could arrange with its correspondent bank in the Gambia and hand over the necessary documents such as the bill of lading and other shipment documents to the bank in the Gambia in return for payment by delivery against payment (D/P) called sight draft, or delivery against acceptance (D/A). However, it could be noted that for the seller, this form of protection is not complete because he would have done acquiring goods or manufacturing expenses and shipping them to the Gambia already. In this regard, if the bill is not honored, he will incur losses and expenses of finding another customer to sell.

Thus, for the seller to have full protection, the seller of goods needs assurance *ab initio* of the commencement of performance that the buyer will pay. In this situation, documentary credit has a role to play- an undertaking by a bank to the buyer that at a certain stage after all necessary documents (such as shipment documents) have been delivered to the buyer; he will execute payment, accept a draft bill of exchange or purchase a draft. The seller can proceed to execute the

order once the buyer receives these documents. The issuing bank will reinforce the payment undertakings.

In situations where the issuing bank is not known to the seller and want to know the financial status, the seller may stipulate for a confirmed credit in which the issuing bank's undertaking is reinforced by the confirming bank usually independent and located in the seller's country. The first port of call for payment is the issuing or confirming bank¹⁸. The seller (beneficiary) cannot seek direct payment from the buyer unless there is failure from the bank to honor the credit. As for demand guarantee which is in contrast with documentary credit- is another assurance given in favor of the recipient of goods and services. Example where the government in Greece proposes a contract to build a rail way which should be carried out by a German company, the Greek government would want to be protected in the event the German company fails to execute its contractual obligation as in accordance with the contract. This can be done by an undertaking by a bank that writes demand and on the presentation of any specified document, pay a maximum sum to the beneficiary.

For documentary credit, the bank that issues a demand guarantee is to ensure the safeguards against the default from the contractor. The demand guarantees maybe directly issued by a bank in the country of the beneficiary against a counterindemnity from the bank of the contractor. Thus, the supplier by a documentary credit and the employer by a demand guarantee is a way put in place to protect both parties.

In the critical analysis of the role of banks in financing international trade, one must be able to spell out clearly parties to a documentary credit.

Firstly, as briefly stated earlier, the beneficiary, the issuer and the customer are the parties to the credit. Example the seller and the buyer had entered a contract for the sale of goods with an agreed term whereby the buyer is to establish a documentary credit with a bank in the amount which commensurate with the purchase prices. We should

¹⁸G. Roy, K. Herbert, and M. Ewan, *Transnational Commercial Law: International Bank Payment Undertakings, The role of banks in financing international trade*, Oxford University Press, 2015, p. 321-323

note that in this transaction, the beneficiary is referred to as the seller, the buyer is the customer, and the issuer is the bank. The letter of credit itself establishes the obligation between the buyer and the seller¹⁹ which is governed by the Uniform Commercial Code (U.C.C), and the Uniform Customs and Practice for documentary credits. As a matter of jurisdiction, such contracts are governed by the substantive law of the jurisdiction where it applies. It has independent rights and obligation created by the letters of credits.

However, by the establishment of a documentary credit, it is not in itself a contract since by statute consideration is not required²⁰. The agreement between the customer and the beneficiary purely focus on upon the customer's reimbursement of the fund extended by the issuer. Intermediaries in documentary credit may include the Confirming, Advising, Paying and Negotiating banks. However, only a Confirming bank is obliged to the beneficiary because its responsibility is to honor the letters of credit issued by another bank as if it were an issuer²¹. An Advising bank is responsible for notifying the beneficiary of the issuance of the letter of credit²², while a negotiating bank purchases as discount drafts from the beneficiary and present it to the issuer²³.

3. BANKING PRACTICE RULES AND THE INTERNATIONAL CHAMBER OF COMMERCE ON THE UNIFORM CUSTOM AND PRACTICES (UCP)

International bank payment obligations are governed by uniform rules of banking practice published by bodies like the International Chamber of Commerce. These rules are given effect by contractual incorporation into all aspects of contracts entered by banks with beneficiaries and customers of payment undertakings. As explained above, the Uniform Custom and Practices for Documentary Credits (2007 revision), which is

¹⁹ International Chamber of Commerce, Uniform Customs and Practice for Documentary Credit (rev. ed. 1983)

²⁰ C. Leon, 'Letters of Credit: A Primer, *Parties to a letter of Credit*, Maryland Law Review Vol. 45 issue 2, pp. 433 - 438

²¹ *Lustrelon, Inc. v. Prutscher*, 178 N.J Super.128,139,428 A.2d 518, 524 (1981)

²² Cf. *D.C.O v Mercantile Nat'l Bank*, 481 F.2d 1224, 1226 (5th Cir.1973), *cert dismissed*, 414 U.S. 1139 (1974) (*Bank can confirm letter of credit issued by non-bank*)

²³ MD. COM. LAW CODE ANN. PP. 5- 114(2) (a) (1975).

known in the industries as UCP 600; the supplement covering electronic presentation eUCP version; the Uniform rules for Demand guarantees (URDG 458) which was revised 2010 (URDG 758); International standby practices (ISP98) which was published in 1998 by the Institute of International Banking Law & practice; ICC'S 1993 Uniform Rules for Contract Bonds (UCB) dealing with suretyship bonds. The ICC published rules for Uniform Rules for Bank Payment Obligations. These rules will not be discussed in detail. The ICC has not only firm directions, which has legal rights and obligations when incorporated into contracts. Banks are urged to follow these practices, but they are not obliged to follow such rules. Chapter 2 has further analysis of the UCP.

CHAPTER 2

SOURCES OF DOCUMENTARY CREDIT LAW

A) The Uniform Custom Practices (UCP600) and Uniform Commercial Code (UCC) published by the International Chamber of Commerce

Primarily, documentary credits are governed by the Uniform Custom Practices (UCP600) as soft law which only applies to the agreed parties. Another applicable law for documentary credit is the Uniform Commercial Code (UCC). It should be noted that each state adopts its own version of the UCC for national documentary credit and not all credits.

The two sources of law are complimentary to each other as in the case of the UCC embodies trade usage and customs, case law in general. Section 5 of the Uniform Commercial Code regulates in instances where documentary credit is issued by a bank and it needs documentary draft or demand for payment, or if such letter of credit is issued by someone other than the bank which requires such letter to be accompanied by a title. The scope of application of the UCC is that, it applies to contract of sale of goods and what constitutes acceptance, revocation of acceptance by a buyer. It defines his or her obligations. Its scope of application also includes when and why the seller should cure delivery. The UCP includes the model statute of frauds as well as warranties and remedies for the seller in instances the buyer breach the contract²⁴. This dissertation does not contain all the rules and concepts of letters of credit. Significant number of sections and subsections has a phrase '*unless otherwise agreed*'. Meaning parties can draft a documentary credit to suit a circumstance of the transaction they are in²⁵. Essentially, the aim of documentary credit is to reflect the parties' needs and to protect the interest of the issuer²⁶.

