

Documentary credits in practice



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Reinhard Längerich

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The contents are primarily based on Nordic aspects and legal practice, unless otherwise stated.



Reinhard Längerich

Vice President, Trade Finance, Nordea (retired)

Reinhard Längerich was born in 1941 in Flensburg, Germany. He became a photo laboratory technician and in 1961 moved to Copenhagen where he met his wife Birgit with whom he has two grown-up children.

In 1963 Reinhard Längerich embarked on bank training in Privatbanken, one of the three banks that merged to form Unibank, which in 2000 was combined with MeritaNordbanken to become Nordea together with the formerly Christiania Bank, Norway. He was transferred to the Documentary Credits Department after six months. He became fascinated with documentary credits and in this department he received extensive training and obtained profound experience in documentary credits, collections and guarantees. For several years he was deputy head of the department and then became head of the Trade Finance Department of Corporate Banking.

For many years Reinhard Längerich has been a member of the Banking Commission of the International Chamber of Commerce (ICC) and today he is a senior member of the Commission on Banking Technique & Practice (Banking Commission). After his retirement from Nordea in 2004 he continued to be a member of the ICC Banking Commission and participated in the revision of UCP 500 as a member of the Consulting Group.

Throughout the years he has actively participated in several working groups, including Model Forms for Demand Guarantees, the DOCDEX Rules and the Electronic Commerce Project with the subgroup Electronic Trade Practice. He took part in the completing working group for ISP98 and the working party for International Standard Banking Practice (ISBP). Reinhard Längerich was a member of the first Group of Experts for the interpretation of

technical queries concerning the (at that time) new international documentary credit rules, the UCP 500.

The ICC often draws on his vast knowledge and considerable experience in connection with the settlement of disputes regarding documentary credits and guarantees submitted to the ICC's Centre for Expertise. He is also consulted in an international context by other banks in his capacity as an expert in solving disputes or as an expert witness in lawsuits.

He has participated both on behalf of Nordea and at the request of the ICC in panel discussions, gives presentations and lectures and on a regular basis writes articles to documentary credit publications.

On the strength of his extensive international activities and wide experience he was Nordea's ultimate expert within his field and was responsible for the relevant products and for the interpretation of the rules.

Acknowledgement

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Preface

This book has a perfect match between title and content. It describes in detail the various steps in a documentary credit transaction from a practical perspective, providing recommendations, checklists and warnings about pitfalls. Thereby it becomes an invaluable companion to companies doing international trade involving documentary credits.

The author's more than 40 years of experience within the field of documentary credits is generously made available to the reader.

It is my hope that this book will serve as a useful tool for many companies, but also be used as a reference book at universities and other institutions of higher education.

Claus Asbjørn Stehr
Executive Vice President, MBA
Global Head of Trade and Project Finance

Introduction

Documentary credit transactions are carried out worldwide in compliance with the international rules for documentary credits issued by the International Chamber of Commerce (the ICC) and according to international customs and practice based on these rules.

In contrast to the general practice in the USA and some other countries, legal advice in the daily acting is seldom used in connection with documentary credits in the Nordic region. Only when disputes cannot be solved by negotiation between the parties legal advisers are consulted. However, it seems that lawyers are increasingly being consulted in the European marketplace, at the instance of importers as well as exporters. Also banks are increasingly taking legal advice and seeking legal assistance for solving disputes in connection with documentary credits, and law courts appear to gain growing importance in Europe. It is too early to judge whether this trend is a result of the rules and their interpretation becoming more and more complex, or whether it is caused by a general tendency for banks and companies alike to rely on judicial decisions rather than negotiation.

This book is based on the *ICC Uniform Customs and Practice for Documentary Credits, Publication No 600 (UCP 600)*, and any reference to articles in this book refers to these international rules.

It may seem confusing that different terms are used for the same parties. The seller, for instance, is also termed the exporter or the beneficiary, and the buyer is also called the importer or the applicant. The reason is that these parties have different functions depending on the stage in the transaction. Thus, the terms buyer and seller are primarily applied in relation to the commercial transaction. In international trade these parties will be called importer and exporter, while in connection with their functions in a documentary credit they will be termed applicant and beneficiary.

This book is intended as a textbook and a reference book. Consequently, many subjects are dealt with several times in different

contexts and with varying degrees of elaboration. Each subject may be significant in a specific context without being the most important issue. Sometimes reference is made to a description in more detail.

Chapter 1

What is a documentary credit?

Although documentary credits enjoy widespread use internationally, in-depth knowledge of the instrument is limited. Most business people, including bankers engaged in international trade, know the concept but prefer not to define what it really is.

In 1929 Mr Valdemar Hvidt, a Danish lawyer, wrote in the introduction to his book on documentary credits:

A letter of credit is a special method of payment used in big business. It is not quite clear how this concept should be precisely defined. The perception among merchants and bankers of the concept of the letter of credit is still blurred and constantly changing as people tend to keep adding new meanings to the concept. Literature on the subject is sparse so there is not much help to get there. Therefore, it is not possible to define the term until the concept has been delimited by a thorough study.

Today we are closer to a definition of the term, but still there seems to be some uncertainty, and encyclopaedias and dictionaries will not always provide a satisfactory answer. For instance, translated into English, the Danish encyclopaedia Gyldendals Leksikon (CD-ROM, 1995), says: *Documentary credit: a method of payment (especially by using bills of exchange) in connection with trade between different countries whereby the seller obtains security for receiving payment and the buyer attains security for receiving goods.*

The information does not explain sufficiently or correctly what the term covers.

The best definition is provided in Article 2 of the ICC rules *Uniform Customs and Practice for Documentary Credits, Publication No 600 (UCP 600)*.

In plain words a documentary credit could also be defined as follows: *A documentary credit is an arrangement whereby a bank that acts according to instructions received from a customer (the applicant) commits itself to pay an amount to a third party (the beneficiary) against that party's presentation of stipulated documents complying with the credit.*

This may be easier to understand because this definition says it in one sentence, instead of picking from the UCP 600, Article 2 (Definitions).

As appears from this definition, a documentary credit is an instrument that

- guarantees payment to the beneficiary
- arranges for payment to be effected
- ensures that the agreed terms and conditions of the credit are observed.

In addition to its functions as a guarantee and an instrument of payment, the documentary credit can also be used as a means of finance. As will be explained, the payment undertaking will be assumed by a **bank**, not the buyer.

When the documentary credit has been issued, payment is conditional upon the presentation of complying documents. Once these documents have been presented and approved, a bank's payment undertaking has been established, which can often be traded, typically at a lower price than that which the beneficiary could obtain by raising a loan in his own name.

It appears from the definition of the Danish encyclopaedia that the concept concerns a transaction in goods whereas the official UCP 600 definition, including my unofficial version, deals with the bank's undertaking to pay against the presentation of documents and not for the goods.

In a commercial documentary credit the documents will typically cover a transaction in goods or payment for the provision of services.

However, the documentary credit can also be used as security for any other transaction in the same way as a traditional bank guarantee. In that case it would be called a standby letter of credit.

For the purpose of the text in this book the documentary credit concept should be taken to mean an irrevocable commercial credit used as an instrument of payment and as a guarantee in connection with transactions in goods and related services.

Today a revocable credit is very seldom used and in this book it will generally be disregarded.

The standby letter of credit is briefly explained in a separate chapter.

Unless otherwise stated, any reference to articles in this book refers to the UCP 600. For a detailed description of these rules and their background, see 5.4 ICC Uniform Customs and Practice for Documentary Credits.

Chapter 2

Historical background

2.1 Development of international trade

The need for trading arose at a very early stage in the development of the different societies. By trading I mean the activity carried out when two persons agree to transfer the ownership of a thing (or a service) for consideration. In the earliest times consideration, or payment, took the form of delivering another thing or service in exchange. This is called barter. Later coins and notes were invented to symbolise the value of goods and services.

As long as people traded by using the system of barter, they had to confine the activity to a limited geographical area for practical reasons, and they typically traded with their own people, and perhaps also with people from neighbouring communities.

With the invention of money and of course means of transport, mainly vessels, it became possible to trade with faraway countries. We know about the travels of the Vikings, who traded with all the European countries that could be reached from the sea, for instance the UK, France, Spain and Italy. However, they also visited distant empires like Russia and Arabia to trade (as well as ravage and plunder).

As the societies became more civilised, people arranged their trade in a more professional way. In ancient Asia Minor and later in Rome goods were traded across national borders.

Trade emerged as a new occupation, and merchants travelled to make purchases on behalf of their customers. Often their journeys and purchases were financed by other merchants, who thereby assumed the risk of losses if the goods did not arrive or were of the wrong kind or of a poor quality.

This method of trading was also used in the Middle Ages, and large quantities of goods like silk, spices and precious woods from Asian countries like India and China came to Europe in this manner.

If the buyer was unknown at the seller's place, it could be difficult to make the purchase in this manner, and as the political situation around 1800 grew unstable, suppliers became more cautious and reluctant when new and unknown purchasers entered the market.

There were ways to solve this problem, and gradually, a new procedure evolved: the purchaser entering the market for the first time asked a well-known commercial house of high standing to accept a bill of exchange.

The fact that these commercial houses seldom specialised in different types of goods but rather in geographical areas facilitated this method of trading. These houses acquired a good reputation and their acceptance of bills became recognised. At this point in time it was not the banks that provided the necessary security for the then widespread international trade but the merchants, who also possessed the required knowledge of the market, goods and local area, and therefore were able to appraise the level of security offered by the documents involved.

Some of these commercial houses gradually made more money on providing the security by accepting bills than they did through their traditional merchant activities, and, notably in London, they evolved into acceptance houses or confirming houses or what is known today as merchant banks.

Not until the time around World War I did the then major banks start taking an interest in this element in international trade.

2.2 The emergence of the documentary credit

It is believed that the documentary credit emerged in the late 18th century. In principle, it took the same shape as we know it today, while the rules that governed its use have become gradually more detailed.

The documentary credit is primarily used in international trade although it is also used to a certain extent within countries of a vast size.

As it often has the function of a guarantee, it is frequently used in times of political unrest. Especially when wars are threatening or just over and normal trade relations have been destroyed. This is explained in more detail below.

Consequently, it was generally believed after World War II that the use of documentary credits would decrease, once peace had been secured and trade relations reestablished.

This assumption proved wrong. The number of documentary credits issued and advised seems to have diminished only a little while turnover in terms of value has risen significantly, not least due to inflation. However, turnover relative to global trade turnover is declining.

One reason for this trend is the significant change in the pattern of trading. Previously, relatively few large companies were engaged in import and export business, whereas in recent years it has become quite common for medium-sized, and even small, companies to import and especially export their goods.

Apart from the changes in the documentary credit structure throughout history, political and financial circumstances also affect the use in specific geographical areas. Civil wars or wars between nations limit trading activity and hence reduce the need for documentary credits or banks' willingness to assume the related risks. However, neighbouring countries are then sometimes regarded as risky, increasing the need for using documentary credits there.

Also the use of documentary credits for specific types of goods undergoes shifts, and so goods that used to be traded by way of a documentary credit are gradually traded by other means. Conversely, goods that were previously traded without a documentary credit may slowly be traded by using a credit.

Viewed from a Nordic angle, a considerable part of the documentary credit import and export business is related to Asia, primarily South-East Asia, with China, including Hong Kong, Taiwan, South Korea, the Philippines, Malaysia, Pakistan and Thailand being strongly represented, and Vietnam and Bangladesh showing rapid progress in this area. Also in India and Japan the use of the documentary credit is common as in other geographical areas like South America, Africa and the Middle East. In Europe the documentary credit is most often used in connection with trade with Eastern and Central Europe and, surprisingly enough, it is not uncommon in export business to countries south of the Alps.

These facts point to the conclusion that a demand for the issuance of a documentary credit is often based on custom and practice and that the use of this instrument is not as geographically limited as many people tend to believe.

Nor is the use of the documentary credit restricted to certain types of goods. It is used quite extensively in the import and export of clothing, electronics, furniture and foodstuffs, that is all kinds of consumer goods, but also in the trading of goods made to order, such as machinery and other fixed assets. In order to cover all the different

needs it is important to emphasise that there are no limits as to the period for which a credit may be issued.

Chapter 3

How the documentary credit works

The purpose of this chapter is merely to give an impression of the various stages a documentary credit runs through during its life, and the cycle of the credit is described in rough outline only. The example concerns a standard commercial credit available by payment at sight, and it is assumed that any dispute arising between the parties has been solved.

The documentary cycle may be said to consist of four successive stages, each of which can be described as a cycle of its own:

- (1) the documentary credit
- (2) shipment of goods
- (3) presentation and honouring of documents
- (4) customs clearance of the goods.

In practice the cycles may overlap, and so the shipment of goods cycle will not necessarily have been completed when the presentation and honouring of documents cycle starts. Also the latter cycle and the customs clearance of the goods cycle will, fortunately, cross.

The specific circumstances and issues relating to the different aspects of the documentary credit will be described in more detail in subsequent chapters.

3.1 Cycle 1 - the documentary credit

Agreement between the buyer and the seller

As denoted by the definition of a documentary credit, it is the buyer who arranges for the credit to be issued.

Before that the buyer and the seller will have negotiated and agreed on the conditions of the actual transaction, including the issuance of a documentary credit (Figure 1, no 1).

Application form

The buyer will fill in the application form based on the (typically) written trade agreement and submit the form to his bank (Figure 1, no 2).

The application form must contain all the information required for the bank to issue the credit as the bank does not know the contents of the agreement. (See the application form in Appendix 2).

The buyer should be aware that an irrevocable credit is binding, not only on the issuing bank but also on the buyer. If the buyer subsequently regrets some of the conditions contained in the credit, it can be amended only with the consent of the seller (Article 10).

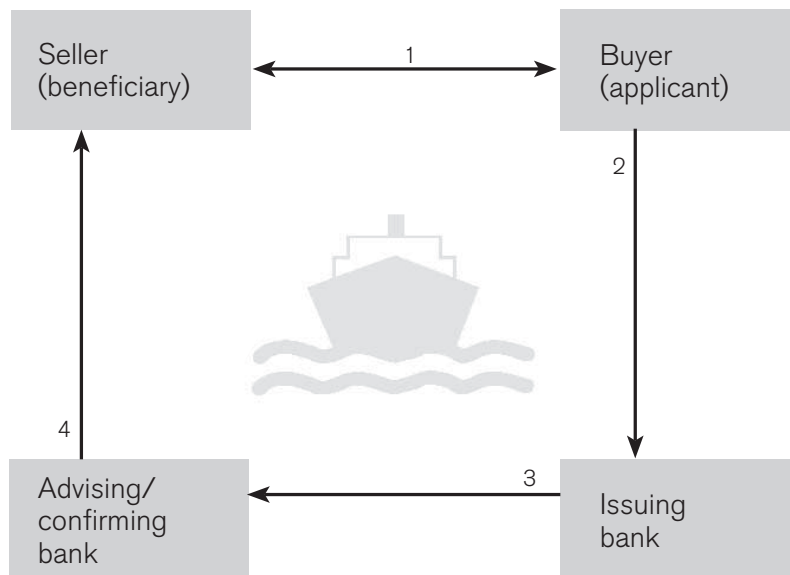


Figure 1 1. Agreement between the buyer and the seller
2. Application form
3. Issuing the credit
4. Advising the credit

Issuing the credit

Having checked the buyer's application and clarified any questions of doubt, the bank will issue the documentary credit and send it to its correspondent bank at the seller's place (Figure 1, no 3).

The documentary credit and the UCP 600 rules describe that bank as the advising bank.

If the buyer states a specific bank through which the credit is to be advised, the issuing bank will use that bank if possible.

The documentary credit is now usually transmitted by teletransmission although it is still possible to do it by letter.

Advising the credit

Having received the credit and made sure that it appears to be genuine, the advising bank will then advise the seller (the beneficiary) of the issuance of the credit by transmitting it to the seller (Figure 1, No 4).

The credit will be advised with or without the confirmation of the advising bank.

The seller should, immediately on receipt of the credit, examine it to make sure it is in accordance with the contract or any other agreement and that all the terms and conditions of the credit can be met by the seller.

If the seller cannot or will not accept the credit, he must ask the buyer to amend the terms and conditions of the credit. The procedure for amending the credit is the same as the procedure for issuing the credit.

3.2 Cycle 2 - shipment of goods

The goods are shipped

When the seller (the beneficiary), having received and examined the credit, has noted that its terms and conditions can be met, he will arrange for shipment of the goods (Figure 2, no 5).

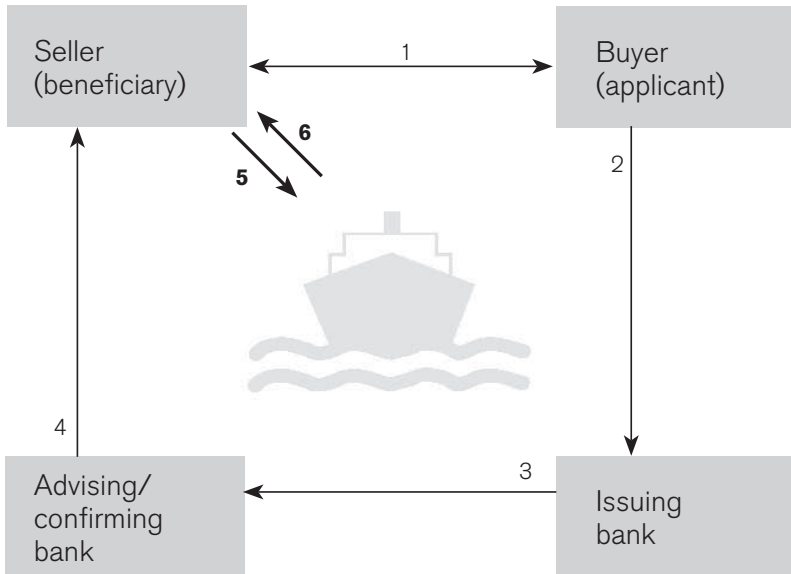


Figure 2 5. Shipment of the goods
6. The seller receives the transport document and arranges for the issuance of all the other documents

Drawing up documents

When the goods have been shipped, the seller will receive the transport document (Figure 2, no 6) from the carrier and arrange for the issuance of all the other documents stipulated in the credit.

3.3 Cycle 3 - presentation and honouring of documents

The seller presents documents

Having received and/or drawn up the documents stipulated, the seller presents them to the nominated bank (Figure 3, no 7) together with the documentary credit instrument.

Settlement

When the bank has examined the documents to ensure that they meet the terms and conditions of the credit and approved the documents, it will usually, depending on the relevant credit, effect payment to the beneficiary (Figure 3, no 8).

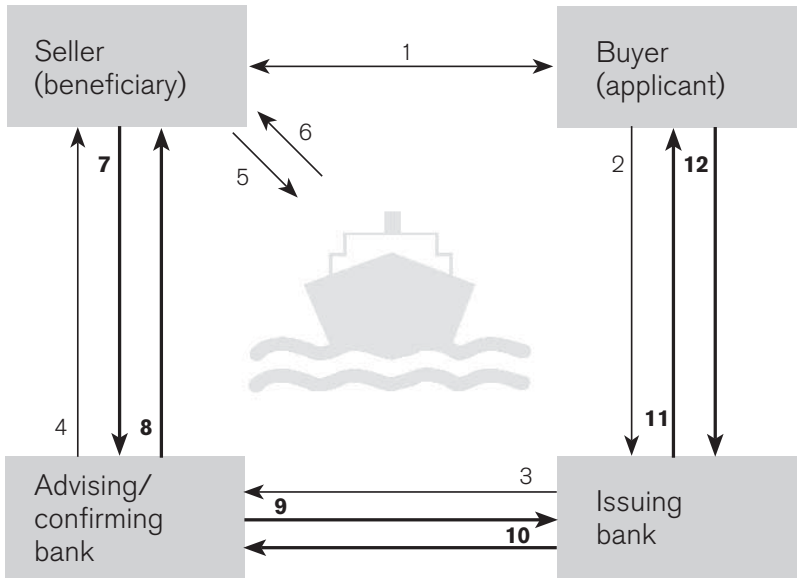


Figure 3 7. The seller presents documents to the bank
 8. The bank effects payment to the seller
 9. Documents are transmitted to the issuing bank
 10. The issuing bank reimburses the nominated bank
 11. The issuing bank passes on the documents to the applicant
 12. The applicant pays

Transmission of documents to the issuing bank

Having examined the documents, the nominated bank will transmit the documents to the issuing bank (Figure 3, no 9) to obtain payment.

Payment by the issuing bank

The issuing bank will also examine the documents upon receipt to ensure that the terms and conditions of the credit have been fulfilled. The issuing bank will reimburse the nominated bank in accordance with the instructions in the credit regarding reimbursement (Figure 3, no 10).

Transmission of documents to the buyer

Provided that conforming documents are presented, or, alternatively, if the buyer agrees to approve them as they are, the issuing bank will pass on the documents to the applicant (the buyer). (Figure 3, no 11).

Payment by the applicant

When sending the documents to the applicant, the issuing bank will demand payment for the documents transmitted as agreed. (Figure 3, no 12).

3.4 Cycle 4 - customs clearance of the goods

Availability of documents to the applicant

Often the applicant (the buyer) needs some of the documents required under the credit to get access to the goods and/or to have them cleared through the customs. In particular, he will need the documents giving title to the goods and those required for clearance or to pay reduced customs tariff. Further documents will be for the buyer's own use.

When the buyer has received these documents, he will, on arrival of the goods, present the transport document to the carrier (Figure 4, no 13), if required.

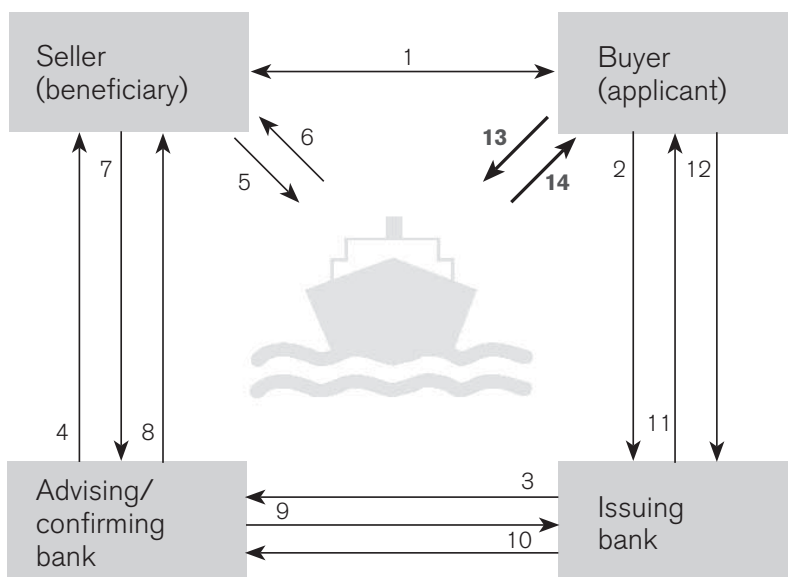


Figure 4 13. The buyer presents the transport document to the carrier
14. The applicant takes over the goods and has them cleared through the customs

Taking over the goods

When the carrier has released the goods, the applicant takes over the goods and has them cleared through the customs (Figure 4, no 14).

Chapter 4

What needs are to be covered
by a documentary credit?

4.1 Purposes and advantages

The seller's security for payment

As appears from the definition, the guarantee element in the documentary credit is one of the most significant, if not the most important, reasons for using an irrevocable credit.

Today a substantial part of international trade takes place between parties who do not know each other or who do not know each other sufficiently well for the seller to want to supply the goods without security for receiving payment from the buyer. Even if the seller makes enquiries about the buyer's credit standing through a bank or a credit agency, this is not always a satisfactory basis for entering into a deal which seems risky to him.

As the credit is issued by a bank (the issuing bank), the seller has thereby changed his risk on the buyer to a risk on the bank. The bank undertakes to pay after the seller has shipped the goods and presented the documents required under the credit.

The bank's payment undertaking under an irrevocable credit also implies that the conditions of the credit cannot be amended without the agreement of the seller and the other parties under the credit. Thereby, the seller has obtained an ideal instrument for securing his export transaction.

Liquidity and cash flow

In addition to security for payment as such, the seller has also obtained security for payment to be made at the time stipulated in the credit. And this is the reason why an increasing number of exporters in recent years choose the documentary credit as a method of payment. In particular in periods characterised by high interest rates or limited possibilities of borrowing money, the documentary credit is an important tool to secure payment on time. Not only can the exporter avoid significant losses of interest but he can also ensure a predictable pattern of incoming payments. This is favourable input to cash-flow analyses and provides better opportunities for companies to enter into financial arrangements.

Cash discount

Sometimes buyers can improve their bargaining position by pointing to the seller's cash-flow advantage and demand compensation for having the documentary credit issued. As the credit is more or less comparable with cash payment, the seller will often grant a reduced price, which may or may not be equal to a cash discount.

The buyer's security

Considering the many advantages for the seller, the buyer would seem to get most or all of the disadvantages. It is true that the documentary credit is the "seller's instrument". In general, the buyer will not ask for a documentary credit if trading on open account terms or by documentary collections is an alternative.

On the other hand, it is interesting to look at the advantages the buyer does gain by using a credit. As the buyer is receiving goods and not money, it is relevant for him to require security for receiving the goods; the right ones, that is.

An ordinary documentary credit cannot offer this benefit. The buyer can be certain that the seller is entitled to receive payment only against presentation of the documents stipulated in the credit, and only provided that the documents comply with the terms and conditions of the credit. It is important to note that it is the buyer himself who has imposed the conditions that apply to the credit (see 6.4 Application form).

The documentary credit as an instrument of finance

The UCP 600 establishes the banks' undertaking to effect payment if the beneficiary presents the documents required. Payment should be taken in a literal sense. This means that the bank must pay when the documents are presented (a sight credit) or at the time stipulated in the credit (usance credit). The deferred payment period may be determined in different ways but will be ascertained on presentation of the documents at the latest.

On the basis of the payment undertaking assumed by the issuing bank the buyer or the seller may obtain simple and often low-priced finance (see "Finance" under 13.2).

It is easy to image a situation where the seller is prepared to supply

goods to the buyer if he receives payment right away. The seller can appraise the financial circumstances of the buyer and the buyer's country and make sure that the goods are not released to the buyer until payment has been made.

If the buyer wishes to get access to the goods to gain more time to process and/or sell them before he pays his debt, the seller may find it difficult to assess the risk involved in the transaction.

This situation can be facilitated by the use of a documentary credit. The security for the seller is based on the documentary credit and not on the goods or the buyer's ability to pay. When the documents have been presented and approved by the issuing bank, the seller is certain to receive the amount at maturity, irrespective of the buyer's solvency.

Therefore, the seller can grant the buyer the credit required without incurring a risk. It is for the seller to decide whether he will include the loss of interest in the price of the goods or whether he prefers to consider the granting of credit a necessity to obtain the order.

Usually the seller will be able to have his outstanding claim discounted under the documentary credit, thereby covering his cash requirement.

Pre-export finance

The seller may have a need for finance to buy parts or raw materials for the goods to be exported under the documentary credit. Provided that he is creditworthy and has no liquidity problems, this will pose no problems. Otherwise, his bank may grant him an advance against security in the documentary credit. This is a widely used method in Asia, for instance in Hong Kong.

However, it is important to note that the documentary credit itself has no actual value. Its "value" presupposes that the documents presented by the beneficiary are in conformity with the credit. Nevertheless, the beneficiary can prove that he has obtained an irrevocable order, and the bank can, based on its trust in the seller, appraise the seller's ability to produce the goods and present the documents. Documentary credits are also used in the Nordic region as partial security for pre-export finance or as advance payments, although to a limited extent.

The documentary credit as a management tool

As mentioned earlier, the documentary credit is often used as security in connection with transactions where the buyer and the seller do not know or trust each other. After some time when their trading relations have proceeded without problems, the parties may agree on using a smoother and cheaper solution. Documentary collections through banks could be the first choice, to be replaced later on by trade on open account terms. Buyers will probably always prefer to trade on open account terms, whereby they receive the goods, examine them and then pay for them. If the seller trusts the buyer based on previous experience, it is natural to proceed to trade on open account terms, especially if the buyer's country does not restrict imports or delays payment. There are, however, several examples of business partners who continue using documentary credits for years even if their trade relations are very good because either party or both parties want to use the documentary credit as a management tool.

When the business deal has been entered into and the documentary credit has been issued, the goods can be dispatched by the seller at the time agreed on or as stipulated in the credit.

Neither the buyer nor the seller need bother more about dates of payment and the like as the documentary credit departments of the banks involved take care of such details.

Requirements by the importer's country

As appears from the definition and description of advantages and disadvantages, it will typically be the exporter rather than the importer who demands the issuance of a documentary credit in connection with a business transaction.

However, sometimes the authorities of the importer's country demand the issuance of a documentary credit, especially in countries with strong control of imports, such as South American, African and Asian countries. These countries often have a poor economy or an adverse balance of trade and therefore wish to curb the import of goods not considered important by the government. Control is carried out by way of import licences, and to ensure that payment is not effected for any other goods, the central bank will issue payment permissions based on the exchange control regulations of the country.

The documentary credit requirement may apply to all imports into the relevant country or only specific types of goods, such as luxurious consumer goods.

In certain countries there are buyers who make agreements on overinvoicing because they want to have foreign currency to buy things that are not available in their own country or not allowed to import. They then pay an excess price, and the money later, mysteriously, finds its way to the buyer's account abroad.

In order to avoid such speculation the relevant countries demand, in connection with the documentary credit, an inspection certificate issued by an internationally recognised firm of inspectors. Such certificate will appraise the condition of the goods certifying that the invoiced price complies with the market price.

When a country requires documentary credits to be issued for all goods imported, there is a side effect, in that sometimes credits are issued for very small amounts causing additional costs and work for the exporter, for instance regarding spare parts for amounts that could not even cover the exporter's costs relating to the credit. In such a situation the exporter will have to decide whether to refuse the deal or perhaps to supply the parts free of charge.

4.2 Disadvantages

It may seem that there are only advantages connected with the use of documentary credits, most of which benefit the seller. However, there is a backside to the coin and there are disadvantages too for the parties involved.

Disadvantages for the seller

Documentary credits have a reputation for being cumbersome to handle and expensive and indeed, drafting the various documents called for in a credit does require a considerable workload. When documents are used in a transaction on open account terms or in a documentary collections deal, no bank will scrutinise them. If they meet the buyer's demands and authority requirements, everything is OK.

Under a documentary credit documents are not only to be drafted "as usual". They have to be drafted exactly in compliance with the

stipulations in the credit, whether it seems important or not to the beneficiary.

And as far as costs are concerned, the charges seem high, but the seller should consider what he gets for his money: faster settlement and security for payment.

Sometimes the issuance of a documentary credit takes longer than the seller, and perhaps also the buyer, had expected. If the parties have entered into a contract containing dates of dispatch, this could cause problems. The reason for the delay seldom lies with the issuing bank, although the processing time varies among the banks and countries. If an import licence or a payment licence from the central bank is required, the time needed for obtaining such document must be taken into consideration. Also, the issuing bank will have to assess the creditworthiness of the buyer, see 6.4 Application form, and if he is unknown to the bank, this may take some time, causing a delay in the issuance of the credit. As a consequence, the seller may not be able to meet the terms and conditions of the contract, notably the date of dispatch wanted by the buyer. The seller's dilemma will be to decide whether to insist on receiving the documentary credit before shipment of the goods or to accommodate the buyer, with the risk that, not having seen the credit before dispatch of the goods, he may not be able to fulfil the terms and conditions of the credit.

Disadvantages for the buyer

In general, an advantage for the seller may be a disadvantage for the buyer. The seller's security for payment implies that the buyer cannot refuse to pay if the documents presented meet the stipulations in the credit. Nothing in the condition of the goods or changes in the market price and product development in the relevant industry will justify the cancellation of an irrevocable credit. And amendments to the credit, such as a price adjustment, can be made only with the consent of the seller.

In order for the buyer to induce his bank to issue a documentary credit, the bank will have to find him creditworthy. Therefore, it is most often the buyer's usual bank which is asked to issue the credit.

4.3 Risks connected with the use of documentary credits

The seller's risk

The security for the seller presupposes that the issuing bank is able to meet the commitment it has incurred by issuing a documentary credit. If the seller does not know the issuing bank, which is often the buyer's bank in a distant country, his security may be questioned. This is particularly true if the seller does not trust the bank or even the country of the buyer and his bank.

In a situation like this the seller will have to ensure that his security requirement is met, and this is possible by having the credit confirmed by a bank and placed in a country he trusts. For further details, see 8.4 The nominated bank's payment undertaking.

A documentary credit is not better than the bank that guarantees payment.

The buyer's risk

The buyer is often believed to take a great risk: there is no guarantee that he receives the goods he has paid for; they may be the wrong goods or of poorer quality or he may even risk not receiving anything as a consequence of fraud.

Under the most common type of credit he cannot even be sure to receive the stipulated documents. All he knows is that the seller has presented them in the bank nominated to effect payment.

It is the issuing bank – and in the end the buyer – who bears the risk of documents being lost in transit after they have been presented to the nominated bank as stated in Article 35, second paragraph, but it is a condition that the documents were complying. In such cases the issuing bank may ask for copies of the documents.

Risk appraisal

By comparison between the buyer's risk and the seller's risk, the seller seems to be able to manage his risks and the buyer appears to be the weaker party.

Everyone who is engaged in documentary credits knows of all the many possibilities of committing fraud that exist and do happen. However, it is important to note that fraud in documentary credit

transactions is rare. The stories people hear are often the same stories told over and over again.

When compared with the very large number of documentary credit transactions carried through on a daily basis, the fraudulent misuse is, fortunately, quite low.

As with most commercial transactions, it is important for the parties to be on their guard, especially if they do not know each other. An offer may be too good to be true, and so the parties should in their own interests be on the lookout for warning signs.

Chapter 5

Governing law and rules for documentary credits

Whenever a new product is developed, whether in physical form or of an abstract nature, such as a payment system there is today a general tendency to ensure the existence of an unambiguous legal opinion or approval of such new product, for instance by way of legislation or international rules.

In earlier times, however, a product was invented and used, and if it proved its ability to survive, the legal basis and rules were then established.

The bill of lading is one example. There was a need to ensure that the right owner received the goods, and this was done by tearing across the document issued by the captain of the vessel. The captain kept one half and the consignor the other. When the vessel called at the port of destination, the goods could be handed out to the person holding the other half of the document.

Later the bill of lading developed into the document as we know it today and gradually the seafaring nations introduced their own maritime laws. Afterwards international agreements sought to harmonise these laws.

5.1 Absence of rules

The same pattern is seen with the documentary credit. In the beginning there were no rules to govern relations between the parties and so they had to make individual agreements.

This proved too cumbersome and banks began to establish their own rules in the same way as banks today have their own general terms and conditions.

However, this was not sufficient, so in the early 20th century banks in different countries agreed to set up national rules for the handling of documentary credits. Therefore, there were rules for London banks, while other rules applied to banks in Paris or Copenhagen.

5.2 National rules for documentary credits

As late as in 1928 documentary credit rules were issued in Denmark under the heading *Joint Regulations governing the Handling of Documentary Credits opened with the Principal Copenhagen Banks* (Appendix 1). These rules had been established by the then three

major Danish banks: Privatbanken i Kjøbenhavn Aktieselskab (which later became Unibank as a result of a merger and in 2000 merged with MeritaNordbanken and Christiania Bank og Kreditkasse to become Nordea), Den Danske Landmandsbank, Hypothek og Vekselbank Aktieselskab, and Aktieselskabet Kjøbenhavns Handelsbank (the latter two of which have merged to become Danske Bank).

These rules existed in Danish, English, French and German versions and they governed the “letters of credit”, as they were then called, “opened” by the relevant three banks. Similar rules applied to letters of credit opened by other banks in other countries and, therefore, trading partners had to use several different sets of rules, which were presumably fairly similar.

The old Danish rules as well as those of other countries were not very precise and mainly focused on the banks’ rights.

The absence of legislation and rules for handling credits internationally was untenable as world trade developed and in particular in view of the growing international unrest and threatening war looming on the horizon.

5.3 International Chamber of Commerce

The International Chamber of Commerce (the ICC) was founded in 1919 by a small group of forward-looking international business people as a private international trade organisation. The purpose of this organisation was to support and develop free cross-border international trade by promoting improved conditions and uniform international rules.

The ICC is engaged on several fronts and is today divided into several commissions. The purpose of the ICC Commission on Banking Technique & Practice (Banking Commission) is to draft and interpret rules and to advise on international banking, such as issues relating to documentary credits, documentary collections and guarantees.

Today the ICC has more than 60 national committees in charge of the organisation’s activities in the relevant countries. Including the personal memberships the ICC is represented in more than 130 countries around the world.

5.4 ICC Uniform Customs and Practice for Documentary Credits

The members of the Banking Commission soon became aware of the need for international rules for the handling of documentary credits.

The first version of the ICC Uniform Customs and Practice for Documentary Credits was adopted at the ICC's congress in Amsterdam in 1929. Only a limited number of countries used these rules, and the first revision was adopted in Vienna in 1933 with a minor amendment in 1949. World War II delayed the widespread introduction of the rules, and so the use was limited to banks in mainly European countries, although banks in Asia and South America had also accepted the rules. Most – if not all – Nordic banks approved the revised 1933 version in the early 1950s.

The major breakthrough came with the revision in 1962. Now British banks adopted the rules and, being influenced by British trade, countries all over the world followed suit. With the 1962 revision it became relevant to describe the rules as truly international. Later on further revisions were made: in 1974, in 1983 and again in 1993 (effective 1 January 1994). In 2006 the rules were revised again (effective 1 July 2007). The latest revision is the UCP 600 – the version applicable today.

The official title of the rules is ICC Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600, mostly referred to as UCP 600.

The original version is in English, and many countries have translated the text into their own language. In the Nordic countries, as in most other countries, the translation into the national language is made by the ICC's national committees in cooperation with the major banks or their banking association, but the ICC's head office in Paris has copyright on both the original text and all the translated versions. The banks in some Nordic countries have agreed to hand out the national version on request free of charge, while in other countries the translations, if any, can be bought from the national committee of the ICC. As regards the UCP 600, it is a part of ICC's copyright rules that any translated version must also include the original (English) text.

5.5 Absence of legislation

Only few countries have specific statutory rules governing documentary credit transactions. In countries without such rules the courts will generally base their decisions on normal legal practice. In many instances courts have relied on the relevant country's legislation relating to similar areas, and frequently they have relied on bill of exchange legislation because a bill of exchange had been issued under the credit and had been or was to be accepted by the issuing bank.

One of the big problems that often appear in connection with lawsuits regarding the interpretation of a documentary credit or one or more of its stipulations or concerning the documents presented is that many lawyers and judges lack sufficient knowledge of the instrument and, therefore, consider a documentary credit as a contract. This problem appears in largely all countries and typically at the courts of first instance. Many "erroneous" decisions, from a technical point of view, are then corrected at the next or highest instance if they are appealed. The main reason for the insufficient knowledge about documentary credits is of course that most documentary credit transactions are, fortunately, settled without problems.

By far most of the disputes relating to credits are settled out of court, perhaps even without a court order (for further details, see 18 Solving conflicts).

A documentary credit is not a contract

In many lawsuits and in many books the documentary credit is referred to as and treated like an "ordinary contract which, by agreement, is subject to the ICC rules". However, many lawyers as well as experts on documentary credits, including me, agree that a documentary credit cannot really be considered as a contract. The main reason is that a contract is based on offer and acceptance. It is signed by at least two parties who are bound by the contract. A documentary credit is not an agreement between a buyer and a seller and cannot replace the purchase agreement or any other agreement between the parties.

The documentary credit is a promise given by the bank in favour of the seller. The seller is not bound by the credit and, as explained later, the buyer is not a party to the credit. If it were a "contract", it would be a unilateral "contract".

5.6 Legislation covering documentary credits

Few countries have given the Uniform Customs and Practice (UCP) the force of law, thereby giving these rules far greater weight than otherwise. Other countries have chosen to make laws covering documentary credits by passing bills with almost the same wording as the UCP rules. Both methods pose problems when the UCP rules are being revised because the wording of the law will remain the same until amended. Moreover, a number of credits issued according to the old rules will still exist for some time, while other credits are being issued in pursuance of the revised version.

UCC - Uniform Commercial Code

The USA has had its own special trade legislation for many years, the Uniform Commercial Code (UCC), of which Article 5 exclusively deals with documentary credits. For a long time the UCC has had a strong influence on judicial decisions in the USA, even where the relevant credits have clearly stated that they were issued according to the ICC's international rules. Judges know the national law and have often disregarded the international rules. To complicate things even more, the different states may have different versions of the UCC.

Recent years have seen a development that reinforced the ICC's international rules, and an increasing number of credits issued in the USA refer to the UCP even if they have been issued for the purpose of being used within the USA. Judges are increasingly paying attention to this.

Not so long ago Article 5 of the UCC was revised in many states to include a clause expressly stating that if the credit has been issued in accordance with the UCP, these rules will apply, and the UCC will be applicable only to matters not comprised by the ICC's rules. Furthermore, the revision reflects a great deal of the attitudes and the wording of the UCP. Many states have adopted the new legislation while others are still reluctant. Massive efforts are being made by US banks and lawyers to persuade the remaining states to approve the revised UCC without further changes.