Most international letters of credit and numerous domestic credits by their terms and conditions are subjected to the Uniform Customs and Practices (UCP600). The International Chamber of Commerce,

²⁴ Article 2 Uniform Commercial Code

²⁵ Article 5 U.C.C: *An exercise in Freedom of Contract*, 11 ST Louis U.L.J. 16 (1967)

²⁶ See Del Duca, *Pitfalls of "Boiler Plating" Letters of Credit*, 13 U.C.C. L.J. 3 (1980-81).

Commission on Banking Technique and Practice to promote international trade by creating uniform standard practices, drafted the UCP600²⁷. Courts find it useful especially on the aspect of interpretation of letters of credit. It Compliments article 5 of the UCC.

B) The eUCP, UCP600 and International Standby Practices (ISP98)

The eUCP is known as the electronic Uniform Custom Practices. There are many stages in which trade payment systems and finance have gone through during the past hundred years. Documentary credit has been issued electronically since the emergence of cables and telegram. Numerous amendments occurred during the past twenty-five years with the introduction of computerized systems, customer initiation of documentary credit issuance. In May 2000, the eUCP started when ICC Banking Commission came up with the establishment of working group with the aim of transforming from paper to electronic letters of credit. This became successful and was approved in 2001 at ICC Banking Commission meeting held in Frankfurt in Germany and became effective in 2002.

The principle in which the eUCP lies on is in the UCP and standard practice used in e-commerce transactions. The eUCP in its interpretation is read in conjunction with the UCP500 and has regard to the standard international letters of credit practices. The eUCP has a reflect evolving practices and norms of banks that has developed from the use of telefax, SWIFT and telex. Article 3 of eUCP has definitive tools used for understanding the use of eUCP. The eUCP can be used with credits subject to UCP500 as stated under article 1 (Application of UCP) which shall apply to documentary credits and to some extent, applies to Standby Letters of Credit²⁸.

The UCP600 is expressed to govern most of the international trade transactions unless in the contract there is an indication as otherwise. Express contractual incorporation gives effect to these instruments as a

²⁷ The U.C.P was adopted in 1933 in Vienna at the Seventh Congress of International Chamber of Commerce. It has been revised four times.

²⁸ D. Meynell, ICC Commentary on eUCP version 2.0, eURC version 1.0, Article- by Article Analysis: *The eUCP and Letter of Credit Law*, p. 6-7

method²⁹. The UCP applies automatically without express incorporation under article e1 (b) where the eUCP has been adopted.

Two instruments can be applicable too as stated under article e2 (a). That is, one is using international trade usage and the other a consistent course of dealing³⁰. Like the UCP and the URDG, the International Standby Practices (ISP98), has concepts of irrevocability, independence of the credit from the defined transaction and the characteristics of the document³¹. Also, the ISP98 has provided for electronic presentation where it is allowed³². Nomination of a person to advise, effect a transfer, confirm etc., transfer of drawing rights is embodied in the ISP98³³.

C) The United Nations Convention on Independent Guarantees and Standby letters of Credit, UNICTRAL Model Law on International Credit Transfers, 1992

The UNICTRAL came up with a project leading to the creation of the UN Convention on Independent Guarantees and Standby letters of Credit which was ideally to harmonize the law governing cross-border independent guarantees and standby letters of credit. In this case, in order to enforce this convention, there must be an established connection to a contracting state. This convention is also applicable to the international letters of credit³⁴. The convention serves as gap filler in situations where the URDG do not apply. The rights of parties are been reinforce by article 19. The UNICTRAL Model Law applies to credit transfers where the receiving bank and sending bank are in different states³⁵. Differences between these concepts from Documentary credit are highlighted in chapter 5.

²⁹ Article 1UCP 600

³⁰ G. Roy, K. Herbert, and M. Ewan, *Transnational Commercial Law: International Bank Payment Undertakings, Documentary Credits: the UCP and the eUCP*, Oxford University Press, 2015, p. 329-330

³¹ R 1.06 and 1.07. As under the UCP, there could be disregard for non-documentary terms and conditions (r4.11)

³² R3.06(d), 1.09.

³³ R6

³⁴ Art 1(2)

³⁵ Article 1 (1) UNICTRAL Model Law on International Credit Transfers, 1992

D) ICC Uniform Rules for contract bonds

The ICC Uniform Rules for Contract Bonds (URCB)³⁶ has traditionally suretyship bond. Meaning the liability, the guarantor's liability is an accessory liability, and is dependent of the previous breach of one of his obligations by the contractor. The URCB are set of contract terms with rules which depend for their use upon the operation of the market. This rule is issued by Insurance companies and not banks, and such rules can be incorporated into any contract where parties choose so³⁷. The URCB is the same with documentary credit because its intention is to give the assurance that the obligations set out in the contract is executed or where there is default, the beneficiary would recover any sum from the principal's failure to perform his or her obligation³⁸.

E) NATIONAL LAW

Except the United States of America; there are few countries enjoying the national statutory provisions on documentary credit such as Greece which was the first country to adopt such law in 1993. The other European country which regulates documentary credit operation under article 1530 of its Civil Code by defining rights of account party and beneficiary is Italy. Bolivia, Colombia, Guatemala, Honduras, El-Salvador and Mexico also have their own national statute for regulating the operations of documentary credit. Lebanese Law and Kuwaiti Law influenced countries such as Qatar and Syria which regulated the operations of documentary credit under article 313 of its Commercial Code. Iraq and Bahrain adopted Kuwait law which is termed as the most comprehensive and modern statutory law of Documentary³⁹.

³⁶ ICC Publication No 524 (E)

³⁷ G. Roy, K. Herbert, and M. Ewan, *Transnational Commercial Law: International Bank payment undertakings, ICC Uniform Rules for Contract Bonds*, Oxford University Press, 2015, p.350

³⁸ http://www.uncitral.org/pdf/english/texts_endorsed/URCB_e.pdf

³⁹ A. Hamed, *Documentary Letters of Credit, Legal Nature and Sources of Law*, *Journal of Legal Studies*, Vol. 17 issue 31/2016, p. 115-116

CHAPTER 3

KEY PRINCIPLES OF DOCUMENTARY CREDIT

A) AUTONOMY OF THE CREDIT

There are fundamental principles of documentary credit in which the Uniform Customs and Practices has incorporated and among them is autonomy of the credit.

This principle was developed to reinforce the underlying importance of documentary credit. It has the concept that where a contract is been concluded under a letter of credit, its operation is completely independent of one another⁴⁰. Documentary credit has a complex contractual obligation⁴¹. It has the basic structure of three (3) different commitments- That is: (1) a contract between the beneficiary and the applicant (the underlying transaction), (2) a contract between the applicant and the issuing bank and the duty of the issuing bank to open credit for an amount which will be reimbursed by the applicant, (3) the undertaking of the issuing bank towards the beneficiary. As academics argue that the complexity of understanding documentary credit lies in the relationship between an underlying contract and the operation of the Credit⁴².