UN Convention

Through its Commission on International Trade Law (UNCITRAL), the United Nations has for several years sought to draft a form of international law on documentary credits and guarantees. There was not agreement or clarity as to whether it was to become international law or a convention.

In 1996, the work was completed and the rules were adopted at the UN's General Assembly under the name of United Nations Convention on Independent Guarantees and Stand-by Letters of Credit.

In order for the UN Convention to be effective, it has to be "ratified, accepted, approved or acceded to" by at least five nations.

Subsequently, it can be acceded to by any nation, and the convention will be effective in the nations having acceded to it. By January 2006 the Convention had been ratified by Ecuador, El Salvador, Gabon, Kuwait, Panama, Liberia, Belarus and Tunisia. The USA has signed but not yet ratified or acceded to the Convention. The Convention entered into force at 1 January 2000.

As the name implies, the Convention is to comprise demand guarantees and standby letters of credits to which it will automatically apply provided that certain conditions have been fulfilled. However, the Convention also covers other definite and independent guarantee undertakings.

According to the wording of the UN Convention, it can also be applied to documentary credits if expressly stated in the specific credit.

By its wording the Convention respects the international rules that may exist in the areas mentioned, including the ICC's UCP 600 and Uniform Rules for Demand Guarantees (URDG).

Consequently, the UN Convention does not compete with the ICC rules but rather functions as a supplement to them for the purpose of ensuring uniform international rules around the world. The ICC has endorsed the Convention.

5.7 The legal scope of the ICC rules

As described, the ICC's international rules for documentary credits (UCP 600 or earlier versions such as UCP 500, 400 or 290) are

not statutory rules and as such they only have the legal effects of an agreement.

In order for the international documentary credit rules to apply to a specific credit, they must be incorporated into the text of the credit (Article 1). Thereby the issuing bank declares that it will respect these rules, and by using the credit, the beneficiary expresses his intention to observe the rules. The same applies to other parties involved in the credit, such as the advising bank, the nominated bank and the confirming bank, if any.

Due to the fact that the UCP has no independent legal effect, the national laws of a country, or perhaps international laws, will carry more weight in a lawsuit concerning a dispute about the interpretation of the stipulations in a credit.

However, one important benefit of using the UCP 600 is that this set of rules has gained wholehearted universal acceptance to the extent that hardly any commercial documentary credit is issued without being subject to these rules.

As indicated by the name, the UCP represents customs and practice, but the rules indeed enjoy the respect of the lawyers and courts of most countries.

5.8 Governing law and venue

In many contracts the parties agree on which country's governing law is to apply and what court is to settle any disputes. Also international rules may contain such provisions which apply unless otherwise agreed between the parties.

The UCP 600 does not mention anything about applicable law or venue, and the commercial documentary credit seldom contains any provision to this effect.

The reason could be that most often the parties are confident that the UCP 600 will suffice. In addition, a documentary credit is not, in my opinion, a contract, and consequently, there are not two parties who agree on and approve the wording. Of course, there is a buyer and a seller, but the credit will not be issued by any of these but by the buyer's bank in favour of the seller. And then there are all the other parties, typically banks, who very seldom have any say when it comes to the wording of the credit.

Generally, the parties do not meet to negotiate about the credit. If they did, they might well agree on a provision in the credit about governing law and venue, but they might just as well disagree, with resulting discussions and delays.

Experience shows that by far most credits are issued and settled without any legal assistance. In cases where disagreements arise, these are to a great extent handled by the parties themselves.

On the other hand, there is a tendency to increasingly involve legal assistance when conflicts occur. This tendency is particularly outspoken in the USA and has spread to other geographical areas, often in times of recession.

If a dispute arising from a documentary credit is brought before a court, the governing law and venue will often be the first issue to be dealt with by the court.

Even if the court may decide this matter itself, it will likely let the location where the credit is available, that is where payment under the credit is to be made, determine which court is to have jurisdiction, unless the court finds that other circumstances speak against it.

5.9 Other sets of rules

Bankers and other people who are actively engaged in documentary credits, consider the ICC's UCP 600 the very "fundamental law" on credits, even if they know that the UCP 600 merely constitutes a set of universally recognised rules without independent legal effects.

It seems to be the general international view that the UCP 600 and national laws rule the documentary credits world.

ISP98 - International Standby Practices

According to its provisions, the UCP 600 also applies to standby letters of credit (also termed standbys). However, even during the process of revising the UCP 400 as well as UCP 500, lawyers, banks and financial organisations in the USA and other countries expressed the need for a specific set of rules to govern standbys, which can briefly be described as a bank guarantee taking the form of a documentary credit.

The reason for the wish to establish independent rules for standbys was that many of the articles of the UCP specifically

deal with the commercial transaction, containing provisions on commercial documents. Nor were the provisions in the UCP about force majeure, drawings and/or shipments by instalments and expiry date acceptable for the American trading society's use of standbys.

The ISP98 was published jointly by the ICC, the Institute of International Banking Law and Practice and the IFSA, the US banking organisation for international banks. For further details about the ISP98, see 20.7 Rules for standby letters of credit.

Chapter 6

Establishing the credit

6.1 The underlying commercial basis

The agreement between the buyer and the seller on their commercial transaction forms the basis of every documentary credit. The UCP 600 contains no requirements as to the form of such agreement.

In connection with major transactions or where the buyer and the seller do not know each other, they will often enter into a formal written contract, sometimes using legal assistance. The contract contains all the details, including those relating to the issuance of the documentary credit.

The contract will typically include the following information:

- A description of the goods and quantity, including any deviations permitted and quality descriptions.
- The total price and unit price of the goods and discounts and/or additional charges as well as freight charges and insurance.
- Terms of delivery (Incoterms or other terms).
- Date of delivery and whether partial shipments are permitted.
- Terms of payment, including date of payment and whether the issuance of a documentary credit is required.
- If payment by documentary credit is agreed, the contract should state the nominated bank (the seller's bank), whether the credit is to be confirmed, who is to pay the costs of the credit and discounting or financing costs if the credit stipulates deferred payment, and the expiry date of the credit.
- The documents to be presented and whether the documents required by the buyer are needed to clear the goods through customs, and other documents required by the buyer for his own use.
- Directions as to how any dispute arising between the buyer and the seller should be settled.

Once the contract has been entered into, it will form the basis of the application to be made by the buyer to the bank issuing the credit.

When the buyer and the seller have become better acquainted, or for other reasons do not find it necessary to enter into a formal contract, they may agree on the transaction in a more informal manner, for instance by the buyer's acceptance of the seller's offer. It

is important that the seller clearly states in the offer that he demands a documentary credit to be issued together with other details of significance to him. Similarly, the buyer should make sure that his needs are fulfilled when accepting the offer.

The simplest way to agree on a transaction is for the buyer to place an order in writing or by telephone with the seller for the delivery of specific goods. It is presumed that the parties have previously transacted business together and so prices and conditions are known by both parties.

In whatever form the agreement has been made, it applies that if it does not contain all necessary terms and conditions to issue the documentary credit, the buyer must provide such details later or make a decision as to the missing details.

6.2 The seller's requirements as to the credit

As mentioned earlier, it is most often the exporter's need to have security for the buyer's ability and willingness to make payment that is the reason for establishing the documentary credit. Consequently, it is essential for him not only to ensure that a credit is issued in his favour but also to be certain that the credit to be issued fulfils his requirements.

As each documentary credit should always be drafted to suit the relevant transaction, it is impossible to provide standard wording for the perfect credit. The exporter is advised, however, at an early stage to inform the buyer of the conditions to be included in the credit. It is relevant to state the conditions in the contract but if a contract is not entered into, such conditions must be provided by other means.

The best way to secure his position is for the seller to think through the whole process of dispatch, drafting and honouring of documents already when producing or buying the goods. By taking into consideration problems or changes that may arise, the seller can ensure a smooth process for the documentary credit and payment on time.

The exporter should, for instance, contemplate the following points and make sure they are incorporated into the credit:

- The seller should demand a documentary credit. It is a good idea to demand that the credit should be advised through one's own

bank. If the seller does not know or trust the issuing bank, or if he wants security against political risks in the buyer's country, he should demand that the credit be confirmed – either by his own bank that advises the credit or by another acceptable bank, such as an internationally renowned bank (see 8.4 The nominated bank's payment undertaking). (According to the UCP 600 all credits are irrevocable, but an issuing bank (or the applicant) may state specifically otherwise in the credit).

- The seller should ensure that the credit shows the correct – and adequate – amount. There must be scope for agreed price adjustments and changes in freight and insurance. The seller must state whether the credit is to be issued for a fixed amount, a maximum amount or an approximate amount (see 9.3 Contents of the documentary credit). The seller should demand that the credit permits shipment from a port or a location he is sure to be able to use. It could also be essential that the credit does not prohibit transshipment if transshipment is necessary.
- Before the credit is issued, the seller should consider the need for partial shipment. If there is such a need – or if he suspects there might be – he should demand that the credit allows it, even if partial shipment might turn out not to be necessary after all.
- If the parties have agreed to have the goods shipped by instalments and to include in the credit the periods within which such instalments must be shipped, the seller should ensure that he can observe those periods agreed upon or that the credit allows skipping or postponing a shipment (see Article 32).
- The credit should state the correct and precise terms of delivery. A term like “FOB” does not suffice, whereas the meaning of “FOB Hamburg, Incoterms 2000” is quite clear.
- If the seller is to receive payment of amounts in addition to the amount of the credit, the credit should clearly state the manner in which such payment is to be made.
- The seller should ensure that the date of expiry of the credit and the date of shipment are realistic. He should consider the risk of delays in connection with the production and dispatch of the goods. Also where the seller does not produce the goods himself but has to rely on delivery on time by his supplier.

- The period allowed for the presentation of documents should not be too short. The seller should make sure that he is able to issue and present the documents within that period. In particular if a consular invoice is to be presented or another document to be certified by a consulate, the time needed for that should be taken into consideration.
- If the seller has accepted a usance credit (whereby the seller grants the buyer a credit facility), the seller should make sure that the form and wording of the documentary credit is in compliance with the agreement.
- It could be an advantage for the seller if an unconfirmed credit is payable by bills of exchange drawn on a bank authorised to honour the documents, or if the credit is payable by deferred payment in that bank. It is preferable, of course, for the credit to be confirmed by the nominated bank. Most often the accepted bills of exchange or the claim can be discounted to the effect that the seller, against payment of the discount, can avoid cash problems in connection with the credit granted to the buyer.
- If possible, the seller should agree with the buyer what documents are required before the credit is issued. This is to avoid a demand for documentation which the seller cannot or does not wish to fulfil. In certain countries it is customary to require special certificates regarding the vessel, the exporter or goods etc, eg in regions at war.
- The seller should demand that the description of goods be brief and general, and he should prevent the buyer from allowing a copy of the pro forma invoice or a contract to form part of the documentary credit. Otherwise, and if the description of the goods is too detailed, it might lead to problems in connection with the drafting of documents as the description of the goods in the commercial invoice must correspond with the description in the credit according to Article 18(c). It should, furthermore, be possible for the buyer and the seller, after the credit has been issued, to modify the description of the goods in the agreement or contract to reflect the actual shipment.
- If the parties have agreed to have the goods shipped in a particular manner, such as by way of a bill of lading or an air

transport document issued by a (named) freight forwarder, this must be stipulated or allowed in the credit. The UCP 600 prescribes that the transport document must be issued by a carrier or a carrier's agent, unless otherwise stipulated in the credit.

As mentioned earlier, the fulfilment of the above requirements does not guarantee smooth settlement of the transaction. It is essential that the exporter thoroughly examines the documentary credit received before making any irrevocable or costly decisions. See also Chapter 10 Advising the documentary credit.

6.3 The buyer's requirements as to the credit

Naturally, it is much easier for the buyer to have his requirements as to the wording of the credit fulfilled than it is for the seller. It is the buyer who arranges for the credit to be issued, and so he can fill in the application form in accordance with his wishes.

Before completing the application form he should, however, consider these requirements as he has an obligation to make sure they tally with his agreement with the seller.

As mentioned earlier, the documentary credit is issued only rarely in order to meet the needs of the buyer. Nevertheless, when the buyer accepts that the transaction is executed by way of a documentary credit, it is important for him to secure the best possible conditions in the credit.

The key thing for him is to receive the correct goods at the price and time agreed.

The only purpose of the documents required by the buyer to be presented under the credit is to ensure that the transaction is effected as agreed and that the buyer gets access to the goods and can clear them through customs.

It is obvious that the interests of the buyer and the seller in connection with the documentation required under the credit differ; sometimes they are even contrasting, although both parties take a natural interest in the completion of the transaction.

Just as it is in the seller's interest to ensure the dispatch of the goods on terms he can fulfil, the buyer needs to be certain that the goods can

be shipped in a manner that is not too inconvenient or costly.

- The buyer will want to have the credit issued as cheaply as possible. Therefore, unless otherwise agreed, he will ask for an irrevocable credit but not request that it is confirmed by the seller's bank. Unless the buyer has agreed otherwise with the seller, he may ask for all costs outside his own country to be for the seller's account.
- The buyer will want to keep the amount of the credit as low as possible in order to prevent the seller from raising the price of the goods.
- If the buyer is to pay for the freight, he will want the goods to be shipped from a location that charges the lowest freight. Often the buyer prefers the time of transport to be as short as possible.
- The buyer should consider whether transshipment is acceptable. However, transshipment can be necessary in certain cases and some forms of transshipment will automatically be allowed according to the UCP 600.
- The buyer should consider whether the goods can be delivered in partial shipments or whether they have to be delivered in one shipment. If partial shipments at fixed dates have been agreed and are incorporated into the credit, the seller is bound by such agreement.
- As the terms of delivery constitute an essential part of the price, they should be described as precisely as possible in the credit to ensure that the buyer does not accidentally pay part or all of the costs of freight or insurance if the seller was supposed to do so. This applies in particular to the transport from the port of discharge to the final destination.
- If the seller is entitled to receive payment in excess of the credit amount, such as freight and/or insurance, the buyer should consider what kind of security he wants in order not to pay more than he has to. He could for instance demand documentation by way of receipts for charges paid.
- The buyer's demand for a detailed description of goods should be balanced against the provisions in the UCP 600 and practical circumstances (see 9.3 Contents of the documentary credit).

- The buyer should thoroughly describe his demands concerning transport. If he has entered into specific agreements with a freight forwarder or an insurance company, or if, for instance, he wants to use a specific shipping company in the seller's country, this should be stated in the credit.

As in credit operations all parties concerned deal with documents, and not with goods (Article 5), it is in the interest of the buyer to receive as many and as detailed documents as possible in order that he can feel assured that the goods have been shipped and that they are the correct goods at the right price and of the quality agreed.

First and foremost the buyer will demand the documents required to carry out the import:

- invoice
- transport document (bill of lading or air waybill)
- insurance document.

In addition the buyer will, of course, demand the documents required by the authorities in the importing country to clear the goods through customs. Such requirement may relate to specific types of goods or to certain countries:

- certificate of origin
- health certificate
- import or export licence
- consular invoice.

Sometimes the buyer will also demand other documents for his own use describing aspects like quality and contents, such as:

- inspection certificate
- packing list
- guarantee issued by the seller or the manufacturer.

There is no restriction as to the documents the buyer may demand and they may take any form. However, it is important for the buyer to be aware that excessive demands as to documentation may annoy the seller or pose a barrier to carrying through the transaction.

If the buyer makes demands in excess of what has been agreed or what the seller considers reasonable, the consequence could be that the seller will demand amendments to the credit or that he does not use it. This could either be because he cannot use it or because he does not want to be bothered with the extra work of preparing documents that – to his mind – are unnecessary.

Amendments take time and cost money, and a documentary credit issued to no avail will be a waste of time and money for the buyer.

Consequently, it is in the buyer's interest to ensure that his agreement with the seller contains the demands to be incorporated into the credit.

6.4 Application form

When the buyer and the seller have agreed on the business deal and, roughly, the conditions of the documentary credit, the buyer will fill in the application form. Most banks that handle documentary credits have their own form for this purpose.

Having filled in the application form, the buyer will usually have provided the bank with all the information required to issue the credit. If more details are needed, he can attach an appendix to the form.

It is not customary for Nordic banks to demand the presentation of a purchase agreement or a pro forma invoice together with the application form. The credit is issued exclusively on the basis of the information provided by the applicant. For an example of an application form, see Appendix 2.

Contents of the application

Since the documentary credit is based entirely on the application, it is very important that the form is correctly filled in and contains all the necessary details. The pre-printed boxes in the form usually guide the applicant to do so, but still, depending on the relevant transaction, additional details may be needed.

The details provided should be unambiguous and easy to understand. There should be no doubt as to their interpretation. The seller, and perhaps also the nominated bank, will interpret the wording of the credit from their point of view, so the applicant must

endeavour to put himself in their place. The applicant must realise that if the seller interprets the wording in a way different from himself, it may be to his detriment at a later stage.

The application form typically contains the following details:

- The full, and correct, name and address of the applicant to ensure that the seller (the beneficiary) knows who has issued the credit. It is particularly important to state these details correctly if the applicant is part of a group of companies where several different company names are almost identical.
- The full, and correct, name and address of the beneficiary.
- The type of credit. Where nothing else has been agreed between the buyer and the seller, it usually suffices to ask for a documentary credit.
- The date of expiry. The documents are to be presented on or before that date by the seller to the bank where the credit is available (Article 6(d)(i)).
- The place for presentation of documents (Articles 6(a) and 6(d)(ii)). It is usual to have the credit available for presentation of documents with a specific bank in the beneficiary's country or with any bank.
- If the seller wants to have the credit advised through a specific bank, the name of that bank should be stated. If no specific bank is requested, the issuing bank will select a bank from among its correspondent banks at the place where the credit is to be available. The issuing bank often knows these banks very well. If the seller wants a bank which the issuing bank for some reason cannot or does not want to use, the credit can, according to agreement with the applicant, be transmitted to another bank in the city or country of the beneficiary.
- The amount and currency of the credit. If the invoice to be presented later by the seller is not to be for the exact credit amount, the variance allowed should be stated as, for instance "up to" or "for a maximum of". Words like "about" or "approximately" mean an allowance of 10% more or 10% less. Other non-international standard variances should be precisely described to avoid misunderstanding.

- A brief but clear description of the goods, including details of quantity. In addition, the unit price, if any, and description of type, colour, size etc can be stated, if relevant. Sometimes it is appropriate to refer to a pro forma invoice or an agreement.
- What documents are required to be presented by the beneficiary in order for him to receive payment? Also the number of originals of each document, who should issue the documents, the contents and other specific details must appear from the relevant documents. Mode of transport and consignee must appear from the transport document.
- The place of shipment, the latest date for shipment, if required, and the destination must appear from the transport document.
- Whether partial shipments are allowed or not. For further details, see Partial shipments under 12.6.
- Whether transshipment is prohibited or not. For further details, see Transshipment under 12.6.
- Terms of delivery agreed in the contract with the seller, including indication of the place, for instance FOB Tokyo, CFR Hong Kong, CIF Copenhagen, preferably in compliance with Incoterms 2000 or other specifically stated versions.
- Date of payment. It should be stated whether documents should be paid at sight (on presentation of documents) or at a later date, either by deferred payment or against the acceptance of a bill of exchange.
- Whether the applicant covers insurance, for instance FOB or CFR delivery terms. The issuing bank may ask for a copy of the insurance policy for its own guidance.
- The number of days after the date of the shipment – maintained in accordance with the stipulations in the UCP 600 for the individual documents – within which the beneficiary must present the documents to the nominated bank. If nothing is stated, the number of days is 21 (Article 14(e)).
- Who has to pay the bank charges from the issuing bank and other banks involved relating to the transaction. If nothing is stated, the applicant will usually pay all these charges. If the applicant chooses to let the beneficiary pay the issuing bank's charges, this should be agreed upon as otherwise, he might not approve the credit.

In addition to the details required to issue the documentary credit, the bank will need some practical information as well. Such information can be stated on the application form or provided to the bank separately to cover a specific documentary credit or all documentary credits to be issued on the applicant's behalf:

- Account number, sort code and name of the branch office to be used for debiting amounts paid and commissions.
- Forward contracts, if any, entered into with the bank.
- Any other information the issuing bank might need, such as telephone number and name of the person(s) to be contacted regarding the application or documents subsequently received.
- The applicant must provide the application with date and signature. The signature must be that of an authorised signatory and be binding in accordance with any powers of attorney expressly including obligations under documentary credits.

The applicant's liability

As appears from the definition of a documentary credit, the credit is issued by a bank. The applicant is merely the party instructing the bank to issue a documentary credit. This is unambiguously stated in the UCP 600, which exclusively deals with the obligations of the banks.

Therefore, the applicant is not a party to the documentary credit, although the applicant, and the beneficiary, are certainly the most important parties to the entire transaction.

Because the applicant is not a party to the credit, the UCP 600 rules do not automatically apply in the relationship between the issuing bank and the applicant, and therefore, it is important for the bank to have a precise agreement with the applicant to the benefit of both parties. The absence of such agreement, or the ambiguity of an existing agreement, might harm the otherwise fruitful cooperation.

Usually, it will appear from the wording of the application form that the credit is to be subject to the UCP 600. By signing the application, the applicant accepts that these rules and their interpretation will apply to the issuing bank as well as to the applicant.

This is one reason why it is essential to the bank that the application is correctly signed; that is bears the correct and binding signature by a person who is authorised to sign for the company.

The obligations of the applicant in respect of an issued documentary credit usually appears from the back of the application (for Nordic banks) or from a separate agreement.

The applicant's reimbursement obligation

The most significant obligation for the applicant is to reimburse the bank for its payments and expenses. In addition, the applicant will have to pay commissions as compensation for the bank's work and risk taken.

The applicant's reimbursement obligation is definite and often reaches further than the applicant is aware. By issuing the credit the bank has undertaken to effect payment on presentation of documents complying with the credit. The documents are often presented in the nominated bank, such as a bank in the city or country of the beneficiary. When this bank has approved the documents and effected payment, the bank is entitled to be reimbursed for its payment by the issuing bank. This also applies if the documents are delayed or perhaps even lost in transit between the two banks. By having a documentary credit issued, the applicant assumes a payment obligation.

It is not always quite clear when the applicant is to effect payment. This depends on the type of documentary credit; that is whether it is a sight credit or a usance credit (deferred payment). If it is a sight credit, the nominated bank may require payment as soon as it has honoured the documents; that is before the issuing bank has received the documents. The nominated bank may also demand payment when the credit is advised and/or confirmed, eg in accordance with local statutory rules. In all circumstances the applicant is under an obligation to effect payment as soon as a justified request has been made.

Documents and goods

It often appears from the application that the applicant must immediately upon receipt of the documents check if they are satisfactory. Only defects or discrepancies relative to the application can justify refusal by the applicant to accept them. The applicant must immediately refuse the documents if they are unacceptable and then

he is not allowed to use the documents or get access to the goods.

In addition to giving his authorisation for reimbursement, the applicant approves that the documents, goods and the relevant insurance sums may be taken by the bank as pledge until the credit amount has been paid. The bank is authorised to take the necessary steps on behalf of the applicant to sell the goods. The sale may be made by auction or otherwise as long as it is done in conformity with the rules concerning pledges.

This pledge clause is seldom used but it serves the purpose of securing the bank if the applicant cannot pay.

If the goods have not been insured by the seller, the bank may demand that the applicant should take out insurance and show documentation for insurance to the bank.

Other matters

The applicant should realise that if the documentary credit expires without having been used or having been used only partially, he will not be released from his obligations under the credit until the issuing bank has been assured that no documents have been presented which it has not yet received, or for which the nominated bank has not yet demanded payment.

In addition, the applicant accepts the bank's general terms and conditions, and agrees to be bound by and liable to indemnify the bank against all obligations imposed by foreign laws and usages (Article 37(d)). He also accepts that the bank is not liable for consequences arising from force majeure (Article 36).

Even if these provisions, usually in fine print on the back of the banks' application forms, may seem rather strict and risky to the applicant, they hardly ever pose problems, at least in the Nordic countries, or constitute an unreasonable risk.

The applicant also undertakes to indemnify the banks involved, primarily the issuing bank, against all obligations and responsibilities imposed by foreign laws and practice (Article 37(d)), and he undertakes to pay charges incurred in the documentary credit transaction that cannot be collected from a third party, for instance the beneficiary, (Article 37(c)), irrespective of the wording of the credit.

The bank's examination of the application form

When the applicant has handed in the completed application form to the bank he wishes to issue the credit, the bank will examine the application.

Often the bank does not know the details of the underlying transaction and, therefore, has limited or no knowledge of agreements between the buyer and the seller. According to Article 5 the parties to the credit only deal with documents and not with goods or services, which, after all, are the key interests of both the buyer and the seller. Furthermore, Article 4 states that credits are separate transactions from the sales or other contract on which they may be based. However, even though the application will reflect the requirements and interests of the applicant, it is the responsibility of the bank that the documentary credit works.

In order to avoid any misunderstanding it is important that the credit itself and any amendments to it are complete and precise, and that banks discourage attempts to include excessive details. The issuing bank is responsible for the wording of the credit and it must ensure that it works in accordance with its wording.

However, the bank is not responsible for the correctness of specific details, such as description of goods, unit price or mode of transport and names of ports. The actual contents are the responsibility of the buyer, while the bank exclusively checks the technicalities to ensure that the credit works.

If the bank believes that certain details are incorrect, missing or mutually contradictory, it will, being a serious business partner, contact the applicant to clarify the contents of the application, not least to avoid the need for subsequent amendments.

It would be very unwise indeed for the issuing bank to leave it to the applicant to decide the wording of the credit. Of course, the applicant is entitled to determine the facts, such as the specific goods to be covered, the documents to be presented by the beneficiary, price and terms of delivery, due dates etc. But the bank should insist that it has the exclusive responsibility for ensuring that the wording of the credit is unambiguous and precise and that the credit works.

If a dispute between the issuing bank and the nominated bank ends up in court, the judge is likely not to accept the issuing bank's

explanation of unclear points with reference to the applicant's express wish. The judge will probably, and rightly so, point to the UCP 600's provision stating that it is the responsibility of the issuing bank. The credit is issued at the instance of the applicant but by the issuing bank.

Credit evaluation of the applicant

The issuing bank is liable for payment under the credit. It is not only liable for the correctness of the details but also, and especially, for payment being effected to the beneficiary against the beneficiary's presentation of documents conforming to the credit. Article 7(a) describes in very precise terms the issuing bank's payment undertaking.

As it is not a guarantee but an independent payment undertaking, the issuing bank cannot refuse to pay the beneficiary on grounds of the applicant's non-acceptance of the goods or documents.

In order to ensure that it can obtain the money from the applicant when it has honoured the beneficiary's claim, the bank will appraise the creditworthiness of the applicant before issuing the credit.

The bank will not confine itself to evaluating the seeming ability of the applicant to fulfil his obligations at present but has to consider if the applicant can pay the amount under the credit when it falls due, perhaps in a distant future.

Even if the commercial credit is based on a commercial transaction, the purchase of goods, the bank will have to take into consideration that payment has to be effected before the buyer has had a chance to sell the goods or receive payment from its sale of the goods.

Goods as security

When signing the application, the applicant pledges the documents and goods and everything that represents the goods to the issuing bank as security. Consequently, the issuing bank can, without the consent of the applicant, take possession of the goods and sell them to obtain cover for its claim if the applicant is unable to pay.

If, in connection with its credit appraisal of the applicant, the bank finds that the security in the goods is of significant importance

to its decision whether to issue the credit, the bank should take into consideration the type of the relevant goods.

The value of the goods to the bank depends on whether they are easy to sell. If the goods are of a special type, such as spare parts made to order or other articles specially produced for a particular company, perhaps with a printed logo, or perishable goods, they will hardly represent any particular value to the bank in a situation where a sale is required.

In addition to the security in the goods and/or documents, it is important for the bank to be able to get easy access to the goods, for instance in a situation where the good relations to the applicant have cooled or he has gone bankrupt.

Therefore, the bank will in some cases demand that the shipment of goods should be made with the bank as consignee, unless the credit stipulates the presentation of a full set of marine bills of lading issued to order and blank endorsed.

Also the insurance should be contemplated. The bank will not benefit much from having security in goods if there is a risk that they are lost or damaged. Thus, the bank may demand that the goods are insured and that the insurance cannot be cancelled without the acceptance of the issuing bank.

However, even though it is fine to have security in the goods, most documentary credits issued by Nordic banks are based on the bank's evaluation and approval of the applicant's creditworthiness. Typically, the security in the goods is considered to be secondary.

Chapter 7

The parties to the credit and
their mutual obligations

In the previous chapters the different parties to the documentary credit have been referred to, and the issuing bank’s obligations towards the beneficiary as well as its claims and rights relative to the applicant have been outlined. Also the relationship between the buyer and the seller has been described, and the term “bank” has been mentioned several times, especially in the chapter on the cycle of the credit. Even though this term is used in the UCP 600 and in this book, it is far from always certain to be one and the same bank. Banks have varying functions and hence different rights and obligations, depending on the stage in the documentary credit process.

All these parties are necessary actors in the credit process. The parties in the credit transaction are generally defined in the UCP 600, whereas their different functions are not all referred to, even if they are of significant importance.

7.1 The contractual triangle

I have mentioned earlier that the documentary credit should not – in my opinion – be considered to be a contract in the legal sense of the word. Nevertheless, I will use that term here to explain the relationships and obligations between the different parties.

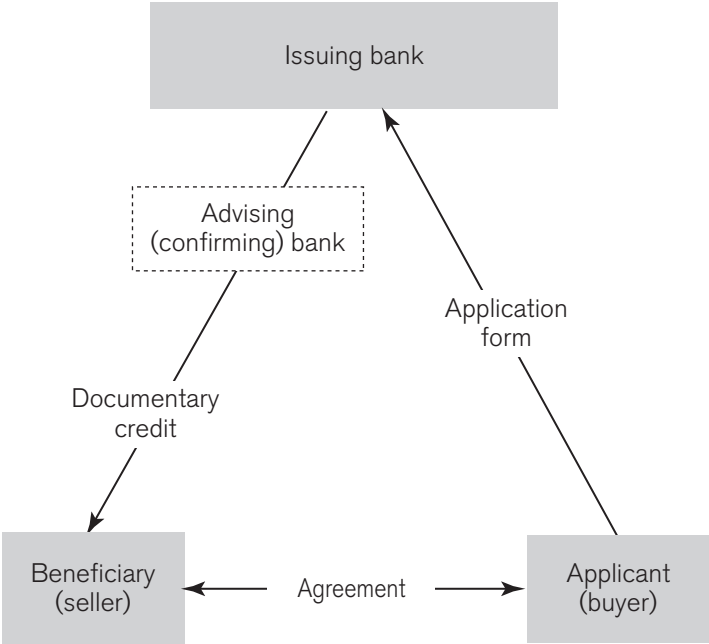


Figure 5

As appears from Figure 5, the agreement between the buyer and the seller is the foundation of the credit transaction.

Based on this agreement the buyer will fill in the application form to request the bank to issue a credit.

The issuing bank will issue the credit on the basis of the application.

The figure shows three different “contracts” which are interdependent even if they are not directly interrelated.

In this connection it is important to note that, according to legal usage in the Nordic countries, parties can enter into an agreement that is binding on the parties to that agreement. However, it is not possible to bind a third party by an agreement between two parties. This is not a particular feature of Nordic laws, but an internationally recognised principle, and documentary credits are also based on this rule.

7.2 The sales contract

(agreement between the buyer and the seller)

Nordic banks do not demand that a sales contract should be entered into in order for the buyer (the applicant) to have his credit issued.

The sole purpose of the contract is to safeguard the interests of the trading partners and a contract is primarily used in connection with large deals or between parties who have not often transacted business together.

Whether or not the business partners enter into a contract or make an agreement on the deal by telephone (the buyer accepts the seller’s offer) or by way of a pro forma invoice, it is important for both parties to know exactly the terms and conditions of the deal for which the credit is to be issued.

The agreement or contract will bind both the buyer and the seller, and therefore it is important in connection with the issuance of the credit that the buyer knows and complies with the agreement entered into.

Non-compliance with a contract can turn out to be a costly affair if the seller claims and obtains damages for breach of contract.

7.3 The application form

(the applicant's undertaking towards the issuing bank)

On the basis of the purchase agreement entered into the buyer fills in an application form whereby he undertakes an obligation towards the issuing bank. If the buyer states details in the application that have not been agreed with the seller, the buyer is very likely to face problems.

Even if the bank may have seen the purchase agreement, the buyer is bound by the application (Article 4(b)). The buyer cannot invoke the details of the purchase agreement in connection with a claim against the bank. If the buyer states the wrong price or quantity of goods in the application, and the bank issues the credit in accordance with that, the buyer is under an obligation to effect payment under the credit if the seller insists on relying on these erroneous details. The buyer can only make claims against the seller for repayment in compliance with the agreement entered into.

An agreement between the buyer and the seller does not bind the issuing bank (Article 4(a)).

7.4 The documentary credit

(the issuing bank's undertaking towards the beneficiary and the nominated bank)

The same is true for the issuing bank's undertaking and the beneficiary's claim under the credit.

If by mistake the issuing bank states other and erroneous details in the credit than those appearing from the application, the bank is under an obligation to pay the beneficiary in accordance with the details of the credit. The bank cannot invoke the contents of the agreement between the buyer and the seller.

Likewise, the bank is only bound by the contents of the credit in relation to the beneficiary. If the beneficiary, when drawing up the documents, discovers any discrepancies between the stipulations of the credit and the agreement he has entered into with the buyer, the beneficiary cannot make claims against the bank under that agreement but only by reference to the wording of the credit.

This point is significant and therefore, the beneficiary should always make sure that the credit he receives tallies with the agreement he has entered into with the applicant.

It is also important that if amendments to the conditions of the credit are requested, they should not only be accepted by the buyer – they should also be effected by the bank that issued the credit.

The issuing bank is not bound by an agreement between the buyer and the seller.

Chapter 8

Different types of credit

The previous chapters describe some of the characteristic features and applications of the credit, what a credit is, why it is used and how it works.

The question may arise whether the credit can take only one form, which by its wording is to cover the various types of transaction involving the credit. Or has it in the course of time developed into different shapes and variants that may be used to suit diverse needs?

The answer is simple: the credit can take various forms, each of which can precisely match the needs of the parties in connection with a specific transaction, if chosen with care.

The documentary credit is, perhaps rightfully, said to be a difficult and complicated instrument that requires comprehensive knowledge and experience. However, it is not too difficult for the buyer and the seller and other parties to get acquainted with the issues posed by the credit.

If the credit issued is to be able to function smoothly and in a manner satisfactory to all parties involved, it is necessary for the buyer and the seller to agree at an early stage what interests the credit is to safeguard. The contents of the credit must be agreed in detail between them.

One issue that the parties or the banks involved have to deal with in addition to the commercial aspects is the form or type of the credit, which, together with the commercial data, will determine the process of handling the credit.

Before discussing the different types of credit, I would like to emphasise that there are two important features that apply to any of the types of credit selected:

1. the documentary credit is subject to the ICC's international rules, the UCP 600, accepted by most countries around the world. Today, practically every documentary credit issued in international trade refers to these rules. It is a great advantage that each individual credit does not have to state the many provisions as the rules apply in all banks and countries. In addition, the terminology and document requirements are known and are, in principle, interpreted in accordance with the UCP 600; and
2. the documentary credit is a document issued by a bank, being a neutral institution and thereby not a party to the commercial

deal. The issuing bank is independently liable for payment in compliance with the contents of the credit and the UCP 600 (Article 7(a)).

On account of the capital adequacy requirements applicable in most countries, banks are generally considered relatively safe, although there are exceptions. It is true that we can talk about the applicant's bank and the beneficiary may not always consider that bank impartial. However, it should be borne in mind that an internationally renowned bank has its reputation to take care of. If a bank repeatedly disregards its obligations under documentary credits, it will get a bad reputation and be turned down in the international world of documentary credits.

Because documentary credits may take different forms according to the need, and being such a flexible instrument, it can be divided in different ways. I have chosen to group them in pairs because a documentary credit does not only belong in one of the groups, but typically consists of one variant in each group. The variants may be combined across the categories, leaving plenty of scope for diversity.

8.1 Import - export

It may seem impossible to distinguish between an import credit and an export credit because it is one and the same credit but viewed from two opposite sides.

Therefore, these will be grouped into two categories only for practical purposes.

If the documentary credit is viewed from two sides: from the importer's view and the exporter's view, it is obvious that the problems that may arise and the interests are contrasting.

And the needs of the seller to be matched by the credit are unlike those of the buyer.

8.2 Revocable - irrevocable

One of the important changes in the UCP 600 compared with the UCP 500 and earlier versions is that it does not mention revocable credits at all. In Article 3 it is stated that a credit is irrevocable even if there is no indication to that effect.

This does not imply that the revocable credit does not exist any more. But the issuing bank (on behalf of the applicant) must state it precisely in the credit, and it must also state all necessary stipulations to this regard.

This is an important detail to all the parties involved, especially the applicant and the beneficiary.

Revocable documentary credit

The revocable documentary credit can, as the name implies, be cancelled, thus substantially diluting the issuing bank's promise to pay. The possibility for the issuing bank to cancel the credit of course gives the buyer increased security and flexibility as the buyer may regret a transaction and ask the issuing bank to cancel the credit.

As stated above it is the obligation of the issuing bank to be very precise in its wording regarding the revocability of the credit. It must state when it may be revoked, as well as the seller's right to be paid before a message of revocation is received.

By cancelling a revocable credit the issuing bank and thereby the buyer is not totally released from its contractual obligations towards the seller outside the credit.

Also the issuing bank may want to be able to cancel a credit, for instance if the applicant's creditworthiness has suddenly impaired or he has gone bankrupt, whereby the bank risks having to pay without being reimbursed for its payment. Even if the bank has security in the goods, most banks will choose not to pay, if possible. A revocable credit gives the issuing bank a possibility to escape from its payment undertaking.

But what about the seller? Can he accept a revocable documentary credit?

If the seller has demanded a credit because he wants to secure himself against cancellation of the order or inconvenient amendments, or in order to ensure payment for the goods he has produced and shipped, the revocable credit can under no circumstances be the right solution.

Depending on the specific wording in the credit, a revocable

credit may be cancelled by the issuing bank at any time or after receipt of a notice. However, normally, a revocation will only be effective until the presentation has been honoured by the nominated bank.

This may imply that a revocable documentary credit can be cancelled even after shipment of the goods and even if the goods are shipped with the buyer as consignee. The seller thereby risks not being paid as well as losing the goods.

However, the issuing bank should state in the credit how to reimburse another bank for any payment, acceptance or negotiation made and documents taken up by such bank relying on the credit. Thus, the revocability ceases at the time of honouring documents.

This is the reason why the revocable credit is seldom used. In fact, many bankers, even those experienced in documentary credits, have never seen a revocable credit, and when such a credit appears, it is often due to a mistake, which is subsequently corrected by an amendment. This is the reason why the UCP 600 does not contain any articles on the revocable credit.

The use of the revocable documentary credit may only be relevant in cases where the seller has not asked for a documentary credit, but where the buyer, due to requirements of the authorities in his country, must use the credit for the contemplated imports or where the buyer uses the credit to obtain finance from his bank.

Revocable credits may also be used in transactions between intragroup companies. The value of the credit is of no importance here, but the buyer and the seller use the credit merely as a payment and management mechanism.

Irrevocable documentary credit

By contrast, the irrevocable credit gives the seller assurance (Articles 7 and 10(a)) that the payment undertaking assumed by the bank cannot be cancelled or modified. With an irrevocable credit the seller has a bank's payment undertaking which is independent of the underlying contract.

The buyer cannot cancel the credit or change its terms and conditions without the seller's agreement. Nor can the issuing bank cancel an irrevocable credit, even if the buyer has gone bankrupt or

if, for other reasons, he cannot or does not want to fulfil his payment undertaking.

The irrevocable credit gives the seller security: he has received a guarantee from the buyer's bank, and this guarantee cannot be amended or cancelled without his consent.

To the buyer the irrevocable credit implies that he is bound by his order, and that documents presented under the credit must be honoured if they comply with the terms and conditions of the credit.

Documentary credits are normally thought to be irrevocable as this is the type generally used.

It will often be the buyer or the buyer's bank that determines what type of credit to choose, but a buyer cannot as a matter of course expect that the seller will accept a revocable credit.

8.3 When to pay

The purpose of a documentary credit is to safeguard payment to the seller (the beneficiary). Generally, this payment undertaking by the bank will be taken to mean that payment is effected when documents complying with the terms and conditions of the credit are presented to the bank that has assumed the obligation to pay.

There is, however, also the possibility for the physical payment to be postponed to a later point in time to be clearly indicated in the credit.

This is usually agreed between the parties, but it also happens that the applicant inserts a clause to this effect in order to obtain credit not agreed upon. As a result, the documentary credit may have to be amended, or the seller may not use the credit as it is unacceptable to him.