The bank cannot withhold payment of a credit in instances where there is no fraud and the beneficiary's breach of a defined transaction. The use of documentary credit is between various parties and conditions for payment obligation is fulfilled when relevant documents are in

⁴⁰G. Roy, K. Herbert, and M. Ewan, *Transnational Commercial Law: International Bank payment undertakings, Autonomy of the Credit*, Oxford University Press, 2015, p.331

⁴¹ Serguei A. Koudriachov, *The application of the Letter of Credit Form of payment in International Business Transactions*, 10 INTERNATIONAL TRADE LAW JOURNAL 41 (2000).

⁴² Serguei A. Koudriachov, *supra* note 29, at 48

conformity with the terms and conditions stated and are tendered within the time frame of the credit⁴³.

A beneficiary cannot avail itself of the contractual relationship between the issuing bank and the applicant or between banks. Also, an undertaking by a bank or defenses by the applicant arising from the relationship with the issuing bank or the beneficiary is not subject to claims⁴⁴. Essentially, the rule in payment must be done first then argument comes later. However, a ground for non-payment can be upheld when there is fraud by the beneficiary or the agent. This though is not found in the UCP, but it is a rule of law and there are differences of legal systems as to whether fraud must be in the documents or whether the defined transaction suffices or whether the beneficiary's good faith is not relevant⁴⁵. The autonomy rule of documentary credit does not exclude the issuer of any liability arising from inexperience and failure to pay towards the beneficiary⁴⁶. Professor McCornarck explains the functions of documentary credit in line with the strict compliance rule which limits the issuer's exposure by document checking and fund transferring⁴⁷.

Potter LJ at 1991-2 in the case of *Montrod Ltd v Grundkötter Fleischvertriebs GmbH* (2002) WLR 1975 states:

“The fraud exception to the autonomy principle recognized in English law has hitherto been restricted to, and it is in my view desirable that it should remain based upon, the fraud or knowledge of fraud on the part of the beneficiary or other party seeking payment under and in accordance with the terms of the letter of credit. It should not be avoided or extended by the argument that the document presented, which disentitles the person making the demand to payment because it is fraudulent in itself, independently of the knowledge and bona fides of the demanding party”.

⁴³ This involves a direct relationship between the confirming bank and the beneficiary which separates the Issuing bank from the latter.

⁴⁴ Art 7(c)- ICC Uniform Customs and Practice for Documentary Credits 2007 Revision (UCP600)

⁴⁵ See Bertram's (n 1), chs 14-16.

⁴⁶ Alan Ward, *The Liability of Banks in Documentary Credit Transaction under English Law*, 13 JOURNAL OF INTERNATIONAL BANKING LAW 207-211 (1991).

⁴⁷ *American Bell Int'l, Inc v. Islamic Republic of Iran*, 474 F. Supp.420,426 (1979) cited by Peter A. Alces, *An Essay in Independence, Independence and surely principle*, 3 UNIVERSITY OF ILLINIOW LAW REVIEW 449 (2003).

In summary, the Court of Appeal (of a different quorum) was of the view that apart from knowledge of fraud or fraud on the part of the beneficiary or other party who is seeking for payment, no separate nullity exception. Even if there is nullity exception, it held that the certificate issued in this case in honest belief that he had the authority of the applicant of the letter of the credit could not be a nullity⁴⁸.

B.) DOCUMENTARY CREDIT TAKES EFFECT UPON THE ISSUE

A credit upon its release becomes irrevocable when it is issued from the control of the confirmer or the issuer⁴⁹, regardless of when it is delivered to or upon receipt by the beneficiary. In reconciling with traditional contracts, the binding force of mercantile usages is enough to displace the rules of ordinary contracts⁵⁰.

C) DOCUMENTARY CHARACTER OF THE CREDIT

The key principle is that both or all concern parties deals with documents and not services, performances or goods which has connection with the document⁵¹. In a maximum of five banking days, banks are expected to decide following the presentation⁵² and examination of goods to be incompatible the necessity for a fast payment mechanism. The main role of banks is to check whether the documents are in conformity with the credit. If a credit has no documentary conditions, it must be disregarded and treated as not stated as seen under article 14(h), restating Article 13 (c) of UCP 500.

D) BANKS ARE CONCERNED ONLY WITH THE APPARENT GOOD ORDER OF THE DOCUMENTS

The principal role of a bank is to conduct document examination presented to it with reasonable care. This examination is done based on the document only as to establish whether such document constitute a

⁴⁸ Beam Technology (Mfg.) Pte Ltd v Standard Chartered Bank [2003] 1 SLR 597- © Singapore Academy of Law under exclusive license from the Government of Singapore.

⁴⁹ Art 7 (b) ICC Uniform Customs and Practice for Documentary Credits 2007 Revision (UCP600)

⁵⁰ Goode on Commercial Law (ed Ewan Mckendrick, 4th edn, Penguin Books/Lexis Nexis, 2009) 1077-9

⁵¹ Art 5-ICC Uniform Customs and Practice for Documentary Credits 2007 Revision (UCP600)

⁵² Art 16 (d) ICC Uniform Customs and Practice for Documentary Credits 2007 Revision (UCP600)- presentation has to be done within a reasonable time and in any event not more than seven banking days.

complying presentation or not⁵³. Where a document contains data, which conflicts with the data in the same document, it is regarded as not in conformity with the complying presentation. International Standards of banking practices as reflected in the UCP determines compliance⁵⁴. It is also elaborated in the ISBP⁵⁵.

Moreover, this rule is set to protect banks. In the case of *United City Merchants (Investments) Ltd v Royal Bank of Canada (The American Accord)* [1983] 1 AC 168, Lord Diplock at page 184-7 stated that:

“It has, so far as I know, never been disputed that as between confirming bank and issuing bank and as between issuing bank and the buyer the contractual duty of each bank under a confirmed irrevocable credit is to examine with reasonable care all documents presented in order to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit, and if they do so appear, to pay to the seller/beneficiary by whom the documents have been presented the sum stipulated by the credit, or to accept or negotiate without recourse to drawer drafts drawn by the seller/beneficiary if the credit so provides. It is so stated in the latest edition of the Uniform Customs. It is equally clear law, and is so provided by Article 9 of the Uniform Customs, that confirming banks and issuing banks assume no liability or responsibility to one another or to the buyer ‘for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents’.”

E) BANKS DEAL AS PRINCIPALS, NOT AS AGENTS

A bank assumes a payment liability as principal and not as an agent for the account party who cannot be sued on the credit (though maybe sued under the original contract) when such bank issued a letter of credit. Thus, banks act as principals and its duty to pay against conforming documents is dependent on the consent of its customer. Therefore, the concern bank must avoid accepting instructions from its customer to withhold payment if the documents are in order.

⁵³ Art 14 (a)- ‘Complying Presentation’; means a presentation of document that complies with the terms and conditions of the credit, (Article 1 UCP and international standard banking practice.

⁵⁴ Art 2 ICC Uniform Customs and Practice for Documentary Credits 2007 Revision (UCP600)-definition of complying presentation.

⁵⁵ International Standard Banking Practice (ISBP) -Examination of documents under Documentary Credits (ICC publication No 681, 2007).

F) THE PRINCIPLE OF STRICT COMPLIANCE

This principle generally states that the terms of a credit must be in conformity with documents and must be presented with the stipulated time frame of the credit. However, a document is not discrepant⁵⁶ because of misspelling or typing error of a word or sentence which do not in fact change the meaning of such word or sentence. Article 17 (a) UCP 600 shows that one original document of each document stipulated must be presented. It must have signature, mark, stamp, or label of the issuer of the document unless if such document shows that it is not original⁵⁷. Thus, it was argued that the principle of strict compliance must be applied in a commercially reasonable manner. The question of what constitutes an original document under UCP500 is been debated and has numerous court decisions. An ICC Banking Commission Policy Statement⁵⁸ has clarified the issue of what constitute an original document.

With regards to the methods of payment, it constitutes ways of obtaining payment and not constituting payment. In the case of *Newman Industries Ltd v Indo-British Industries Ltd (Govingdram Bros Ltd., Third parties*⁵⁹, Seller J states that:

“I do not think there is any evidence to establish or any inference to be drawn, that the draft under the letter of credit was to be taken in absolute payment. It is a payment method, but it does not constitute payment itself”.

However, with regards to the duty of care, the case of *United Trading Corporation S.A and Murray Clayton Ltd v Allied Arab Bank Ltd*⁶⁰, courts held that the issuer owes a duty of care to the account party the duty of care not to pay out credit where there is evidence that the beneficiary is

⁵⁶ International Standard Bank Practice, para 28.

⁵⁷ UCP 600, Article 17 (b) (c)

⁵⁸ The Determination of an “Original” document in the context of UCP sub article 20(b)’, (document 470/871 (Rev), buttressed by James E Byrne, The Original Documents Controversy: from Glencore to the ICC Decision (Institute of International Banking Law & Practice Inc., Montgomery Village (MD), 1999, PARA 11.26.

⁵⁹ Van Houten, op., 371

⁶⁰ (1985)2 Lloyds Rep. 554 at 560

fraudulent⁶¹. From the Common Law position, strict compliance means that the seller must tender all documents required and must be of exact type with sufficient description of goods on it. Then the issuer must examine all documents to determine whether it is in conformity with the requirement stated.

G) A CREDIT IS NOT TRANSFERABLE UNLESS IT IS EXPRESSLY AGREED OTHERWISE

This is another principle to be followed when dealing with documentary credit. A credit is said to have been transferred when it may be made available in whole or in part to another beneficiary who could be the second beneficiary at the request of the first beneficiary⁶². Generally, only the agent of the beneficiary or the beneficiary itself has the right to collect payment as well as present such documents. The transfer form in banking practice is a novation. That is, the transferee is the beneficiary who replaces the transferor. In Instances where a credit is transferred to more than one second beneficiary and rejection of one or more second beneficiary does not make the acceptance invalid by any other second beneficiary⁶³. Thus, the transfer credit must reflect the conditions and terms of the credit including the expiry date, the amount of the credit, the stipulated period of presentation, the latest shipment date, the unit price etc.⁶⁴. With regards to the proceeds, the beneficiary can still assign the proceeds even though there is no written statement that it should be transferred⁶⁵.

H) THE PRICIPLE OF INDEPENDENCE

For the purpose of assurance between the seller and the buyer, documentary credit and sales relationship must be treated separate from one another⁶⁶. The nature of documentary credit is separate

⁶¹ Hortico (Australia) Pty Ltd V Energy Equipment CO (Australia) Pty Ltd (1985)1 NSWLR 545, at 550 to 554

⁶² UCP600, Article 38 (b)

⁶³ UCP600, Article 38 (f)

⁶⁴ UCP600, Article 38 (g)

⁶⁵ UCP600Article 39

⁶⁶ R. de las Heras Ballell Teresa, Associate Professor of Commercial Law, Universidad Carlos III de Madrid 2017-2018 Chair of Excellence, CLC, Harris Manchester College Oxford University, "Lectures on Basics principles of Documentary Credit", Transnational Commercial Law II. International Hellenic University, Thessaloniki. Power point presentation day 1, 16 &17 March, 2019.

transactions⁶⁷; they are autonomous transactions from sales relationship. According to article 4 UCP 600, it states:

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

The principle of independence is also recognized in the United States legal system. For instance, the UCC ('95) at 5 to 103 (d), states:

“Rights and obligation of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of the contract, or arrangement out which the letter of credit arises or underlies it including contracts or arrangement between the issuer and the applicant and between the applicant and the beneficiary”.

Furthermore, in consideration to all these principles of documentary credit, what happens if there is a dispute concerning the credit incorporated in the ICC Uniform Customs and Practice for Documentary Credits (UCP)? In this case, the answer is found under ICC Documentary Credit Dispute resolution⁶⁸. Documentary credit dispute is made available by the International Chamber of Commerce (ICC) through its International Centre for Expertise⁶⁹. The initiator can individually or jointly apply for a dispute request to the center in Paris⁷⁰. This dispute request must contain all relevant information⁷¹ to the dispute. Within the stipulated time frame the respondent may individually or jointly, submit an answer to the initiator's request which must be received by

⁶⁷ Enonchong. N. ' *The principle of independence of letters of credits and Demand Guarentees* ', Oxford University Press, (2011) p. 7-9

⁶⁸ Willem J.H. Wiggers, *International Commercial Law Source Materials: ICC DOCDEX Rules Documentary Credit Dispute Resolution*, Second, Revised Edition, Kluwer Law International 2007, Page 44 -47

⁶⁹ Article 1 (1.2) ICC DOCDEX Rules

⁷⁰ Article 2 (2.1) ICC DOCDEX Rules

⁷¹ Article 2 (2.2), (2.2.1), (2.2.2) ICC DOCDEX Rules

the center⁷². All the necessary information must be stated by the respondent too. When a dispute has been submitted and received by the Center, the center shall appoint three experts from the Banking Commission to decide the case in consultation with the Technical Adviser of the Banking Commission. However, unless parties agreed, the decision of a DOCDEX shall not be binding⁷³.

⁷² Article 3 (3.1) ICC DOCDEX Rules

⁷³ Article 1 (1.3) (1.4) ICC DOCDEX Rules

CHAPTER 4

THE NATURE OF DOCUMENTARY CREDIT, RIGHTS AND RESPONSIBILITIES OF PARTIES IN INTERNATIONAL TRADE

A. TYPES OF DOCUMENTARY CREDIT AS REGARDS THEIR COMMERCIAL CHARACTER

The types of documentary credit are differentiated by the form in general, characteristics and Payment period.

The following are the types of documentary credit:

I). **Documentary type of credit based on its general Form.**

This type of documentary credit has two types. That is:

REVOCABLE DOCUMENTARY CREDIT

In this type of credit, one party can cancel it at any time without having the approval of the parties involved such as the beneficiary, the applicant, the issuing bank or the confirming bank.

IRREVOCABLE DOCUMENTARY CREDIT

This type of credit cannot be cancelled by one party. Cancellation can be done once there is approval from the beneficiary, the applicant, the issuing bank and or confirming bank if there is any.