Credit available by sight payment

The sight credit, where the bank will pay the beneficiary against presentation of documents in conformity with the stipulations of the credit, is the most common type.

With a sight credit the beneficiary will receive payment as soon as the bank assuming the payment undertaking has made sure that the documents presented are complying. The bank confirming the credit, see Confirmed credit under 8.4, and the issuing bank have assumed a payment undertaking. Payment made by a bank that has assumed a payment undertaking is always without recourse; that is the payment is final and repayment cannot be claimed.

The beneficiary can often obtain payment already on presentation of documents to the nominated bank, even if that bank has not confirmed the credit, see Unconfirmed credit under 8.4. Payment by the nominated bank can be made with or without recourse, depending on whether the credit is available by payment or by negotiation, see Credit available by negotiation under 8.5.

When the buyer is to pay is determined by his agreement with the issuing bank. The issuing bank will usually, especially in the Nordic region, demand payment only when it has received the documents. In other cases the claim for payment will be made when the issuing bank is notified that the nominated bank has effected payment. In all circumstances the applicant is under an obligation to reimburse the issuing bank for interest accrued from the time when the issuing bank assumes the payment undertaking and until the applicant actually pays.

These reimbursement rules apply to all irrevocable credits, to credits available by negotiation or by payment as well as to confirmed and unconfirmed credits. (Revocable credits should state a precise reimbursement clause).

Usance credit

Usance credit is a common term for all credits where the beneficiary does not receive payment on presentation of documents but at a later time specified in the credit.

The reason for issuing a usance credit is the buyer's (the applicant's) wish or need to defer payment.

It is worth noting, however, that according to Article 7(a), the issuing bank assumes an undertaking to pay on the maturity date in accordance with the stipulations of the credit.

Thus, the only purpose of the usance credit is to defer the date of payment without changing the payment undertaking under the credit.

Unless otherwise stated in the credit, it is implied that the beneficiary (the seller) bears the loss of interest as the issuing bank will not pay until the later date as indicated.

If the buyer is to cover the loss of interest, this can be stated in different ways in the credit.

If the buyer and the seller agree on deferred payment, the interest payable may be included in the price of the goods. Then the applicant will pay a higher price, whereas the seller will pay the loss of interest out of the price received for the goods.

In other cases the credit will state that the seller may add interest to the price of the goods in his invoice, such interest usually being limited to a certain percentage and for a given period.

Another way of indicating that the buyer pays the interest is for the credit to stipulate that the issuing bank will effect payment at sight, even if the credit takes the form of a usance credit. According to one variant, the credit may allow the nominated bank to pay at sight and then demand reimbursement from the issuing bank for the amount paid plus interest at maturity.

Over the years there have been several cases, covering alleged fraud or fraud where a local court has issued an injunction prohibiting the issuing bank's payment obligation to be fulfilled.

One type of case is where a nominated bank has financed the transaction and the issuing bank has approved the documents but not yet paid. The UCP 600 makes it clearer than its predecessors that the issuing bank's payment obligation is independent of whether the nominated bank has paid (financed) or not (Article 7(c)). It remains to be seen whether this stipulation will have an effect on cases taken to court in the future.

The period for deferred payment

In principle there are no rules on how to determine the period for payment or its length.

A number of models have gradually become the most used ones. The period for deferred payment is usually 30, 60, 90, 120 or 180 days. However, there is nothing to prevent the use of longer periods, such as one or more years. However, as credits are mainly used for transactions in consumer goods, periods exceeding one year are rare. When credits are used in connection with the handling and financing of projects, periods ranging from five to seven years are quite common.

There are two traditional ways in which to state from which date the deferred payment is to be reckoned.

One is related to the shipment of the goods and is therefore based on the date of shipment stated in the transport document. And so the credit could stipulate “90 days after the date of shipment” or “60 days after the bill of lading date”.

Another method of calculating the period is based on the presentation of documents to either the nominated bank or the bank on which a bill of exchange may have been drawn. Here the credit could state “draft to be drawn on the issuing bank 30 days after sight”. In this case the final date of maturity cannot be determined until the documents have been received by the issuing bank. If the credit is available for presentation to the nominated bank, and the documents are lost in transit between this bank and the issuing bank, the date of maturity will be determined on the basis of an estimated date of arrival of the documents.

The credit could also stipulate “the credit is available by payment at the nominated bank 90 days after receipt of documents”.

There are different variants of credits assuming payment at a date later than the presentation of documents to the bank authorised to take up the documents.

Acceptance credit

The traditional way to issue a usance credit is to stipulate in the credit that the beneficiary should draw and present a bill of exchange together with the documents. Depending on the requirements of the credit, the bill of exchange must be drawn on one of the banks involved, and the relevant bank is expected to accept the bill, provided that the documents presented are approved. A bank that has accepted a bill thus guarantees payment of the bill at maturity, not only in compliance with the UCP 600 but also according to the national legislation on bills of exchange.

If the credit provides for a bill to be drawn on a bank that has confirmed the credit or on the issuing bank, such bank is under an obligation to accept a bill of exchange and pay it at maturity (Articles 7(a) and 8(a)).

If the credit calls for a draft to be drawn on another bank, such as the nominated bank or perhaps a reimbursing bank, and that bank has not confirmed the credit or otherwise assumed an obligation to pay (Article 12(c)), that bank may refuse to accept the draft.

The UCP 600 rules state that if the drawee bank does not accept the draft, the issuing bank (Article 7(a)) or the confirming bank (Article 8(a)) undertakes to accept a draft subsequently drawn on the issuing bank or the confirming bank as the case may be. Likewise, these banks undertake to pay at maturity if the bank accepting the draft does not pay it.

These provisions have been inserted in the UCP600 in order to emphasise the obligation of the issuing bank and the confirming bank, if any, to pay at maturity.

In pursuance of earlier versions of the international rules a credit could also state that the draft could be drawn on the buyer. However, this has caused misinterpretations by several banks throughout the years. Even if the issuing bank, also according to earlier versions of the rules, had assumed a definite payment undertaking, some banks claimed that they were only to pay if the buyer had accepted the draft. In other cases the dispute concerned the specific date when a draft drawn on the buyer stating for instance 120 days sight was to be paid.

As the documentary credit indisputably remains an undertaking by the issuing bank and is independent of the buyer's ability or willingness to pay, the ICC has removed the provision in the rules allowing drafts to be drawn on parties other than banks.

Article 7(a) clearly states on whom drafts can be drawn, and further Article 6(c) states that a credit must not be issued available by a draft drawn on the applicant. Banks will consider such drafts as an additional document. This means that such drafts will have no relation to payments under the credit but will be viewed as a document to be presented to the applicant like any other document required.

Deferred payment

Whether or not a draft is drawn under a credit or used as an independent payment instrument, it is subject to the laws of the relevant country. In recent years many experts on documentary credits have expressed their belief that there is no need for using both a credit and a draft as a payment instrument. Moreover, several countries have introduced stamp duty payable on bills of exchange, thus adding to the cost of the transaction.

As a result the issuance of a usance credit that does not require the presentation of a draft has been devised. Rather than making the credit available by acceptance, it is made available by deferred payment.

Also when this type of credit is used, the issuing bank and the confirming bank, if any, are under a definite obligation to pay at maturity.

As is the case for the acceptance credit, a nominated bank that has not confirmed the credit is under no obligation to pay. In case of a credit available by deferred payment, the nominated bank that has honoured the documents will thus only guarantee payment at maturity if it has confirmed the credit, or if the bank expressly assumes an undertaking to pay at maturity (Article 12(a)).

Maturity

The period of time until maturity is determined in the same manner for a draft and for a deferred payment undertaking. Often maturity is fixed as a certain number of days after sight (presentation) or after shipment of the goods. However, it can also be a specific date as indicated in the credit and presumably agreed between the buyer and the seller.

Instead of receiving cash payment the beneficiary will receive either the accepted draft or a promise that payment will be made at maturity. Such promise or acceptance will be given by the bank that has assumed an obligation according to the credit or which has chosen to assume such payment undertaking. Both the draft and the promise to pay can in many cases be discounted, and so the seller can get his money immediately (less interest).

Sometimes credits call for the presentation of a draft with a specified term to maturity while stating that the seller (and the paying bank) will receive payment at sight. These are not actual usance credits in relation to the seller as the draft only serves the purpose of a means of finance between the buyer and the issuing bank.

8.4 The nominated bank's payment undertaking

The previous text repeatedly refers to the issuing bank's obligation to pay provided that the beneficiary presents complying documents, and reference is also made to the confirming bank, if any.

Article 9 describes the advising bank's liability in connection with advising the credit. It is important to distinguish between the function of the advising bank and that of the nominated bank. They are often one and the same bank, but not necessarily so.

I will now discuss the nominated bank's function and obligation, disregarding the fact that the nominated bank may also have acted as the advising bank.

The difference between a revocable and an irrevocable credit concerns the issuing bank's obligation, whereas the manner in which the credit is advised by the advising bank to the exporter determines the obligation of that bank and of the nominated bank, if any.

A **revocable** credit can only be advised in a manner that does not commit the advising bank; that is without that bank adding its confirmation, since neither the advising bank nor another nominated bank will want to incur an undertaking to pay if the issuing bank reserves its right to cancel the credit at any time.

By contrast, an irrevocable credit can be advised to the seller in either of two ways:

- the advising bank advises the credit unconfirmed
- the advising bank or another nominated bank adds its confirmation.

Whether a credit is confirmed or not does not change the obligation of the issuing bank, and this is the only concern of the beneficiary. The applicant will not benefit by having the credit confirmed.

Unconfirmed credit

When the issuing bank requests its correspondent bank, usually in the seller's city or country, to advise a credit, it will often do so with an instruction that the advising bank is not to add its confirmation to the credit.

If the credit is advised in this manner, the advising bank incurs no obligation, except for its assurance that the credit is genuine; that is the advising bank has taken reasonable care to check the apparent authenticity of the credit which it advises and has made sure that the credit originates from the bank stated (Article 9(b)).

To the beneficiary the receipt of an unconfirmed credit means that he has a credit that has been guaranteed only by the issuing bank. The advising bank or another nominated bank has no obligation to honour the documents subsequently presented by the seller.

Consequently, the beneficiary should contemplate whether he considers the payment undertaking of the issuing bank sufficient, and he should also assess the political risk relating to the buyer's country. Many banks will provide the necessary, but non-binding, information on the relevant bank and country.

Even if the advising bank has no obligation to honour the documents, many banks will not turn down a request to pay against a complying presentation, provided it is nominated to honour or negotiate, as the issuing bank has undertaken to reimburse the nominated bank for its payment (Article 7(c)).

However, if the nominated bank does not fully trust that it will be reimbursed by the issuing bank for its payment, the nominated bank is entitled to refuse to honour documents presented under an unconfirmed credit. Especially outside the Nordic region, many banks do not want to honour an unconfirmed credit until it has received payment. Other banks choose to honour unconfirmed credits only on behalf of their good customers. Most Nordic banks are prepared to honour documents presented under an unconfirmed credit.

There are different reasons for banks' refusal. A nominated bank will critically evaluate both the issuing bank and the political and commercial creditworthiness of the relevant country. If the creditworthiness is found insufficient, the bank will not be prepared to assume a risk. Wars or civil commotion definitely aggravate the political or commercial risk on the buyer's country.

The beneficiary will have to take all these factors into consideration when estimating whether or not the unconfirmed credit received meets his security requirements. **An unconfirmed credit is no better than the issuing bank and/or its country.**

However, also aspects relating to the examination of documents may cause a bank that has not confirmed the credit to refuse to honour it. If the nominated bank finds the wording of the credit imprecise or if its business relationship with the issuing bank has a

bad track record, the nominated bank may choose not to honour the credit.

Confirmed credit

If, for the reasons mentioned earlier, the seller does not trust that the irrevocable and unconfirmed credit provides the security required, or if, for other reasons, the beneficiary wants to have the credit confirmed, he must inform the buyer that the credit must be confirmed.

As when appraising the issuing bank, the beneficiary must decide which bank he wants to confirm the credit. The advising bank will often be requested to confirm the credit. Sometimes the seller wants his own bank, which he knows and trusts, to confirm the credit. The issuing bank may then choose the seller's bank as the advising and confirming bank, or the credit will be advised by another bank and can then be confirmed by the seller's bank.

It may be advantageous for the seller to give the buyer details about his advising and confirmation requirements already when signing the contract, but he may also do so at a later point in time. If his request is made after the credit has been issued and advised, the credit will have to be amended with resulting extra costs.

When the beneficiary receives an irrevocable and confirmed documentary credit, he has not only the commitment of the issuing bank but also a binding promise from the confirming bank to pay when complying documents are presented in due time.

A bank that confirms a credit cannot refuse payment if the documents are in accordance with the stipulations of the credit, and the bank must perform a binding examination of documents.

This means that the seller has a guarantee for receiving his money, even if the buyer cannot pay or refuses to pay, if the issuing bank goes bankrupt, or a war breaks out in or around the buyer's country or the country suspends its payments. The seller has obtained a payment guarantee from a bank he trusts.

According to the UCP 600, a credit is confirmed by the advising bank upon the authorisation or request of the issuing bank (Article 8(a)).

The advising bank will then decide whether to assume the risk

involved as the assumption of a risk cannot be imposed on it. Should the bank not be prepared to confirm the credit, it must inform the issuing bank accordingly and may, unless otherwise stipulated in the credit, choose to advise the credit to the beneficiary without adding its confirmation (Article 8(d)).

The confirmation of a credit is a primary liability of the confirming bank, and this means that the obligation is independent of the commitment of the issuing bank.

The confirming bank assumes a definite undertaking to pay, accept or negotiate against presentation of complying documents, and it is not entitled to postpone payment until it has ascertained that the issuing bank has paid or to await reimbursement by the issuing bank.

The confirming bank will not take such risk without getting paid for it. It will charge a confirmation fee the size of which will depend on the credit amount and date of expiry, and on the credit standing of the issuing bank and its country.

Silent confirmation

As described, and according to the UCP 600, Article 8(a), of a credit is confirmed by a bank upon the authorisation or request of the issuing bank.

Despite the beneficiary's express wish or even demand contained in his agreement with the buyer, it nevertheless happens that the beneficiary does not receive a confirmed credit, because the advising bank never received such request or authorisation from the issuing bank. There are several reasons for this. The applicant may have forgotten to include this instruction in his application, or the issuing bank and/or the buyer finds it unnecessary to confirm the credit as they believe, or wish to impart the impression, that the issuing bank and the relevant country are so sound that a confirmation is unnecessary.

Unfortunately, such attitude on the part of the buyer or the issuing bank is more a reflection of national pride than a realistic credit appraisal. Very often these are exactly the documentary credits that especially require a confirmation by a bank in the beneficiary's country.

In order not to offend the buyer or the issuing bank with a requirement that the credit must be confirmed, or perhaps also not to inconvenience the applicant with a request for an amendment to the credit, some banks are prepared to guarantee payment under the credit without the request of the issuing bank, and even without informing that bank. This method is usually referred to as a “silent confirmation”.

Even though the term “silent confirmation” is applied, it is important to note that it is not a confirmation in a technical sense of the word. A bank issuing a “silent confirmation” does not enjoy the protection of the UCP 600, and therefore, it cannot invoke the provisions in Article 10 (a) (regarding the right to refuse an amendment).

It is rather a promise or a kind of guarantee to pay, provided that complying documents are presented. The “silent confirmation” covers a risk that only relates to the relevant bank and the beneficiary, and the scope of such risk cover is exclusively regulated by the agreement entered into. The agreement may be drafted in different ways. Nordic banks usually manage with a few lines of promise to pay, whereas for instance US banks tend to draw up contracts of several pages.

While some banks take a favourable attitude towards this method, others are absolutely negative as they believe this procedure contravenes the international rules on documentary credits and their spirit.

Therefore, banks that are prepared to issue a “silent confirmation” will often impose certain conditions for assuming the risk involved. One condition may be that the beneficiary is not allowed to approve amendments to the credit without the consent of the bank as, according to Article 10, only the beneficiary and the confirming bank, if any, may refuse to accept amendments. The bank may also demand, depending on the credit and its wording that documents should be presented earlier than stipulated by the credit.

In addition to imposing certain conditions for issuing a “silent confirmation”, most banks pursue their own policies that determine for which credits such a solution is acceptable. One principle may be that the credit must be available at the relevant bank. This means

that the bank must be nominated according to the credit, either by being designated by name or because the credit is negotiable at any bank (Article 12(b)). Apart from these specific assumptions, all the conditions applying to the traditional confirmation must be fulfilled as well.

8.5 Credit available by payment or negotiation

The UCP 600 mentions that the credit must stipulate how it is available. A distinction should be made between credits available by payment and those available by negotiation. In this connection the date of payment will be disregarded. This distinction between these two types of credit is incomprehensible to many people, including bankers.

In many cases it is simply the practice of the relevant country that determines which of these two types of credit to choose, and, therefore, it may be difficult to state an obvious reason for the choice.

Credit available by payment

According to the issuing bank's wording of a credit available by payment, such credit will release payment when the beneficiary presents documents at the bank where the credit is payable; that is either the issuing bank or a nominated bank, often the advising bank, acting on behalf of the issuing bank.

A credit available at the issuing bank always constitutes an undertaking by that bank to pay for complying documents at the time stated in the credit.

If the credit is available for payment at a nominated bank, that bank will pay on behalf of the issuing bank, although it will examine the documents at its own risk. Thus, this is not an agent–principal relationship.

Once the nominated bank has taken up and paid for the documents received from the beneficiary, the beneficiary is discharged from his obligations. This also means that the nominated bank's payment is final, be it an unconfirmed or a confirmed credit.

As mentioned in Unconfirmed credit under 8.4, the nominated bank has no obligation to pay when the beneficiary presents documents under an unconfirmed credit, even if the nominated bank

has checked the documents and found them satisfactory. But if the bank pays for documents it has approved under a credit available by payment, then its settlement with the beneficiary is final. This means that the nominated bank cannot later turn to the beneficiary in case it does not receive payment from the issuing bank. Only if the nominated bank has expressly agreed with the beneficiary that payment is effected subject to receipt of the funds, will the nominated bank have such right, which does not appear from the UCP 600.

The taking up of documents under a credit available by payment can only be made by the bank authorised in the credit to do so (the nominated or issuing bank).

Credit available by negotiation

A credit is available by negotiation at a bank named in the credit or at any bank, although never at the issuing bank.

The UCP 600 defines the concept of negotiation in Article 2:

Negotiation means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

For many years the definition and also the meaning of negotiation have caused a great deal of discussion internationally among experts on documentary credits – not least during the various revisions of the UCP. Some of these experts believe that the UCP 600 definition of negotiation (as mentioned above) reflects a renewed interpretation of the concept of negotiation.

However, nothing has changed. The UCP 600 has merely sought to clarify certain moot points that existed and still exist in this area. Different banks apply different meanings to the term “negotiation”, sometimes depending on the country.

The below description is based on attitudes prevailing in most banks in the Nordic countries.

The negotiating bank will not – unlike in the case of the credit available for payment – effect payment on behalf of the issuing bank when taking up the seller’s documents. Instead it will negotiate (purchase) the documents together with the draft presented by the

seller. According to the UCP 600's provision on credits available for negotiation, this draft must be drawn on a bank, although not on the nominated bank.

When the documents stipulated in the credit have been presented to the negotiating bank, it will decide whether to negotiate the documents and/or draft. Subsequently, if the bank elects to negotiate the presentation and the seller has received settlement from the bank, it will normally have recourse against the seller according to the relevant national law on bills of exchange and by reference to general practice. The right of recourse lasts until the drawee bank has paid the draft, in practice when the negotiating bank has been reimbursed by the issuing bank for his payment.

The UCP 600 is fairly silent about recourse against the beneficiary. It only states that the confirming bank, if any, must pay the negotiating bank without recourse, which – without being stated in the UCP 600 – also prevails in terms of the issuing bank.

As mentioned, recourse is based on the use of a draft and on the legislation on bills of exchange. However, according to Article 2, credits available for negotiation can also be issued without a draft, in which case recourse will exclusively be based on the recourse expressly stated by the negotiating bank both when advising the credit and negotiating the documents.

In Denmark this right of recourse applies, even if drafts under some credits will have been drawn without recourse, since the Danish Bills of Exchange Act does not allow a drawer to prevent the holder from exercising his right of recourse. This also applies in certain other countries.

Due to the right of recourse the negotiating bank may demand that an amount paid should be repaid. This may occur if the negotiating bank is not reimbursed for its payment, for instance because the issuing bank has gone bankrupt or the importing country has introduced exchange control regulations.

However, even if the negotiating bank is reimbursed later than assumed, it may assert its right of recourse. The bank will then present its claim to the beneficiary for payment of interest accrued in the period by which payment was delayed. This is probably the most common use of the right of recourse, and the effects will depend on

the length of the period after maturity and interest rates applicable at the time.

As mentioned, the UCP 600 explains the concept of negotiation in Article 2 without stating recourse. Thus, it is possible for the negotiating bank to negotiate without recourse, depending on an agreement, if any, with or without compensation.

The rules merely indicate that the result of negotiation must be to advance or agree to advance funds to the beneficiary (see the UCP 600 definition quoted above).

In case of sight credits such value will most often consist in money. Payment with recourse is also covered by the term “value”. However, value can also be given by the negotiating bank assuming a commitment to pay at maturity, and such commitment may also be subject to recourse.

It is important to note that the rules clearly describe the examination of documents and/or submitting them to the issuing bank against payment as not constituting negotiation.

If the beneficiary presents complying documents to a bank authorised to negotiate, and such bank is not prepared to negotiate, the transmission of documents to the issuing bank is made at the issuing bank’s risk. The issuing bank is under an obligation to pay when the documents are presented in due time at the place stipulated in the credit, provided that the terms and conditions of the credit have been met. As provided by Article 13(b)(iii), the issuing bank is responsible to the bank that has paid under the credit for any loss of interest, based on the reimbursement clause in the credit. However, in some cases the negotiating bank has to charge interest from the beneficiary, eg due to a delay in the transmission of documents or because the issuing bank has not paid in due time despite its payment undertaking.

When evaluating the negotiation credit, one might come to the conclusion that this type of credit is useless to the beneficiary. But we have to remember that the issuing bank’s obligation to pay is unrestricted if the terms and conditions of the credit have been fulfilled. It does not happen often that the negotiating bank asserts its right of recourse requesting repayment. By far most credits available by negotiation are indeed negotiated without the seller ever noticing

the difference between this type of credit and the credit available by payment.

In terms of a **confirmed** credit available by negotiation, the confirming bank has no right of recourse (Article 8(a)(ii)), and in practice there is no difference between a confirmed credit available by negotiation and a confirmed credit available by payment.

The credit must stipulate whether negotiation is restricted to a named bank, or if any bank may negotiate. Under the UCP 600 the issuing bank cannot make a credit available at its own place if it provides for negotiation.

The reason why credits available by negotiation often state “any bank” as nominated bank is that in many cases the beneficiary finds it attractive to have his own bank negotiate the documents, also when the documentary credit was advised through another bank.

As mentioned, some banks may offer negotiation without recourse so that the beneficiary gets final settlement if the documents are in order. Such an offer will be based on the contents of the credit, the bank that has issued it and probably also the customer relationship between the beneficiary and the bank.

Chapter 9

The issuance of documentary credits

Even though it is most often the seller who requires the issuance of a documentary credit and the buyer who instructs his bank to do so, the credit must be considered as the instrument of the banks. The credit does not exist until it has been issued by the issuing bank. And the applicant is not a party to the credit.

Since the issuing bank is responsible for the contents and wording of the credit, that bank has to make sure that no mistakes are made in connection with the issue.

9.1 Handling by the issuing bank

The bank's issuance of a credit is based on the applicant's instructions. Most banks active in international trade have drafted their own application form and the banks usually demand that the applicant uses this form as, in addition to the details provided by the applicant and his signature, it also contains the terms and conditions for the bank's issuance of credits (see 6.4 Application form).

Several banks in the Nordic countries and outside that region have developed IT programs for the applicants to use for sending their application details to the bank's trade finance department electronically. These systems vary and data can for instance be sent through fixed-line networks and by telecommunication or via the Internet. The use of these systems is usually based on an agreement between the applicant and its bank and is subject to the general terms and conditions applicable to the issuance of documentary credits.

Using these electronic systems offers several advantages. It gives a better overview and it is much easier to input the application data and, especially to make amendments, on the screen. The systems will generally reject obvious errors made in the input data. As a result a better basis is provided for the issuance of the credit. To facilitate the input process for the applicant some systems offer a facility for entering one's own standard credits, thereby limiting the number and volume of data that are to be entered to credit amount, date of expiry and type or quantity of goods.

Filling in the application by electronic means does not only benefit the applicant but also the banks. Instead of having to retype all the terms and conditions of the credit, the bank's system can reuse the applicant's data and prepare detailed draft wording of the credit.

The bank will have to add some data required to issue the credit and examine the details stated by the applicant.

To encourage their customers to use their electronic systems, some banks make it a condition for their customers to use the bank's electronic system in order to obtain a special agreement on prices or other advantages.

The bank will provide each credit with a credit reference and choose the bank through which the credit is to be advised. In addition, it will include in the wording of the credit various information about the form and function of the credit (see 9.3 Contents of the documentary credit).

No matter through what media the bank receives the application, it will have to arrange for the forwarding, registration and booking of the documentary credit risk in its systems.

Previously most credits were printed out on paper and transmitted to the advising bank by air mail. The text would be written on the bank's writing paper or on a special form. Only on rare occasions was the credit issued by cable or telex. Cable costs were relatively high and therefore, this means of communication was used only when expressly requested by the applicant, who was prepared to pay the cost because it was urgent.

To limit teletransmission costs, a variation was used: the credit was issued by letter and sent by air mail, but the issuing bank sent a brief cable with a few details pre-advising the beneficiary that the credit had been issued and was on its way. The beneficiary still had to wait for all the details until he received the credit by mail. This method can still be used (Article 11(a)), but is rarely applied due to the currently low teletransmission costs.

In the early 1980s SWIFT was extended to include documentary credit transactions. SWIFT (Society for Worldwide Interbank Financial Telecommunication) is headquartered in Brussels and was founded by and is still owned by banks in many countries. The purpose was to establish and use an electronic network connecting the participating banks. These banks can send each other information in this closed and very secure system involving most of the banks' business areas and often in a very structured format.

The use of SWIFT considerably reduced the telecommunication costs

of each transaction, although the participating banks had to invest large amounts in electronic equipment. The number of banks and countries that have joined SWIFT is increasing and the society can rightfully be described as worldwide.

Today most credits are issued via SWIFT or telex as a standard. Some banks no longer have a form for the issuance of credits nor any programs that can print out a letter-based credit. If such a format is called for on a rare occasion, the bank may print out the credit in a SWIFT format, provide it with binding signatures and send it by air mail.

When the credit has been issued in its final version and its contents checked, it will be transmitted. Most credits are sent to one of the issuing bank's correspondent banks requesting that bank to advise the credit to the beneficiary.

If the electronic message is to be considered the operative instrument, the issuing bank should not send a letter-based confirmation (Article 11(a)).

Whether or not the issuing bank sends the credit by letter or cable, it assumes no responsibility for the consequences arising out of mutilation or other errors arising in the transmission or out of loss in transit (Article 35).

If the applicant has stipulated in his application that the credit is to be advised through a specific correspondent bank, most banks, at least in the Nordic region, will respect such request, if ever possible. A specific bank is usually stated if the seller has requested in his pro forma invoice or in the contract that a named bank in his country should be used.

If the issuing bank does not know the relevant bank, it will contact the applicant and suggest the use of another bank known by it. It will also do so if, in the issuing bank's experience, the relevant bank has previously handled documentary credits unprofessionally.

If the applicant does not request the use of a specific bank, the issuing bank will choose a bank itself, based on its knowledge of banks in the country in question. Major international banks command a network of correspondent banks numbering several thousand banks scattered all over the world.

The issuing bank assumes no responsibility for a correspondent

bank's compliance with the instructions (Article 37(a)), even in cases where the issuing bank has recommended the use of a certain bank (Article 37(b)).

9.2 Liability of the issuing bank

As mentioned earlier, the issuing bank is responsible for the issuance of the credit and for its form, contents, wording and, not least, payment.

The payment undertaking of the issuing bank is described in the UCP 600, especially in Article 7(a).

By far most documentary credits are issued at the instance of the applicant and are, therefore, based on the applicant's instructions, the basis of which is the business transaction with the seller.

Article 4(a) clearly expresses that documentary credits are separate transactions from all agreements or contracts on which they are based. And credits are also separate transactions from the conditions and details contained in the application form. Neither the buyer nor the seller can demand that a credit should be amended or have documents presented under it approved or refused by reference to the underlying contract. It is the wording of the credit alone that determines what is to apply.

Article 4(a) also emphasises the fact that the beneficiary cannot avail himself of the contractual relationship existing between the banks or between the applicant and the issuing bank. One example could be a situation where the applicant has deposited an amount as security for the payment of the credit, and where the issuing bank, nevertheless, elects to refuse documents for technical reasons.

When Article 5 states that in credit operations all banks concerned deal with documents, and not with goods etc, this also means that the bank must approve documents that comply with the terms and conditions of the credit, whether or not the bank has been informed or suspects – perhaps even knows – that the goods delivered were not the right goods.

To guard against and to reduce the risk of differing interpretations of the wording of the credit it is important that the wording and amendments are complete and precise. Consequently, excessive detail and misrepresentation should be avoided.

It is the responsibility of the issuing bank to ensure that the credit does not contain contradictory, incomplete or unclear instructions and, if requested to do so, it must provide the necessary information if incomplete or unclear instructions are received. The bank cannot plead that the instructions had been given by the applicant and that he had demanded that they should be included in the credit. It is exclusively the issuing bank that is responsible for the wording of the credit and for its capability of working.

However, the issuing bank cannot be held liable for the beneficiary's ability to fulfil the credit. And so the bank will not check if shipment can be made from a certain port, if the goods can be insured against a specified risk, if a request for a certain country of origin can be met, or if a certain document can be issued by the requested firm or person. The issuing bank must make sure that it is in fact possible, on the face of it, to meet the terms and conditions of the credit.

Probably the most essential provisions on the liability of the issuing bank are contained in Article 7(a). This article clearly states that the credit constitutes a definite payment undertaking of the issuing bank, provided that the stipulated documents are presented to the nominated bank and that the terms and conditions of the credit are complied with. This applies whether or not the documents are lost in transit between the nominated bank and the issuing bank (Article 35, second paragraph).

If the issuing bank has requested or authorised other banks to pay, and such other banks fail to do so, then the issuing bank is obligated to pay.

Provided that the beneficiary has complied with the stipulations of the credit, the issuing bank must effect payment.

It is not in the interests of the banks to encourage deliberate misuse of documentary credits, and much less do they wish to support or contribute to fraud or forgery. Banks should, therefore, seek to prevent the applicant from deliberately having provisions or clauses included in the credit that allow the buyer to take possession of the goods without intending to pay for them. Most serious banks are aware of these possibilities and sometimes have to inform an applicant that they do not wish to issue documentary credits for him in future.

9.3 Contents of the documentary credit

On account of the flexibility of documentary credits the contents will vary among different credits to the extent that it may be claimed that not two credits are alike.

The details of a credit are based on the instructions given in the application and on those provided by the bank.

Data provided by the bank - UCP 600

The bank will state in the wording of the credit that it is subject to the ICC Uniform Customs and Practice for Documentary Credits, ICC Publication No. 600 (the UCP 600).

Practically all documentary credits are subject to these rules. It appears from Article 1 that the UCP 600 must be incorporated into the text of the credit by reference, whereby these rules apply to the credit and are binding on all the parties to it – whether the bank or its country has announced that it will issue credits subject to the UCP 600 or not.

In order to avoid any misunderstanding, it is stated in Article 1 that all credits must state that they are issued according to the UCP 600. This must also be stated in credits issued via SWIFT.

Documentary credit number

The bank will provide each credit with its own unique number, thus ensuring that it will always refer to and handle the correct credit.

The documentary credit reference number may be structured in different ways: a consecutive numbering system or a system also showing the year and/or date of issue. Other banks include further data into the number, such as the relevant department/branch or type of credit. Several banks add a modulus control digit to ensure that erroneous entries are detected.

The most important point is that the number is unique to avoid confusion in the handling process.

Correspondent bank

Most documentary credits are transmitted to one of the issuing bank's correspondent banks with the instruction to advise the credit to the beneficiary.

The application form of most banks contains a box where the applicant can state a preferred advising bank, usually stated by the beneficiary.

Failing such information, the issuing bank will choose one of its correspondent banks in the country or city of the seller.

The same will happen if the issuing bank does not know the bank stated by the applicant, or if the banks have not exchanged lists of authorised signatures and telegraphic keys. Such exchange is to ensure that the advising bank can ascertain from which bank the documentary credit actually originates and hence establish the authenticity of the credit (Article 9(a) and (b)).

If the issuing bank has previously experienced poor business relations with a bank indicated by the applicant, it should inform the applicant accordingly and choose another advising bank.

Should the issuing bank wish to use another advising bank than the one stated by the applicant, it should contact him. If the applicant believes that the beneficiary attaches great importance to using the bank stated, the credit can be transmitted to the bank known to the issuing bank with an instruction to advise the credit to the beneficiary through the bank requested by the applicant (second advising bank) (Article 9(c)). The wording of the credit should be precise to avoid any doubt as to where the credit is available.

Where the credit provides for negotiation, it can be made available with any bank. According to the UCP 600 credits available by payment may also be available with any bank, but it is yet to be seen whether this practice will be common. Even if the credit is not advised to the beneficiary through the requested bank, the beneficiary can, nevertheless, use the services of his bank in connection with the handling and negotiation of documents.

Form of credits

The details concerning the form and type of the credit may originate from the application. Banks use different practices as to the details to be provided and approved by the applicant and those to be stated by the bank. If not otherwise instructed by the applicant, the issuing bank will have to make its own decision as to the contents.

Despite the general practice only to issue irrevocable credits

today, the credit is deemed to be irrevocable unless it clearly states to be revocable (Article 3).

The credit usually contains instructions to the advising bank whether or not to confirm the credit, although this is not a requirement. In the absence of such instruction, the advising bank can only advise the credit as unconfirmed. If the intention is for the advising bank (or another bank) to confirm the credit, this must be clearly stated, either in the credit itself or in an accompanying letter.

The issuing bank should clearly state whether the credit is available by sight payment, by deferred payment, by acceptance or by negotiation (Article 6(b)). Furthermore, the credit must state the bank authorised for this purpose. This is an important point as it serves to clarify whether the documents, when presented, are presented in due time and at the correct place.

Reimbursement

The issuing bank is under an obligation to pay when complying documents have been presented. It is, therefore, a good practice to include instructions on reimbursement in the credit, that is how payment from the issuing bank to the honouring or negotiating bank will be effected.

Reimbursement instructions may take different forms, and each of the parties to the credit must judge whether they are acceptable. The issuing bank's payment to the honouring or negotiating bank will be effected according to one of the following principles:

- The issuing bank authorises the nominated bank to debit its account with the honouring or negotiating bank.
- The issuing bank authorises a third bank (the reimbursing bank) to meet the honouring or negotiating bank's claim under the credit.
- The issuing bank transfers the amount upon request from the honouring or negotiating bank.

If the credit allows the honouring or negotiating bank to obtain reimbursement from a third bank (the reimbursing bank) this must appear from the credit. The UCP 600 contains provisions in Article 13 concerning how the issuing bank must instruct the reimbursing

bank. It is stated in Article 13(a) that a credit should stipulate whether reimbursement is subject to the ICC rules for bank-to-bank reimbursement or not. If it does not state so, reimbursement shall be effected as stated in Article 13(b). As a general rule (Article 13(b)(iv)) the costs of the reimbursing bank are for the account of the issuing bank, unless otherwise indicated in the credit and the reimbursement authorisation. This is particularly significant if another bank has been authorised, and is prepared, to confirm the credit. The readiness of the bank to confirm the credit and the price at which it will do so may depend on the information from the issuing bank concerning the reimbursement of the amount.

Instructions as to the transmission of documents

The credit often states the manner in which the documents are to be transmitted to the issuing bank. Instructions may be to send the documents in two or more batches or to send them by air mail or by courier.

Previously it was general practice for credits requiring the presentation of a bill of lading to state that the documents were to be transmitted in two batches. The purpose was to ensure the existence of at least one original bill of lading, should the other one get lost in transit. Sometimes the first set of originals was to be sent by air mail, while the duplicates (the second set of originals) were to be sent by ordinary mail as a kind of extra security and to save postage.

Today it is increasingly common for credits not to mention anything about the method of sending documents and it is now customary to send them by courier, and they are rarely lost in transit.

Data from the applicant

Even if the above details are important in order for the documentary credit to work in the manner expected by both the buyer and the seller, it is the data in the credit concerning the commercial contract that is the primary interest of the parties.

These data should be acceptable to both the buyer and the seller, although from the issuing bank's point of view it is only the information provided by the applicant on the application form that matters.

Since many details in a contract, and hence also in the application, may be fairly technical or written in a foreign language, banks reserve the right to transmit credit terms without translating them (Article 35). The bank may translate the terms if requested by the applicant, but it assumes no liability for errors in the translation and/or interpretation of technical terms.

Beneficiary

The credit must clearly indicate in whose favour it has been issued, stating name and address, and both must be precise to ensure it is the right beneficiary who receives the credit. Also the correct statement of corporate form is important, and the difference between for instance “John Doe” and “John Doe plc” should be noted. The bank that later examines the documents cannot know if “plc” has been erroneously left out in the first example or whether a public limited company and a family business in fact share the same address.

Also the applicant has to make sure that the credit is issued to the right business partner. Sometimes the goods are not produced and sold by the same company. Only the beneficiary is allowed to present the documents under the credit and receive payment for the goods.

Description of goods

The purpose for the applicant to have a credit issued is to ensure that he receives the goods requested. As the credit is not concerned with the physical goods, but only with documents representing or describing the goods, the credit should describe the goods as precisely as possible, avoiding excessive detail. A description in too much detail does not necessary guarantee receipt of the right goods, while an imprecise description may cause the beneficiary to deliver the wrong goods, with or without intent.

Amount of the credit

Statement of the correct credit amount is essential. The credit amount, stated in the correct currency, is the amount to be paid to the beneficiary in connection with the honouring of documents.

The amount may be described in different ways, each of which serves a specific purpose. The most important words are defined

in Article 30(a). It should be borne in mind that even if there is generally not one correct way, only one way will be correct to state the credit amount in connection with a specific transaction.

If the credit just states the currency and the amount, it is because it has been issued for precisely that amount, and the amount must not be reduced or exceeded. This is common for the delivery of one unit, such as a machine, the price of which is fixed according to a contract, but a fixed amount can also apply to the delivery of more than one unit. The credit may also allow partial shipments under a fixed amount.

In Article 30 two situations are described where it is acceptable not to fully utilise the credit amount.

If the credit does not stipulate the quantity of the goods concerned in terms of a stated number of packing units or individual items, a tolerance of 5% more or 5% less in the quantity is permissible. For instance, the credit may stipulate delivery of 50 tonnes of half pig or 100 metric tonnes of fertiliser. Particularly in the first example it may be difficult to precisely supply the 50,000 kg required. However, Article 30(b) clearly states that the credit amount must not be exceeded. Even with correct invoicing of the quantity of goods supplied this means that the credit amount may not be fully utilised.

The other situation is described in Article 30(c), which states that a tolerance of 5% less in the amount of the drawing is permissible, even when the credit does not allow partial shipments and that the entire quantity covered by the credit has been shipped. The purpose of this provision is to ensure that a reduction in, for instance, the cost of freight or the insurance premium does not prevent the honouring of documents under the credit.

If the applicant does not object to the amount stated in the documents being less than the credit amount, the credit may use words like “up to” or “not exceeding”, indicating that it is for a maximum amount.

The credit amount is sometimes stated in that way if, at the time of entering into the agreement, the parties do not know the exact market price or the costs of freight and insurance.

This means that the amount may be reduced, and there is no lower limit to the amount of the drawing.

The UCP 600 describes a possibility to vary the amounts by using the words “about” or “approximately” when the parties do not know the exact value and/or quantity.

To avoid any doubt as to the interpretation of these imprecise expressions, Article 30(a) offers a definition: the words mentioned will be construed as allowing a difference not to exceed 10% more or 10% less than the amount or the quantity or the unit price to which they refer.

This tolerance should be taken seriously, and so a credit for about USD 500,000 will allow documents for USD 450,000, but not for USD 449,999. As 10% may be added, documents for USD 550,000 are acceptable, whereas for instance an additional one US dollar will not be acceptable as the documents will then not be complying.

It is important to note that the tolerance of 10% applies only to the amount or quantity, as the case may be, to which the term “about” etc refers.

If a credit is issued for approximately DKK 100,000 and covers 5,000 kg chemicals, then the 10% tolerance applies only to the DKK amount and not to the quantity. If the tolerance is to apply to the quantity as well, the goods should be described accordingly. The same applies to a unit price that may be stated in the credit.