II). **Documentary Type of credit based on the payment term.**

In this type of credit, the DC is divided into 2 (two) types:

DOCUMENTARY CREDIT AT SIGHT

Article 10 (a) of the UCP stated a requirement that all credit must indicated whether they are available by sight payment, deferred payment, acceptance or negotiation.

Documentary Credit at sight is made when payment is made by a Bank which could be Nominated Bank and Issuing Bank upon ensuring that the principle of ‘complying Presentation’ has been met at the time specified in DC.

In a nutshell, Sight documentary credit is done when draft and other required documents conformed to the terms and conditions stated on the credit.

III. DEFERRED PAYMENT LETTER OF CREDIT

Deferred payment letter of credit which is known as usance letter of credit provides that payment will be done not at the time when the beneficiary makes a complying presentation, but at a specified maturity date. This maturity date can be a specified number of days after the beneficiary's presentation. For instance, 45 days. Then in this case the letter of credit would state that payment would be 45 days after sight. This payment method can also be done on a specified days after an event. Example is done on the date of the bill of lading or payment can be made on a specified calendar date.

IV) DOCUMENTARY CHARACTER OF CREDIT

Documentary type of credit based on its features or characteristics is another type. The types of the documentary credit based on its features have various combinations of characters. Such types could be: Transferable Documentary Credit; Irrevocable Transferable Documentary Credit; Revocable Transferable Documentary Credit; Red Clauses Documentary Credit etc.⁷⁴.

B) CLASSIFICATION OF CREDITS BY PAYMENT

Article 10 (a) of the UCP has a requirement that all credits must indicate whether they are available by differed payment, acceptance, negotiation, or by sight payment. In the case of *Banco Santander SA v Bayern Ltd*⁷⁵, the Court of Appeal of England held that the confirming bank which has no authorization from the issuing bank, has discounted its own deferred payment obligation and assumed the risk that the issuing bank would refuse to pay in instances where there is fraud on the

⁷⁴ Finny Redjeki, Sugihartanti and Vip Paramarata: DOCUMENTARY CREDIT AS A BANK INSTRUMENT THAT CAN PROVIDE PAYMENT ASSURANCE FOR EXPORTERS: *Documentary Credit type*; University of Sangga Bunna YPKP Bandung, West Java, Indonesia; Academic Research International Vol. 8 (4) December 2017 pp 229-230

⁷⁵ [2000] 1 All ER (Comm 776)

part of the beneficiary before the maturity of the credit or dates in accordance with the terms and conditions stipulated under the credit, typically on expiry of a specified period after bill of lading date, or after shipment date. However, article 12 (b) UCP600 is created to reverse the effect of the court's decision.

A credit payment at sight gives the beneficiary the entitlement to payment at sight on presentation of the documents. An acceptance credit enables the beneficiary to call for acceptance of a draft. This is done by the issuing bank or other bank stated in the credit and maturity payment of that draft.

Negotiation credit should be contrasted with a straight credit. It is a credit payment which extends the payment promise to cover a bank which purchases the draft or other documents. The stated bank in the credit is authorized by negotiation credit to purchase drafts or documents upon the condition that all requirements are met (Complying Presentation) by an agreement to advance payment to the beneficiary before or on banking day⁷⁶.

B) RIGHTS AND RESPONSIBILITIES OF PARTIES TOWARDS THE CREDIT

1) BANKS OBLIGATIONS TOWARDS BENEFICIARY OF THE LETTER OF CREDIT

As stated, earlier documentary credits' functions involve four independent parties who has interrelated contracts. They are the buyer (applicant), seller (beneficiary), issuing/confirming bank, negotiating or nominated bank which does the payment. Usually international commercial transaction bearing letter of credit transaction starts by the agreement between the buyer and the seller having a clause which defined documentary credit as method of payment. In this case, for the buyer to open a 'Letter of Credit' otherwise called Documentary Credit in favour of the beneficiary, he must approach the issuing bank. In such transaction once the issuing bank agrees to, it will issue the credit and

⁷⁶ R. Goode, H. Kroenke and E. Kendrick, *Transnational Commercial Law: International Bank payment undertakings, Classification of credits by payment method*, Oxford University Press, 2015, p.330

advised to the beneficiary by her correspondent in the country of the beneficiary called the advising bank or by issuing bank.

It is the banks (issuing, nominated, confirming bank) duty to examine the documents presented by the beneficiary within a specified period⁷⁷. This examination determines whether the beneficiary has met the complying presentation stated in the credit or not. The examination is done when the documents has clearly stipulated the principle of autonomy to prevent bank from considering issues like performance of beneficiary under the contract underlined.

Article 15 of UCP 600 states;

“Complying Presentation:

- a) *When an issuing bank determines that a presentation is complying, it must honour;*
- b) *When a confirming bank determines that a presentation, it must honour or negotiate and forward the documents to the issuing Bank;*
- c) *That a presentation is complying and honours or negotiates, it must forward the documents to the confirming bank or issuing bank”.*

Banks have no obligation to honour or negotiate the presentation when documents do not comply with the terms and conditions in the credit⁷⁸. Bank’s decision to reject the presentation requires a bank to provide to the beneficiary a notice of refusal either to accept or negotiate the presentation within a time frame specified as stated in article 16 (c) UCP 600, Article 13 (b) UCP 500. The bank is also entitled to reimburse the presentation after giving the notice.

Article 13b of the UCP states that:

“The issuing bank, the confirming bank, if any, or a nominated bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the

⁷⁷ UCP600, Article 14 (a) , UCP500, Article 13 (a)

⁷⁸ UCP600, Article 16 (a) , UCP500, Article 14 (b)

documents and to inform the party from which it received the documents accordingly”.

There is ambiguity in interpreting ‘reasonable time’, but it depends on different factors in different countries. For instance in the case of *Banker’s Trust Co v State of India*⁷⁹, the Court of Appeal and the Supreme Court of Singapore in the case of *United Bank Ltd v Banque Nationale de Paris*⁸⁰, held that *the* most complicated presentation is given seven days as maximum time limit.

However, there is a severe consequence for banks which fail to comply with the due procedure of rejection stated in article 16 (f) UCP600. With regards to discrepancies the court held that article 13 and 14 UCP600 (then UCP500) does not apply in the case of presentation. Thus, issuing or confirming bank which has intention to reject presentation should mention all discrepancies of documentary and non – documentary credit within the rejection notice⁸¹.

2) LIABILITY OF ISSUING BANK TO BENEFICIARY

Issuing or Confirming bank is liable in instances where such bank had executed payment to a party who is not entitled to receive money, such bank is obliged to pay once again to the right party⁸². In the case of *Cleveland Manufacturing Co Ltd v Muslim Commercial Bank*⁸³, there was an instruction by the plaintiffs to the shipping agents to prepare documents and present it to the defendant. Beneficiary was not paid by the bank as a result of liquidation, instead effectuated payment to shipping agents. The plaintiff succeeded in court because the shipping agents were not agents of beneficiary.