Documents

The credit must state precisely the documents to be presented by the beneficiary in order for him to receive payment. As the principle underlying the documentary credit is based on documents and not goods or services, the documents constitute a central part of the wording of the credit.

For further details, see chapter 12 Documents and UCP 600 document requirements.

In the application form the applicant will have mentioned the documents to be presented and given the necessary instructions concerning documents not described in the UCP 600.

Banks will usually not be able to determine what documents the applicant needs, and therefore, they will include those in the credit that the applicant has stated.

Consignee

It would seem obvious that the buyer wishes to receive the goods for which he has had a credit issued and that he is prepared to pay for them. However, in this connection there are different aspects that must be clarified and so the credit must state the correct information.

As appears from the description of the transport documents, the consignee is to be stated in either of two different ways, depending on the transport document in question (see Types of transport document under 12.6).

If the document is a bill of lading or a similar transport document giving access to the goods, the consignee stated in the document or the person in possession of the document will have access to the goods. If the latter version is required, it should be indicated in the credit that the bill of lading is to be issued to shipper's order and blank endorsed by the shipper.

A transport document issued to shipper's order gives direct access to the goods on their arrival, allowing the applicant to transfer the goods to a third party.

By contrast, when the credit stipulates a transport document of the waybill type, the credit must also state the consignee.

Even if the applicant will usually wish to have the goods surrendered to himself on their arrival, it is also possible to call for surrender of the goods to someone else, if for instance the applicant has resold the goods. To speed up clearing through customs the goods should then be released direct to the relevant buyer. In some cases the applicant is not the actual buyer, but an agent or perhaps someone offering his creditworthiness to the buyer, such as a parent company that has a credit issued on behalf of a subsidiary. Also a finance company may, against commission, request the issuance of a credit, especially if the actual buyer does not possess the creditworthiness required.

9.4 Physical establishment of the credit

When the issuing bank has incorporated its own details and the data from the applicant into the credit, it is to be transmitted.

As described in 9.1 Handling by the issuing bank, the traditional way to issue the credit used to be to print it out on the

bank's stationery, often safety paper preventing attempts to make corrections. Subsequently, the credit was sent together with a covering letter to the relevant correspondent bank.

Only if the applicant stated that the matter was urgent, would the credit be transmitted by cable or telex, for instance if the goods were ready to be shipped or to observe the delivery dates agreed.

Today most credits in the Nordic region and in the industrialised part of the world are issued via SWIFT, the banks' own telecommunication system, ensuring that they reach the advising bank very fast.

In connection with the physical establishment the bank will book its documentary credit commitment and confirm to the applicant that the credit has been issued and that the applicant is now also committed to the bank in accordance with the application.

Some banks will send a copy of the documentary credit itself together with its confirmation in order for the applicant to see exactly what the beneficiary will receive. Perhaps the bank will charge the applicant at this point in time for commissions and costs in connection with the issuance of the credit.

Chapter 10

Advising the documentary credit

Although it is not a requirement that an advising bank is involved in the transaction, by far most commercial credits are, in practice, advised through a bank situated nearer to the beneficiary than the issuing bank is.

The reason is simple: when the beneficiary receives a credit that is to guarantee the payment for shipment of the goods to the buyer, the beneficiary must be certain that the credit received is genuine, and hence that it has been issued by the issuing bank as stated. The beneficiary cannot be expected to know the authorised signatures of the issuing bank as that bank is often far away, perhaps even in another part of the world. The same need to verify the authenticity exists if the credit has been issued by teletransmission.

Consequently, the issuing bank will transmit the credit through one of its correspondent banks, which is probably better known by the beneficiary or even his own banker.

10.1 The handling obligation of the advising bank

In principle, the advising bank has no obligations under the credit. The credit is the instrument of the issuing bank and hence that bank bears the responsibility for payment.

The role and liability that the advising bank does assume to a certain extent are described in the UCP 600, Article 9.

It appears from Article 9(e) that the advising bank may choose not to advise the credit or amendment.

The bank elects not to advise the credit

If the bank elects not to advise the credit, it must so inform the issuing bank without delay. This means that it must not ignore a request to do so but has to determine what action to take.

Even if the advising bank does not assume any payment undertaking when advising the credit, the bank may have its reasons not to want to have its name connected with the credit:

- Circumstances in relation to the issuing bank or the relevant country may cause the bank to back out. The bank may have previous experience of poor handling or non-payment on the part of the issuing bank, but also provisions on boycott can play a part.

- Also the advising bank may abstain from participating in transactions with the beneficiary based on previous experience.
- If the credit concerns goods that are subject to an embargo on exports or trading in the beneficiary's country, or goods, such as weapons or narcotics, which the advising bank does not want to have anything to do with for ethical reasons, the bank will choose not to advise the credit.
- If the advising bank cannot comprehend the purpose of the credit, and therefore assumes that an illegal financial transaction is behind it, such as money laundering, it will refuse to advise the credit and according to local and international laws contact the police.

The bank advises the credit

Usually, the bank chooses to accommodate the issuing bank's wish to advise the received credit to the beneficiary.

In accordance with Article 9(b), the advising bank "... signifies that it has satisfied itself as to the apparent authenticity of the credit or amendment and that the advice accurately reflects the terms and conditions of the credit or amendment received".

It is important to note that this does not mean that the advising bank assumes responsibility for the authenticity of the credit. Although this may not constitute a big difference in practice, the legal distinction is important.

In practice, for credits issued by telecommunication (telex, SWIFT or cable) the advising bank will check the authenticity by looking at the stated test key. A test key is a code agreed among the banks, and each bank is provided with a test key according to an agreed system.

If the credit is issued by letter, the advising bank will compare the signatures on the credit with the specimen signatures it has previously received from the issuing bank. At the same time the advising bank will check that the signatories are authorised to sign documentary credits. Today the issuance of credits by letter is not so common.

When the advising bank has ascertained that these details are in order, it will forward the credit to the beneficiary.

However, if the credit is fraudulent, and the advising bank despite

taking due care has been unable to detect the forgery because it has been performed perfectly, it is not liable. To my knowledge, Nordic banks have generally been able to establish the authenticity of credits advised by them.

If the advising bank cannot establish the authenticity of the credit, it must, according to Article 9(f), without delay, so inform the issuing bank (or the bank from which it received the credit). The advising bank must choose whether or not to advise the beneficiary about the credit received. If the advising bank elects to advise him, it must inform the beneficiary that it cannot establish the authenticity of the credit.

The fact that the bank cannot establish the authenticity of the credit does not necessarily mean that it is fraudulent. Often, the issuing bank can document, upon request, that the credit is in order.

10.2 The advising bank's payment undertaking

As mentioned in Article 9 and above, the advising bank has no obligations under the credit.

Even if the bank has been nominated in compliance with Articles 6(a) and 12(a), such nomination does not constitute any undertaking by the nominated bank, except if expressly agreed to by that bank (Article 12(a)).

This means that even if it has advised the credit, the advising bank is not liable to examine the documents presented or to take them up. Even less does the bank, not having confirmed the credit, have a payment undertaking.

In order not to contravene Article 14(b), prescribing that also a nominated bank must observe the 5-day rule concerning refusal of non-complying documents, a nominated bank that does not want to honour or negotiate or even examine the documents, must inform the beneficiary accordingly, either when advising the credit or, at the latest, when the documents are presented.

These considerations apply only to the bank's function as advising bank. If the advising bank has confirmed the credit or has given a "silent confirmation", it has of course an obligation in relation to that role. The same is true if the advising bank, towards the beneficiary (or the issuing bank), has expressly assumed a certain task or obligation.

10.3 The beneficiary's evaluation of the credit

The primary purpose of the credit is to secure payment to the seller for the goods he delivers. It is an all-important condition, and certainly the very essence of the documentary credit that the documents presented must comply with the terms and conditions of the credit.

Consequently, it is not sufficient for the seller to demand that the buyer should have a credit issued, even a credit to be confirmed by an approved bank. It would be a great help if the seller makes demands as to the contents and conditions of the credit as well.

It is of paramount importance that the seller, who becomes the beneficiary on receipt of the credit, makes sure that the credit he receives fulfils all the requirements made by him.

Thus, the beneficiary should, not least in his own interest, examine the credit in detail as soon as he receives it.

The purpose of his examination is to ensure that the documents to be prepared and subsequently presented under the credit comply with the conditions of the credit.

When examining the credit, the beneficiary should check

- that the terms and conditions of the sales agreement, pro forma invoice or correspondence have been met by the contents of the credit (see 6.2 The seller's requirements as to the credit) and
- that also the terms and the conditions appearing from the credit can be approved. It is quite common for a credit to contain requirements that have not even been discussed between the parties.

If the parties have agreed that the goods are to be delivered CIF Hong Kong, such agreement may imply wording in the credit to the effect that the goods must be shipped from Odense in Denmark to Hong Kong, perhaps without transshipment. Neither the applicant nor the issuing bank knows that container vessels do not call at the port in Odense (nor do they call at Copenhagen or Århus for that matter) as very large vessels only call at a few European ports, such as Hamburg or Rotterdam. If the transport document then indicates that shipment has been made from a port different from that mentioned in the credit, the documents will show a discrepancy.

It is important to ensure that the dates stated in the credit can be adhered to. Sometimes it is necessary to allow for a potential delay in the production or delivery from the sub-supplier of the goods. Often it takes more time than expected to draw up the necessary documents, like bills of lading and certificates issued by a third party. If the documents are to be legalised by an embassy, that takes time too.

The seller or the staff of the sales department may have a different view of the sales contract and the documentary credit than the staff of the shipping department. Therefore, the relevant staff of both these departments should read the credit instrument. It may be a good idea to involve an in-house or external freight forwarder to have the conditions relating to shipping evaluated.

The beneficiary should remember that when it comes to the banks' approval of documents, it is only the wording of the credit that applies. The banks will not pay regard to any agreements or contracts between the buyer and the seller (Article 4), the seller's requirements and requirements made to the seller.

If, when examining the credit, the beneficiary ascertains that it has not been issued in accordance with the contract or agreement with the buyer, or if he finds there are conditions he cannot accept, the beneficiary must arrange for the credit to be amended.

Chapter 11

Amendments to the documentary credit

Even though the credit is irrevocable, it may be amended, but any amendment must be made in conformity with the UCP 600.

It is quite common to amend the conditions of a credit; in fact, one in every two documentary credits is amended. This proportion is, however, somewhat distorted, in that some credits are amended several times, while others are not changed at all.

If the beneficiary finds that he cannot or will not use the credit in its present form, he should see to it as soon as possible that it is amended.

Apart from the situation where the credit has been issued with the wrong conditions in the opinion of the beneficiary, the buyer and the seller may in the meantime want to change the agreement on which the credit is based. Such a change, which is ordinary, may cause the contents of the credit not to be consistent with the business deal, and so the credit must be amended.

A different cause for amendments is a delay in the production of the goods or the fact that the goods cannot, after all, be shipped in the manner or at the time agreed. Also this situation calls for an amendment.

11.1 Procedure

When the beneficiary requires an amendment to be made, he must ask the applicant to arrange for the issuing bank to amend the credit. The issuing bank is not likely to be prepared to make amendments without being instructed by the applicant to do so. If the issuing bank amends the credit on its own or only at the request of the beneficiary, the bank risks that the applicant will not approve the presented documents that are in compliance with the amended credit, but not in compliance with the original credit (based on the applicant's credit application).

If the bank has made an error in connection with the issuance of the credit, it can correct it without consulting the applicant.

If one bears in mind that the credit is the issuing bank's responsibility, it is obvious that only the issuing bank can make amendments to the credit, and considering that the credit is an irrevocable undertaking by the issuing bank (and the confirming bank, if any) to effect payment against documents presented, it is

understandable that the issuing bank cannot simply amend the credit.

When advising an amendment, the issuing bank must send it through the same bank that was used in connection with the issuance of the credit (Article 9(d)).

Article 10(a) states that an amendment can be made only with the agreement of the issuing bank and the beneficiary as well as of the confirming bank, if any.

It should be noted that the advising bank or the nominated bank, which has not confirmed the credit, has no influence on the acceptance of an amendment. This also applies to a bank that has made a “silent confirmation”.

11.2 When is the issuing bank bound by an amendment?

The issuing bank is bound to honour or negotiate by its issuance of the credit (Article 7(b)).

If the bank subsequently amends the credit, whether the amendment was desired by the applicant or the beneficiary, it is also bound by such amendment (Article 10(b)). The issuing bank does not know the final wording of the credit until it has received the beneficiary’s approval (or rejection) of the amendment (Article 10(c)).

In exceptional cases where the issuing bank has made several amendments without having been informed of the beneficiary’s acceptance, there may be a large number of variants of the credit under which documents may be presented.

If amendments concern the date of expiry of the credit and/or changes in amounts, it may be difficult to precisely calculate the bank’s maximum risk. In this situation the prudent bank will combine the longest term to expiry with the highest credit amount, even if such details originate from different amendments.

The issuing bank will be bound by the amendments it makes, even in a situation where the confirming bank, if any, elects to advise the amendment without adding its confirmation.

11.3 When is the confirming bank bound by an amendment?

The confirming bank's liability corresponds to that of the issuing bank.

According to Article 10(b), this presupposes that the confirming bank agrees to modify the conditions of the credit. Even if the issuing bank has agreed to amend a credit, the confirming bank will not necessarily approve the amendment.

If the confirming bank refuses to accept the amendment, it is still bound by the terms of the original credit (Article 10(c)), and it must inform both the issuing bank and the beneficiary that it does not confirm the amendment.

If the confirming bank accepts and advises the amendment, it is, like the issuing bank, bound by it, but cannot rely on the contents of the credit until the beneficiary has accepted the amendment.

11.4 When is the beneficiary bound by an amendment?

As a documentary credit cannot be amended without the acceptance of the beneficiary, the terms of the original credit will remain in force until the beneficiary communicates his acceptance of the amendment.

The best way to communicate such message is for the beneficiary to make up his mind about it when he receives the amendment and then either approve or reject it through the advising bank. Banks may attach a form to the amendment for the beneficiary to use for communicating his acceptance of the amendment to the banks.

However, as an (irrevocable) documentary credit cannot be amended right away, documentary credit experts agree that it is not possible to amend the credit and demand an immediate reply from the beneficiary (see Article 10(f)). The mere risk that the amendment for some reason does not reach the beneficiary constitutes a great deal of uncertainty.

This is the reason why Article 10(c) states that presentation of documents that are based on an amendment to the credit will be considered as an approval of the amendment, which will then also be binding on the beneficiary in terms of future presentations.

Due to this provision, the beneficiary is able to postpone his decision to accept an amendment until just before shipment or the drawing up of the documents required.

However, the provision can easily entail difficulties for the banks involved, and therefore it will be good practice for the beneficiary to notify the relevant parties of his acceptance of the amendment as soon as he is able to make his decision.

As appears from Article 10(e), partial acceptance of an amendment is not allowed. If an advice of amendment contains several pieces of information, they will not constitute an amendment, unless all of them are accepted.

The purpose of this provision is to smoothen the procedure for making amendments, hence avoiding correspondence back and forth between the different parties with mutual proposals for adjusting the amendment text.

Chapter 12

Documents and UCP 600 document requirements

The documents form the basis of the documentary credit. This is reflected in the terminology used by several countries (English: documentary credit; German: Dokumentenakkreditiv). In the context of documentary credits, documents mean the documents to be presented by the beneficiary in order to meet the stipulations of the credit.

The documentary credit itself is often called the documentary credit instrument so as not to cause confusion. Contracts and other agreements relating to the transaction do not concern the credit and, therefore, have their own designations.

As described in the UCP 600, Article 5, the banks involved in the documentary credit transaction only deal with documents and not with goods, so the banks may refuse to honour or negotiate solely on the basis of the documents presented, and the documents are those presented by the beneficiary.

12.1 The responsibility of banks as to documents

When talking about presentation of documents under the documentary credit and the banks' very strong focus on these documents in their function of releasing payment, the actual value represented by the relevant documents is of great importance, particularly to the applicant (the buyer).

According to Article 34, banks do not assume any responsibility for the genuineness or correctness of the contents of the documents they receive and examine. Banks will examine the documents in the form in which they appear on their face and will (usually) not check the underlying circumstances.

A nominated bank with a professional attitude that receives documents which it finds to be non-authentic or incorrect will not simply disregard that, referring to Article 34, but will refuse to pay under the credit, and in serious cases of forgery the bank should inform the police.

12.2 Original documents

The UCP 600 (Article 17(a)) states that at least one original of each required document must be presented in order to meet the stipulations of the credit, unless otherwise stipulated in the documentary credit.

During the past years the discussion as to what constituted or could be considered to be an original document has intensified as a result of some judicial decisions and judges' explanatory statements in this connection. The reason for this revitalised discussion was no doubt the development of more perfect technological production methods.

The UCP 600 now defines in Article 17(b) and (c) what a bank will accept as an original document.

A document written by hand with a fountain pen or a ballpoint pen is unquestionably an original document. Also a document written on a traditional typewriter will seldom cause doubt as to its original status. Article 17(b) explains how a signature can be made.

If there is a need for several copies of a document, such copies were previously produced as carbon copies or photocopies. Nobody could be in doubt about what was a photocopy or a carbon copy and what the original document was.

To make it possible to use such copies as originals, the UCP 600, Article 17(b) and (c) stipulates how to act in order to fulfil this requirement.

In the opinion of most banks, the document may state that it is an original if the document has been photocopied in its entirety.

Many bankers handling documentary credits find it difficult to understand that documents produced in a way that, at least, in the industrialised part of the world, constitutes a normal process so that they are in practice accepted as original documents, should be specifically marked as original when used in connection with a documentary credit.

The UCP 600 rules do not expressly stipulate that this should be done by the issuer of the document. However, it is obvious that it should. Otherwise, the question of forgery may easily arise.

There are also other methods to mark a document as original; for instance, by using the words "duplicate", "triplicate" etc. Particularly in English these words may have different meanings in the same way as the expression "two copies" can both mean two actual copies and one original plus one copy.

However, it is beyond doubt that, for instance, a bill of lading or an insurance policy marked with the word "duplicate" etc should be considered an original document.

In April 1999 the ICC Banking Commission, therefore, issued its decision for the purpose of solving the problem. According to this decision banks, in line with the practice ruling before the above-mentioned judgments were passed, will consider a document as an original if it appears on its face to be one, even if it has been printed via a PC and on the issuer's stationery. If a photocopy is provided with the issuer's signature, it will be considered as an original as well. It is, of course, a prerequisite that the document does not in any other way clearly indicate that it is or should be considered to be a copy.

Thus, the ICC was of the opinion that the UCP 500 (in force at that time) did not intend to change the general perception of what is an original document, and that modern methods of producing documents are not to influence the status of a document as an original.

The ICC's decision has influenced the interpretation by banks, and several judgments passed by law courts have been affected by it as well.

The UCP 600 includes ICC's decision as Article 17(b) and (c).

12.3 Copies and duplicates

If the credit stipulates the presentation of a document in more than one copy, it should be specified whether they are to be originals and/or copies.

If the documentary credit does not stipulate otherwise, or if it uses expressions such as "duplicate", "twofolds", "two copies" and the like, banks will be satisfied by the presentation of one original and the remaining number in copies. Any type of copy will be accepted, that is both carbon copies and photocopies. Copies need not be marked "copy". If a credit requires the presentation of a copy, the presentation of an original will also satisfy (Article 17(d)).

If it appears from the document itself that it is issued in several originals, and the credit does not mention the number to be presented or how to deal with them, banks will demand all the originals of a full set. Usually, bills of lading and insurance policies are issued in several originals.

12.4 Signature

The UCP 600 does not contain any provisions to the effect that all documents, including the originals, should be signed.

Obviously, certificates, declarations and the like have effect only if they have been provided with a signature. This is also the case where the certificate or declaration has been written on an invoice or another document (ISBP Paragraph 37).

Other articles concerning specific documents do, however, mention that the relevant document must be signed, and sometimes even by whom. Otherwise, credit stipulations, if any, concerning signatures must be complied with.

In our part of the world credit requirements concerning signatures will usually be met if the document is signed by handwriting. It should be emphasised that a photocopy of a signature, and hence a signature transmitted by fax, cannot be considered as an original signature.

Article 17(b) also mentions other ways of signing that can be approved in connection with the presentation of documents under the credit. Other widely used methods of authentication are by facsimile signature and by stamp which, particularly in China, is used as a binding signature.

An ordinary company stamp cannot be approved, even though the word “stamp” is mentioned in the rules.

Article 3 interprets how a condition under a credit calling for authentication, validation, legalisation and the like is to be understood, unless otherwise stipulated. Such requirement will be satisfied by any signature, stamp etc appearing to meet the requirement in the credit unless the stipulation in the credit is specific.

12.5 Language

Sometimes the question arises as to the language in which a document is to be drafted.

The UCP 600 does not contain any provision concerning language, and the ICC Banking Commission has not provided any answer to this question. Therefore, it hinges on the banks involved.

Nevertheless, the ISBP states in Paragraph 23 that it is international standard practice that documents issued by the beneficiary should be in the language of the credit.

It is certain that documents in English will not cause any problems. Similarly, it is hard to imagine that French or Spanish would be debatable.

The problem arises when a document is written in a language which is fairly unknown at the place where the decision on the document is to be made. It happens now and then, for instance, that a document drafted in Russian (with Cyrillic letters) is refused by for instance a German bank (the confirming bank).

The only way to solve this problem is to state in the credit the language(s) in which documents must be drafted in order to be approved.

It would not be a practicable solution to demand that documents should be written in the same language as that of the credit in all cases. Most credits are issued in English in this part of the world. If a credit issued by a Danish bank in favour of a South Korean beneficiary calls for a declaration to be issued by a local authority, it is to be expected that such declaration will be issued in Korean, and it may even have been issued before the establishment of the credit. Similarly, a Chinese post office receipt is likely to be written in Chinese.

Banks take different positions as to this issue. For instance, the German bank in the above example may insist that, being liable to pay on the presentation of complying documents, it is necessary for it to examine the documents to check if they fulfil the conditions. To do so, the bank must be able to read and understand the documents.

Other banks believe it is their problem to evaluate the documents in cooperation with the beneficiary, perhaps after they have been translated. Who is to pay the costs of translation if the bank does not command the required linguistic qualifications, is an open question.

12.6 Types of document required under a credit

It is natural to ask the question: which documents are called for under a credit? However, it is not so easy to answer.

The fact that the credit is such a flexible instrument and can be

used for any variation of international trade, and that it can cover both goods and services, makes it impossible to make general demands as to the form and content of the credit instrument. For each transaction it must be agreed which documents are required to release payment under the credit. And to the largest possible extent, the applicant's need for security for the beneficiary's ability to present complying documents should be considered. A credit covering a simple purchase of goods usually stipulates a transport document and an invoice as the most important documents, whereas a credit concerning services calls for documentation of what has been performed.

Each individual credit will require the presentation of exactly those documents that are necessary and suit the specific transaction, and there is no limit to the documents that can be called for under a credit.

As this book is primarily about commercial documentary credits covering transactions in specific goods or services, there are, of course, documents that are more often used than others. Below some of the most common documents are described, although the list is by no means exhaustive.

Payment under the credit is conditional upon compliance with the terms of the credit, the presentation of complying documents being among the most important conditions.

The documents must be drawn up in accordance with the stipulations of the credit and the UCP 600 (and the ICC's "ISBP", International Standard Banking Practice).

Many of the UCP 600's articles deal with documents and topics related to documents. The purpose of describing the documents and connected matters so thoroughly is for the ICC to set the clearest possible guidelines to provide the same framework of reference for all the banks in different countries when a credit calls for a particular document.

As a main rule, the provisions of these articles apply where the credit does not provide otherwise. This is to maintain the wide flexibility of the credit instrument to allow it to cover any type of transaction. This also leaves it to the applicant to define for himself what he really wants. Popularly speaking, it could be argued that if

the applicant does not clearly describe the contents of a document and by whom it must be issued, he has to accept what the beneficiary presents. An imprecise wording can easily harm the applicant.

In this connection it is important to know Articles 3 and 14(f). Article 3 states among other things that a credit should not describe the issuer using imprecise words such as “first class”, “well known”, “qualified” and “official” etc. If such terms are, nevertheless, incorporated into the credit, the documents will be accepted as presented, unless issued by the beneficiary himself.

Article 14(f) applies to documents other than transport documents, insurance documents and commercial invoices and states that the credit should stipulate by whom such documents are to be issued and their wording or data content. If the credit does not so stipulate, banks will accept them as presented, provided that they otherwise comply with the terms and conditions of the credit. In other words, both articles underline the importance of being meticulous when issuing a credit. If a document or matters relating to a specific document are not dealt with in the UCP 600, nor referred to in the credit itself, banks will accept such document as presented, provided that it does not conflict with any other stipulated document or the credit.

Issuance and presentation

It appears from Article 14(i) that banks will accept a document bearing a date of issuance prior to that of the credit, provided that it is presented in time; but the article also states that a document must not be dated later than the date of presentation. This should not be necessary to state, but it is stated for reasons of clarification.

According to Article 6(e) documents must be presented at the nominated bank on or before the expiry date and within the bank’s normal opening hours. If the expiry date falls on a day on which the nominated bank is closed, the expiry date will be extended to the first following day on which such bank is open (Article 29(a)).

In addition to the date of expiry, the period of time for presentation of documents is further restricted by Article 14(c). Credits calling for an original transport document should stipulate a specified period of time after the date of shipment during which

presentation must be made. If no period of time is stipulated, banks will not accept documents presented to them later than 21 days after the date of shipment.

It should be noted that copies of transport documents are not considered transport documents for the purpose of the UCP 600, and for example a presentation that only includes a copy of a transport document would not be subject to the 21 days' presentation period as described above.

Documents relating to payment

In a documentary credit transaction, primarily the credit itself should be considered as the instrument that determines payment. The other documents complement and support the claim under the credit. The UCP 600 describes the obligations of the issuing bank and the confirming bank, if any. Only in exceptional cases, usually in matters not relating to the undertaking under the credit itself, can the claim be based on other circumstances or documents.

Bill of exchange

For centuries the bill of exchange has been used as a means of payment and finance, and so it is natural for it to have played a part, also in connection with documentary credits throughout the years.

Today the importance of a bill of exchange in connection with a credit transaction is open to discussion, although its use is diminishing as a result of the stamp duty imposed by several countries.

Now the payment undertaking of the banks is based on the documentary credit, rather than the bill of exchange and consequently the practical implication of the bill lies more in matters not regulated by the UCP 600.

The draft is issued by the beneficiary and drawn on a bank in compliance with the stipulations of the credit. Depending on the payment conditions of the credit, the draft should prescribe payment at sight or at a subsequent date of maturity.

A sight draft is typically called for in credits available by negotiation, which will usually require it to be drawn on the issuing bank. According to the national legislation on bills of exchange,

such draft forms the basis of the negotiating bank's right of recourse towards the beneficiary. It depends on the involved bank and country whether a negotiation will be with or without recourse.

Credits available by acceptance will provide for a draft on the nominated bank with a maturity date as prescribed by the credit. The accepted draft will be handed over to the beneficiary as "payment". By discounting the draft, the beneficiary may finance the credit facility he has granted to the buyer. Instead of having a draft on the nominated bank, the credit may stipulate that the bill of exchange should be drawn on the reimbursing bank, which after its acceptance of the draft will be liable for its payment.

The advantages of using a draft in connection with usance credits are that it can be discounted by parties other than those to the credit, and that it can be used as a means of refinance on account of its transferability.

In connection with a documentary credit, the bank accepting a draft which it has handed over to the beneficiary should be aware of the fact that it actually assumes an undertaking to pay at maturity through two instruments. According to the UCP 600 the issuing or confirming bank has an obligation to pay at maturity, and under the national legislation on bills of exchange the acceptor must pay the holder of the accepted draft at maturity. Consequently, the bank should pay under the credit only if, at the same time, the draft is returned to it.

According to Article 6(c) a credit should not call for a draft on the buyer (who has no obligations under the credit!). If, nevertheless, the credit provides for a draft on the buyer, the draft will be considered and treated as an ordinary document in compliance with Article 14(f) and not as a "documentary credit draft". The UCP 600 does not contain any provision on "documentary credit drafts".

Receipt

Sometimes, although it seldom happens today, a credit calls for the presentation of a receipt. The reason why the applicant may want a receipt is that, with a receipt, he can always prove to the beneficiary that he has paid.

The beneficiary may not wish to issue such receipt in advance as he has not received payment on presentation of the documents. However, the beneficiary ought to remember that the applicant (the buyer) does not receive the documents until they have been accepted by the issuing bank. Thus, the applicant cannot obtain the receipt if he refuses the documents on account of a discrepancy.

Articles 3 and 14(f) also apply to the issuance of a receipt.

Invoice

By far the majority of commercial credits call for the presentation of an invoice. Article 18 contains provisions concerning commercial invoices.

Beneficiary and applicant

Both according to usual commercial practice and the UCP 600 (Article 18(a)(i and ii)), the invoice must be made out by the beneficiary of the credit to the applicant of the credit. The reason is that the beneficiary is considered as the seller of the goods, irrespective of by whom they have been produced, and that the applicant is the buyer of the same goods. If these assumptions are not true, the credit must stipulate who is to make out the invoice or in whose name it is to be made out.

Sometimes the buyer demands that the invoice should be signed or receipted, perhaps because of local statutory requirements or usage. According to Article 18(a)(iv), the credit must then stipulate so to ensure that the invoice is signed or receipted.

For many years it has been discussed whether the addresses and other references (“contact details”) stated in the credit regarding the beneficiary and/or the applicant should be stated in the invoice – more or less literally. The UCP 600 states in Article 14(j) that an address of the beneficiary and/or the applicant stated in the invoice may be different from that stated in the credit, but must be in the same country. It also stipulates that contact details will be disregarded. The last sentence, however, states that if the applicant’s address and contact details are used on transport documents as consignee or notify party details, they must be as stated in the credit.

Description of goods

The description of the goods must correspond with the description in the credit (Article 18(c)). It is worth noting that this provision does not stipulate that the description of the goods in the invoice must be literally consistent with that of the credit.

It is acceptable for the invoice to specify the goods description in more detail, and so additions are permissible. However, it must be ensured that such additions are not or cannot be perceived as being inconsistent with the goods description in the credit.

If the credit describes the goods as “50,000 pcs chicken wings”, the description “50,000 pieces of chicken wings, Royal Danish Brand” in the invoice will be accepted.

A reference in the invoice to a pro forma invoice or a contract will not cause the banks to check the contents of the pro forma invoice or the contract to ensure that the goods descriptions are consistent. If the reference stipulation is contained in the wording of the credit, the banks will merely check that the reference stipulated appears from the invoice.

Invoice amount exceeds credit amount

The price of the goods has usually been agreed between the parties and should appear from the credit. Consequently, it is normal for the invoice amount to tally with the credit amount.

However, Article 18(b) allows the nominated bank to accept an invoice for an amount exceeding that of the credit, provided that the bank can accept the reason. The nominated bank’s decision will be binding upon the issuing bank and the confirming bank, if any. It is a condition though, as mentioned in the article, that the amount of payment must not exceed the amount permitted by the credit.

One reason for this could be that the buyer has made a prepayment of DEM 50,000 of the total price of DEM 300,000. Thus, the credit will then be issued for DEM 250,000 only. Ideally, this situation should be described in the credit.

If, instead, the beneficiary had made out the invoice for DEM 250,000 to be consistent with the credit amount, he would have complied with the stipulation of the credit, but he might be accused of having attempted to commit fraud in relation to the

importing country's customs authorities by stating a value lower than the actual value.

Transport documents

Throughout the years transport documents have always caused by far the greatest problems or interpretation difficulties in connection with the drawing up and examination of documents presented.

There are several reasons for this. The international rules on documentary credits usually have a lifespan of some ten years and add to this the approximately four or five years it takes to prepare the rules. In the meantime, changes will have occurred in the field of transport which are then not reflected in the rules in force. Furthermore, the rules apply worldwide, and therefore, local variations in transport conditions cannot be covered by these rules.

If these two circumstances are combined with the exporter's and his carrier's wishes and needs to arrange the most flexible and low-priced transport, it is no wonder that banks come across transport documents that conflict with the provisions of the rules and the credit itself.

Consequently, it is particularly important in this area for the parties to agree on the details of transport, and that the applicant subsequently makes sure that the credit reflects such agreement. He should also ensure that documents or wording that are not contained in the general provisions of the UCP 600 can be accepted. It may be a good idea to consult one's freight forwarder or carrier.

For the purpose of guidance and of defining the specific requirements concerning the various transport documents used, the UCP 600 contains a large number of articles with regard to transport documents.

These articles describe in detail the rules applicable to the issuing and signing of each document and deal with specific requirements, such as an on board notation, transshipment and payment of freight charges. Anyone who is to have transport documents prepared is strongly recommended to read these articles carefully.

Each of the articles (Articles 19-25) dealing with a specific transport document states in its introduction that the provisions apply to the relevant document, no matter how it is named. And

so it is the contents of the document and not its designation that determine whether banks will accept it under a documentary credit transaction.

The transport document is to provide details of the shipment and its contents and should, as a minimum, function as a receipt evidencing that the carrier has received the goods for shipment. Apart from the type of goods, the transport document should also state the quantity in units and/or weight. Often such details have been provided by the consignor, and hence the document may bear a clause like “shipper’s load and count” or “said by shipper to contain”. According to Article 26(b), such clauses are acceptable.

A bill of lading will typically state the weight of the goods, not least because the payment of freight charges is often based on the weight. If the credit calls for an attestation or certification of the weight of a consignment, a weight stamp or a declaration of weight on the transport document will be accepted if it appears to have been provided by the carrier. A separate document is to be presented only if expressly stipulated in the credit.

Often the transport document will state the beneficiary as the consignor, but there are sometimes reasons for stating another person as consignor. Article 14(k) mentions that banks will accept a document indicating as the consignor a party other than the beneficiary of the credit, but on condition that all documents show the same name.

Types of transport document

There are many different types of transport document, each designed to fit the relevant mode of transport, but by and large they have the same functions:

- receipt evidencing that the goods has been received
- documentation, if any, proving that the goods has actually been shipped
- transport agreement
- terms and conditions for the transport (perhaps by reference to general rules)
- evidence of the right to take control of the goods
- transferability of the document.

This book will not deal with transport documents or discuss problems relating to transport for any purpose other than what is relevant to documentary credits and the UCP 600. Therefore, transport agreements and the like will not be discussed.

In the context of documentary credits, transport documents may be divided into two groups:

- waybills (consignment notes)
- negotiable transport documents.

The most well-known example of a negotiable transport document is a marine or ocean bill of lading. By contrast to a waybill, a marine or ocean bill of lading gives title to the goods, and this is a characteristic feature of this type of document. As it is a document of title, the goods will be handed out to the person presenting an original bill of lading.

The bill of lading is a negotiable instrument, and its holder will have access to the goods. Consequently, bills of lading are used for ordinary transport by sea, but in particular if the goods are to be resold before they arrive at their destination; bills of lading are a suitable transport document.

Usually the bill of lading and other negotiable transport documents can be transferred to a new holder, either by way of an endorsement in blank making it a bearer instrument, or by endorsement in full transferring the goods to a named party.

In some countries it is the rule of “straight” bills of lading that the goods are delivered to the consignee on arrival of the goods – without the presentation of one original bill of lading. In such a situation the straight bill of lading works similarly to the waybill.

A straight bill of lading will not be issued to “the order of” the shipper or the consignee.

It may be worth reading the wording of a negotiable bill of lading (or any other negotiable transport document) on the carrier’s right to release the goods without receiving one of the issued originals. It is not the normal way carriers act, but in recent years international bankers have noticed several clauses in bills of lading allowing release of goods without presentation of the original.

Bills of lading are subject to the maritime laws of the relevant countries.

Waybills do not provide access to the goods but state who is the consignee to whom the goods are to be delivered on their arrival. The consignee is not to present any transport document to get access to the goods. The holder of the original waybill can stop and redirect the goods during the period until they arrive at their destination or are released.

Accordingly, the waybill is not suitable in transactions where the goods are to be resold while in transit. Furthermore, the issuing bank does not have security in the goods, unless the credit stipulates that the issuing bank is to be the consignee.

The advantage of using a waybill rather than a negotiable transport document is that a delay in sending the documents to the consignee is of no significance as he can take possession of the goods immediately on arrival.

Carrier versus freight forwarder

It is a good thing to remember that in the context of documentary credits, transport documents are documents covering the transport of the goods and, as a main rule, they have been issued by or on behalf of a carrier.

According to the UCP 600, banks will accept transport documents issued by a freight forwarder or any other party only if expressly authorised in the credit, or if that party acts as a carrier or as an agent for the carrier (Article 14(l)).

The provisions on the issuer of transport documents have become quite detailed because of the confusion that was ruling previously, not only among banks but also among exporters and even among shipping people. The confusion concerned the actual obligation of the issuer in respect of a specific shipment. In particular, the term “freight forwarder” gave rise to problems if the document did not indicate if the relevant freight forwarder had issued the document in its own name or on behalf of a carrier

The difference between a carrier and a freight forwarder can briefly be explained as follows: the carrier is responsible for carrying through the transport in compliance with the conditions stipulated in the transport document. To assume such responsibility, the carrier need not own or have full possession of the relevant means of transport.

By contrast, the freight forwarder is merely an intermediary arranging the transport. His only responsibility is to fulfil his agreement with his customer. The transport will then be performed by one or more carriers.

What often makes it difficult to see if a person acts as a carrier or as a freight forwarder is that it is in fact possible for a freight forwarder to assume the responsibility of a carrier, or rather to actually be a carrier, in addition to performing his duties as a freight forwarder in other situations.

This description is primarily based on the provisions in the UCP 600 and the interpretations made by the International Chamber of Commerce in that connection. No doubt, the transport industry can come up with other examples based on their practice.

Transshipment and the UCP 600

The articles in the documentary credit rules dealing with transport documents (Articles 19(b) and (c), 20(b) and (c), 21(b) and (c), 23(b) and (c) and 24(d) and (e)) define transshipment in relation to the relevant mode of transport and contain provisions as to when transshipment can be accepted on certain conditions, notwithstanding that the credit prohibits transshipment.

These provisions have been inserted to update the rules to fit modern modes of transport and practice, thus offering advantages to the beneficiary (the exporter).

The importer should be aware of these specific provisions when agreeing on a certain mode of transport to ensure that the goods are forwarded in a manner acceptable to him.

In each case the applicant can choose to opt out of the general provisions of the UCP 600 by stating that transshipment is not in any circumstance permitted, or that transshipment may take place only at the place specified in the credit. It is possible to state in the wording of the credit that transshipment permitted according to the relevant article in the UCP 600 will not be accepted.

Clean transport document

A clean transport document or a “clean on board” clause relates to the condition of the goods and/or packaging (Article 27).

If, on receipt of the goods, the carrier finds that the packaging or the goods are defective, he will make a notation on the transport document to this effect to avoid being subsequently held responsible for such defect. Hence, the document is no longer clean, and any objections or claims for damages will have to be directed to the consignor.

Article 27 stipulates that banks will only accept transport documents without such clauses or notations, unless the credit stipulates otherwise. The article also states that a transport document need not indicate that it is clean. If the document bears no clause expressly declaring a defective condition, the document is considered to be clean.

Many credits require a bill of lading to be “clean on board”. This condition is met if the bill of lading is clean and complies with the requirement for an indication that the goods have been loaded on board (Article 27).

Container transport

In connection with transport by sea, in particular, the majority of goods are shipped in a container rather than the conventional way as general cargo where the units are loaded direct in the hold of the vessel without any other protection than the packaging used by the consignor.

The container adds significantly to the protection of the goods to avoid damaging of the goods and theft or pilferage, which constitutes a major risk in certain ports.

Furthermore, container transport offers the shipping companies the advantage of more rational handling and hence lower costs of freight.

The provisions in the UCP 600 concerning transport documents, notably bills of lading, sea waybills and not least multimodal transport documents support the use of container transport as a natural mode of transport today.

Depending on the volume of goods in each case, a full container may be shipped from one seller to one buyer. The seller himself will have loaded the container, and the carrier will, without checking the contents, transport it to the buyer, who will unload it himself. In this case, the transport document will state the shipment of a container

and perhaps indicate the contents. Such details will originate from the consignor and, therefore, the shipping company will not assume responsibility for that.

In other situations the seller will hand over the goods to the carrier, who will then place them in a container together with other goods from other exporters with the same destination. At the destination the carrier or his agent will unload the container and hand over the different consignments to various consignees. In this case the transport document will indicate the shipment of a certain number of units.

Whether it is a full container or the goods have been placed in a container with other goods by the carrier, the transport document will usually indicate that the goods have been shipped in a container, stating the container number and perhaps also the number of the seal.

As these different ways of loading and unloading can be combined, the transport industry has introduced a code system, usually appearing from the transport document.

FCL means full container load, implying that the container is to be loaded and unloaded by parties other than the carrier. Typically the consignor will load and the consignee will unload the container or a freight forwarder will do so on their behalf.

LCL means less than container load, implying that the carrier is in charge of loading and unloading. The container will often hold goods from different consignors and/or to different consignees.