In addition, English law stated that in situations where a bank is late to pay the beneficiary, that beneficiary should proof that he or she incurred

⁷⁹ [1991] 1 Lloyd’s Rep 587

⁸⁰ [1993] 2 SLR 64

⁸¹A. Hamed, Comparative Study of Issuing Banks’s Obligations towards Beneficiary of the Letter of Credit under UCP and English Law: Banks duty for examination, Honouring or Rejection of Presentation; Faculty of Law, Universitat Autònoma de Barcelona , Halrev Vol. 2 Issue 3, December 2016 pp 300-303

⁸² A. Malek, D. Quest, (2009), Op. Cit., p. 120

⁸³ [1981] 2 Lloyd’s Rep 646

losses under ordinary rules of caution plus remoteness of damage⁸⁴. In the case of *Ozalid Group (Export) Ltd v African Continental Bank Ltd*⁸⁵, the court gave an order in favour of the beneficiary leading them to recover sterling value of dollars between the time they had to receive and the actual time they received plus interest of two months delay by the issuing bank, and reasonable cost incurred by the sellers in attempting to collect payment. Presently, the decision of the House of Lords in the case of *Sempra Metals Ltd v IRS*⁸⁶ governs claims for interest where banks pay with delay and must be before court proceeding begins. In this case, court has jurisdiction to award compound and simple interest on claims for breach of a contract to pay debt⁸⁷.

With regards to nonpayment, beneficiary has the right to sue the bank where issuing bank is under obligation to honour the conforming presentation but dishonored the presentation and refused to pay the beneficiary. This is done upon condition that the seller beneficiary is capable of tendering documents to the bank against payment. Beneficiary has two different bases to claim damages against the bank where such bank wrongfully dishonored the presentation by not paying the beneficiary on due time.

The first basis is that the beneficiary can bring an action against the bank for breaching its obligation. The second base is beneficiary can claim against the bank in debt of the sum due under the credit.

Greer J in the case of *Dexters Ltd v Shenker & Co*⁸⁸ stated that:

“...the date of the payment has passed and the payment has not been made the way to read the claim of this sort is that it is the claim for damages for non-payment of money, and in ninety-nine out of hundred

⁸⁴ A. Malek, D. Quest, (2009). Op. Cit., p. 120 cited by Alavi, H., Liability of issuing bank to beneficiary at p. 303

⁸⁵ [1979] 2 Lloyd's Rep 239

⁸⁶ [2007] 3 WLR 745

⁸⁷ A. Malek, D. Quest, (2009). Op. Cit., p. 120 cited by Alavi, H., Liability of issuing bank to beneficiary at p. 304

⁸⁸ (1923) 14 Lloyd's Rep

cases the amount of damages will be the sum which there has been the undertaking to pay.⁸⁹”

3) ISSUING BANKS’ RIGHT TO RECOURSE AGAINST THE BENEFICIARY

As discussed earlier that issuing or confirming banks are liable to beneficiaries in certain circumstances, they also have rights to recourse against beneficiaries. This may arise where a bank examines presentation, finds documents complaint to terms of the credit and rendered payment to beneficiary. In such cases, documents would be found discrepant and banks would not be obliged to reimbursement. Another circumstance is when the applicant files for bankruptcy, the applicant cannot reimburse the issuing bank after honoring the credit.

Thirdly, banks have right to recourse against beneficiary when after negotiating the credit and drawn a draft on the applicant and such draft was later dishonored.

Regarding complying presentation, issuing or confirming banks can take an action against the applicant in a situation where the applicant refuses to reimburse the bank for any given reason after being paid by the bank against complying documents to the terms and condition of the credit. Banks are not obliged to pay beneficiary against presentation of non-complying documents.

On the matter of Bill of Exchange, banks also have right of recourse against beneficiary where a concern bank under takes negotiation drafts drawn on the applicant by the beneficiary after complying documents have been presented, and parties have excluded UCP (Section 43 (2) or 47 (2) of the Bill of Exchange Act (1882).

Finally, issuing bank has right of recourse against the beneficiary where proof have shown that there is fraud on the part of the beneficiary. English law created a way for banks to claim for restitution.

⁸⁹ Cited by A. Hamed, Comparative Study of Issuing Banks’s Obligations towards Beneficiary of the Letter of Credit under UCP and English Law: *Liability of issuing bank to beneficiary*; Faculty of Law, Univertitat Autonoma de Barcelona , Halrev Vol. 2 Issue 3, December 2016 pp 304

CHAPTER 5

DOCUMENTARY CREDIT AND DEMAND GUARANTEES

A. DIFFERENCES BETWEEN DOCUMENTARY CREDIT, DEMAND GUARANTEES, STANDBY LETTERS OF CREDIT AND SURETYSHIP

Distinctions between documentary credit and demand guarantee are that: demand guarantee is primarily used for the assurance of non-monetary performance. Secondly, in the use of demand guarantee, the primary source of payment is not intended as the guarantor. The beneficiary can only make a demand where he genuinely believes that the principals have defaulted in his or her obligations; otherwise he or she must not do so. However, this transaction only involves the relationship between the beneficiary and principal. The guarantor's payment undertaking is not dependent on the proof of default. The reason is that it is purely documentary in nature. This is why it is difficult to distinguish documentary credit from demand guarantee.

Article 2 of the URDG defines demand guarantee as:

“Any signed undertaking, however named or described, providing for payment on presentation of a complying demand”.

Article 15 (a) URDG, states that it is mandatory that a demand under the guarantee be supported by other documents relevant as specifies, and by a statement by the beneficiary, showing the manner in which the applicant has breached its obligations under the underlining relationship.

Generally, a demand guarantee is a simple and short document issued by other financial institution or issued by a bank. The issuance of this instrument is the obligation to pay a maximum sum of money stated in the prescribed form. It may also involve the presentation of documents. Demand guarantees are like a substitute for cash and it must be honored when presentation of a written demand is done. The bank or any financial institution involved is autonomous from the underlining

contract establishing a relationship between the principal and the beneficiary. Once complying presentation of documents is established, the bank must pay the principal.

1. STANDBY LETTERS OF CREDIT

With respect to a standby letter of credit, it is regarded as a financial instrument which is used basically in international trade and the construction of domestic projects. The bank usually issued this instrument on the buyer and guarantees behalf in order for the beneficiary (seller) to receive payment once he presents the specified document in situations where the buyer on his part failed to pay the seller. All the necessary documents such as shipping documents and information are provided by the buyer for the beneficiary upon applying for this credit in a bank. It is an assurance to the seller that the buyer will surely execute payment. Banks in the United States are used to standby letters of credit as a substitute to demand guarantees. It is seen as a simple term used to describe demand guarantees. It supports both financial and non-financial obligations of the principal and enhances the provision of credit for the financial undertaking.

However, the major difference is that standby letters of credit is usually drafted in the form of letter of credit⁹⁰.

2. THE PURPOSE OF DEMAND GUARANTEES

The purpose of demand guarantee is to enable the beneficiary to access funds immediately in order to remedy the alleged default under the contract⁹¹.

Demand guarantees are an instrument for international trade. It responds to the changing needs to suit a reliable security instrument in instances where there is increase significant risk and risk avoidance⁹². It

⁹⁰ Klein, C., *Letters of Credit: Practical use in Financial Transactions*, Geyer - McAllister Publications, New York, 2007, cited by M.Sc. Aleksandra Lukic

⁹¹ M.Sc. Aleksandar Lukic : *Bank Demand Guarantee and Standby Letter of Credit as collateral in international trading operation*, Vol. 4 No.1 October 2014 at p. 508-509

⁹² Roeland F Bertram, *Bank Guarantees in International Trade: The Law and Practice of Independent(First Demand) Guarantees and Standby Letters of credit in Civil Law and Common Law Jurisdictions*, 4th revised edn, Kluwer Law International, The Hague 2013, paras 1-7, cited by R. Goode, H. Kroenke and E. Kendrick, *Transnational Commercial Law: International Bank payment undertakings, International character of demand guarantees*, Oxford University Press,2015, p.341

is used to favor employers under construction contracts and under contracts of sale involving buyers and sellers. Demand guarantees is used to secure proper performance obligations that are non-monetary in character.

B. DIFFERENCES BETWEEN SURETYSHIP AND DEMAND GUARANTEES

Though this topic does not form the key essentials about documentary credit, it is also important to briefly differentiate these international undertakings from each other. Demand guarantees are different from suretyship guarantees. Under the later, the guarantor's liability can occur when there is default by the principal and unless otherwise agreed, liability is limited to only loss arising from the default of the principal. Suretyship guarantees is not documentary in nature but has to do with proof of facts to establish the default. Demand guarantees have a feature of independence like documentary credit.

CHAPTER 6

CURRENT TREND IN INTERNATIONAL BUSINESS LAW

A. ANALYSIS ON THE RISK OF FRAUD UNDER THE UCP

Firstly, as aforementioned, the core principle of documentary credit is the principle of autonomy. Meaning documentary credit is independent and is separate from the underlining contract between the applicant (buyer) and the beneficiary (seller)⁹³. In this case, the issuing bank is obliged to pay the beneficiary regardless of what dispute may arise from the contract between the beneficiary and the applicant. Banks are also obliged to honor the complying documents⁹⁴.

Secondly, the principle of strict compliance is a principle which governs documentary credit and is closely related with the autonomy principle. That is, the beneficiary must present documents that comply with the terms and conditions of the underlining credit. In any discrepancies between the documents presented by the beneficiary and the terms of the credit, the bank should reject payment. This principle protects banks and the applicant. Autonomy principle involves risks which creates ways for manipulation by the seller. The bank has limited obligation to examine documents with reasonable care, and if the beneficiary presented documents which complies with the credit, it will execute payment⁹⁵.

However, the International Chamber of Commerce failed to address the issue of fraud under the UCP600. There is only a reference made under article 34 UCP600.

My focus of interest is where fraud was not committed by the beneficiary but by a third party. The risk of fraud may not be

⁹³ Article 4 UCP for documentary credit, which was promulgated by the International Chamber of Commerce (I.C.C) IN 1993, revised in 1951, 1962, 1974, 1983, 1993 1st 2007 (I.C.C. Pub. No.600).

⁹⁴ UCP600, Article 15

⁹⁵ ⁹⁵ C. Pejovic., Documentary Fraud Under the UCP: Revisiting an 'Exception from Exception' Principle: Current Trends in international Business Law, Kyushu University, 28th August,2018, SP 45, Ep, 62 at pp. 1-15

underestimated because large companies could be defrauded under the present system. There is an issue causing a lot of different opinions and different approaches as to whether the bank should pay against fraudulent documents in instances where the beneficiary is not responsible for the alleged fraud.

1. THE CASE OF UNITED CITY MERCHS. (INV.) LTD. V. ROYAL BANK OF CANADA

In the case of *United City Merchs. (Inv.) Ltd. v. Royal Bank of Can. (1983) 1 A.C. 168 9Eng.*, it relates to an FOB sale of plant where confirmed irrevocable credit as payment was to be made. In this case, goods supposed to be loaded on or before the 15th of December 1976, however, the cargo was loaded on the 16th of December 1976, and the bill was by fraud backdated by brokers on behalf of the carriers. This was done with the aim of concealing the breach of contract. The confirming bank refused to pay against forged documents after been notified about the fraud.

Lord Diplock in addressing the issue of whether the confirming bank's action to refuse payment was justified, acknowledge the fraud exception from the autonomy principle and invoked a Latin Maxim *ex turpi causa non oritur action*. In English it means '*fraud unravels all*'.

In this case, the House of Lords held that there is some limitation for the aforementioned maxim because it applies to fraud committed by dishonest person and not the beneficiary. In this regard, there was no justification by the confirming bank to reject payment because fraud was committed by a third party and not the beneficiary.

As a result, the beneficiary is not entitling to payment if he commits fraudulent misrepresentation, but he is entitled to payment if he makes misrepresentation which is not fraudulent.

Here, the bone of contention to justify the decision of this case is that the good faith of the beneficiary should be protected. The rationale is if a third party forged the document without the notice of the beneficiary, it will be unjust to penalize the beneficiary for acts he is not aware of or did so. There must be protection of sanctity of documents as Lord

Diplock argued. Thirdly the principle of *caveat emptor* could be applicable because in this transaction, the applicant agreed to the risk involved with this way of payment.

Moreover, with respect to banks, there is no protection or security for it in instances where a bank executed payment against fraudulent documents or documents that are been nullified. Of course, bank must rely on the principle that payment against fraudulent documents is against the fundamental principles of documentary credit and undermine the credit. Lord Diplock held that banks owe a contractual duty to the buyer to pay against improper and forged documents⁹⁶. The court held in the *United City Merchant* case, that the bank could have verified the date of loading through the carrier at the place of loading. However, this seems in contravention with the principle of autonomy. Is it the duty of the bank to verify the date of loading, as it has limited time for checking? No! Neither the bank is responsible to investigate fraudulent acts. The bank is entitled for reimbursement from the applicant, though there is risk. Banks rely on documents as security.

2. WHO AMONGST THE PARTIES (BENEFICIARY AND APPLICANT) WOULD BEAR THE CONSEQUENCES OF A FRAUDULENT ACT BY A THIRD PARTY?

On the issue of the applicant, the question is the applicant and the beneficiary, who should bear the consequences of a fraudulent act committed by a third party without their notice? We should recall that strict compliance rule only benefits the beneficiary. Here unless the applicant prove fraud at the time when the documents are presented for payment. However, this may find him in difficult position because locating the person who commits fraud maybe difficult.

The solution for the applicant which may work is the use of *caveat emptor* principle (let the buyer be aware). The buyer must open his eyes and carefully examine goods as to whether they are in conformity with the terms and conditions of the credit. The law only offers protection to the prudent buyer. *Caveat emptor* principle also applies to the seller and is independent from the fraud exception rule.