The letters before the slash refer to the dispatch and the letters after the slash refer to the receipt of the goods. The most common combinations are: FCL/FCL, LCL/LCL and LCL/FCL.

The combination FCL/LCL would be unlikely (although not quite impossible) as a carrier would not normally be expected to assume responsibility for delivering goods he has not himself placed in the container.

Banks will rarely need to pay attention to these codes, unless otherwise stipulated in the credit, but knowing the codes provides better understanding of the relevant transport.

However, in connection with the examination of documents banks will make sure that the transport document does not contain a clause

to the effect that further transport documents are to be presented in order to get access to the goods, or that it does not state “part load”. Thus, unless expressly permitted in the credit, banks will not accept documents for which two or more sets of original transport documents have been issued, all of which, together, will have to be presented to the carrier in order for him to release the goods.

Goods loaded on deck (carriage by sea)

Banks will not accept a bill of lading or any transport document indicating that the goods are loaded on deck (Article 26(a)) as this would entail a significant risk of damage to the goods caused by sea water or because the goods have fallen overboard in a gale. Nevertheless, banks will not refuse a document containing a provision that the goods may be carried on deck. If a container has been loaded on deck, this will not be a barrier to the acceptance of the relevant document.

Partial shipments

The applicant will have to consider the implications, if any, of allowing the goods to be sent by several shipments or of receiving the goods at the same time at the destination. As a main rule, partial shipments are allowed (Article 31(a)). If partial shipments are to be prohibited, this must appear from the credit.

Article 31(b) takes this question a bit further by stating that transport documents indicating that shipment has been made on the same means of conveyance, such as “MS Hansa”, and for the same journey, will not be regarded as covering partial shipments, provided that it indicates the same destination, such as “Hong Kong”, even if the transport document indicates different dates of shipment and ports of loading, such as “Amsterdam, 12 May” and “Rotterdam, 15 May”. The latest date of shipment as evidenced on any of the sets of transport documents will be regarded as the date of shipment (Article 31(b)).

The reason for this article is that it is important that the goods arrive together. It is worth noting that the article clearly assumes that shipment has been made on the same means of conveyance. Hence, shipment made by two lorries driving the same route in a convoy will not fall under this article, because this would constitute partial

shipment as the possibility exists that one lorry does not reach its destination (Article 31(b)).

The definition in Article 31(b) does not apply to shipments made by post or courier. Such cases will not be regarded as partial shipments (Article 31(c)) if the post receipts or certificates of posting or courier's receipts or dispatch notes have been stamped and signed in the same place and on the same date.

Latest date for shipment

To ensure that the goods will arrive in due time, many applicants will state the latest date for shipment in the credit.

Different expressions are used for shipments, both in practice and in the UCP 600, depending on the relevant mode of transport. The word "shipment" is generally used in the UCP 600 and in this book and includes various expressions as stated in the articles regarding transport documents, provided that they are used in stipulating shipment dates in a documentary credit.

According to Article 3, expressions such as "prompt", "immediately" and "as soon as possible" should not be used, and if they are used, banks will disregard them. If the expression "on or about" or similar expressions are used, banks will interpret them as five calendar days before or after the specified date, start and end dates included.

The credit may stipulate a specific date as the latest date for shipment, and this is recommendable. Article 3 describes date terminology for periods of shipment and how a number of different expressions will be understood in the context of a documentary credit.

The expiry date of the credit will be extended according to Article 29(a) if such expiry date falls on a day on which the nominated bank is closed. It is important to note that the latest date for shipment will not be extended correspondingly. If no latest date for shipment is stipulated in the credit, the goods may be dispatched no later than on the expiry date of the credit. If such expiry date falls on a Saturday on which the bank is closed, the documents may be presented the following Monday, although the goods must still have been dispatched on the Saturday.

Payment of freight

The agreed terms of delivery determine whether freight charges are to be paid by the consignor or the consignee. The importing country may have special rules to which the parties are subject and they should take these into account when making the agreement. Other countries require freight to be paid in advance if goods are to be imported. These factors will have to be considered when the credit is to be established. Banks will accept transport documents stating that freight charges have still to be paid (“freight payable at destination”), unless otherwise stipulated in the credit or inconsistent with any other document. If CIF or the like is stated in the invoice, this will be taken to mean that freight charges must have been paid.

If the credit stipulates that freight charges must have been paid or prepaid, banks will accept a transport document on which words clearly indicating payment or prepayment of freight has been written, stamped or otherwise affixed. The rules do not require the presentation of a receipt for prepaid freight.

Words like “freight prepayable” or “freight to be prepaid” appearing on transport documents will not be accepted as constituting proof of freight prepaid.

Whether or not freight charges have been prepaid, there may be certain expenses in addition to freight costs that have to be paid on arrival of the goods, such as loading, unloading and the like. Banks will accept transport documents bearing reference to such additional costs, unless the credit specifically prohibits such reference (Article 26(c)).

Bill of lading (marine/ocean)

A bill of lading is the traditional instrument issued in connection with carriage by sea, although today the term is also used for other means of conveyance. To most bankers and business people the term will, however, mean a marine or ocean bill of lading, which is described in Article 20.

If the credit calls for the presentation of a bill of lading covering a port-to-port shipment, the document presented must comply with the provisions in Article 20.

This article is very detailed. This is not just because a bill of lading is a much used document in connection with documentary credits.

The purpose of giving these details is also to provide security for the parties involved, including banks that have based their participation or granting of credit on having security in the goods.

Issuer

According to Article 20(a), the bill of lading must be signed by the carrier, the master of the vessel or an agent for the carrier or master. To avoid any doubt as to the signature, it must be indicated on the bill of lading on whose behalf and in what capacity (carrier or master) the party has signed. The name of the carrier must be indicated on the bill of lading.

Loading on board

Basically, a marine or ocean bill of lading must indicate that the cargo has been loaded on board a named vessel. The reason for this requirement is that the applicant (the buyer) wants to be sure that the cargo is on its way and not waiting on the quay in the port of loading waiting for the vessel that may not arrive for a long time.

The on board notation may be made in either of two ways, both of which are permitted, as described in Article 20(a)(ii). The printed text of certain bills of lading states that in addition to giving receipt for the cargo, the carrier also certifies that the cargo has been dispatched or received on board the vessel. Such bill of lading is, therefore, often termed “shipped on board bill of lading”. The date of the bill of lading is regarded as the date of shipment.

Another type of bill of lading is often referred to as “received for shipment bill of lading”, implying that the shipping company has received the goods to ship them from one specific port to another specific port.

When using such form, the carrier must evidence the loading on board of the cargo as well as the date of such loading by way of a notation on the bill of lading. The said date is regarded as the date of shipment.

In case an onboard bill of lading also shows an onboard notation, and the dates are different, the date of the onboard notation will be deemed to be the date of shipment.

If the bill of lading contains the indication “intended vessel” or

similar qualification in relation to the vessel, loading on board a named vessel must be evidenced by an on board notation on the bill of lading which, in addition to the date on which the goods have been loaded on board, also includes the name of the vessel on which the goods have been loaded, even if that vessel is the same as the “intended vessel” (Article 20(a)(ii)).

If the bill of lading indicates that the carrier has received the goods at a place different from the port of loading, the on board notation must also include the port of loading, to evidence that the goods are shipped on board a vessel in the port of loading stipulated in the credit.

Port of loading and port of discharge

The provisions of the UCP 600 concerning ports of loading and discharge appear from Article 20(a)(iii).

The bill of lading must indicate the port of loading stipulated in the credit as the port of shipment and also indicate the port of discharge referred to in the credit as the destination.

It is important that the rules permit the cargo to be taken in charge at a place (place of receipt) different from the port of loading and/or a place of final destination different from the port of discharge, provided that the stipulations of the credit concerning ports of loading and discharge have been complied with and are indicated in the bill of lading.

Transshipment

Transshipment has often been the source of much debate, in particular concerning the issue whether or not transshipment should be allowed. In principle, this question must be negotiated between the applicant and the beneficiary.

According to Article 20(c) transshipment is permitted, unless prohibited by the terms of the credit, provided that the entire ocean carriage is covered by one and the same bill of lading.

Banks have been involved in discussions as to what is meant by transshipment and also whether shipment can actually be made without transshipment.

It appears from Article 20(b) that, for the purpose of documentary credits, transshipment means unloading and reloading from one vessel to another vessel during the course of ocean carriage from the port of loading to the port of discharge. Consequently, the possibility referred to in Article 20(a)(iii) for a bill of lading to indicate pre- and post-transport is not regarded as transshipment.

Example:

A credit prohibiting transshipment stipulates shipment from a European port to Hong Kong.

A bill of lading indicating that the cargo has been taken in charge in Copenhagen (place of receipt) and stating Hamburg as the port of loading, Hong Kong as the port of discharge and Shantou as the final destination, will fulfil the conditions of the credit, provided that it evidences an on board notation made on the vessel in Hamburg.

Even if a credit stipulates that transshipment is prohibited, banks will, in accordance with Article 20(d), accept a bill of lading indicating that the carrier reserves the right to tranship the cargo.

The UCP 600 takes this issue a bit further in Article 20(c) (ii), stating that banks will accept a bill of lading indicating that transshipment will take place as long as the cargo is shipped in containers, trailers and the like, provided that the entire ocean carriage is covered by one and the same bill of lading. This could be explained by the widespread view that in modern transport, a container etc is regarded as a unit to be moved in its entirety. As long as the cargo is held in such unit, the negative effects of transshipment are considered to be eliminated.

Other

The bill of lading must meet the terms and conditions of the credit in all respects, and it is a requirement that, unless otherwise stipulated in the credit, a full set of originals must be presented (Article 20(a) (iv)). Furthermore, the bill of lading must indicate the number of originals issued.

According to Article 20(a)(v), the bill of lading must contain all the terms and conditions of carriage or some of them by reference to

another source or document. Banks will not examine the contents of such terms and conditions.

Banks will not accept a bill of lading indicating that it is subject to a charter party (Article 20(a)(vi)).

Non-negotiable sea waybill

Even though this document is highly suitable for documentary credit transactions, it is seldom used.

The first reference to this document was in the UCP 500 and the UCP 600 contains the provisions in Article 21. The provisions are very similar to those applicable to a marine or ocean bill of lading.

A sea waybill is a non-negotiable instrument. Accordingly, when the goods arrive, they will, as with other types of waybill, be released to the consignee indicated in the waybill.

As regards other provisions in the UCP 600 concerning sea waybills, see Bill of lading (marine/ocean) above and Article 21.

Charter party bill of lading

A charter party bill of lading is subject to the terms and conditions of a charter party. Briefly explained, a charter party is a contract between the ship owner and the party chartering the vessel or part of the vessel for a specific period of time. The charter party will contain a great deal of the details otherwise appearing from an ordinary bill of lading. The provisions applying to charter party bills of lading are described in Article 22.

The use of charter party bills of lading in connection with documentary credits is fairly limited in the Nordic countries, except in connection with bulk goods, such as grain, chemicals and foodstuffs, for which charter party bills of lading are widely used.

A charter party bill of lading must indicate that it is subject to a charter party and must be issued and signed by the master, the ship owner or the charterer, or alternatively by an agent of either party. As with ocean bills of lading, it must appear from the charter party bill of lading who has signed it and in what capacity (Article 22(a)(i)).

A charter party need not indicate the carrier but must, like the marine/ocean bill of lading, state that the goods have been loaded on board a named vessel (Article 22(a)(ii)).

A charter party bill of lading must indicate the port of loading and the port of discharge (Article 22(a)(iii)), and as with ocean bills of lading, the full set of originals must be presented (Article 22(a)(iv)). Article 22(b) clearly states that banks will not examine the charter party contract, even if the credit requires the presentation of such contract.

The provisions for charter party bills of lading are far less detailed since many of the details relating to transport will appear from the charter party rather than the charter party bill of lading. Furthermore, at least one of the parties involved, quite often the applicant himself, will have signed the charter party.

By accepting, in the application form, the presentation of a bill of lading referring to or being subject to an underlying charter party, the applicant has accepted such conditions, even if it is the seller who may have chartered the vessel or part of it.

Transport document covering at least two different modes of transport

This document often named “multimodal transport document” (MMTD) and sometimes – especially in former times also referred to as a “combined transport bill of lading”, is issued by a party (for example a multimodal transport operator), who acts as carrier, and covers at least two different modes of transport, one of which is typically by sea.

The importance and the use of this type of transport document is growing and may be seen as the most used transport document in documentary credits. Probably therefore it is stated as the first transport document in the UCP 600.

In modern transport multimodal transport documents often accommodate the needs of the seller and the buyer far better than the traditional marine/ocean bill of lading. Far more documentary credits ought to prescribe a multimodal transport document. Should the applicant feel insecure because the UCP 600 rules do not require the multimodal transport document to indicate that the goods are on board the relevant ocean vessel, this may be stipulated in the credit itself.

Quite often a multimodal transport document is presented today, despite the fact that the credit stipulates the presentation of a marine/ocean bill of lading. In many cases this document will fulfil the requirements of the credit, once the necessary notations and corrections have been made. However, in other cases it does not, to the great dissatisfaction of the beneficiary, the goods having been shipped as agreed with the buyer.

The flexibility of the multimodal transport document has made it a highly used transport document. This is the reason why it is mentioned as the first type of transport document in the UCP 600.

The relevant provisions are contained in Article 19. Like the marine/ocean bill of lading, the multimodal transport document is often a negotiable transport document, and consequently, the full set of originals will have to be presented (Article 19(a)(iv)).

According to Article 19(a)(i), the document must be issued by a carrier, the master or a person acting as agent for either of such parties. To avoid a situation where doubt may arise about the signature on the transport document, the article further states that it must clearly indicate on whose behalf and in what capacity the party has signed the document. The transport document must clearly indicate the name of the carrier or the master.

By contrast to the marine/ocean bill of lading, a multimodal transport document need not bear an on board notation.

The document must indicate that the goods have been dispatched, taken in charge or loaded on board. The date of issuance will be regarded as the date of shipment. However, if the document indicates, by stamp or otherwise, a date of dispatch, taking in charge or loading on board, such date will be deemed to be the date of shipment.

The document must indicate the place of taking in charge and the final destination, both as stipulated in the credit. These may both be different from the place of loading or place of discharge, as the case may be (Article 19(a)(iii)(a)).

As the document is to cover at least two different modes of transport, transshipment will be accepted, whether or not this is prohibited in the credit, provided that the multimodal transport document covers the entire carriage.

According to Article 19(a)(v), the document must contain all the terms and conditions of carriage or some of such terms and conditions by reference to another source or document. Banks will not examine the contents of such terms and conditions.

Banks will not accept a bill of lading that is subject to a charter party or any of the provisions of a charter party (Article 19(a)(vi)).

Air waybill

The air waybill (AWB) is a non-negotiable air transport document and is issued by an airline (carrier) or its agent in connection with the shipment of cargo as airfreight. An air waybill evidences that the airline has received the goods for shipment.

The provisions of the UCP 600 on air waybills appear from Article 23.

The air waybill must indicate the name of the carrier and must be signed by the carrier or its agent. The signatory must indicate in what capacity he signs (Article 23(a)(i)).

The document must indicate that the goods have been accepted for carriage (Article 23(a)(ii)), and the date of issuance of the air transport document will be deemed to be the date of dispatch, unless the air transport document contains an actual date of dispatch (Article 23(a)(iii)), in which case the notation will be deemed to be the date of dispatch.

It should be noted that Article 23(a)(iii) clearly states that the date and other information appearing on the air transport document relative to the flight number and/or date will not be considered in determining the date of shipment.

The reason is that this box is usually filled in on the drawing up of the document and hence, the written date, inter alia, is the expected date. It does not constitute a declaration by the carrier to the effect that the goods have actually been dispatched.

The air waybill must indicate the airports of departure and destination stipulated in the credit (Article 23(a)(iv)), and the document presented under the credit must be the original for the consignor/shipper. This is often termed “original No 3” and is usually blue. Even if the credit stipulates a full set of originals, the presentation of such original will suffice (Article 23(a)(v)).

The document must either contain all the terms and conditions of carriage or some of such terms and conditions by reference to another source or document. Banks will not examine the contents of such terms and conditions (Article 23(a)(vi)).

For the purpose of Article 23(b), transshipment means unloading and reloading from one aircraft to another aircraft during the course of carriage from the airport of departure to the airport of destination stipulated in the credit.

Even if the credit prohibits transshipment, banks will, according to Article 23(c), accept an air transport document indicating that transshipment will or may take place, provided that the entire carriage is covered by one and the same air transport document.

Rail consignment note (CIM)

A rail consignment note, also termed duplicate waybill or rail transport document, is used in connection with carriage by rail. It is issued by a railway company and is of the waybill type (see Types of transport document).

The rules applicable to rail consignment notes (and to road and inland waterway transport documents) are contained in Article 24.

A rail consignment note evidences that the railway company in question has received the goods for shipment (Article 24(a)(ii)).

The date of the reception stamp is regarded as the date of shipment. The document must indicate the name of the carrier,

If the carrier is not stated, any signature or stamp made by the railway company will be deemed to evidence that the document has been signed by the carrier.

It must be issued and signed by the carrier or his agent and/or bear the carrier's reception stamp or other indication of receipt by the carrier. The signatory must state the capacity in which he signs the document (Article 24(a)(i)).

In practice the rail consignment note will not be signed but provided with the reception stamp referred to in Article 24(a)(i).

The document must indicate the place of shipment and the place of destination stipulated in the credit (Article 24(a)(iii)).

According to Article 24(b)(ii) a rail transport document marked "duplicate" will be accepted as an original.

For the purpose of Article 24, transshipment means unloading and reloading from one means of conveyance (railway carriage) to another means of conveyance in different modes of transport. This applies to carriage from the place of shipment to the place of destination stipulated in the credit (Article 24(d)).

Even if the credit prohibits transshipment, banks will, according to Article 24(e), accept a transport document indicating that transshipment will or may take place.

Road consignment note (CMR)

A road consignment note is used for carriage by lorry and is issued by a carrier.

The road consignment notes evidences shipment of the goods and should not be confused with a transport document issued by a freight forwarder (see Freight forwarder's certificate and Article 24).

Despite the existence of an international convention for transport by road (CMR), the waybill forms differ, even within the same country.

The rules applicable to road consignment notes (and to rail and inland waterway transport documents) used for the purpose of a documentary credit are described in Article 24.

The road consignment note evidences that the carrier has received the goods for shipment (Article 24(a)(ii)). The date of issuance will be considered to be the date of shipment, unless the transport document contains a dated reception stamp, an indication of the date of receipt or a date of shipment, in which case that date will be regarded as the date of shipment.

The consignment note must indicate the name of the carrier, be issued and signed by the carrier or his agent and/or bear the reception stamp or other indication of receipt by the carrier.

The signatory must state the capacity in which he signs the document (Article 24(a)(i)).

The consignment note must indicate the place of shipment and the place of destination stipulated in the credit (Article 24(a)(iii)).

If a transport document issued in accordance with Article 24 does not indicate the number of originals issued, banks will regard the original consignment note presented as constituting a full set.

Often the CMR form states the number of originals and for whose use each individual original is issued. According to Article 24(b) the consignment note need not be marked as original but banks will not accept a consignment note bearing a mark such as “for statistical use” or which clearly indicates that this is not the original intended for the shipper/consignor.

For the purpose of Article 24, transshipment means unloading and reloading from one means of conveyance to another means of conveyance in different modes of transport. This applies to carriage from the place of shipment to the place of destination stipulated in the credit (Article 24(d)).

Even if the credit prohibits transshipment, banks will, according to Article 24(e), accept a transport document issued in accordance with Article 24 indicating that transshipment will or may take place.

Inland waterway transport document

This document, which is a non-negotiable transport document, is hardly ever used in connection with documentary credits in the Nordic countries, whereas in other European countries it is used, for instance, for carriage on the Rhine and the Danube and also on the network of canals where small cargo vessels and barges go.

The rules applicable to inland waterway (and to road and rail) transport documents used for the purpose of a documentary credit are described in Article 24.

The inland waterway transport document evidences that the carrier has received the goods for shipment (Article 24(a)(ii)). The date of issuance will be considered to be the date of shipment, unless the transport document contains a dated reception stamp, an indication of the date of receipt or a date of shipment, in which case that date will be regarded as the date of shipment. The transport document must indicate the name of the carrier, be issued and signed by the carrier or his agent and/or bear the reception stamp or other indication of receipt by the carrier. The signatory must state the capacity in which he signs the document (Article 24(a)(i)).

The transport document must indicate the place of shipment and the place of destination stipulated in the credit (Article 24(a)(iii)).

If a transport document issued in accordance with Article 24 does not indicate the number of originals issued, banks will regard the

transport document presented as constituting a full set. According to Article 24(b), the document need not be marked as original.

For the purpose of Article 24, transshipment means unloading and reloading from one means of conveyance to another means of conveyance within the same mode of transport. This applies to carriage from the place of shipment to the place of destination stipulated in the credit (Article 24(d)).

Even if the credit prohibits transshipment, banks will, according to Article 24(e), accept a transport document issued in accordance with Article 24 indicating that transshipment will or may take place.

Post receipt

Post receipts (or certificate of posting) relating to documentary credit transactions are used only for goods of limited weight and volume. The receipt is issued by a post office and evidences the receipt of the goods for dispatch (Article 25(c)).

The post receipt must be stamped or otherwise authenticated and dated in the place from which the credit stipulates that the goods are to be dispatched. For the purpose of documentary credits, such date will be considered as the date of dispatch.

Courier receipt

Courier receipts relating to documentary credit transactions are used to a limited extent as this type of carriage is suitable only for goods of limited weight and volume.

The receipt is issued by the relevant courier service or expedited delivery service and evidences the receipt of the goods for dispatch.

The courier receipt must indicate the name of the relevant courier or expedited delivery service and be stamped or otherwise authenticated (Article 25(a)(i)).

The receipt must indicate the date of pick-up or of receipt, and such date will be regarded as the date of dispatch (Article 25(a)(ii)).

Freight forwarder's certificate

Notwithstanding that it is a fundamental principle of the UCP 600 that transport documents are to be signed by a carrier, it does happen that a documentary credit requires presentation of transport documents issued by a freight forwarder.

The UCP 600 does not include any article or any provision on freight forwarder documents, so the credit must precisely state all conditions for such document. The ISBP (International Standard Banking Practice, ICC Publication 681) underlines the need to be careful when writing and reading the specific terms of the credit regarding non-carrier issued transport documents.

These documents may take many different forms. Among the common features are that they are issued by a freight forwarder and that the documents can cover carriage by any conceivable means of conveyance or a combination of these.

The freight forwarder will not act as carrier but will, on the basis of his knowledge and contacts, arrange the carriage according to the needs and requirements of the customer.

This certificate can be issued as proof of either the dispatch of the goods or the receipt for shipment of the goods. It may be a negotiable instrument, depending on the contents of the document.

The International Federation of Freight Forwarders' Associations (FIATA) has drawn up its own document termed Negotiable FIATA Multimodal Transport Bill of Lading (FBL). The FBL usually indicates that the freight forwarder acts as a carrier, and so this document can be used in a credit transaction, even if the credit does not authorise the use of a freight forwarder's document. Similarly, any other freight forwarder's document will be accepted, provided that such document indicates that the freight forwarder acts as a carrier. It is a condition that the document in all respects meets the terms and conditions of the credit.

Insurance documents

Among the many details the parties must clarify when entering into an agreement for the purchase and sale of goods are the terms of delivery. One important aspect here is where and when the risk passes from the seller to the buyer. The relevant party can usually cover such risk by taking out insurance.

Considering that, by having a documentary credit issued, the buyer pays for goods that have been taken in charge by the carrier, the buyer will usually stipulate in the application form that the goods are to be insured until the risk passes to the buyer.

The typical clauses in the Incoterms 2000 are:

- CIF: Cost, insurance and freight
- CIP: Carriage and insurance paid to
- DAF: Delivered at frontier
- DES: Delivered ex ship
- DEQ: Delivered ex quay (duty paid)
- DDU: Delivered duty unpaid
- DDP: Delivered duty paid

All these clauses should be extended to include the place where the seller is to deliver and the buyer is to receive the goods, to which place the seller is responsible for the goods or has insured them. The clause CIF, for instance, is relevant only if the destination is added where the buyer will take control of his goods, for instance CIF Singapore.

The terms are described in detail in Incoterms 2000, which also contain the provisions on the rights and obligations of both parties. Some of the clauses are intended for carriage by sea, while others relate to any mode of transport. In addition to the clauses referred to above, Incoterms 2000 contain clauses where the risk passes to the buyer before the carrier takes the goods in charge, and the buyer must then either take the risk or take out insurance.

The banks will usually check that the credit prescribes the presentation of an insurance document to ensure that the goods are insured while in transit. There may be two reasons for this, both of which concern the bank's risk assessment of the documentary credit.

If the applicant does not require any documentation for the seller's insurance obligation, and the seller has not taken out insurance, a serious loss may be incurred if the goods are damaged or lost. If the seller does not cover such loss, there is a risk that the buyer cannot pay for the complying documents under the credit or that he goes bankrupt.

In certain circumstances the bank will only issue a credit if it has security in the goods. Such security is of no or little value if the goods have not been insured. For that reason, the bank will usually demand proof for the applicant having taken out insurance if the applicant is to do so. Depending on the customer relationship and the bank's

assessment of the buyer's creditworthiness, the bank may demand a statement from the insurance company declaring that it will not cancel the insurance without notifying the bank.

The purpose of such statement is to allow the bank to pay the insurance in order for it to continue to be in force in case the applicant fails to pay.

Insurance documents are often issued in several originals, and in case they are, all originals must be presented (Article 28(b)).

Article 28(a) states that an insurance document must be issued and signed by an insurance company or an underwriter or an agent of either. As with transport documents, the insurance document must indicate whether an agent (or proxy) has signed the document on behalf of the insurance company or an underwriter.

Insurance policy, insurance certificate or declaration under an open cover

An insurance company may issue an insurance document as an insurance policy, an insurance certificate or a declaration under an open cover.

The insurance policy is issued by the insurance company in the form of an agreement containing the amount insured, details of the consignment insured and the transport, the risks covered as well as the terms and conditions applicable to the insurance, usually printed on the back of the form.

An insurance certificate or a declaration under an open cover is also issued by an insurance company and contains the amount insured and any other details concerning the relevant shipment. Further, the text will refer to the terms and conditions indicated in an open policy.

Unless the credit stipulates provisions as to the form of the insurance document, banks will accept both a policy and a certificate, and banks will accept the presentation of an insurance policy, even if the credit stipulates an insurance certificate or a declaration under an open cover (Article 28(d)).

Effectiveness of cover

Basically, it is expected that insurance has been taken out before commencement of the transport. Consequently, Article 28(e)

stipulates that the insurance document must not bear a date of issuance later than the date of dispatch as indicated in the relevant transport document.

An exemption is where it appears from the insurance document that the cover is effective at the latest from the date of dispatch as indicated in the relevant transport document.

It is important to note that an indication of a bill of lading date or a date of dispatch in the insurance document is not sufficient. It should clearly state that the cover is effective as from the date of shipment.

The insurance cover must be effective at least between the place of taking in charge or shipment and the place of discharge or final destination according to the stipulations in the credit (Article 28(f) (iii)).

Banks are not expected to accept insurance documents under a credit if they state a period of effectiveness for the cover. It is difficult, if not impossible, for the banks involved to estimate whether the goods will actually arrive at their destination before expiry of such period and the banks will have to consider the risk of transport being interrupted if unexpected situations arise. The carrier will usually reserve the right under certain circumstances to discharge the cargo at a place different from that stated in the transport document.

Amounts insured

The purpose of taking out insurance is to receive compensation in case the goods do not arrive or are damaged. Therefore, the policy holder must ensure that the sum insured is adequate to replace the goods. The sum insured should include the price of the goods as well as the cost of transport and a new insurance. Sometimes compensation for loss of income and expenses incurred in replacing the goods are also included.

In the context of a documentary credit the amount insured is usually expressed as the CIF or the CIP value of the goods plus a certain percentage. Such percentage premium is often stated in the credit, in which case this condition must be adhered to. If a credit stipulates the insurance cover to be the CIF value plus 10%, an amount for less will not be accepted, while a higher amount will be accepted.

If the credit does not indicate the amount of the cover, the seller must take out insurance for at least the CIF/CIP value plus 10% (Article 28(f)(ii)).

In both cases the percentage has to be understood as a minimum cover (Article 28(f)(ii)).

Article 28(f)(ii) further states that if the CIF/CIP value cannot be determined from the documents, banks will accept as a minimum amount 110% of the gross amount of the invoice, or of the amount for which payment, acceptance or negotiation is requested under the credit, whichever is higher.

In order to prevent the insurance cover from being reduced on account of exchange rate fluctuations, Article 28(f)(i) states that the insurance document must be expressed in the same currency as the credit.

Type of insurance cover

Although it ought to be a matter of course, Article 28(g) states that the credit should stipulate the type of insurance and the additional risks, if any, that are to be covered. The buyer and the seller know the goods and have agreed on the price. They should also determine the type of insurance that is to be taken out in respect of the specific goods.

If the credit does not stipulate the risks to be covered or uses expressions like “usual risks” or “customary risks”, banks will accept an insurance document as presented, without checking if certain risks are covered (Article 28(g)).

If the credit stipulates that the insurance is to cover “all risks”, failing to specify a certain “all risks” clause, banks will accept any clause appearing to provide “all risks” cover, whether or not it bears the heading “all risks”. Nor will banks refuse an insurance document containing an “all risks” clause, even if the insurance document indicates that certain risks are excluded (Article 28(h)).

It is pointed out that banks cannot be expected to know what a clause covers. Therefore, the banks must be able to see from the document itself whether the cover complies with the stipulations of the credit such as “all risks”, without having to know or interpret the conditions in small print on the back of the document. The insurance

document will be accepted even if it states that any risk stated is excluded.

It must also be noticed that an insurance document may refer to any exclusion clause (Article 28(i)).

Unless prohibited in the credit, banks will accept an insurance document which indicates that the cover is subject to a franchise or an excess (deductible) (Article 28(j)). Such clause allows an insurance company to refuse to pay compensation below a certain amount or percentage, and so the owner of the goods will have to contribute a certain amount towards the costs of a claim.

It must be said again that it is important to read the credit carefully, as any article of the UCP 600 may be amended or deleted by wording in the specific credit.

Cover notes

An insurance document issued by a broker in the form of cover notes will not be accepted under a credit (Article 28(c)) unless he acts as an underwriter or agent/proxy for the insurance company or underwriter.

Beneficiary's advice

Although the transaction does not presuppose that the seller (the beneficiary) is to take out insurance, the credit sometimes stipulates the presentation of a document by which the beneficiary gives information about the shipment made in order for the buyer (the applicant) to be able to take out insurance in due time or, alternatively, to provide the information required under an open policy.

The credit may require that a copy, possibly signed, of such advice is to be presented, or a declaration, signed by the beneficiary, evidencing that the advice has been sent.

It should be stipulated in the credit what data the advice must contain, when it must be given and whether it is to be sent by post, courier or by telecommunication. It should also appear from the credit whether the advice is to be sent to the applicant, the applicant's bank or to the insurance company or to any other party.

The UCP 600 does not contain any particular provisions on such advice and therefore, banks will, according to Articles 3 and 14(f), accept the document as it is presented, unless the credit contains

provisions regarding the issuer, specific data and the like, and unless the document conflicts with other documents.

Documents for inward customs clearance

In many countries the customs authorities require special documentation in connection with inward clearance of goods. These requirements vary from country to country, and the requirements for importing goods to countries with a liberal trade policy may be limited to serve statistical purposes. Countries with strict control of imports, be it all goods or only certain types of goods, often impose quite extensive requirements as to documentation.

Import of special types of goods, such as weapons, pharmaceuticals and narcotics, will usually, and independently of the general policy on import to the relevant country, require import licences and related documentation.

The UCP 600 contains no specific provisions for such types of document. Consequently, they will have to be drawn up in compliance with Articles 3 and 14(f) unless the credit contains specific requirements concerning the issuer, data and form.

Customs invoice

The customs authorities of certain countries demand customs invoices issued by the beneficiary for import of goods. The use of this document has diminished in recent years.

Usually a special form is to be used and different conditions will apply in the countries demanding such document, one of which may be legalisation by the embassy or consulate of the relevant country.

In addition to information about the goods such as volume, unit price, total price, terms of delivery and dispatch, the customs invoice may require information on the type of packaging. To prevent or reduce the risk of certain harmful insects entering the country, the beneficiary may be required to advise whether wood, paper or other organic material is used.

Consular invoice

A credit may stipulate the presentation of a consular invoice because this is a requirement for import into the relevant country. The use of such documents is diminishing.

The consular invoice is made out on a special form available at the embassy or consulate of the relevant country, or issued as a copy of the commercial invoice, depending on the requirements of the country in question.

The consular invoice is then to be legalised by the embassy or consulate, see Article 3.

The beneficiary should take into consideration that such legalisation may take some time, often more than expected, and should also check if the relevant country has an embassy or a consulate in the beneficiary's country or if the document will have to be sent to another country. The credit should be examined to ascertain if the legalisation made in such other country meets the stipulations in the credit.

The original purpose of having a country's representation legalise import to that country was to make certain that the transaction was approved by the importing country's authorities and that the original documents thus legalised were the ones used for the inward clearance. A country's representation in the exporting country is expected to possess more extensive and detailed knowledge about these matters than do the authorities of the importing country.

Legalisation is usually subject to a charge, and some people claim that the requirement for legalisation is primarily due to the income thereby obtained by the consulate to help finance its operations.

Certificate of origin

The requirement for presentation of a certificate of origin may be due to the importing country's rules but may also be based on the importer's own wish.

A certificate of origin is often issued by a chamber of commerce, the customs authorities or another body authorised to do so. The document states the country of origin of the goods and in some cases the credit further stipulates an indication of the name and address of the producer or other data.

The certificate of origin is usually issued in the beneficiary's country or in the country of origin. Unless otherwise required in the credit, the document may also be issued in a third country.

If the presentation of a certificate of origin is stipulated because it is required by the customs authorities of the importing country, the document requirements are typically strict and fairly specified. The document must often be issued by a public authority or another recognised body.

If it is the buyer who demands documentation for the country of origin, the credit will often allow a notation on the invoice instead of a separate document. Certain countries also accept such notation on the invoice regarding the origin of the goods.

Where nothing is stated in the credit, a certificate of origin issued by the beneficiary will be accepted.

While the UCP 600 does not contain an article on the often required certificate of origin, it may be of interest to refer to the ISBP, Paragraphs 181 – 185.

GSP certificate

A GSP certificate (GSP: Generalised System of Preferences established by UNCTAD) is issued to allow the use of the scheme for customs preferences.

Some years ago a large number of highly industrialised countries, including the EU, Norway, Switzerland, several Eastern European countries (such as Poland, Hungary, Russia and Belarus), Japan, the USA, Canada and Australia agreed on setting up a scheme whereby a number of developing countries could obtain customs preference on the import of certain of their goods to the industrialised countries.

According to this principle, the importer obtains a reduction in the customs tariff to encourage him to buy the goods in the relevant developing country as importing the same goods from other countries would entail a higher price on account of the higher customs tariffs.

The relevant developing countries are divided into groups according to the degree of industrialisation and the purpose is to limit the import of certain goods from specific countries. Furthermore, the participating countries may reject individual countries, even if they participate in the scheme.

In order to obtain a reduction in customs tariffs, the importer must present a “generalised system of preferences certificate of origin” or a GSP certificate of origin for the inward clearance.

This certificate is issued by the exporter, who certifies that the goods have been produced in the relevant country, and that the provisions applying to the export of the goods to the importing country are in compliance with the rules on the “generalised system of preferences for goods”. The document must also be signed by the authorities of the exporting country.

Health or phyto–sanitary certificate

As indicated by its name, this certificate gives evidence of the health condition of the goods and is usually issued by a veterinary surgeon, by veterinary authorities or the agricultural ministry. Certain types of goods and certain countries require the presentation of a health certificate to import the goods. The document for importing live plants is called a phyto–sanitary certificate.

Even where the importing country does not require the presentation of a health or phyto–sanitary certificate, the applicant may, nevertheless, stipulate it in the credit to make certain that the goods imported meet the conditions of the contract and that their standard of health is sound.

Different credits may contain varying stipulations as to the contents and by whom such document is to be issued. To ensure that it is issued by the right authority or person, the credit should (Article 14(f)) state the issuer and indicate the data required by the applicant to be contained in the document.

Import licence

A country pursuing a policy of strict control of its imports will normally issue import licences to be able to determine what types of goods are imported into the country. Luxury goods are often subject to such permit because a country may wish to limit the import of such goods to protect its foreign currency reserves. An import licence is often a precondition for obtaining a foreign exchange permit, without which the bank is not allowed to issue a documentary credit.

Some countries require an import licence for importing certain

sensitive goods like narcotics, pharmaceuticals and weapons.

To make certain that the applicant does not ship goods other than those permitted by the import licence, a copy of the import licence is sometimes required to be presented together with the other documents. The beneficiary will then receive the copy in advance from the applicant.

Export licence

Some countries impose export restrictions on certain goods and, for instance, weapons, narcotics, electronics and toxins are subject to an export licence.

Although the buyer is not directly affected by such restriction imposed on the exporter, it is likely that the goods cannot be imported into the buyer's country, unless the customs authorities of that country are presented with the export licence.

An export licence is also used in connection with the import of certain goods which are subject to import restrictions. Each year the importing country, or the EU, will make a list of the volumes of each type of goods permitted to be imported. The importing countries make agreements with the authorities of the exporting countries and control the volumes of such imports into the importing countries through the export licences issued.

Movement certificate (EUR)

As a result of a trade agreement entered into between the EU and certain non-EU countries, including the remaining EFTA countries, goods from these countries enjoy a tariff preference or a relief from customs when imported into the EU.

This requires documentation on inward clearance of the goods by the presentation of a EUR certificate issued by the customs authorities or by the exporter if authorised by the customs authorities.

There are different versions of the EUR certificate, EUR 1, EUR 2 etc, to be used, depending on the value of the goods.

Special forms are used for imports from certain countries, and so goods imported from Turkey require the ATR form, corresponding to one of the EUR versions.

Single administrative document (SAD)

The SAD is issued by the exporter or his freight forwarder in connection with export of goods to countries that are not members of the EU. This document is seldom required under a credit.

Documents issued for various purposes

Documents in this group are typically required by the applicant to make certain that specific conditions are fulfilled.

The UCP 600 does not contain any specific rules on this type of document. Consequently, they must be drawn up in compliance with the provisions of Articles 3 and 14(f), unless the credit stipulates specific requirements concerning the issuer, data content and form. Unless otherwise stipulated in the credit, the document can be issued by any party, including the beneficiary.

Packing list

The packing list is usually drawn up by the seller or the producer of the goods and specifies the relevant shipment. The list will give details on the contents of each packing unit, and perhaps net and/or gross weight. Sometimes the marking of each unit is also indicated.

Weight list and weight certificate

The weight list may contain the same details as the packing list but must, as a minimum, indicate the weight of the goods and usually the weight of each packing unit.

A weight certificate must be signed by the issuer of the document and all certificates must be signed.

Quality certificate

If the applicant wants a specific declaration as to the quality of the goods, he may demand presentation of a quality certificate. Such document will typically be issued by the beneficiary or by the producer of the goods and must contain the data stipulated in the credit concerning the quality of the goods and be signed by the issuer.

Certificate of analysis

When importing chemical substances and foodstuffs, for instance, the applicant will often require that the beneficiary should present a certificate of analysis describing the composition of the goods. The document must be signed by the issuer, and often the credit stipulates that it must be issued by a specific laboratory, sometimes indicating limit values applicable.

The more sophisticated documentary credits may stipulate that the invoice must indicate a price reduction as specified in the credit if the certificate of analysis indicates a value other than that prescribed in the credit.

Warranty

If the trading partners have agreed that a warranty is to be provided for the quality, durability or the like, the credit may stipulate that a warranty is to be presented together with the other documents. The warranty is usually issued by the producer or the beneficiary as indicated in the credit and contains details regarding the liability of the issuer towards the buyer under the warranty.

Inspection certificate

The nightmare for any applicant is if the goods received do not tally with the agreed delivery. Worse even when the cargo is completely without any value, for instance because the containers etc hold scrap metal instead of machinery or rags instead of dresses.

To avoid this situation the applicant may choose to be present when the goods are shipped. However, it will usually be too expensive, both in terms of money and time, for the applicant to send his own representative to the place of shipment.

Instead the applicant may demand an inspection certificate to be issued and signed by the party stated in the credit.

If the buyer (the applicant) is not able to send a person he trusts to the place of shipment, he can ask an internationally recognised inspection company, such as the Geneva-based Société Générale Surveillance (SGS) to perform the inspection required. The applicant will instruct the inspection company as to the manner in which it is to check the goods and what they must look for. Depending on the type

and value of the goods, the inspection may be commenced when the goods are in process of being manufactured or packed and until they are on board the means of transport concerned.

The inspection certificate will be delivered after completion of the inspection and will provide data on the result of the inspection. Sometimes an evaluation of the invoiced price relative to the market price of the goods is required as well.