⁹⁶ MCKENDRICK (2016) P. 1062

J. Mocatta in the case of *United City Merchants*⁹⁷ held that one of the snopaked bills of lading was differently altered by dates of 15 and 16th December, and as a result shows that the beneficiary acted carelessly in failing to verify the accuracy of the date in the bill of lading⁹⁸.

3. DIFFERENT APPROACHES BY VARIOUS LEGAL SYSTEMS IN ADDRESSING “THE FRAUD EXCEPTION RULE”.

Finally, on this issue, it is important to compare various legal systems addressing the fraud exception rule. In Canada the court in the case of *Bank of Nova Scotia v. Angelica-Whitewear*, the court held that the fraud exception should be limited to fraud caused by the beneficiary of a credit and not to a third party⁹⁹.

However, America has a differing approach. In the case of *Old Colony Trust*, the court held that the issuer of a credit cannot be called upon to recognize the document to be in terms and conditions of the credit in instances where such document is correct in form but in point of fact false or illegal¹⁰⁰. It was held that the fraud exception applies if the documents are not relevant (genuineness of documents)¹⁰¹. There is a simple and straight forward stand for France. The bank is required to reject payment once fraud is established¹⁰².

Singapore takes the opposite to England. There is nullity exception, separate from the fraud exception and are distinctive. In the case of *Beam Technology (Manufacturing) Pte Ltd v. Standard Chartered Bank*¹⁰³, the court of Appeal held that the conforming of a document is the assumption of its genuineness.

“To say that a bank, in the face of a forged, null and void document (even though the beneficiary is not privy to that forgery), must still pay on the credit, defies reason and good sense”.

⁹⁷ (1983) 1 A.C. 168 9Eng.)

⁹⁸ *United City Merchs. (Inv.) Ltd. v. Royal Bank of Canada (The American Accord)* [1979] 1 Lloyd's Rep. 251, 278.

⁹⁹ (1987) 36 DLR (4TH) 161-177

¹⁰⁰ *Bank of Nova Scotia v. Angelica-Whitewear* (1987) 36 DLR (4TH) 161-174

¹⁰¹ *Sztejn v J. Henry Schroeder Banking Corp* 177 Misc. 719, 31 N.Y.S. 2nd 631 (1941)

¹⁰² Cass. Comm. 25 April 2006, DMF 2006, 877

¹⁰³ (2003) 1 SLR 595 - 597

Finally, there is a need to regulate the fraud exception rule because it's still creates legal uncertainty as countries have diverging approach on the matter. The ICC should revisit the UCP600 and enact a law clearly which will establish who is liable in case of fraud.

B. OVERVIEW OF DOCUMENTARY CREDIT IN TRANSNATIONAL COMMERCE

Documentary credit is the life blood of international trade and its word is believed to have come France 'acreditif'. As mentioned earlier, the usages of documentary credit in international trade could be dated back to the old Egypt and Babylonian banking system. In ancient Greece, banks draw documentary credit to their correspondents as a way of obviating spices transportations in return for payment of accounts

The function of documentary credit is to enable the supplier and the buyer to trade. This is done by the supplier accepting an undertaking from a bank which pays in substitution for the payment obligation of the buyer. This arrangement enables the issuing bank to act at the behest of the buyer in which it undertakes to pay the supplier (beneficiary).

Payment to the supplier usually is on differed terms by the bank once it accepts the bills of exchange drawn by the beneficiary, and all terms and conditions of credit are compiled¹⁰⁴. Notwithstanding, Payment may also be done directly¹⁰⁵. Documentary credit is typically governed by the Uniform Customs and Practices for Documentary Credits (UCP), which was published by the International Chamber of Commerce¹⁰⁶.

Documentary credit is by nature irrevocable and can neither be amended nor cancelled without the beneficiary's consent. A buyer cannot authorize its bank to revoke it once issued¹⁰⁷.

A revocable credit can be used instances to satisfy a formality, examples in circumstances of exchange-control regulations. Documentary credit

¹⁰⁴ ICC Uniform Customs and Practices for Documentary Credits, UCP 500, 1993, Art. 2.

¹⁰⁵ History of letters of credit: E. P. Ellinger, *Documentary Letters of Credit* (Singapore, Uni. Of Singapore press, 1970), pp. 5-7.

¹⁰⁶ A. Watson, , *Financial of International Trade* (7th edn, London IFS, 2001) P. 104- 107

¹⁰⁷ UCP, Article 9 (d) (ii)

may involve the advising and confirming bank also. It may indicate which nominated bank or another bank payment is done.

Moreover, regarding the principles of documentary credit is that a bank's undertaking on a credit is independent from the underlining contract. Banks are not concern with such contracts. A Bank is not subjected to any claim or defenses with the applicant for credit. The beneficiary cannot also avail itself to a contractual relationship between the applicant and the issuing bank or between banks¹⁰⁸.

Finally, the fraud exception to the principle of autonomy justifies a bank failing to pay a beneficiary under a credit. "*Fraud unravels all*". A dishonest person would not be allowed by courts in the process to carry out fraud¹⁰⁹. Common law fraud has the element of dishonesty and carelessness. It does not require a corrupt motive¹¹⁰. It is rarely impossible for the buyer to proof fraud in order to restrain its bank from paying the beneficiary¹¹¹, but he should ensure that he examines goods thoroughly before buying (*the principles of caveat emptor*).

Banks main duty is to execute payment once there us certainty of complying presentations of documents. It may reject documents if goods are described differently in the credit.

C. CONCLUSION

In conclusion, the dissertation only entails key analysis of major components and issues of documentary credit starting from the definitions, history, principles of documentary credit, and sources of laws of documentary credit, differences between documentary credit and bank guarantee, standby letters of credits, the fraud exception rule and institutions involved in international trade transactions with its responsibilities.

Documentary credit enables the exercise of seven content of payment method which minimized potential risk at international trade

¹⁰⁸ UCP600, Article 3 (b)

¹⁰⁹ *Szetejn v. J. Henry Schroder Banking Corp.*, 31 NYS 2nd 631(1941)

¹¹⁰ *Derry v. Peek* (1889) 14 App. Cas. 337

¹¹¹ *United Trading Corporation SA v. Allied Arab Bank Ltd.* (1985) 2 Lloyd's Rep. 552-5544 (CA)

transaction. These includes parties to the credit (beneficiary and the applicant), period of payment, terms and conditions that secures both parties, complying presentation, tenure of payment, promise to pay and the obligation to pay by the buyer. Both parties are required to fulfill their obligations. Banks as buttressed earlier plays a pivotal role in ensuring that the beneficiary is paid by the buyer. It has responsibility to cross check documents as to whether such documents meet complying presentation before executing payment. Documentary credit payment method as referred in the rule of International Chamber of Commerce (ICC) that is, the Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600, gives security to all parties involved in international business transaction. It must not deviate from the international customs and norms as agreed, especially when dispute arise.

Documentary Credits are governed by the UCP 600, International Standby Practices (ISP98) when agreed by the parties, the UNCITRAL Convention on Independent Bank Guarantees and Standby Letters of Credit, the UCC Revised article 5.

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