Such price evaluation is notably required where the authorities of the importing country require the presentation of an inspection certificate to prevent overinvoicing by agreement between the buyer and the seller, which would then eventually be deposited on secret accounts in neutral countries, such as Switzerland. In particular countries with foreign exchange restrictions use such control.

The inspection company will send the invoice for the inspection performed to the applicant. The buyer and the seller should agree when entering into the business deal whether an inspection is to be made and by whom as the requirement for an inspection certificate may be disadvantageous to the seller, even if the buyer pays the costs involved.

The beneficiary should also be aware of what the inspection company will check. There have been examples of requirements on the part of the applicant concerning the inspection company not complying with those of the credit. In such cases the certificates issued were discrepant to the credit, barring payment, even if the goods had been dispatched in compliance with both the contract and the credit.

Shipping company's declaration

The applicant may have his reasons for demanding that the goods are not to be shipped by a certain type of vessel. He will then require a declaration to be issued by the carrier or its agent with contents as stipulated in the credit.

For reasons of safety of transport and insurance the applicant may demand that the age of the vessel should not be above a certain number of years or that it should have been inspected by, for instance, Lloyd's within a certain period of time. Sometimes the credit also stipulates provisions as to the suitability of the vessel, for instance that it is not a wooden vessel.

The credit may also prohibit the calling at a port in certain countries before the discharge. The reason is to avoid a situation where the cargo is confiscated for political reasons and/or due to a war or the risk of war.

Chapter 13

Honouring documents under the credit

Although it is hard, if not impossible, to determine which of the cycles of the documentary credit is the most difficult to carry out, there is no doubt that honouring or negotiating is the most important element, particularly for the beneficiary. It could even be argued that this is the very purpose of the credit. The honouring or negotiation is evidence that the beneficiary's demand to have a credit issued as security for his delivery of goods has produced the desired result. For the applicant the honouring or negotiation serves the purpose of fulfilling his requirement to receive the stipulated documents.

13.1 What is honouring and negotiation?

The term "honouring" has now been defined in the UCP 600. The UCP 500 and earlier versions neither used nor defined what was meant by honouring, but it was used by some banks earlier, and much favoured by a number of banks, including Nordic banks.

Contrary to how banks earlier may have used the word honour, we now have a definition in the UCP 600 (Article 2), which also states a difference between "honour" and "negotiation".

According to Article 6(b) a credit may be (and must indicate whether it is) available by sight payment, by deferred payment, by acceptance or by negotiation.

Any of these four expressions means that, having examined the documents presented by the beneficiary, the relevant bank will honour or negotiate, provided that the presentation meets the conditions of the credit.

Rather than using these expressions, as stated in Article 6, all of which are not necessarily used everywhere, the word honouring may be used for all types of credits except negotiation. Honouring covers both the examination of documents and payment under a credit, and payment in this context is used in a very broad sense of the word, comprising cash payment or final payment.

Negotiation is also defined in Article 2 as a purchase by the nominated bank of drafts drawn on other banks than the nominated bank. A negotiation has only been made when the negotiating bank advances the amount or promises to advance the amount on or before the date when the reimbursement is due to the nominated bank. The UCP 600 does not mention whether such purchase or promise to pay

must be with or without recourse. The negotiation by a confirming bank will always be without recourse (Article 8(a)(ii)).

From the definition of negotiation in Article 2 it appears that the sole examination of documents and/or forwarding of the presentation to the issuing or confirming bank do not constitute a negotiation.

Certain banks erroneously has used or use the word “negotiation” for both honouring and negotiation. “Negotiation” has also been used for purposes other than assumed in the UCP 600, such as the checking of documents or expressing that documents have been passed on to the issuing bank in order for it to effect payment after approval of the documents.

Since the UCP 600 (and the UCP 500 to some extent) has defined the word “negotiation”, the use of this word in other meanings may often lead to misunderstandings.

What the beneficiary is to do

As mentioned earlier, “payment” for the documents presented is actually the sole purpose of the documentary credit from the beneficiary’s point of view.

When the wording of the credit has been approved by the beneficiary, he will start producing the goods or purchase the goods, unless he has already done so because he has been willing to run the risk of not getting the requested credit.

In conformity with the agreement with the buyer, the goods will then be shipped. At this stage it is very important to adhere to the terms of the agreement and to make sure that shipment is made as stipulated in the credit.

If the beneficiary is not sufficiently familiar with the concept of documentary credits and the interaction between the dispatch of the goods and the documents then to be drawn up, it may be advantageous at this stage to involve an expert. The bank may be able to answer some of his questions, whereas those related to shipping should be directed to shipping staff. It may also be wise to address an insurance company in matters concerning insurance.

Once the goods have been dispatched and all the necessary documents issued by the relevant parties, all the documents stipulated as well as the credit itself must be presented to the bank

authorised to perform the honouring or negotiation.

An exporter is often required to issue documents not stipulated in the credit. These documents may be for the use of either the exporter or the importer. The beneficiary need not present such documents to the bank, and if he does present them, the bank will not examine them (Article 14(g)).

If the beneficiary knows or presumes that the applicant will need these documents or want to receive them before the documents presented under the credit are handed over to him, he may send the documents not stipulated in the credit direct to the buyer.

Of course, the beneficiary must realise that the buyer has received these documents, also in situations where the beneficiary does not receive payment under the credit due to discrepancies found in the presentation by one of the banks or for other reasons.

Time and place for presentation

Besides making sure that all the documents required have been presented and fulfil the conditions in the credit and the UCP 600, the beneficiary must ensure that the documents and the credit itself are presented in due time and at the right place, that is to the bank authorised to honour or negotiate (the nominated bank).

It should be noted that banks are under no obligation to accept presentation of documents outside their opening hours (Article 33). If documents are presented after such time, the bank may consider presentation to have been made on the following banking day.

The beneficiary may, in accordance with the UCP 600, choose to present documents at either of two places:

1. The usual choice would be to present the documents to the bank designated: the nominated bank. According to Article 6 (a), the credit must nominate such bank. This may be done by indicating the name of the bank or by stating that the credit is freely negotiable, in which case any bank is nominated.
2. No matter which bank has been nominated, the beneficiary may always present the documents directly to the issuing bank (Articles 6(a) and 6(d)(ii)), which cannot refuse to honour a presentation under its own credit, by stating that it has nominated another bank to do so.

It is the beneficiary's responsibility to ensure that the documents are received by the nominated or the issuing bank before the credit expires. It is worth noting that presentation must be made in accordance with the conditions of the credit.

Under a credit expiring on 15 April, for instance, the documents must be presented to the nominated bank, for instance in Denmark, on or before that date.

If the beneficiary elects to present the documents direct to the issuing bank, for instance in Bangladesh, the documents must be presented there on or before 15 April. Had honouring or negotiation been made in Denmark, the issuing bank would have received the documents somewhat later (for instance after five days).

The beneficiary cannot use this period for transmitting documents in order to delay presenting documents correspondingly. If the documents are presented to the issuing bank, whether in accordance with the stipulations of the credit or at the choice of the beneficiary, it is the beneficiary who bears the risk of transmitting documents. The documents are not regarded as having been presented until the bank authorised to honour or negotiate them has received them.

Time limits

There are two different provisions in the UCP 600 that determine what the latest date for presenting documents under a credit is.

Expiry date

The first and most important provision regards the expiry date of the credit. As stated in Article 6(d), all credits must stipulate an expiry date. Such date will be considered as the latest date for presenting the documents to the nominated bank (or the issuing bank). If the expiry date of the credit falls on a day on which the nominated bank normally is closed, the expiry date will be extended to the first following banking day (Article 29(a)). In the Nordic countries banks are closed on Saturdays, Sundays and public holidays.

Article 29(a) clearly states that this provision does not apply if the bank is closed for reasons of force majeure (Acts of God, strikes etc) as Article 36 will be applicable in those situations.

It is important to note that an extension of the expiry date according to Article 29(a) does not imply an extension of the period for shipping the goods, whether or not such period has been stipulated in the credit. If the credit does not state any specific latest date for shipment, the latest date for shipment will be the expiry date stated in the credit. If this date falls on a Saturday, the documents may, to comply with the rules, be presented on the following Monday, provided that the transport documents evidence that the goods have been dispatched no later than on the relevant Saturday.

If the beneficiary applies the provisions in Article 29(a), the honouring bank must provide a statement to the issuing bank that the documents were presented within the time limits extended and so before expiry of the credit (Article 29(c)).

Instead of specifying a date of expiry for the credit, some issuing banks may state a period for which the credit is to be available, for instance one month. However, banks should discourage indication of the expiry date of the credit in this manner as there is a risk of misinterpretation, and the UCP 600 contains no guidelines on this any more.

Period for presentation

In addition to the expiry date, any stipulated period of time must be adhered to for credits under which an original transport document is to be presented: the period for presentation.

The reason for stipulating a period for presentation is that it is inexpedient for the applicant to receive the documents too late. Usually the applicant will need the documents for inward clearance, especially in connection with marine transport. Consequently, the credit should state a period of time for presentation of documents after the date of shipment of the goods as indicated in the relevant transport document. Article 14(c) states that the documents must be presented no later than 21 calendar days after the date of shipment, (if no such period is stipulated). Article 14(c) covers only original transport documents issued according to Articles 19, 20, 21, 22, 23, 24 or 25.

Irrespective of the length of the period of time for presentation, the documents must never be presented after the date of expiry of the credit.

As with the expiry date, the period for presentation may be extended to the first following banking day if it falls on a day on which the bank is closed.

Instructions to the nominated bank

When presenting the documents, the beneficiary will usually provide the nominated bank with the information required in connection with the honouring or negotiation. Such information may include the account to which the amount is to be credited, whether it is to be remitted by cheque, whether a foreign currency amount is to be converted into a local currency when credited or if it is to be received in the foreign currency. For credits available by deferred payment, it may be relevant to state the type of finance, if any. The beneficiary may also state the name of a person for the bank to contact if it needs further information. If the beneficiary is aware of discrepancies in the presentation, he could also mention them, and how he wants the bank to act, in order to save time after the bank's examination.

13.2 The role of the nominated bank

The nominated bank is to effect honouring or negotiation according to the type of the credit. As described in Confirmed credit and Unconfirmed credit under 8.4 and in conformity with Article 12(a), a nominated bank that has not confirmed a credit is under no obligation to honour or negotiate, even if that bank has examined and/or forwarded the documents to the issuing or the confirming bank, if any (Article 12(c)).

As mentioned earlier, it is possible that the nominated bank will honour even an unconfirmed credit. Especially in the Nordic countries this is customary.

Examination of documents

An essential function in connection with honouring or negotiation is the bank's examination of the documents presented. Whether the nominated bank will effect payment or any other form of honouring or negotiation depends on its judgment as to whether it will be reimbursed by the issuing bank. Another important, if not the most important, condition is that the presentation fully meets the stipulations of the credit.

If the presentation does not, payment will depend on the applicant's willingness to approve documents which he has not undertaken to accept under the credit.

The checking of documents is explained in more detail in Chapter 15 Examination of documents.

For the examination of documents banks will use staff with many years of experience as this is considered to be the most sophisticated area within documentary credits.

Settlement towards the beneficiary

Under a confirmed credit or an unconfirmed credit which the nominated bank is prepared to honour or negotiate, the bank will effect settlement towards the beneficiary when it has approved the documents.

If it is a sight credit, the bank will pay the amount less the commissions and expenses to be borne by the beneficiary under the stipulations of the credit.

If the credit is available by payment, settlement is final, whether the credit is confirmed or unconfirmed. When settling a credit available by negotiation, the negotiating bank may state that payment is made with recourse, so that the bank can demand repayment of the amount if it is not reimbursed by the issuing bank (see Credit available by negotiation under 8.5). If the nominated bank has confirmed the credit, the negotiation will be without recourse.

For settlement of a credit available by acceptance, the nominated bank (the honouring bank) will accept the draft on the nominated bank, issued by the beneficiary in conformity with the conditions of the credit. This acceptance constitutes honouring, and the beneficiary, or any other lawful holder of the draft, must on the maturity date present this draft to the bank to have the amount paid. It should be emphasised that the nominated bank is under an obligation to accept the draft only if presented in connection with a confirmed credit. If the credit is unconfirmed, the nominated bank determines whether to accept it or not (Article 12(a)).

For honouring a credit available by deferred payment, the nominated bank will state on the settlement note when and by whom the amount is to be paid at maturity. If the credit is confirmed, the

nominated bank must pay itself, and it will therefore state in the settlement note that it will effect payment on the date of maturity.

If, on the other hand, the credit is unconfirmed, the nominated bank may choose either to assume a payment undertaking or to inform the beneficiary that it will settle the amount only when it has received the amount from the issuing bank at maturity (Article 12(a)).

Finance

In principle, the finance of documents under a credit means the nominated bank's payment of the amount before it has received the amount from the issuing bank (or the confirming bank, if any) against payment of a discount (deduction of interest). The finance period may vary from a few days to very long periods of time. In practice, periods exceeding one year are rare in connection with documentary credits.

Most people relate the financing of a documentary credit to a usance credit where the credit is available by acceptance or by deferred payment. However, also sight credits may be financed.

Irrespective of the length of the period to be financed, it may be affected in either of two manners, depending on the type of credit and the willingness of the bank.

If the bank has assumed an undertaking, by confirming the credit, by accepting a draft or otherwise, to pay the credit amount at maturity, finance will usually take the form of forfaiting (discounting without recourse). With forfaiting the bank cannot demand repayment of the amount in case it is not reimbursed by the issuing or the confirming bank. Nor can the bank demand payment of interest if refund is delayed.

Irrespective of the basis on which the bank has undertaken to pay at maturity, the bank will demand payment for assuming the obligation (acceptance fee or commitment fee) in addition to interest.

On the other hand, if the bank has not confirmed the credit nor subsequently assumed a payment undertaking, finance will be in the form of discounting with recourse against the beneficiary. As a result of such recourse the bank can, in case it is not reimbursed at maturity

or reimbursement is overdue, demand repayment of the amount or refund of the interest expense from the beneficiary.

Depending on the type of credit, some banks will be prepared to convert discounting to forfaiting at the request of the beneficiary.

Under the UCP 500 some legal actions with different decisions made it unclear whether an honouring or negotiating bank (being a nominated bank) was to be reimbursed in cases where the applicant or the issuing bank claimed that documents were fraudulent or there was fraud in the transaction. In many cases the claim was turned down by a court order not to pay, issued by a local court in the importer's country.

The UCP 600 has fortified the honouring or negotiating bank's right to be reimbursed by strengthening Articles 7(c) and 8(c).

Article 12(b) also states that a nomination to honour or negotiate is also an authorisation to prepay etc. Under the earlier versions of the UCP 500 this was a part of the discussion whether a nominated bank was entitled to reimbursement.

Usance credit

Usance credits offer a splendid opportunity for finance. Often the beneficiary has had to accept that the buyer effects payment later than foreseen. Then the beneficiary can obtain cash payment less interest in connection with the honouring. In principle, the bank's finance is based on the obligation of the issuing bank, even if it has recourse against the beneficiary.

Previously usance credits were financed on the basis of the draft issued by the beneficiary. Today drafts are less frequently used as credits are increasingly available by deferred payment.

Sight credit

A sight credit is expected to be paid when documents are presented, and it usually is. However, it is often a question at which bank it has to take place. Where the beneficiary rightly expects to receive money when presenting his documents to the nominated bank, the reimbursement clause of the credit may contain stipulations resulting in a delay in payment.

If the issuing bank's reimbursement instructions as to how the

amount is to be paid state that the nominated bank may debit the amount to the issuing bank's account with the nominated bank, payment will not be delayed, unless, in connection with an unconfirmed credit, there are insufficient funds on the account and the nominated bank is not prepared to accept an overdraft.

With any other form of reimbursement, the nominated bank will receive the amount after it has requested that payment should be transferred, either from the issuing bank or from a third bank, the reimbursing bank.

The credit shall indicate how the issuing bank is to reimburse the nominated bank for its honouring or negotiation.

It may state that the issuing bank will credit the honouring bank's account after having received the honouring or negotiating bank's telecommunication advice or the documents, or that it will transfer the money to the correspondent bank designated by the nominated bank.

It may appear from the credit that the nominated bank is to be reimbursed through a third bank, the reimbursing bank, usually in the country of the relevant currency of the credit.

As regards the period for which interest is to be paid, it is important that the nominated bank is able to demand payment of the amount by telecommunication (telex or SWIFT).

If payment depends on a letter reaching the relevant bank in time, the interest period must be expected to be considerably longer. The poorest reimbursement for the beneficiary is when the issuing bank will effect payment only after having received and approved the documents.

If the issuing bank is located on another continent, it may easily take three weeks to transfer the money, taking into account the time for transmitting the documents, the issuing bank's handling of the documents and the time for transferring the money.

The nominated bank will charge interest for the aggregate time, calculated as the actual number of days from the bank's payment to the beneficiary until receipt of the reimbursement. Some banks will settle the amount less an estimated number of days, possibly as forfaiting whereby the amount is settled immediately and the bank will assume the risk of delayed payment, including enjoy the

advantage in case the amount is credited earlier than expected.

For very short periods of time (two to three days) interest will usually be deducted as a small percentage of the amount (reimbursement interest).

Pre-export finance

The fact that a documentary credit is a guarantee covering a specific consignment of goods has led to the general assumption that loans can be raised against it.

In principle this is possible, but one has to realise that the release of payment under the credit is solely based on the presentation of documents, and not the physical goods.

Consequently, the value of a documentary credit as collateral against which to raise loans cannot be judged on its own, but must be evaluated together with the beneficiary's ability to ship the goods and to draw up the documents required.

Besides these conditions, the form and content of the credit as well as the creditworthiness of the issuing bank are significant.

Loans are sometimes raised against a documentary credit where a beneficiary needs to finance the purchase of raw materials or components to be used for manufacturing the goods to be shipped under the credit.

This method of finance is not common in the Nordic region and the neighbouring countries, but is extensively used in Hong Kong and in other South-East Asian countries where such finance often constitutes part of the agreed credit facility to be granted by the bank to its customer. This finance method is applied in particular by the clothing industry and contributes to building close relationships between banks and exporters.

Discrepancies

As mentioned earlier, it is not sufficient to present the documents stipulated in the credit. They have to be in full conformity with the conditions of the credit and the provisions of the UCP 600 if honouring or negotiation is expected to be made.

Unfortunately, far too many of the documents presented turn out not to conform to the relevant credit. This has been the case for a

long time and despite the revision of the rules. Even the information campaigns launched by banks, the ICC and other institutions have not been able to change the situation. Banks involved in international cooperation on documentary credits agree that up to 75% of all sets of documents are more or less discrepant on their first presentation.

The problems caused by this circumstance to the beneficiary as well as possible solutions are described in detail in Chapter 16 Discrepancies in the documents presented and in Chapter 15 Refusal of documents. This chapter deals solely with the principles.

Banks are not under an obligation to honour or negotiate documents that do not fulfil the conditions of the credit. This cannot be repeated often enough as it is the very essence of the obligation of issuing and confirming banks in accordance with Articles 7 and 8, among others.

The reason is simple: the issuing bank and the confirming bank act at their own risk and on their own responsibility, but on the basis of instructions given by the applicant. If the issuing bank accepts documents that are not in full compliance with the credit application and the UCP 600 rules, the bank may risk that the applicant refuses to approve the documents.

As a consequence, complying documents are to be approved and paid for by the issuing bank, while documents showing discrepancies require the acceptance of the applicant.

The nominated bank runs a similar risk. If the documents do not fully meet the stipulations of the credit, the bank cannot rely on the issuing bank's willingness to approve the document and effect payment.

If, having examined the documents, the nominated bank ascertains that they do not fulfil the conditions of the credit, the bank will not just pay the beneficiary, and a confirmation, if any, of the credit will have no bearing on that situation.

The nominated bank should ask the beneficiary to correct the documents, if possible. If this cannot be done, settlement can be expected only (1) when the documents have been approved by the issuing bank or (2) if the honouring or negotiating bank and the beneficiary make an agreement on settlement under reserve.

13.3 The role of the confirming bank

The issuing bank will sometimes designate the advising bank to be the nominated bank as well, in addition asking it to confirm the credit.

In that case the role of the confirming bank in connection with the honouring or negotiation of documents will be identical to that described under the nominated bank, with the addition that the bank confirming a credit cannot refuse to examine documents and that it must honour or negotiate, provided that the documents meet the conditions of the credit.

In other situations the issuing bank may ask one bank to confirm the credit and advise it to the beneficiary through another advising bank, typically in the country of the beneficiary.

A typical example could be a credit issued by a bank in Argentina, confirmed by a bank in the USA and with a bank in Denmark designated as the nominated bank. The confirming bank will often examine the documents itself. Consequently, the nominated bank will, having checked the documents, send the documents to the confirming bank, which will then pass them on to the issuing bank.

Alternatively, the credit may stipulate that the nominated bank is to forward the documents direct to the issuing bank, and then the confirming bank will not pay until it has received the nominated bank's statement that it has received complying documents and passed them on to the issuing bank or – depending on the stipulations of the credit – make payment against a claim from the honouring or negotiating bank.

13.4 What the issuing bank is to do

In fact, the issuing bank has only one task to perform in connection with the honouring or negotiation of documents under the credit: to pay when complying documents are presented.

The form or type of the credit is irrelevant to the issuing bank. The only question is when payment is to be made, and whether it is a sight credit or a usance credit (a credit with deferred payment).

Examination of documents

As banks do not necessarily trust each other, the issuing bank will also check the documents received to make sure that they are in

conformity with the stipulations of the credit. For further details, see Chapter 15 Examination of documents.

According to Article 14(a), the issuing bank will determine on the basis of the documents alone whether or not they meet the requirements of the credit. If they do, the bank must pay in compliance with the payment instruction stated in the credit.

If the issuing bank finds that the documents are not in compliance with the stipulations of the credit, the issuing bank may contact the applicant in order for him to approve the honouring or negotiation despite the discrepancies (Article 16(b)).

The applicant will approve the documents in by far the majority of cases, after which the issuing bank will notify the nominated bank accordingly and either approve the reimbursement made or arrange for a transfer of the amount. (See details in Chapter 17 Refusal of documents).

Reimbursement claim against the applicant

When the issuing bank has approved the documents, either because they meet the stipulations of the credit or because the issuing bank had accepted the documents based on the applicant's approval, the issuing bank will demand payment from the applicant in compliance with the payment terms of the credit.

The bank cannot base its claim against the applicant on the UCP 600 as the applicant is not a party to the credit instrument (except for the stipulation in Article 37(d) stating that the applicant must cover banks against all obligations and responsibilities which are imposed by foreign laws and usages).

Therefore, to secure the legal basis in case the bank and the applicant are in disagreement or the applicant has gone bankrupt, the bank should include an unambiguous clause into the application form to be signed by the applicant concerning the applicant's obligation to effect payment.

Financing the applicant

The buyer's wish or need to delay payment until after presentation of the documents is often the reason why the exporter asks the honouring or negotiating bank to have his claim under a usance credit financed.

If this proves impossible, or if it is too expensive for the buyer to obtain credit from the seller, it may be possible to arrange finance through the issuing bank.

One way to do this is to have the credit state that the beneficiary will receive payment at sight, even if the credit stipulates the presentation of a draft, for instance maturing 90 days after the date of shipment.

It may also be done without stating it in the credit. The applicant may have obtained an adequate overdraft facility or loan to enable him to pay the amount plus interest, for instance 90 days after shipment of the goods. The issuing bank may have security in the goods, either during the entire period or during the period from the arrival of the goods and until they have been sold by the applicant.

Chapter 14

The buyer's customs clearance of the goods

From the buyer's (the applicant's) point of view, the purpose of the credit is to ensure that the seller delivers the goods ordered.

The seller (the beneficiary) naturally wants to make sure that he receives payment for the goods. Often the credit is structured in a manner so that the buyer needs the documents to be presented under the credit for clearing the goods through customs.

In particular the bill of lading gives direct access to the goods, but other documents may be required as well.

14.1 Use of the documents under the credit for customs clearance

As described in the cycle of the credit, the documents are expected to be received by the issuing bank in due time for them to be used in connection with the inward clearance of the goods.

The buyer is not entitled to get hold of the documents under the credit unless the issuing bank approves them at the same time. Accordingly, the buyer must also approve any discrepancies in the documents, if any, if he wants to have the documents handed over to him. If the bank gives the applicant access to the documents, the bank must accept the documents and effect payment.

It is worth noting that the use of a documentary credit does not always prevent the applicant or any other party from getting access to the goods. If the credit stipulates that the goods are to be sent by lorry or aircraft, and the transport document is to indicate the buyer as consignee, the buyer will receive the goods without having paid for or approved the documents presented under the credit.

The issuing bank is under no obligation to accept documents or pay just because the buyer has taken possession of the goods.

Only if the bank has actively contributed to handing over the goods to the buyer, will it have assumed an obligation.

Any costs incurred because the documents required for customs clearance have not reached their destination are irrelevant to the credit, so this matter will have to be dealt with between the buyer and the seller.

14.2 The goods arrive before the documents

With transport time being continuously reduced, goods often arrive before the documents reach the applicant or the issuing bank. This is because the various means of transport have become faster, but also because aircraft and lorries are increasingly used for consignments shipped under documentary credits.

The late arrival of documents is often explained by the long processing time of banks for examining documents and settlement, and by the time taken for transmitting the documents from the nominated bank to the issuing bank. This is often true, although this explanation is sometimes used as an excuse for late presentation of documents to the bank. In fact, the banks' handling time, especially in the Nordic countries and large parts of Western Europe has been significantly reduced as a result of the fierce competitive environment. Several banks today have service standards of one or two days. The banks frequently send the documents by courier, thereby further reducing the forwarding time.

Delays in presentation may, besides the beneficiary's slow handling, be due to circumstances beyond his control. If the consignment is shipped from a port in another country, the bill of lading will often be issued and signed there and subsequently passed on to the beneficiary through his local agent. It can take several days from the dispatch of the consignment until the beneficiary receives the bill of lading.

Another situation that may delay the presentation arises where one or more documents have to be legalised by an embassy or a consulate, perhaps in another country. In particular, if a bill of lading is to be presented, it may take a long time until the beneficiary can present the documents to the nominated bank.

As a result of all these circumstances, the goods may arrive at their destination before the required documents reach it.

If a waybill has been issued with the issuing bank as consignee, or if a bill of lading has been issued, the buyer (the applicant) cannot get access to the goods right away.

If the carrier hands over the goods to a party other than the consignee or is not presented with an original bill of lading, he will incur a liability for damages towards the rightful owner of the goods.

This problem can often be solved with the assistance of the bank in either of two ways, according to the method of transport:

If the goods have been shipped by vessel, and a bill of lading is required to take possession of the goods, the bank can issue a bill of lading guarantee in favour of the carrier (the shipping company). Carriers will rarely accept a bill of lading guarantee in any form limiting the liability of the bank issuing the guarantee. The carrier has assumed an obligation to hand over the consignment to the first person presenting an original bill of lading. Consequently, it would constitute wilful breach of the contract of transport if he handed over the goods without being presented with the bill of lading. As the carrier would not be able to disclaim responsibility in full or in part, he wants to make certain not to have to pay damages to the holder of the bill of lading, if demanded. Consequently, the guarantee will often have to be issued for an unlimited period of time and for an indefinite amount. It is not unlikely that the value of the goods will have increased during the period from dispatch to arrival.

If the goods have been shipped by modes of transport other than by sea, and a transport document of the waybill type (air waybill, road consignment note (CMR), rail consignment note (CIM) or the like) indicates the issuing bank as consignee, the bank may instruct the carrier to hand over the goods to the applicant. Such release of the goods will satisfy the carrier, who will then have completed his part of the agreement. The bank is only dealing with the party (the beneficiary or the honouring or negotiating bank) which is the owner of the goods as long as such party has not been paid under the credit. The goods are consigned to the issuing bank in order for it, on behalf of the owner, to be able to prevent them from being handed over to the buyer without payment.

Irrespective of the manner in which the issuing bank gives the applicant access to the goods, it thereby incurs an obligation to accept the documents when they arrive.

The UCP 600 does not describe this situation as Article 5 expressly states that all the parties concerned deal with documents and not with goods.

Therefore, the bank's obligation can only be viewed as a result of a general liability incurred by handing over goods it does not own itself.

Of course the bank will not hand over goods, unless the party requesting it to do so will indemnify it for any loss it may incur. Consequently, most banks will require a written statement from the applicant evidencing that he will indemnify the bank for any loss it may incur and that he will approve documents in the form in which they are presented.

By requesting to have the goods released before having received the documents, the applicant precludes himself from refusing non-complying documents. If he has any objections against the documents, he must turn to the seller outside the scope of the credit.

Before making the goods available to the applicant, the bank will assess whether the applicant is still creditworthy and perhaps ask for payment or the provision of security.

As the issuing bank and the applicant cannot refuse documents received later on, even if they are discrepant, it may be difficult to assess the actual risk. One discrepancy may, for instance, be a higher price than indicated in the credit.

This chapter does not discuss the purely legal aspects of a situation that arises when document requirements are clearly unreasonable. Nor do I discuss how to solve the problem arising if the issuing bank, nevertheless, refuses the documents while at the same time stating that it is liable for the value of the goods in question. However, according to international practice, a bank that has handed over the documents will have assumed an undertaking to accept and pay for them.

Chapter 15

Examination of documents

The undertaking to effect payment under a documentary credit is based on the presentation by the beneficiary of all the documents called for in the credit. It is also a condition that the documents are presented in due time and that all the stipulations of the credit are fulfilled, including those of the UCP 600. These elements are the essence of a documentary credit and are described in Articles 2, 4, 5, 7(a) and 8(a).

To make certain that the documents meet all the terms and conditions of the credit, the relevant bank will naturally examine the documents. It goes without saying that any bank that is liable in any way under the credit will perform such examination itself rather than trust what other banks have determined.

Today virtually all banks follow the UCP 600. This is to aim at a uniform treatment of documentary credits, and it is not uncommon to use this set of international rules, even for credits that do not contain an indication that they are subject to the UCP 600. The UCP 600 is used worldwide as an internationally recognised frame of reference concerning documentary credits, irrespective of the relevant national legislation.

In this connection a US court of appeal once declared: “The UCP is a set of international rules and practices with legal effects if written into the relevant documentary credit.”

The rules and provisions in the UCP 600 apply to all the banks involved.

15.1 UCP 600 and international banking practice

The background for the need to include wording regarding a uniform international interpretation of the credit and the documents presented are described above. However, there is also a tendency in some parts of the world to defend “local practice”. Of course it is hard to avoid local practice, but a large number of banks, supported by the ICC Banking Commission, make an active contribution to ensure that the international rules are observed in the spirit in which they were formulated.

Article 14(a) says:

A nominated bank acting on its nomination, a confirming bank, if any, and

the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.

And the UCP 600 states in Article 14(d):

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

The text clearly states that the documents should be examined in conformity with the UCP 600 rules and not on the basis of local practice. Furthermore, it appears that banks are to check the documents presented as they “appear on their face”. This means that the banks will not examine whether the data stated are correct. The credit deals with documents and not with the goods or the underlying agreements. It is worth noting that “on the face” does not mean on which side a page is to be examined. The phrase solely means what can be read from the document.

As said before, the examination of documents must not be based on local practice but on “international standard banking practice”. The UCP 600 gives a large number of details, also regarding the documents to be presented. To strengthen this requirement the ICC Banking commission has published *International Standard Banking Practice for the Examination of Documents under Documentary Credits subject to UCP 600 (ISBP)*, which must not be seen as a separate set of rules, but is to be regarded as an explanation to the UCP 600 in line with the ICC Banking Commission’s opinions and decisions.

The fact that banks will only look at the documents and compare them with the terms and conditions of the credit and the international rules implies that they cannot be expected to possess any knowledge of the various goods or their quality or nature and hence, they cannot judge whether, for instance, “wetsalted codfish” is the same as “salted cod, wet”. If a credit stipulates dispatch from a named port, the bank will check if the goods have been shipped from that port.

Consequently banks will check only the documents presented, and merely as they appear.

It is not up to the bank to determine whether or not the specified type of vessel is able to call at the port named in a document, or whether another port would have been preferable.

The knowledge possessed by a Nordic banker about conditions in Nordic and perhaps European markets cannot be expected from a banker in China; or the other way round. The level of experience may also vary widely among bank officers engaged in trade finance.

The formulation to the effect that banks will only examine the documents “as they appear” implies that they are not under any obligation to evaluate the documents. However, it does not say that a bank should always accept documents that are clearly discrepant, if not outright forged, in contravention of the knowledge possessed by the relevant bank.

Still, it is important to look at the role of the bank that checks the documents.

It is beyond doubt that the nominated bank – being the bank receiving the documents from the beneficiary – is entitled to refuse to honour documents if it ascertains that the documents presented contain untrue data. A beneficiary cannot assert a right to receive payment under a credit if he presents documents containing demonstrably wrongful data. Although it does not appear from the UCP 600 that banks must be in good faith, general legislation should also be taken into consideration.

It is a different matter when we deal with the examination of documents by any of the subsequent banks, notably the issuing bank.

According to Article 7(c) the issuing bank must effect payment if the nominated bank has honoured the documents. Accordingly, the issuing bank cannot refuse to reimburse the nominated bank, unless the issuing bank can prove that the nominated bank knew or ought to have known that the data contained in the documents presented were wrong. The issuing bank cannot claim that the nominated bank ought to have made a further examination as, according to Article 14(a), banks must determine on the basis of the documents alone whether or not they appear on their face to be in compliance with the terms and conditions of the credit.

Thus, the nominated bank’s right to refuse to honour documents containing wrongful data is not based on the UCP 600, but solely on a conception of law that is founded on general legislation.

Even though Article 14(f) mentions that banks will accept documents such as they are presented, unless the credit indicates specific requirements as to the documents in terms of their data content or the issuer, it is necessary to look at the provision in Article 16(a) stating that: *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.*

This provision should also be taken to mean that the documents must concern the same transaction. If, for instance the invoice and the bill of lading relate to a shipment of frozen fish, a certificate of origin stating that the “fresh fish” are of Danish origin cannot be accepted.

Add to this that banks will not be able to determine which of these two discrepant statements is the correct one in relation to the transaction concerned.

Some banks interpret the provision in Article 14(d) banning documents that “conflict with data in another document” to the effect that they actually require the documents to indicate a clear relation between the documents. For instance, the documents must refer to the same order number, contain the same description of goods and so on. This interpretation seems to go beyond what is justified by the UCP 600.

Documents not stipulated in the credit

Article 14(a) and (b) and others require banks to examine the presentation which is to be understood as an examination of the documents stipulated in the credit.

To underpin this, Article 14(g) says: *A document presented but not required by the credit will be disregarded and may be returned to the presenter.*

This provision should be taken literally. If the credit or the UCP 600 stipulates the fulfilment of one or more conditions, and such conditions appear only from a document not called for in the credit, the bank will ascertain while examining the documents that the conditions of the credit have not been met. One example is the rule that goods must be loaded on board a named vessel. If the carrier has not included such information in the bill of lading, but stated it in a

separate certificate, the rule in Article 20(a)(ii) will not have been met.

The rule also applies if the document not stipulated contains data that are inconsistent with the credit or other documents. None of the banks involved can use such “discrepancy” as a cause for refusing documents.

To avoid that, the issuing bank, for instance, will, nonetheless, look at a document not stipulated in the credit and, in contravention of the UCP 600, use data from such document as a cause for refusal, some banks choose not to forward documents that are not called for. Most Nordic banks will probably accommodate the beneficiary’s wish to pass on such documents in order for the applicant to receive all the relevant documents together, whether or not they are required under the credit.

Requirements in the credit not related to a document

For many years users of documentary credits have felt uncertain about and divided between two requirements: on the one hand, according to Article 3 and especially Article 14(f), the credit must stipulate by whom the documents are to be issued and their data content and, on the other hand, there is the general rule demanding that “all the terms and conditions” must be met.

The schism happens when a credit indicates conditions separately; that is without stating the document to which they relate.

These conditions may vary but are sometimes significant to the applicant, but the problem arises if the beneficiary and/or the banks cannot comprehend the requirement as it is not clear what documentation the issuing bank and the applicant will consider acceptable.

Examples of conditions in the credit:

- The goods (for instance fish or meat) must be forwarded in a refrigerated container.
- The packing units must be marked in a special way.
- The goods must be of Danish origin.
- The beneficiary must send a telex to the buyer not later than 24 hours after dispatch of the goods.

Just as many questions may be asked regarding such conditions:

- Is a special document to be issued?
- By whom is such document to be issued?
- What data should the document contain?
- Who is to use the document?

In an attempt to clarify this situation, Article 14(h) was formulated and included into the UCP 600: *If a credit contains a condition without stipulating the document to indicate compliance with the condition, banks will deem such condition as not stated and will disregard it.*

However, this article has not (fully) solved the problem and although the wording seems unmistakable, there may still be interpretation difficulties.

First of all it seems that this is a problem the issuing bank should have taken care of before the credit was issued. It should discuss the problem with the applicant whether the applicant requires a specific document or how the condition stated is to be seen from the required documents.

I would interpret the wording of the article "... without stipulating the document to indicate compliance..." to the effect that if the credit calls for the presentation of a document to which a so-called non-documentary condition naturally belongs, such condition should be fulfilled by the document stating the data. For instance, if the credit stipulates that the goods must be of Danish origin, and a certificate of origin is required. On the other hand, if the credit had not called for a certificate of origin, the bank cannot demand the presentation of such document or require information on the origin of the goods to be included in an invoice or another document.

However, it would be unacceptable for the invoice to state that the goods are of Swedish origin. There is a clear distinction between not providing information and stating conflicting data.

15.2 Principles for examination of documents

It is essential that banks examine the documents under a credit in the same manner and apply a uniform interpretation of the UCP 600 (Article 14). But just as every country needs lawyers and judges to interpret its laws, one must accept that the interpretation of the

international documentary credit rules may vary among countries and among banks, and even among different employees of the same bank, and hence, differences do arise in the interpretation of the rules.

Consequently, many discussions are conducted between customer and bank as well as between banks, despite the detailed rules and the provision concerning international banking practice.

Especially expressions like “the terms and conditions of the credit have been met” and “documents which appear on their face to constitute a complying presentation” may give rise to debate.

According to Article 2, a complying presentation means a presentation in accordance with the terms and conditions of the credit, the applicable provisions of the UCP 600 and international standard banking practice.

The questions pop up: must the documents be exactly consistent? And what is meant by “exactly”? Or are the documents to fulfil their purpose and ensure that the deal is carried out in accordance with the agreement between the parties?

Two principles are applied when evaluating whether documents meet the requirements of a credit: substantial compliance and strict compliance.

Substantial compliance

What is meant by this concept is that the conditions of the credit and the UCP 600 rules have been met in such a manner that, naturally, the documents stipulated are to be presented and all the conditions have been met in principle.

Banks and applicants primarily attach importance to the fact that all the terms and conditions have been fulfilled, but do not necessarily require the same wording as in the credit. What is essential is that the right goods reach the buyer and that prices and periods stipulated have been observed, rather than that the documents are precise.

This principle seems sensible. However, problems do occur when a bank is to judge what is reasonable, in particular to the buyer or the issuing bank.

When problems arise in connection with a particular transaction, the issue is often about a party’s evaluation of “reasonableness” and then particular formulations will carry more weight than others, whether or not they are significant.

Therefore, this principle is more theory than practice in today's world of documentary credits.

Strict compliance

According to this principle, all conditions and details must be in strict compliance with the credit and the UCP 600, and the documents may not conflict with one another (Article 14(d)).

Banks will not assess the scope of a discrepancy and will not accept discrepant details, even if they are in favour of the applicant (the buyer).

The terms and conditions of the credit and the UCP 600 must be met completely.

If a credit stipulates insurance to be taken out for the CIF amount plus 10%, an insurance policy of USD 38,000 will not be accepted if the invoice shows a CIF value of USD 34,560.

Strict compliance is the most common principle, and it is supported by judicial decisions in several countries.

However, the problem with this principle is that banks, especially in certain countries or some parts of the world, overinterpret it and cannot even accept an evident spelling error or a change in the beneficiary's address. In extreme instances banks have even refused documents on the grounds of spelling errors made by the bank itself when issuing the credit.

Strict compliance should not imply that the documents reflect the wording of the credit literally, neither as to the description of goods or other details.

Spelling errors should be accepted if they unmistakably are spelling errors. Otherwise, if the word gets a new meaning, the discrepancy cannot be categorised as an unambiguous spelling error (ISBP Paragraph 25).

The acceptance of minor discrepancies is often termed the *de minimis* rule, implying that documents must be in "strict compliance" but such minor errors have no bearing. Also the *de minimis* rule is open to interpretation.

15.3 Time limits

The provisions in the UCP 600 about periods for handling documents have solved a lot of misunderstanding under the UCP 500 and earlier versions, because of the phrase “a reasonable time not to exceed seven banking days...”. The phrase reasonable would be difficult to determine because banks in different areas of the world have different views.

The UCP 600 has tightened the wording and content of the article regarding time for examination of a presentation in order to make it easier to understand and to be in line with the needs of customers.

The issuing bank, the confirming bank, if any, or a nominated bank must still have a reasonable time to examine the documents and determine whether to take up or refuse the documents and to inform the beneficiary or the bank from which it received the documents accordingly. But in the UCP 600 the phrase “reasonable time” has been removed and substituted by a more precise wording.

Article 14(b) stipulates that the banks mentioned “each have a maximum of five banking days following the day of presentation...”, thereby setting a firm limit to the time taken by the banks to examine the documents.

This is a question of a better international documentary credit practice. Judicial decisions in the UK and the USA have earlier established that a bank had not acted within reasonable time because it had spent more than three days without being able to provide evidence that justified more than three days.

It should, under normal circumstances, be possible to process a simple credit prescribing one or two documents on the same or next day.

In addition to checking the documents and determining whether they conform to the credit, time should be allowed for the issuing bank to obtain the applicant’s waiver of discrepancies, if any. In such cases the need for maximum five banking days may be realistic.

As appears from Article 14(b), the time to examine the documents and perhaps refuse them applies to all the banks involved in the credit transaction. However, non-compliance with this provision has the most serious consequences for the issuing bank and the confirming bank, if any. If these banks do not observe the time limit, they will

forfeit their right to refuse documents and must, therefore, effect payment (Article 16(f)).

Also the nominated bank, which has not confirmed the credit, will have to observe the rule, but as this bank has not assumed a payment undertaking, it cannot be required to pay just because it has not observed the time limit referred to in Article 14(b).

Provisions in the UCP 600 on refusal of documents discusses the consequences for the bank of non-compliance with the time limit.

The 5-day rule in Article 14(b) should be seen in relation to the presenter and does not in principle concern the relations to the next party in line, such as the issuing bank.

Chapter 16

Discrepancies in the presentation

A documentary credit is usually issued as a result of the seller's requirement for being assured that he will receive payment when the goods have been shipped. In order for the seller (the beneficiary) to obtain payment, he must hand over documents that are stipulated in the credit and fully meet the conditions of the credit.

Considering the fact that on concluding the deal, the seller has the opportunity to agree with the applicant on the document requirements, and after receipt of the credit instrument the seller can determine which documents will be needed in order for him to obtain payment, it may seem surprising that many document sets do not comply with the conditions of the credit.

International banks have, separately and together, estimated that approximately 75% of the sets of documents presented do not meet the requirements of the credit.

16.1 Why are documents discrepant?

There are many and different reasons why documents do not conform to the credit, but it is seldom because the beneficiary does not want to maintain his security.

Absence of agreement between buyer and seller

Whether a deal is made by the parties entering into a formal contract or they agree on the terms over the telephone, they often fail to make a clear-cut agreement on the details of shipment and/or the documentary credit. Probably, the buyer presumes that the seller will know about these things or that they can be agreed with the issuing bank.

The buyer will then fill in the application form, perhaps in consultation with the issuing bank, in such a manner as to primarily satisfy his own needs and, most likely, without knowing or taking into account details that may be important to the seller.

A typical example is the provisions in the credit on shipment. Even if the seller may be situated near a port, it is not always possible to obtain a marine or ocean bill of lading indicating that port as the port of shipment. Also prohibition against partial shipment or transshipment may cause problems to the beneficiary as may too short periods for shipment or presentation of documents.

Sometimes it happens that the applicant, in contravention of an agreement, adds or amends conditions of the credit.

The beneficiary fails to check the credit

Virtually all banks urge the beneficiary to check if the credit received is acceptable, and of course it is relevant to check that. Nevertheless, banks know of beneficiaries who merely watch if the credit arrives without paying attention to the correctness of the contents.

The beneficiary should scrutinise the wording of the credit and contemplate any consequences as the value of the credit depends on whether he is able to fulfil its conditions. For more details, see Chapter 10.3 The beneficiary's evaluation of the credit.

If the credit is not satisfactory, the beneficiary should ask the applicant to have it amended before shipping the goods.

The beneficiary fails to ask for an amendment

Quite often a beneficiary does not ask the buyer to amend the credit, even if, after having thoroughly checked it, he has found reason to do so.

The typical explanation is that the beneficiary feels certain that the applicant will approve the documents despite a minor discrepancy. Moreover, the buyer is eager to receive the goods quickly and does not want to delay the dispatch.

Even if this explanation is true, the beneficiary should contemplate why he has asked for a documentary credit to be issued in the first place, considering that he has such great confidence in the buyer.

The applicant does not arrange for an amendment

Although the beneficiary has asked the applicant for an amendment, having thoroughly checked the credit, such amendment may not be made at all because the applicant promises the beneficiary to approve the documents.

However, the beneficiary ought to take into account that the credit is the issuing bank's undertaking, not the buyer's. Should the financial circumstances of the buyer impair to the effect that he cannot pay when the documents arrive; it is the issuing bank that

determines whether the documents are to be accepted despite any discrepancies. If the bank does not expect to get payment from the buyer or be reimbursed through the sale of the goods to another party, it will not accept documents that do not meet the terms of the credit.

In some countries it may take a relatively long time to make an amendment and, therefore, the beneficiary may not want to wait any longer and ships the goods, knowing that he cannot fulfil the terms of the credit.

The beneficiary does not comply with the credit requirements

When shipping the goods and/or drawing up the documents a beneficiary sometimes act in contravention of the terms of the credit.

This may be due to the beneficiary's lack of knowledge of the UCP 600 and of the relevant matter, but it may also be because he believes it does not matter as the applicant is not worse off for that reason – he may even be in a more advantageous situation.

The explanation “this is the way we always do it”, is not unknown. However, what is true and correct for one credit is not necessarily so for another.

As described in Chapter 15.1 UCP 600 and international banking practice and in Strict compliance under Chapter 15.2, banks will not assess the scope of a discrepancy. They will merely check if the documents conform to the credit.

The problem is realised too late for amending the credit

Another reason for presenting incorrect documents is that the situation calling for amendments arises at such a late point in time that the beneficiary does not have time to amend the credit.

This may be due to problems in the manufacturing process or delays in the supplies from a subsupplier, as a result of which the goods cannot be shipped on the day stipulated in the credit. In other situations the goods are ready for shipment waiting for the vessel to convey them according to the transport agreement. The vessel may be delayed for technical reasons or because of a strike on board the vessel or in a port.

If a document is to be authenticated or otherwise endorsed or

perhaps issued by a third party, this may cause delays. The problem particularly arises if the third party is situated in another city or in another country, where delays or losses in transit may cause serious difficulties if the time limit for presenting documents is to be observed.

The beneficiary should to a certain extent anticipate the risk of such delays, although it seems impossible to take precautions that fully guard against these situations.

16.2 Handling of non-complying presentation

The rule in the UCP 600 to the effect that banks are solely under an obligation to pay, provided that all the terms and conditions are fulfilled, should be taken literally. On the other hand, banks are aware that the documentary credit is to function as an instrument of payment and security between the buyer and the seller. Therefore, banks will endeavour to find a solution to ensure that the credit works in practice, despite the presentation of non-complying documents.

However, it is important to note that the banks' contribution to getting payment and documents in place is beyond their payment undertaking under the credit.

When the nominated bank, which is relevant in this connection, has received documents under a credit and then when examining them ascertains that they do not meet the terms of the credit, the bank will, in accordance with Articles 14(b) and 16(c), contact the beneficiary to make an agreement with him as to what to do with the documents.

Correction of documents

If the documents are non-complying, they should be corrected, if at all possible. There is only one reason for this: documents that meet the terms of the credit cannot be refused.

This reason ought to convince any beneficiary, and the documents should be corrected whether the discrepancy is significant or of minor importance.

Sometimes the beneficiary chooses not to avail himself of this possibility as it may be cumbersome to correct the documents and because it takes time and delays settlement. However, the

consequence of not making the necessary correction of documents may be considerably more serious.

The beneficiary is entitled to have his documents corrected and to present them once again to the bank. He must make sure, however, to present them within the time limits set in the credit and the UCP 600. The limit is not extended just because the documents are to be corrected, nor if one or more of the documents are retained by the bank because they are in order.

Documents are returned

If the examination of documents reveals severe discrepancies, for which reason the issuing bank (or the applicant) is not expected to accept the documents, the best solution may be to return them to the beneficiary.

The beneficiary can choose, if possible, to redirect the goods, either back to himself or to another recipient, unless the beneficiary believes he can induce the buyer to pay outside the credit or sell the goods to another party at his place.

The expectation that the issuing bank (or the buyer) will refuse to accept the documents may be due to several factors, including that the issuing bank has tried to have the credit cancelled. Among other factors is awareness of the applicant's bankruptcy and payment difficulties for the issuing bank or the importing country. The tightening of rules governing the import of the relevant goods may also play a part. Also heavy price reductions in world markets and changed marketing opportunities for, for instance, luxury goods in the importing country may strongly affect the willingness of the issuing bank and the buyer to accept documents if they are no longer under an obligation to do so.

However, banks come across few instances only, where documents are returned to the beneficiary.

The issuing bank is asked

If the documents cannot be corrected, and the beneficiary wants them to be presented under the credit to the issuing bank because he expects the applicant to accept them despite the discrepancies, the nominated bank may, according to agreement with the beneficiary,

send a request to the issuing bank asking it to accept documents containing the discrepancies described in detail in the request.

Today such request will usually be sent via SWIFT or, if this is not possible, by telex. In rare cases it will be forwarded by cable. Telecommunication costs are for the account of the beneficiary, including expenses incurred by the issuing bank when replying. Even if the reply is negative, the beneficiary must be prepared to cover the banks' expenses.

It may take some time for the issuing bank to reply because it will usually leave it to the applicant to make the decision.

The waiting time may represent a loss of interest to the beneficiary, unless it is a usance credit with a fixed expiry date, but the waiting time has no bearing on the time limit allowed for the presentation of documents since they have been presented.

If it is a confirmed credit, it is important to be aware that the confirmation is binding upon the confirming bank only if the beneficiary presents documents that comply with the terms of the credit before its expiry.

Thus, the confirming bank is no longer under an obligation to pay if it receives a message from the issuing bank to the effect that the documents have been accepted after expiry of the credit. This will normally pose a problem only in situations where the creditworthiness of the issuing bank or the importing country has impaired after the credit has been confirmed, and the confirming bank therefore wishes to back out of its obligation.

Most banks, especially Nordic banks, will normally stick to their payment undertaking if they receive the issuing bank's reply without unreasonable delay.

Documents are sent to the issuing bank for approval

If the beneficiary cannot or does not wish to correct the documents, and it is not possible to describe the discrepancies in a telecommunicated message to the issuing bank, or if the beneficiary is not prepared to pay the costs of telecommunication due to the insignificant amount of the credit, the nominated bank may offer to forward the documents to the issuing bank for approval.

By having the documents forwarded to the issuing bank for

approval the beneficiary will gain a further advantage, in that the documents can be handed over to the buyer more quickly after having been approved. Thereby, he may save costs of warehousing and the like.

The documents having been presented already, their late arrival at the issuing bank has no effect on the time limit for presentation or the expiry date of the credit. The documents are forwarded “under the credit” and the issuing bank will, therefore, have to comply with the provisions of the UCP 600 on the taking up or refusal of documents (Articles 14 and 16).

The issuing bank must also adhere to the time limit applying to refusal despite the fact that the nominated bank and the beneficiary obviously know of the discrepancies. There is, however, disagreement among banks as to whether the UCP 600 rules apply if the documents are presented to the nominated bank after the date of expiry of the credit. According to the prevailing view, the credit does not exist any more and hence, the presentation is to be considered as documentary collection, while other banks maintain that presentation after the expiry date constitutes a discrepancy like any other discrepancy.

The beneficiary should be aware that the documents are transmitted to the issuing bank for his account and at his risk, the latter of which implies that he bears the risk of the loss of documents in transit to the issuing bank.

If the documents are lost in transit, none of the banks involved are under an obligation to pay since the documents presented do not meet the terms of the credit.

Payment to the beneficiary will not be effected until the nominated bank has received a message from the issuing bank stating that it (and hence also the applicant) has approved the documents despite the discrepancies.

Settlement under reserve

There is a further method of handling documents that do not meet the stipulations of the credit: settlement under reserve.

By contrast to the above methods, documents are not corrected, and the issuing bank is not approached for approval of documents before the beneficiary receives payment under the credit if documents

can be approved. The purpose of effecting settlement with the beneficiary under reserve is for him to receive payment for the documents presented under the credit in accordance with the conditions of the credit despite the fact that the documents are nonconforming.

This presupposes a clear-cut agreement between the honouring or negotiating bank and the beneficiary to the effect that the beneficiary repays the amount paid if the documents are not approved by the issuing bank.

The honouring or negotiating bank (a nominated bank) will enter into such agreement only if it has found the beneficiary creditworthy and trusts that he will observe the agreement.

Consequently, settlement under reserve does not eliminate the beneficiary's risk that discrepant documents are refused, but serves the sole purpose of giving the beneficiary money immediately against his liability for repayment. This may be regarded as a loan where the beneficiary is not to pay interest if the issuing bank and the applicant accept the documents without delay.

By far the majority of document sets settled with the beneficiary under reserve are accepted by the issuing bank. Consequently, this method of settlement is a good solution for the beneficiary, who not only receives payment more quickly but also saves administration work in bookkeeping and the like.

In some cases the issuing bank, after having refused documents due to the discrepancies, will later approve them at the request of the applicant. Depending on the reimbursement provisions of the credit, such delayed approval of documents may result in the loss of interest, which the honouring or negotiating bank will charge to the beneficiary.

Repayment and exchange rate risk

If, on the other hand, the documents are not approved, the beneficiary must repay the amount plus interest as from the date when honouring or negotiation was made and he must also pay all the costs relating to honouring or negotiation, the transmission of documents, and the handling and returning of documents by the issuing bank. The repayment of the amount of the honouring or negotiation may involve an exchange rate risk.

If the credit is denominated in a foreign currency, the nominated bank will demand repayment of the amount in foreign currency or in the currency of its country converted at a rate applicable on the date of repayment. This applies whether or not the beneficiary has been paid in foreign currency or the amount was converted into his own currency.

As the bank's exchange rate risk is not actually based on the currency of the credit but on the currency in which it was reimbursed, the beneficiary's exchange rate risk may also exist in a credit in the currency of his country. In rare cases the honouring or negotiating bank may reimburse itself for the equivalent of the amount of the honouring or negotiation, such as in US dollars, and the honouring or negotiating bank must then in case of refusal repay the amount in US dollars.

Scope of the settlement under reserve

The UCP 600 contains no rules on settlement with the beneficiary under reserve and there are at least two different opinions concerning the understanding of this concept.

Some banks are inclined to the view that, once they have settled an amount with the beneficiary under reserve, they can demand repayment of such amount, whatever the reason for non-reimbursement is. These banks regard the settlement as a loan and the transmission of documents as presentation of documents to the issuing bank for approval.

However, in the opinion of an increasing number of banks, including most Nordic banks, it is the responsibility of the honouring or negotiating bank, according to Article 15, that documents checked by the bank are approved, with the exception of the discrepancies ascertained by the bank and notified to the beneficiary.

Accordingly, the nominated bank will state in its settlement note all the discrepancies on which it will rely. If the issuing bank refuses the documents, the honouring or negotiating bank will only be entitled to demand repayment of the amount from the beneficiary if it has indicated the discrepancy in its settlement note on which the issuing bank has based its refusal.

16.3 Types of discrepancy in document presentation

There is no limit to the kind of discrepancy evidenced in documents, except as set by imagination.

As the causes for discrepancies differ, so does their nature. Nonetheless, banks see some more often than other discrepancies.

It should be noted that in principle, there is no distinction between major and minor discrepancies. Either the documents comply with the requirements of the credit or they do not, and refusal may be based on even the slightest discrepancy. What seems insignificant to one party may be important to another. As described in Chapter 17.1 Reasons for refusing a presentation, the nature of the discrepancy may determine whether or not a document will be accepted.

Discrepancies may take different forms according to whether they concern the interpretation of the UCP 600, the wording of the credit, a specific document or relations between the documents.

Consequently, it is hard to single out those that are particularly significant, and it is impossible to make a complete list of frequent errors. The below examples are typical and the banks' trade finance departments come across them on an everyday basis:

The date of expiry has been exceeded

The documents must be presented to the nominated bank on or before the date of expiry of the credit. For more details, see Expiry date in Chapter 13.1.

The period for presentation has been exceeded

The documents must be presented to the nominated bank on or before the last day of the period of time after shipment of the goods as stated in the credit but not later than on the date of expiry of the credit. For more details, see Period for presentation in Chapter 13.1.

The date of shipment has been exceeded

In the absence of a specific date of dispatch in the credit, the date of expiry of the credit is regarded as the latest date of shipment.

An extension of the date of expiry or the period of time for presentation in accordance with Article 29(a) will not cause a corresponding extension of the date of dispatch (Article 29(b)).

The amount of the credit has been exceeded or not fully utilised

If the credit does not state any limit to or extension of the credit amount, the credit amount must be precisely utilised, subject to the limitations following from Article 30. Article 30(b) allows for a tolerance in the quantity of the goods of plus/minus 5%, unless the goods are expressed as a certain number of packing units or individual items. The amount of the credit must not be exceeded. If the quantity of the goods is reduced by up to 5%, a similar reduction in the invoice amount will be accepted.

According to Article 30(c), a tolerance of 5% less in the amount of the credit is allowed, even when partial shipment is prohibited, provided that the quantity of the goods has been shipped in full and that the unit price has been adhered to. Article 30(c) cannot be applied together with Article 30(a) or (b). The aim is to allow invoicing for a lower amount, for instance, if the costs of freight or insurance were less than assumed when the credit was issued.

If the words “maximum” or “up to” are used in connection with the credit amount, any amount up to the credit amount will be accepted.

The expressions “about” and “approximately” are dealt with in Article 30(a) and should be taken literally. The tolerance allowed is 10% and not approximately 10%. Although not stated in the UCP 600, similar wordings (ie “circa”) will by most banks be treated in the same manner.

For further details concerning the amount of the credit see Amount of the credit in Chapter 9.3.

Dispatch from a place other than that stated in the credit

It is important to distinguish between the port of loading and the place of receipt, just as there is a difference between the port of discharge and the final destination. The problem often arises in connection with multimodal transport documents. For more details, see Port of loading and port of discharge in Chapter 12.6.

The description of goods in the invoice is inconsistent with that of the credit

Article 18(c) stipulates that the description of the goods in the invoice must correspond with that in the credit. An extended version will usually be accepted, provided that it does not contradict the credit. For more details, see Description of goods in Chapter 12.6.

The bill of lading does not indicate that the goods are on board the vessel

As a main rule, the bill of lading must state that the goods have been loaded on board (Article 20(a)(ii)). For more details, see Loading on board in Chapter 12.6.

The transport document does not indicate a carrier

In the articles concerning transport documents, the UCP 600 prescribe that the carrier must be stated. For further details, see Carrier versus freight forwarder in Chapter 12.6.

Transshipment is made

Unless the credit prohibits transshipment, it is allowed. The articles concerning transport documents deal with instances where transshipment is accepted, even if prohibited in the credit.

Partial shipment is made

Unless the credit prohibits partial shipment, it is allowed (Article 31(a)). For more details, see Partial shipments in Chapter 12.6.

The transport documents indicate a consignee other than that stipulated

The insurance policy or certificate does not contain the risks stipulated

For more details, see Type of insurance cover in Chapter 12.6.

The insurance document contains a date later than the date of shipment

For more details, see Effectiveness of cover in Chapter 12.6.

The insurance policy is in the wrong currency

Article 28(f) requires insurance to be taken out in the currency of the credit.

The insurance policy does not cover the CIF or CIP value + 10%

For more details, see Amounts insured in Chapter 12.6.

Certificates do not contain the text stipulated

Articles 14(f) and 3. For more details, see Documents issued for various purposes in Chapter 12.6.

The documents contain unauthenticated corrections and/or alterations

The UCP 600 rules do not contain any provisions on corrections or additions to documents. According to international banking practice, corrections or additions will not be accepted if made to transport or insurance documents or any other documents not issued by the beneficiary himself, unless the corrections or additions are marked to evidence that they have been made by the issuer of the document. The ISBP Paragraphs 9 – 12 give more details regarding different forms of corrections or alterations.

Several banks and institutions have made check lists to help the beneficiary avoid errors in the documents presented.

However, this does not seem to have reduced the number of discrepancies to any significant degree. Many errors can be avoided by reading the text of the credit carefully and studying the UCP 600 and then adhering to the conditions and rules, even those that appear to be unnecessary.

16.4 The applicant's approval

By signing the credit application form and requesting the issuing bank to issue the credit, the applicant has only undertaken to reimburse the issuing bank, provided that the beneficiary presents conforming documents.

Consequently, the issuing bank will not accept documents on its own behalf if they are discrepant. Whether or not these discrepancies

seem to be significant or of minor importance, the bank will ask the applicant to decide if he wants to approve the documents.

The applicant will often consider the actual circumstances rather than the documents when making his decision. However, the UCP rule that refusal can only be based on the documents presented cannot be deviated from (Article 14(a)).

The applicant cannot take possession of the documents until he has accepted them despite the discrepancies, for instance in order to have the goods cleared through customs.

Chapter 17

Refusal of a presentation

“A documentary credit is an instrument of payment and not a means by which to avoid payment”. This is a typical statement made by bankers in trade finance departments and is at the heart of the function of a credit. In fact, it is the aim of the International Chamber of Commerce that a credit should serve such purpose. Unfortunately, a large number of exporters take a different view since they have suffered from the consequences of non-complying documents being presented.

If we compare the number of refusals (finally) with the number of documentary credits honoured, the result is, luckily, acceptable, if not quite satisfactory. The documentary credit is truly an instrument of payment.

On the other hand, we must admit that the scepticism of exporters is not quite unfounded. The risk, or even fear, that the issuing bank does not accept the documents presented causes many honouring or negotiating banks to find discrepancies which are incomprehensible or unacceptable to the beneficiary.

The reason is the issuing bank's sometimes extreme subtlety in finding discrepancies, often urged by the applicant or because of the bank's risk of losing money if the applicant cannot pay. In recent years the world of documentary credits has taken a stricter view of this attitude, and so, banks in certain countries are in focus. In these areas a different mindset is prevailing as to the ideology of documentary credits and misunderstandings caused by linguistic problems play a part as well. As a result of an increasing number of injunctions or threats to use injunctions and bring disputes before the courts, the honouring or negotiating banks are now taking greater care when examining documents.

Fortunately, however, only in relatively few cases are documents refused with non-payment as the result.

17.1 Reasons for refusing a presentation

When the applicant spends time and money on having a credit issued, and the beneficiary applies resources following the instructions of the credit and, relying on the credit, ships the goods agreed upon between the buyer and the seller, there ought to be a serious motive for refusing documents.

And frequently there is, although sometimes the reason may be speculative.

As appears from the below examples, the reasons for refusing documents may differ.

Discrepancy affects the applicant

Generally, one must assume that there are reasons for the applicant's requirements as to the contents of the credit.

Consequently, it cannot be said to be unfair for the applicant to insist that the conditions stated in the credit should be met, and hence that the documents presented must be in conformity with the stipulations in the credit.

If the documents appear to contain discrepancies that have a direct impact on the applicant's possibility to take possession of the goods or that weaken his position in relation to the transaction entered into, then it is understandable if he does not approve the documents.

The following examples illustrate some of the causes for refusal:

- An importer of Christmas decorations arranges for the issuance of a documentary credit indicating 15 October as the date of shipment in order for the goods to arrive at their destination in good time before Christmas. If the documents then show that they have been shipped as late as 15 November, it is not surprising if the applicant is unwilling to pay for the documents, since the goods will arrive too late for that year's Christmas. The same is true of fashion or seasonal clothing: if the clothes cannot be sold at the time planned, their value will have decreased or they may even have become worthless.
- A delay in the delivery of components to be used for manufacturing purposes may cause a delay in the applicant's production of goods.
- Erroneous specifications of size, alloy or the like regarding machine components may be so significant that the applicant cannot use the components at all.
- A higher price than that agreed may render it impossible for the applicant to sell the goods or he will make a negligible profit.
- Shipment of the goods to a different destination may entail a

bigger risk or higher costs and/or delays for the applicant than were foreseen or covered by the insurance.

These and many other discrepancies are likely to cause the documents to be refused. Furthermore, they may, outside the sphere of the documentary credit, give rise to claims for damages raised against the beneficiary on account of his non-fulfilment of the contract.

Deficiencies in goods

Even if Article 5 clearly states that in credit operations all parties concerned deal with documents, and not with goods, it is beyond doubt that delivery of the right goods is the most essential aspect to the buyer. If, before the arrival of the documents, it comes to the applicant's knowledge or he has reason to believe that the goods dispatched are not in conformity with the agreement, for instance because they may be of poorer quality than ordered or have even perished, he will often avail himself of the possibility to refuse the documents if they are discrepant.

In this case the reason for refusal is the condition of the goods. However, as the credit does not deal with goods, the refusal can only be justified by discrepancies found in the documents presented, even if they may be of no actual significance.

The market price has fallen

World market prices of certain goods fluctuate widely, and sometimes the applicant is tempted to refuse non-complying documents for the only purpose of buying the same goods elsewhere at a lower price. This does not typically occur with goods specially produced to the buyer or for goods manufactured as branded goods, but is likely to happen with bulk goods like oil, grain, chemicals, sugar, fertilisers, frozen chicken, metals and ore.

Especially in times of crisis and during periods of slumping prices for the relevant goods, banks regularly experience that documents are refused against that background, although the reason stated is discrepant documents.

When it is a buyer's market, some applicants will breach a contract entered into or strain a long-standing business relationship, while other applicants will ignore the fact that they do not observe good business practice when they have transacted with someone with whom they have not yet built firm trade relations.

The buyer's philosophy seems to be that, with a market being a buyer's market, the seller will "forget the matter" later and want to do business again.

The nature of the discrepancy has no influence on the cause for refusal, but is only used as a formal reason in a documentary credit context.

The applicant does not want the goods

The buyer may regret having entered into the business deal. However, having had a documentary credit issued, he must realise that he cannot have it cancelled, and hence the order, without the seller's consent.

Failing the attempt to cancel the contract, or in case the buyer has not even tried because he is convinced that the seller will not consent, the beneficiary faces the risk that the applicant, to avoid having to pay for the goods, will exploit a discrepancy in the presented documents to refuse them.

There may be several reasons for the buyer to regret his purchase. The technological development is fast and the buyer may believe that the goods ordered are already obsolete, even before he can sell them. This is particularly the case with electronic equipment. Also economic recession in the buyer's country may considerably weaken his opportunities to sell, notably luxury, goods. A strong devaluation in the buyer's country has the same effect: goods bought in foreign currency may become so expensive when paid for in the local currency that it is practically impossible to sell them.

An exporter who experiences a situation where the applicant wants to cancel the order and hence the credit, or who becomes aware of a circumstance like those mentioned above in the buyer's country, should realise that the risk of refusal has grown substantially. In such situations, in particular, the beneficiary should do his utmost to fulfil the requirements of the credit.

The nature of the discrepancy has no bearing on the cause of refusal but is only used as the reason put forward in the context of the documentary credit.

The applicant demands an unfounded reduction in price

In rare cases the applicant exploits the discrepancies to refuse the documents, not because he does not want the goods or something is wrong with them or the price is unreasonable. Quite cynically, the applicant simply reckons that he can obtain a price reduction if the credit is cancelled. The applicant knows it will entail extra costs for either the beneficiary or one of the banks involved if payment is refused, and hence, he expects, usually rightly so, to be able to save money.

The nature of the discrepancy has no bearing on the cause of refusal but is only used as the reason put forward in the context of the documentary credit.

The applicant cannot pay

In order to secure payment to the beneficiary (the seller) of the goods shipped, a bank has issued a credit that is quite independent of the applicant's (the buyer's) ability and willingness to pay.

The separate payment undertaking of the bank is described in Articles 4(a) and 7. However, it cannot be questioned that the bank has assumed such undertaking on the basis of the applicant's request and obligation to reimburse the bank for its payments. If the applicant under the credit has gone bankrupt at some time before the issuing bank has received the documents, or his capacity to pay has otherwise significantly weakened, the issuing bank will have to realise that it must pay, even if it cannot be reimbursed by the applicant.

In this situation the issuing bank is likely, at its own accord, to refuse documents that are non-complying.

Even if the issuing bank is partially secured by a charge over the goods, the bank will seldom accept and pay for the documents if it is able to refuse the documents in accordance with the UCP 600. A sale of the goods will hardly cover the bank's payments, and the bank will usually not be interested in getting involved in the goods transaction itself.

In recent years the documentary credit world has seen that banks, particularly from some Asian countries (but not only from that area), try to refuse documents on grounds that seem inconsistent with the wording of the credit or the UCP 600, not to mention the spirit of the documentary credit.

The nature of the discrepancy has no bearing on the cause of refusal but is only used as the reason put forward in the context of the documentary credit.

17.2 UCP 600 provisions on refusal of a presentation

For the purpose of emphasising the role of documentary credits as an instrument of payment and to point out that credits deal with documents alone, and not with goods, the UCP 600 contains precise rules in Article 14(a) and (b) governing the conduct of banks, notably issuing banks and confirming banks, when they receive documents.

While Article 7(c) describes the issuing bank's duty to reimburse the nominated bank for its payments when honouring or negotiating complying documents, Article 14(a) mentions the obligation of banks to determine on the basis of the documents alone whether or not they are in compliance with the terms and conditions of the credit. Article 16(a) pinpoints the right of the banks to refuse to take up documents that are non-complying.

The issuing bank decides

Article 16 also underlines that the bank determines whether or not the documents are complying, and Article 16(b) allows the issuing bank to approach the applicant for a waiver of the discrepancies.

This article is important as regards the decision whether or not non-complying documents are to be accepted. The text of the article underlines that it is the issuing bank that makes the decision. The bank may leave the approval to the applicant but is not under an obligation to do so. Nevertheless, even if the applicant approves discrepant documents, it is still the issuing bank that is to determine whether they are to be accepted or refused. The issuing bank must make the decision and notify the presenting bank or the beneficiary accordingly within the period stated in Article 14(b) (“... maximum of five banking days...”).

Although the issuing bank has the right to make the decision on refusal, if any, it will seldom make such decision against the applicant's wish. It is difficult to imagine a bank refusing documents that the applicant needs in order to fulfil the commercial contract. This would damage the relationship with the customer and a claim for damages might ensue.

The main reason why the UCP 600 allows the issuing bank the right to make this essential decision is that a documentary credit constitutes a separate undertaking by the issuing bank in which the applicant takes no part from a documentary credit point of view. If the applicant, in the opinion of the issuing bank, cannot fulfil his payment undertaking under the credit, the issuing bank may refuse the documents to avoid assuming a payment undertaking under a credit where the documents are non-conforming.

UCP 600 procedure for refusal

The international rules prescribe that refusals must follow the guidelines set. This is to ensure that banks adhere to good practice when they refuse documents under a credit, and to prevent the issuing bank from safeguarding its own and the applicant's interests to an unreasonable extent to the detriment of the beneficiary and the bank that honoured the credit trusting the payment undertaking inherent in the credit.

The rules in Article 16(c) outline the procedure for refusing documents and the consequences of not complying with the rules are dealt with in Article 16(f). The procedure is described in great detail, and the issuing bank or the confirming bank is expected to strictly adhere to the rules when refusing the documents presented.

Having decided to refuse the documents, the bank must do so not later than at the closing of the fifth banking day following the day when it received the presentation. The UCP 600 Article 14(b) clearly states that the number of days is a maximum, which is underlined by the fact that the wording "without delay" used in the UCP 500 has not been used.

The notice of refusal must be given by telecommunication, if possible. Bank-to-bank communication is usually effected via SWIFT or telex, while messages from the confirming bank to the

beneficiary are usually conveyed by telephone or fax. If it is not possible to use any form of telecommunication, the bank must give notification “by other expeditious means”. The message must also clearly state that the presentation is refused (Article 16(c)(i)).

The main reason why the notice of refusal must be given by telecommunication is that the beneficiary should be allowed time to present new or corrected documents.

The beneficiary has an undisputed right to present new or corrected documents in replacement of the discrepant ones before the expiry of the credit and the time period for presentation.

If it is not possible to re-present the documents, the beneficiary or the honouring or negotiating bank must, if possible, be able to get access to the goods.

The UCP 600 rules are strict on the bank refusing documents under a documentary credit in terms of adhering to time limits and the means of communication. In addition, Article 16(c)(ii) stipulates that the bank must state all discrepancies on the basis of which it refuses the documents.

The issuing bank must also state how it deals with the presentation.

The bank may:

- hold the documents pending further instructions from the presenter
- hold the documents until it receives a waiver from the applicant and it agrees to accept the waiver or receives further instructions from the presenter before it accepts a waiver from the applicant
- return the documents to the presenter
- act in accordance with instructions previously received from the presenter.

As a consequence of this rule, the issuing bank or the confirming bank cannot put forward further reasons for refusal after having sent its first advice of refusal. This situation could arise if the reasons for refusal stated turn out to be unjustified.

The article states that documents refused belong to neither the buyer nor the issuing bank and thus, they cannot use them to get

access to or to inspect the goods. The documents belong to the party who has presented them to the bank.

Article 16(g) states the obvious fact that the issuing bank or the confirming bank, as the case may be, is entitled to claim from the nominated bank a refund, including interest, of any reimbursement which has been made to the nominated bank in accordance with the conditions of the credit.

17.3 Consequences of refusal

Trusting the payment undertaking inherent in the documentary credit as well as the applicant's willingness to pay, the beneficiary has shipped the goods, and the nominated bank expects payment to be made under the credit, either because it has accepted the documents or because, having consulted with the beneficiary, it trusts the applicant's willingness to approve the documents.

The consequence of refusing documents is indisputable: no payment will be made under the credit.

Who bears the risk of loss?

If the seller has shipped the goods and payment is not effected under the credit, because the documents are non-complying, the seller still has a claim against the buyer according to the purchase agreement entered into. We will not discuss this matter here, but only deal with non-payment and hence the loss under the credit.

In the first instance refusal of documents will imply that the bank remitting the documents either to the confirming bank or to the issuing bank does not receive the money.

The nominated bank has not honoured

If the nominated bank has not honoured or negotiated the documents under the credit and thus has not paid any money to the beneficiary or promised to pay, the bank will not suffer a loss. The loss will be borne by the beneficiary alone. The reason for the bank's non-payment may be that it cannot accept the documents presented or that it does not want to effect payment under a credit which it has not confirmed because it does not know or trust the issuing bank.

However, there are exceptions, in that an increasing number

of banks, including most of the Nordic banks, take the view that according to Article 15(c), the nominated bank is responsible for the approval of documents which it has examined, except for the discrepancies the nominated bank has ascertained and of which it has notified the beneficiary.

The nominated bank has honoured the documents

Refusals are very often made under credits honoured by the nominated bank and where settlement has been made in favour of the beneficiary.

In this situation it must be clarified whether the beneficiary or the honouring or negotiating bank is to bear the loss.

The honouring or negotiating bank has not found any discrepancies

If the beneficiary receives payment from the honouring or negotiating bank for documents presented, and the bank has not made any objections as to the documents presented, the beneficiary will expect that the documents are complying.

In this case there is no difference between a confirmed and an unconfirmed credit.

If the bank does not notify the beneficiary within the time allowed for refusal (Article 14(b)) that the documents are not acceptable, the risk that documents are refused by the issuing bank will pass to the nominated bank.

According to the general view today, this also applies to credits available by negotiation, but it cannot be ruled out that some banks still believe that the recourse includes refusal due to discrepancies ascertained by the issuing bank but not pointed out by the nominated bank (see Credit available by negotiation in Chapter 8.5).

In order to avoid a situation where the bank incurs a loss resulting from a refusal due to minor inaccuracies in documents, which the nominated bank did not regard as actual discrepancies, a large number of banks state such inaccuracies as actual discrepancies in their settlement notes.

Settlement made under reserve

If the honouring or negotiating bank has found discrepancies in the documents presented, and the bank has agreed with the beneficiary to make settlement under reserve (see Settlement under reserve in Chapter 16.2), the beneficiary must bear the loss arising as a result of the issuing bank's refusal of the presentation.

As mentioned in Scope of the settlement under reserve in Chapter 16.2, banks take different views as regards the scope of the settlement under reserve. In the view of most Nordic banks the beneficiary must bear the loss only if the refusal is founded on one or more discrepancies stated in the advice of settlement under reserve.

What happens to the goods?

As mentioned in UCP 600 procedure for refusal in Chapter 17.2, the documents must not be used by the applicant or the issuing bank as they belong to the beneficiary or the honouring or negotiating bank. Of course, they belong to the beneficiary if he is to bear the loss, while the right to the documents will have passed to the honouring or negotiating bank if it has effected payment and thereby has to bear the loss.

The same applies to the goods, although subject to the limitation inherent in the difficulty in securing goods that have already been handed over to the buyer or any other consignee. In case the applicant is insolvent and the goods have been handed over to him, they may be considered of no value to their rightful owner.

If the issuing bank has contributed to the goods being handed over to the applicant, the bank is presumed to be under an obligation to either accept the documents or indemnify the rightful owner of the goods. If the documents have been refused, the beneficiary or the nominated bank will, as far as possible, ensure the goods for itself to limit its loss.

If the owner of the goods does not take action fast enough, he will face the risk that the customs authorities at the destination sell the goods by auction to provide money for storage and to secure adequate room in the customs warehouse. The time limits vary among the countries.

There are different possibilities of taking possession of the goods. If none of them can be used, the goods must be regarded as lost and have to be destroyed or otherwise disposed of.

A loss is expected to be incurred if the goods have to be sold outside the usual channels, and so banks have often ascertained that the value of goods has slumped when they are to sell a consignment of goods.

The goods are sold to a third party

Unless the goods have been manufactured for a specific buyer, there will often be other potential buyers. It is generally advantageous for the owner to sell the goods to another buyer in the same city or country or at least not too far away, thereby saving costs of freight and insurance.

If the honouring or negotiating bank owns the goods, it may ask the beneficiary to assist it in selling them as he will usually have business contacts within the relevant sector. Or the bank may choose to arrange for the sale itself, perhaps through a broker.

The goods are sold by auction

Where the goods are of a general nature, such as branded goods or bulk goods, the sale can also take place by auction. It is possible that the owner thereby obtains a better price, but an important aspect is whether there is a market for the goods at the destination or they will have to be transported elsewhere, entailing further costs of freight and insurance.

The goods are returned to the seller's place

If a sale cannot be effected on reasonable terms at the destination, the beneficiary may contemplate whether to take back the goods even if he incurs costs of freight and insurance. Being the owner of the goods, the beneficiary may choose to sell part of the goods or all of them to a third party at a later point in time, perhaps after having modified them to suit the new buyer.

If the bank has title to the goods, the beneficiary may buy them back at a price to be agreed between the parties.

Chapter 18

Solving conflicts

One would assume that, with its detailed description of credits and the most common documents used, the UCP 600, as the name Uniform Customs and Practice for Documentary Credits suggests, enables the checking of documents in a standardised manner so as to avoid different interpretations of credits and of the rules.

The word “uniform” does indeed have this aim. The intention is further supported by the wording of Article 14(a) prescribing that 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. Whether or not they are conforming will be determined by international standard banking practice as reflected in these articles.

To underline the importance of uniformity in the examination of documents the ICC Banking Commission already in 2002 (referring to the UCP 500) issued a publication (No. 645) with the title *International Standard Banking Practice (ISBP)* which covered several points not described in the UCP 500, but what a banker should be aware of when examining a presentation. The ISBP is not to be regarded as a set of new rules; it is a clarification and a kind of supplement based on the practice internationally known and ICC opinions, especially regarding details not specifically mentioned in the UCP. The ISBP has been revised to fit the UCP 600, ICC Publication No. 681.

As indicated by the name of the UCP 600, the rules reflect customs and practice and so they do not constitute legislation (for further details, see Chapter 5 Governing law and rules for documentary credits). As a consequence, some customs may be changed in the course of time and, unfortunately, they may also differ in various geographical areas despite the ICC’s endeavours to counteract such local practice.

Even legislation may be construed in different ways so that interpretations will have to be tested in court to attain a final decision. Correspondingly, one has to accept a certain need to interpret the UCP 600. Although it is regrettable, it is also understandable that the interpretation of a credit, the international rules and documents can result in disagreement between different parties under the documentary credit, and these disagreements will have to be solved on the basis of the possibilities available.

18.1 Guidelines issued by the ICC

Throughout the years the ICC Banking Commission has drawn up and published different versions of the UCP. In addition, the Commission has for several decades offered its interpretation of specific as well as general questions of doubt regarding documentary credits and/or documents.

Queries

A bank or any other party under the relevant credit may send queries, which must concern matters of principle, direct or through the ICC's national committees to the ICC Banking Commission in Paris. The ICC Banking Commission will not answer specific questions relating to an ongoing conflict between parties (see, however, the description of DOCDEX and expert solutions through the Centre for Expertise in Chapter 18.5).

The Banking Commission has performed this task using different procedures throughout the years. At present a query will first be dealt with by the appointed technical adviser, who is the Commission's technical expert and adviser to its officers. When the technical adviser has considered the matter, he will give his opinion direct to the enquiring party, subject to the reservation that the reply is not final until it has been approved by the Banking Commission. At its next meeting the members of the Commission will discuss all the technical queries, after which the enquirer will receive the ICC Banking Commission's final interpretation of the rules in relation to the specific query.

Opinions and interpretations by the Banking Commission do not, and are not to be considered to, constitute any change of or supplement to the UCP applicable.

Any opinion given by the Commission merely reflects its interpretation on the basis of the question asked.

The Commission's answers, termed "opinions", have no legally binding effect but are regarded worldwide as guidance on the interpretation of documentary credit problems. Not all of these opinions are published (see Publications in this chapter), but of course, they are all known to the members of the Commission.

The ICC's opinions mirror the attitudes and circumstances prevailing at the time when they are given and so one interpretation of a query on documentary credits may modify an opinion provided earlier.

A large number of the opinions given refer direct to a particular version of the UCP, while other queries of a more general nature also apply to later versions. Consequently, a query and the answer to it should always be read in conjunction with the wording of the rules.

Position papers

No position paper has yet been issued by the ICC Banking Commission regarding the UCP 600.

Shortly after the UCP 500 came into force, the ICC published four position papers trying to explain some of the articles/wording of the UCP 500. The position papers were not approved by the Banking Commission, but were prepared by some members of the revision group.

These position papers are not applicable under the UCP 600.

Decisions

No decision has yet being issued by the ICC Banking Commission regarding the UCP 600.

As regards the UCP 500, the Banking Commission has published two decisions.

The European single currency (euro)

In April 1998 the Banking Commission issued its decision *The impact of the European single currency (euro) on monetary obligations related to transactions involving ICC Rules* (document 470/822). The decision outlines the rules as to documents issued and payable before 1 January 1999 and during the transition period from 1 January 1999 to 1 January 2002, as well as after that period, describing how they may be denominated either in euro or in national currency.

In principle the decision is still valid, but seems not to be relevant any more.

Original documents

Following several years of discussions both in and outside the ICC Banking Commission, during which the Commission had answered a number of queries, and also based on the judgments passed by courts concerning the interpretation of what is an “original” document under a documentary credit, the Banking Commission in July 1999 issued its decision *The determination of an “original” document in the context of UCP 500*. This decision provides a lucid interpretation of the UCP 500, Article 20, emphasising that the decision does not amend, but merely indicates the correct interpretation of the UCP 500.

The decision has no value anymore since the principles are fully included in the UCP 600 as Article 17 and is fully covered in the ISBP.

Publications

In order to make the Banking Commission’s interpretations more widely known, the ICC regularly publishes them in the form of books. These books are available from the ICC in Paris and the ICC’s national committees in various countries.

In September 2000 the ICC, in a project sponsored by the European Commission and with the support of three business partners, introduced a new online service making all of its documentary credit information available on the Internet. This service is called DC-PRO and will be sold on an annual subscription basis to banks, companies and individuals alike. Among other texts, DC-PRO includes:

- all ICC rules (UCP 600 documentary credit rules, URC 522 collections, URR 525 bank-to-bank reimbursements, URDG 458 Demand Guarantees and DOCDEX decisions)
- all published ICC Banking Commission opinions on documentary credits as well as a number of unpublished queries
- legal cases on documentary credits going back 20 years
- all issues of the ICC’s newsletter DCInsight.

In addition, subscribers will have the opportunity to discuss technical issues with other subscribers.

18.2 Negotiation between the parties

Despite the high level of detail in the UCP rules, they are often interpreted in different ways and the parties cannot always agree whether or not the presentation complies with the conditions in the credit. In the first instance the parties will usually seek to reach a decision by way of argumentation. Each party will base his arguments on his knowledge and experience, and sometimes they will include previous opinions made by the ICC in their discussions.

If these arguments do not lead to clarification, each party may appeal to his counterparty and on the strength of their business relationship they may find a solution to the problem.

By far the majority of disagreements are solved by way of negotiation – either between two banks or between a bank and its customer. This is because the parties usually want to do business with each other afterwards as well and, furthermore, it takes time and money to have an impartial body to resolve the dispute.

18.3 Court decisions

As in all other cases, whether or not they concern documentary credits: if negotiations prove fruitless, the parties can bring the matter before a court to have it decide who is in the right.

Relatively few disputes concerning documentary credits are settled through the courts as it usually takes a long time before a decision is reached and, in addition, legal proceedings are costly. Banks, in particular, will only choose this solution if large amounts of money are involved or in matters of principle which are important to the banks to have determined.

Both parties need not consent to have the case heard by a court as either party may take the matter to court.

The first question that arises is which court is to hear the case and what country's laws should form the basis of the judgment.

The UCP 600 does not mention anything, and only few commercial documentary credits contain a stipulation about this. This could be explained by the general attitude that the credit should be handled in accordance with the international rules, which are incorporated into the wording of the credit by the stipulation that it is subject to the UCP 600.

Usually a court in the country where the credit is available, that is where the documents are to be presented with binding effect, will be considered as the court that is to pass judgment.

However, there are examples where such courts have refused to hear the case and where a court in another country has accepted the case on the grounds that, for instance, the beneficiary or the nominated bank cannot expect fair litigation from a court in the nominated bank's country.

Unless otherwise stipulated in the credit, the courts themselves will determine what country's laws are to be applicable, and they will usually base their decisions on the international rules and on the ICC's opinions to the extent that they are relevant. In addition to the UCP 600, the laws of the country and the judge's evaluation of the matter will form the basis of the hearing of the case and judgment.

Sometimes the court or the parties themselves will call technical experts to hear their opinion about the technical issue of the matter. They are not to make any statements as to the process of the specific credit transaction.

As appears from Article 4, credits are separate transactions from any underlying contracts, but the underlying business relationship is often drawn into the case. It is the judge alone who decides what is relevant.

Many judges and lawyers have little knowledge of documentary credits and their function. Consequently, decisions sometimes do not follow common practice for documentary credits, in particular in courts of first instance.

These decisions may well solve a particular problem, but they do cause confusion among bankers handling documentary credits if such decisions become known and are referred to by other users of credits.

It is thus open to discussion whether a court decision on a documentary credit transaction should influence the future examination of documents by banks, or whether such decision should be restricted to apply to the relevant transaction only.

The banks' practice should preferably build on the ICC's opinions as they are based on the UCP 600 and have been made by bankers with vast experience in documentary credits.

The decision by a court is binding and can be executed directly or with the assistance of a sheriff if the counterparty does not adhere to the judgment.

18.4 Arbitration

Instead of obtaining a court decision the parties may choose to submit the dispute to arbitration.

There are several international institutions that can give arbitration awards. ICC International Court of Arbitration in Paris is among the most well-known and frequently used. In the USA there is a fairly new, and hence not yet so well-known, arbitration tribunal: the International Centre for Letter of Credit Arbitration, Inc. (ICLOCA). This tribunal was established in 1996 and follows the UNCITRAL Rules for Arbitration drawn up by the United Nations.

The disadvantages of tribunal awards are virtually the same as those of court decisions. It may take a long time and the costs are comparable.

The most significant advantage of using an arbitration tribunal rather than an ordinary court of law is that both parties may appoint documentary credit experts who will make the decision together with the arbitrator. Hence, the parties are assured that the decision is to a higher extent based on expert know-how. Furthermore, the tribunal may summon experts as witnesses.

Another advantage is that decisions are not published and hence, the parties do not have to exhibit their disagreement to the public.

As with court decisions, an arbitration award has binding effect and can be executed.

18.5 Expert decisions

If the parties in a dispute concerning a documentary credit matter do not wish to submit the case to a court or an arbitration tribunal, they may opt to have an impartial third party, a documentary credit expert, settle the dispute. A decision by such expert will be binding on the parties only if they agree to it. Otherwise, the matter can still be brought before a court or an arbitration tribunal.

The International Chamber of Commerce (ICC)

The ICC is renowned for its arbitration tribunal, while it is less known that there are several other possibilities under the ICC arbitration body to obtain a non-binding decision by experts.

International Centre for Expertise (ICC)

The ICC International Centre for Expertise is situated in Paris and forms part of ICC International Court of Arbitration.

The centre is prepared to offer services in all fields and has been involved in several documentary credit disputes.

The rules of the International Centre for Expertise are available from the ICC's national committees.

Any of the parties may approach the International Centre for Expertise with their problem, after which the centre will choose an impartial expert to be approved by the parties, or the parties may themselves appoint the expert.

The parties will describe the disagreement in outline, and the expert will base his decision on the explanations of all of the parties as well as on the credit and the relevant documents.

The decision is made quickly and the costs involved are fairly small. As mentioned, the decision is not binding but it is likely to be included as evidence or documentation if the matter is referred to a court or an arbitration tribunal.

ICC DOCDEX Rules

As appears from the description under International Centre for Expertise, this institution is not particularly geared for settling documentary credit disputes. Therefore, the ICC Banking Commission, together with ICC International Court of Arbitration, has drawn up a special set of rules for documentary credits, *Rules for Documentary Instruments Dispute Resolution Expertise*, specially adapted to resolve disagreements over documentary credits as regards their interpretation. The rules took effect in 1997 and have already been used several times. The rules were revised with effect from 15 March 2002 (Publication 811).

According to the principles of the expert decision, it is made in the name of the ICC and the names of the experts are not known to

the parties involved; nor will they be released later on. The ICC will appoint three independent experts who will make their decision. This decision will be considered by the ICC Banking Commission's technical adviser to ensure that it is in line with the other opinions of the ICC.

All, or some, of the parties will approach the ICC submitting the documentation required. The parties do not have any contact with the experts.

The decision will be made exclusively on the basis of the material provided by the parties, including their arguments.

The decision is made quickly and the costs involved are fairly small (at present USD 5,000 and for complicated matters exceeding USD 100,000, this amount may be increased by a maximum of USD 5,000). As with the rules of the International Centre for Expertise, the decision is not binding on the parties, but will even more likely be included as evidence or documentation if the matter is referred to a court or an arbitration tribunal.

Other expert decisions

If the parties want to make use of a decision by experts, they do not have to use the ICC's rules or the ICC as an institution.

Any expert trusted by the parties may provide an opinion, and thus, many disputes can be solved just over the telephone. Often it is a question of genuine willingness to have the problem solved.

Many internationally renowned bankers concerned with documentary credits contribute to this type of advisory service and decisions by experts, without anybody knowing about it.

Chapter 19

Third party's security under a credit

As reflected in the principle behind documentary credits and in the UCP 600, the credit implies an undertaking for the issuing bank to pay a specific amount to the beneficiary when he presents complying documents. The terms of payment are contained in the credit itself and in the international rules. A corresponding undertaking also exists for the confirming bank, if any.

This implies that only the beneficiary is entitled to demand payment under the credit and to present documents resulting in payment.

If the beneficiary has assumed a payment undertaking towards a third party, it is the beneficiary's duty to effect payment, for instance when he has received settlement under the credit. This principle applies whether or not the beneficiary's payment undertaking relates to the credit transaction or to an ordinary debt obligation.

Although the main purpose of the documentary credit is to provide security for the beneficiary and not for a third party, the use of credits provides different possibilities of securing a third party to some extent, provided that the terms and conditions of the credit are met. Some of these possibilities arise out of the UCP 600, while others are based on the individual terms in the credit itself or on general business principles or legislation.

Most of the requirements concerning the third party's security under a credit seem to result from the business transaction covered by the credit.

This is typically the case, for instance, where the beneficiary under a credit is not the manufacturer of the goods or an actual supplier, but has to buy the goods from the manufacturer or a subsupplier. In this situation there may be a need for the beneficiary to provide security towards the supplier, either by way of a documentary credit or in another form acceptable to the third party.

If the beneficiary is the manufacturer of the goods to be shipped under the credit, he may need to raise a loan from his bank with which to buy raw materials, pay wages etc. Payment under the credit will not take place until the documents are presented, typically after dispatch of the goods. The lending bank may then want to have some kind of security for the loan granted, for instance security in the documentary credit.

The credit instrument cannot be considered as security on its own, see the remark above that only the beneficiary can demand payment under the credit. The credit is not a negotiable instrument, and consequently the special rules in this connection will have to be complied with. Throughout the years various possibilities have evolved for using the credit as security, full or partial, towards a third party, irrespective of the independent nature of the documentary credit.

The different methods of using the credit to provide security may be grouped into four different categories:

- inserting a special clause in the wording of the credit ("red clause" and "green clause")
- the UCP 600 (transferring the credit)
- the issuing bank's payment undertaking (back-to-back credit)
- local laws and practice (assignment and payment order).

These methods provide different types of security and also the degree of security varies.

The party requiring or receiving security in a documentary credit with another party as beneficiary should assess the adequacy of the type of security offered and ask for additional security, if necessary.

19.1 Red clause credit

Neither the UCP 600 nor any of the earlier versions of the international rules contains special provisions concerning this type of credit, the name of which denotes that a special clause in the credit used to be highlighted in red ink to underpin its importance.

The red clause credit is said to originate from Australia and/or New Zealand and was specially designed to be used for trading in wool.

The wool exporter (the beneficiary) had to buy the wool from local sheep farmers before he could ship the wool and hence obtain payment under the credit. Often the beneficiary did not have the necessary funds to buy the wool and, therefore, asked the buyer (the applicant) for an advance payment.

Sometimes the applicant would accommodate the beneficiary's wish by, for instance, inserting a clause into the credit giving the beneficiary an opportunity to obtain an advance payment specified as, say, 30%.

The nominated bank was authorised to effect such payment against the presentation of the beneficiary's receipt and statement that he would present complying documents before the expiry of the credit. On the presentation of the documents, the advance would be deducted from the payment. The issuing bank guaranteed reimbursing the nominated bank for its payment plus interest. The clause in the credit could read as follows:

The beneficiary may ask for an advance of up to X% of the credit amount in order to make it possible to purchase the (goods). The nominated bank may make such advance against the beneficiary's receipt and declaration stating that he will present documents in compliance with the stipulations of this documentary credit before the expiration.

.....

The advance, including interest, is to be deducted from the proceeds of the negotiation/payment under this credit.

.....

We (the issuing bank) undertake to reimburse the nominated bank in case the amount advanced should not be repaid. All advances must be notified to us"

As this clause was fairly unusual, it became common to highlight it in red ink, hence the name.

The advance payment enabled the beneficiary to buy the wool and collect, pack and ship it by the first ship available. He would then present the usual documents and receive the balance due to him.

According to the wording of the clause, the nominated bank can be certain to be able to demand payment from the issuing bank, should the beneficiary fail to present the documents after shipment of the goods, or if the documents do not conform to the stipulations in the credit. Thus, the issuing bank bears the risk of loss, but has in turn secured its payment according to the applicant's reimbursement undertaking.

This form of credit is used even today, not just for wool, but for any type of goods, especially in Asian countries, in cases where the applicant is willing to take the risk of the beneficiary's non-fulfilment of his undertaking to deliver the goods.

19.2 Green clause credit

Both the name and function are almost similar to those of the red clause credit, and it may be regarded as a variant of that form of credit. There is no evidence indicating whether the clause was originally written in green ink or whether the name reflects a wish to attach an association to the well-known “relative”, the red clause. Undoubtedly, however, this clause was highlighted too because of its significance. It is not evident from which geographical area this form of credit derives, although tradition has it that it was used by buyers of wool in Australia and New Zealand. Perhaps both forms of credit were used in parallel.

As with the red clause credit, the purpose of the green one was to enable the beneficiary to obtain an advance payment based on the wording of the credit. Also the need to be paid in advance was the same as with the red clause: the beneficiary was enabled to buy the goods that were to be shipped under the credit.

The difference between the green and the red clauses is the security provided in the goods.

Under a credit with a green clause the beneficiary was to present a receipt for the goods in addition to a receipt for payment and the statement that he would repay the amount, should complying documents not be presented in due time under the credit. The receipt, a warehouse receipt, was to be issued by a warehouse independent of the beneficiary, and the nominated bank would usually be indicated as the party to take possession of the goods. When all the goods to be shipped had been bought, they could be shipped in one batch, and the warehouse receipt was exchanged for a bill of lading to be presented under the credit.

On the strength of the clause, the nominated bank effecting payment can demand reimbursement of its payment and interest from the issuing bank, should the beneficiary fail to present complying documents.

As opposed to the red clause, the green clause provides more security to the issuing bank, and hence the applicant, as they will have access to the goods by presenting the warehouse receipt.

The green clause constitutes a condition in the credit for which the issuing bank is responsible. Accordingly, that bank will also bear

the risk of loss if the credit is misused by the beneficiary. In the last instance the applicant is liable towards the issuing bank.

19.3 Transferable credit

The UCP 600 mentions one possibility of using the credit as security to a third party. It is a condition for the provision of security that the third party is a subsupplier and hence is to supply the specific goods covered by the credit. What constitutes the security is that the subsupplier is able to present his own documents, thereby obtaining the same security for payment as the beneficiary of the credit. Thus, the security comprises a credit in the subsupplier's own name, and so the subsupplier does not have to rely on a bank's undertaking under a credit in favour of his buyer (the beneficiary under the credit).

Transferring a credit may be a suitable method in cases where the beneficiary cannot or does not want to provide the security required in order to have a credit issued in favour of the subsupplier or if he cannot induce the applicant (the ultimate buyer) to make the advance payment required without the beneficiary having to provide security for such advance.

When a credit is transferred from a beneficiary (the first beneficiary) to his subsupplier (the second beneficiary), the UCP 600 allows the second beneficiary to present the stipulated documents and obtain payment on the same terms and conditions as the first beneficiary.

By using the ordinary non-transferable credit, both the applicant and the issuing bank know that only the beneficiary can present documents and that the beneficiary is the seller of the goods to the buyer.

In the case of a transferred credit the shipment is made by a third party, who is often unknown to the applicant. Consequently, the UCP 600 prescribes, in Article 38, on what conditions such transfer can be made, stating the special rules applicable. It is important to note that there is only one credit, even if it sometimes looks as if there are two independent instruments because of the way the transferable credit functions.

The beneficiary often insists that the identity of his subsupplier is not disclosed to the buyer and vice versa. Being the company

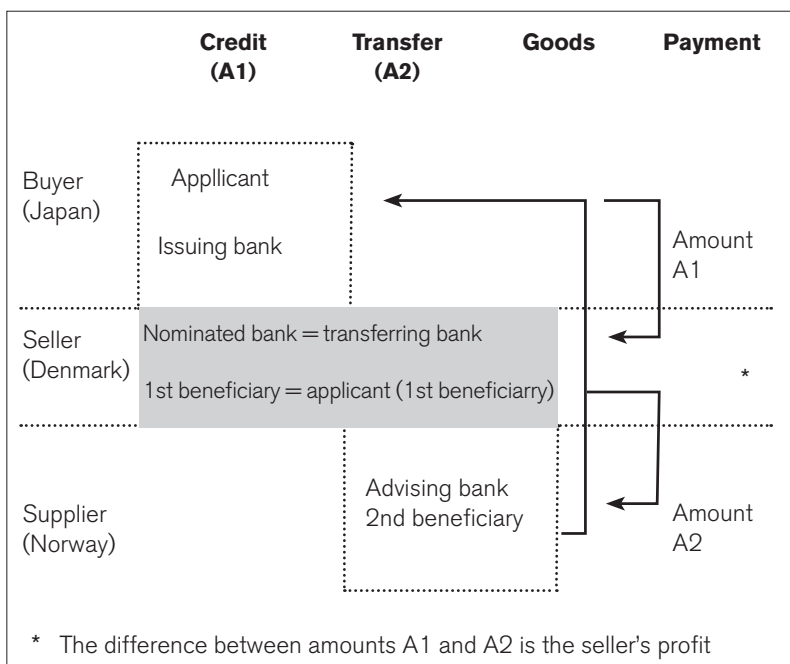


Figure 6

in between two other parties, the beneficiary naturally does not want those parties to be able to transact business direct with each other, bypassing him. Likewise, the beneficiary will usually endeavour to ensure that the buyer does not know the price of the goods payable by the beneficiary to the subsupplier, just as the subsupplier is not supposed to know the sales price payable by the ultimate buyer.

In other situations all the parties to a transaction as well as the prices are known to all the parties involved, and the credit is transferred for technical reasons relating to credits and to the relevant business transaction.

Provided that the conditions of the credit and the UCP 600 rules are strictly complied with, notably Article 38, the transferring of a credit does not involve a credit risk for the transferring bank. On the other hand, the bank has a significant handling risk due to the more complex structure of the credit and the business transaction.

Even though the bank does not assume any credit risk, the transferring bank is considered an important party to the transaction. In order to avoid getting involved in mysterious or unethical transactions, many banks will only transfer credits at the request of

their own customers and on behalf of companies the ethical standards of which they rate high.

As mentioned, due to its structure the transferred credit is often regarded as being two closely connected instruments rather than one. It is understood to be two credits where the beneficiary of credit (A1), in a transferred credit termed the first beneficiary, becomes the “applicant” under the transferred credit (A2).

Similarly, the nominated and the transferring bank of credit (A1) are regarded as a kind of issuing bank for the credit transferred (A2) in favour of the subsupplier, who becomes the second beneficiary (see Figure 6).

The first beneficiary is sometimes referred to as “the company in the middle”.

Conditions for the transfer

Upon instructions from the applicant, the issuing bank may make conditions applicable to the transfer. If the credit merely states that it is transferable, the possibilities are limited only by the UCP 600. According to Article 38(b), a credit can be transferred only if it is expressly designated as “transferable” by the issuing bank.

As stated in Article 38(b), only the nominated bank named in the credit may transfer the credit. If the credit is freely negotiable, according to which any bank is a nominated bank (Article 6(a)), only the bank specifically authorised in the credit as a transferring bank may transfer the credit.

It is worth noting that, according to Article 38(a), the transferring bank is under no obligation to effect the transfer and, furthermore, it can determine the conditions itself on which to do so. Many banks will only transfer credits that are available at themselves. Some banks even demand that the credit should be confirmed by them.

Article 38(c) states that the costs incurred in connection with transfers are payable by the first beneficiary, unless otherwise agreed, that is unless it is stated in the credit, and that the transferring bank is entitled to defer the transfer until such costs are paid. This provision concerning commissions, fees and the like is interesting since, otherwise, the UCP 600 does not mention the payment of other documentary credit commissions (see Article 37(c)). This

underlines the fact that a credit is transferred at the request of the first beneficiary, even if the issuing bank has stated in the credit that transfers are allowed.

The credit must not be transferred to a third beneficiary at the request of the second beneficiary. However, as appears from Article 38(d), the second beneficiary may retransfer the credit to the first beneficiary, and then a new transfer may be made to a new second beneficiary.

It is absolutely in accordance with the UCP 600 to transfer fractions of a credit, not exceeding the aggregate amount of the credit, to different second beneficiaries. Combined these transfers will be considered as constituting only one transfer of the credit in accordance with Article 38(d).

As with non-transferable credits, it is sometimes necessary to amend a transferable credit. As mentioned earlier, a credit can be amended only with the agreement of the beneficiary, among others, see Article 10(a).

The fact that several beneficiaries exist after the transfer of a credit has often caused difficulties throughout the years, until the international rules were revised. It is easy to imagine a situation where the second beneficiary does not agree to an amendment requested by the first beneficiary. If the second beneficiary had made arrangements, an amendment of the conditions of the credit could cause losses or restrict his possibilities of presenting complying documents.

Therefore, Article 38(e) prescribes that, before having the credit transferred, the first beneficiary must give the transferring bank irrevocable instructions under which conditions the transferring bank is to advise amendments to the second beneficiary. The transfer must clearly indicate this.

Depending on the instructions from the first beneficiary as to amendments, the value of the credit to the second beneficiary may be reduced. Consequently, as mentioned in the article, the transferring bank is entitled to refuse a request for transfer if it does not agree to the conditions stated by the first beneficiary.

In cases where fractions of a credit are transferred to more than one second beneficiary, each of these second beneficiaries may

accept or reject amendments (Article 38(f)). Such acceptance or rejection will only apply to the relevant fractional transfer and will not affect the fractional transfers made in favour of other second beneficiaries.

If a second beneficiary under a transferred credit does not accept an amendment, the terms and conditions of the original credit (or a credit incorporating previously accepted amendments) will remain in force, as stated in Article 10.

The transfer

If the prerequisites for transferring a credit exist and the transferring bank has agreed to transfer the credit, the transfer can be made. The bank will usually demand a written request from the first beneficiary, stating to whom and on what conditions the credit is to be transferred.

The transfer must be made in compliance with the provisions of the UCP 600 (Article 38(g)).

According to this article, a credit can be transferred only on the terms and conditions specified in the original credit, except as described below:

1. The amount of the credit may be reduced.
2. Any unit price stated in the credit may be reduced.
3. The expiry date may be changed to an earlier date.
4. The period for presenting documents in accordance with Article 43a may be reduced.
5. The latest date for shipment or period for shipment may be reduced.
6. The percentage for which insurance cover must be effected may be increased in such a way as to provide the amount of cover stipulated in the original credit.
7. The name of the first beneficiary in the transfer (A2) may be substituted for that of the applicant in credit (A1). If the name of the applicant is specifically required by the original credit to appear in any document other than the invoice, such requirement must be fulfilled.

This article also states that if a credit is confirmed, the transfer is also confirmed by the same confirming bank.

Whatever the first beneficiary is entitled to change, it is often necessary in order for his contract with the second beneficiary to function properly under the credit without placing the applicant in a weaker position.

In particular the provision that the credit amount and unit price, if any, may be reduced is important to the first beneficiary, who will thereby be allowed to derive a profit from the difference between his purchase price and the selling price to the applicant.

Unless otherwise stated in the credit, the beneficiary may freely choose in whose favour and to what country the credit is to be transferred. In this connection see Article 38(j), according to which the first beneficiary may request that the credit should be made available at the second beneficiary's place, unless expressly prohibited in the original credit.

The possibility to change the place at which the credit is available is definitely an advantage to the second beneficiary, who can then present the documents to his own bank or a bank at his own place with binding effect for the issuing bank.

Presentation of documents after transfer

In order for the first beneficiary to have his profit in the transaction released, he is entitled to substitute his own invoice, which is often for a larger amount, for that of the second beneficiary, provided that the amount of his own invoice does not exceed the original amount of the credit.

The right to exchange the invoices follows from Article 38(h) and also applies to a draft, if any, stipulated in the credit.

According to the wording of this article, the transferring bank must not agree to an exchange of any other documents by the first beneficiary.

If the first beneficiary wishes to exercise his right to exchange invoices (and drafts, if any), he must do so "on first demand". The first beneficiary may utilise this right even if the credit has expired in the meantime because it was made available at the second beneficiary's place.

If the first beneficiary fails to present his invoice (and draft, if any) immediately at the request of the bank – or the presented invoice

does not conform to the credit – the bank may, according to Article 38(i), use all the documents presented by the second beneficiary for honouring or negotiation of the second beneficiary's presentation.

Thereby the transferring bank can demand reimbursement from the issuing bank for its honouring or negotiation, if any. The credit will be utilised and the applicant receives the documents required. This also implies that the second beneficiary's invoice presented under the transfer, often for a lower amount than that of the first beneficiary's invoice, will be used for the presentation to the issuing bank.

If, nevertheless, the first beneficiary believes he is entitled to demand payment of this difference, representing his profit, this must be done outside the credit and hence without involving the banks.

It should be noted that the payment undertaking under the credit remains imposed on the issuing bank and the confirming bank, if any. A transfer of the credit does not entail any payment undertaking for the transferring bank, except for the obligation it assumed when advising the credit to the first beneficiary.

Accordingly, the second beneficiary cannot demand payment from the bank advising the credit to the second beneficiary, nor from the transferring bank, unless any of these have confirmed the credit or have separately assumed a payment undertaking. However, the second beneficiary does have a claim against the issuing bank, provided that he has presented complying documents in due time to the bank where the credit is available. Such claim remains, even if the first beneficiary should act in contravention of the international rules.

It is important to notice that a second beneficiary according to Article 38(k) must present the documents to the transferring bank and not to the issuing bank

19.4 Back-to-back credit

The back-to-back credit does not exist as an instrument but is used as a concept for the same purpose as the transfer. Also the back-to-back credit is to serve as security for a seller's purchase of goods to be supplied to the applicant under a credit.

As opposed to a transfer, which constitutes part of the documentary credit, a back-to-back credit is a separate documentary credit based on another credit.

In contrast to the transferable credit, the back-to-back credit is not even mentioned in the UCP 600 as both credits are regarded as independent instruments, each of which, of course, is subject to the UCP 600.

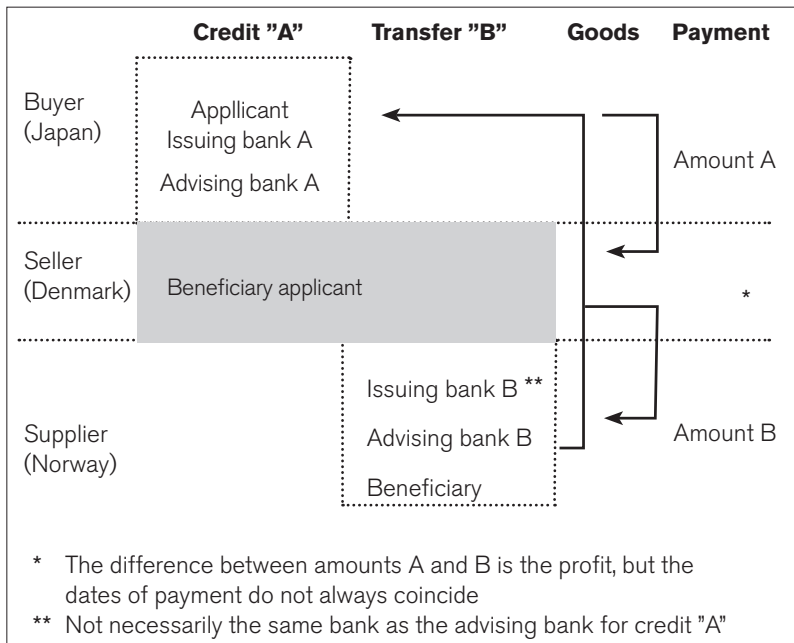


Figure 7 illustrates the process of the back-to-back credit.

There may be different reasons for using a back-to-back credit. The applicant may not want his credit to be transferable because thereby he would lose some of the control and security inherent in the credit. The beneficiary may also refrain from requesting a transferable credit because he does not want to leave the impression with the applicant that he needs this security to get the goods. A third reason could be the beneficiary's need to make alterations to the conditions in a credit to be issued in favour of a subsupplier. One of the most essential factors the beneficiary, or the "company in the middle", should be aware of is that the bank issuing a credit in favour of the subsupplier has to consider the "company in the middle" creditworthy or, alternatively, be assured that the company can provide adequate security. The underlying credit may to a limited extent constitute

partial security, but for the reasons stated below, this will hardly be sufficient.

As there are two separate credits, the bank issuing credit “B” cannot be certain to be able to use the documents presented under credit “B” for an independent presentation under credit “A” complying with the terms of that credit.

One reason is that the beneficiary under credit “A” (the “company in the middle”) is to make out the invoice in his own name. If the “company in the middle” for some reason is unable to do so, payment under credit “A” cannot be made, while the payment undertaking under credit “B” remains unchanged. Add to this that problems may easily arise in connection with observing time limits for the presentation of documents under credit “A” as documents presented in due time under credit “B” may not arrive in time for them to be used under credit “A”.

Some of these risk elements may be diminished by ensuring appropriate issuance of the credit in favour of the subsupplier. The credit may, for instance, be made available at the issuing bank, eliminating difficulties resulting from non-compliance with deadlines. However, it is a prerequisite that the subsupplier agrees to it. Likewise, the problem concerning the issuance of the invoice can be solved by having the credit from the original buyer allow an invoice issued by parties other than the beneficiary or by having a back-to-back credit stipulate the presentation of an invoice issued by the “company in the middle”. Both of these methods suffer from the disadvantage that the “company in the middle” cannot guard against the two other parties becoming aware of one another’s identity.

To protect itself the “company in the middle” must ensure that the conditions of the two credits are exactly the same in the same manner as with the transfer, or alternatively, that any difference is so insignificant that it can be coped with by presenting the documents under credit “A”.

If the terms of delivery, modes of transport or the destinations differ, discrepancies can hardly be avoided in connection with the honouring or negotiation of documents under credit “A”. Differences as to the date of payment, currency and the like can more easily be accepted and handled by an experienced user.

19.5 Transfer of proceeds to a third party

In contrast to a transfer of a documentary credit (and partly to the use of a back-to-back credit), a transfer of the proceeds under the credit does not allow a third party to demand payment under the credit. The third party will receive a declaration from the bank to which the request for transfer of proceeds has been submitted, and such transfer can thus be used to secure the claim of a third party, even a claim that is not due to the purchase of the goods in question or derives from the transaction covered by the credit.

This means that the third party cannot himself present documents or advance claims under the credit as it is the beneficiary alone who is to present documents, even if his claim for the proceeds or part of the proceeds has been transferred to a third party.

According to Article 39, rights under the documentary credit itself can be assigned to a third party only by way of transferring the credit in compliance with the provisions of Article 38. As mentioned in Article 39, the fact that a credit is not stated to be transferable will not prevent its proceeds from being assigned to a third party. Assignment must be made in conformity with the applicable law in the relevant country. The UCP 600 contains no guidelines as to the assignment of the proceeds of a credit.

As will appear from both of the methods described below, the right of a third party is no better than the right of the beneficiary in relation to the relevant bank. This could be in connection with an unconfirmed credit or regarding the fulfilment of the conditions in a credit.

- The credit proceeds can be transferred in either of two ways:
- by notification of an assignment of the credit proceeds
 - by issuing an irrevocable payment order (in some countries).

Assignment

In many countries the assignment of claims in favour of a third party is covered by the relevant national Act on instruments of debt and offers the assignee a certain degree of security for payment under, for instance, a documentary credit not being made to the beneficiary but to the assignee. If all the provisions of the Act are complied with, the assignment will also secure the third party in cases where

the beneficiary under the credit goes bankrupt or suspends payments as the estate must respect an assignment if the debtor has been duly notified. Notification of the assignment of an export credit provides no guarantee from the notifying bank that payment will be made to the assignee. As mentioned earlier, the assignee can only claim payment if and to the extent that the beneficiary, who is the assignor, has a claim for payment under a credit.

If the beneficiary of a credit wishes to assign the proceeds of a credit, fully or partly, to a third party, the beneficiary will usually draw up the assignment and hand it over to the nominated bank for notification.

In order for the assignment to be binding, the debtor must be notified. It is being debated among lawyers who are to be considered as the debtor under a documentary credit.

Considering that the credit represents the undertaking of the issuing bank, and hence is independent of the applicant's ability and willingness to pay, and is also independent of the underlying business transaction, notification to the issuing bank is regarded as adequate. There are no rules as to who is to effect notification, and the nominated bank will usually offer to do it on request. As it may affect the assignee's right to receive payment, he should examine whether notification has taken place and perhaps do it himself. If the credit is confirmed by a bank other than the nominated bank, notification should be made to such bank too.

Beneficiaries will usually and often rightfully so, believe that an applicant considers it a negative sign if the beneficiary assigns the proceeds of a credit to a third party. As there is a risk that notification to the issuing bank comes to the knowledge of the applicant, the beneficiary sometimes does not wish notification to be effected. However, it is for the assignee to decide whether to demand perfection according to legislation.

The issuance and notification of an assignment does not give the assignee a guarantee for payment. As mentioned earlier, a third party does not have a better right than that of the beneficiary. Consequently, the assignee must assess the degree of security provided by the assignment by evaluating the value of the claims of the beneficiary under the credit.

The beneficiary's claim for payment under the credit depends primarily on the following factors:

- The beneficiary of the credit presents the stipulated documents to the nominated bank.
- The documents are presented in due time.
- The documents presented fulfil the conditions of the credit.
- The credit is confirmed or the nominated bank is prepared to pay under an unconfirmed credit.

It is sensible to draw up the assignment meticulously. Unintended complications may particularly occur if assignment has been made to different assignees. If the assignment does not state when payment should be made to these assignees, payment for a partial shipment may be effected to an assignee who did not deliver the goods.

This can be avoided if the assignment states in what order the assignees are to be paid or, otherwise, clearly indicates that they should receive payment when a specified consignment of goods has been shipped under the credit.

If several assignments have been issued simultaneously and they do not contain any payment instructions, the bank will effect full or partial payments under all the assignments in proportion to the amount available under the credit.

Irrevocable payment order

An irrevocable payment order is an irrevocable instruction to the bank to pay an amount to a third party. Of course it is binding upon the issuer, but unlike an assignment, an irrevocable payment order is not subject to the national legislation. Consequently, a third party incurs a risk that the payment order is not respected by the estate of the beneficiary in case he suspends payments or goes bankrupt, or the legal status changes.

It has not yet been clarified whether the applicant is bound by his instruction to the bank to pay a specified amount, if the basis for the transaction between the applicant and the recipient of the payment order has changed. So the question is whether an irrevocable payment order is, in fact, irrevocable or whether it can be cancelled through the courts.

In certain cases a manufacturer or a supplier who is to ship goods to a beneficiary under a credit and who wants some security for payment of his claim will, nevertheless, be satisfied with an irrevocable payment order issued by the beneficiary under the credit and registered by the nominated bank.

Sometimes the banks do register such irrevocable payment orders. However, such registration should not be confused with a guarantee from the bank and, therefore, registration does not always offer the security that the beneficiary of the payment order might want.

As mentioned earlier, a third party does not have a better right than that of the beneficiary. Consequently, the beneficiary of the payment order must assess the degree of security provided by the irrevocable payment order by assessing the value of the beneficiary's claim under the credit, at the same time evaluating the risk that the issuer goes bankrupt, suspends payments or otherwise changes its corporate form.

The beneficiary's claim for payment under the credit primarily depends on the following factors:

- The beneficiary of the credit presents the stipulated documents to the nominated bank.
- The documents are presented in due time.
- The documents presented fulfil the conditions of the credit.
- The credit is confirmed or the nominated bank is prepared to pay under an unconfirmed credit.

Consequently, registration of a payment order cannot be considered as security for payment of goods delivered to the beneficiary under the credit or as security for other claims. It is merely to be regarded as security for payment of the amount if payment is made under the credit and if the beneficiary under the credit remains the same legal person as at the time of registration.

Most often a bank registering a payment order will reserve the right not to pay until an objection, if any, or any other uncertainty arising prior to or in connection with payment has been clarified, if necessary through the courts.

Chapter 20

Standby letter of credit

20.1 What is a standby letter of credit?

Many people regard standby letters of credit as not being proper documentary credits, which is partly justified. The standby letter of credit is used in the same way as a bank guarantee but, like commercial credits, it is subject to the international rules and any existing legislation pertaining to documentary credits.

The main difference between a commercial credit and a standby letter of credit is that a commercial credit is expected to be used according to its purpose, which is to act as a means of channelling documents and payment between the buyer and the seller. A standby letter of credit (like a guarantee) is not supposed to be used, unless the parties fail to perform their obligations, hence the name.

A standby letter of credit can be defined as a bank guarantee taking the shape of a documentary credit and being subject to the UCP rules.

The standby letter of credit is a relatively old product, the use of which has gained ground in recent years in the Nordic region and in the rest of Europe. Most bankers refer to it simply as a “standby”.

As with the commercial credit, the standby is issued so that the beneficiary is to present documents in accordance with the stipulations of the credit in order to obtain payment.

Instead of requiring the presentation of invoices, transport documents and insurance documents evidencing shipment of a specific consignment of goods, the beneficiary under a standby must present a document declaring that the applicant has not fulfilled his obligations, and that the beneficiary is, therefore, entitled to receive payment under the standby. Quite often the credit stipulates that the beneficiary's declaration must be accompanied by other documents supporting the claim, either as originals or copies.

Like the commercial documentary credit and the bank guarantee, the standby is a very flexible instrument and can be used for all types of business. It can cover anything ranging from an ordinary guarantee commitment to sophisticated financial instruments.

If a payment risk of a single commercial transaction is to be covered, it is normally recommendable to use a commercial credit, while the standby would be favoured to secure the payment of a claim in connection with a more permanent business relationship.

Many business people prefer to use a standby rather than an ordinary guarantee because the standby is subject to the *ICC Uniform Customs and Practice for Documentary Credits* or, since 1 January 1999, *International Standby Practices* (ISP98) (see Chapter 20.7 Rules for standby letters of credit), while the ICC's *Uniform Rules for Demand Guarantees* (URDG) has not yet gained international acceptance to the desired extent, but efforts made by the ICC Banking Commission seem to take the usage of the URDG to a higher level.

Since 2006 a working party under the Banking Commission has been involved in a revision of the URDG.

Apart from the wish to obtain financial security in a business transaction, there may be a need to move the risk and commitment relating to the execution of a judicial decision from the beneficiary to the applicant as the beneficiary can generally demand payment under a standby. If the applicant finds that a drawing by the beneficiary is unjustified, the applicant will have to initiate legal proceedings to obtain a refund.

20.2 Historical background

The standby letter of credit was created in the USA about half a century ago and is still regarded by many as a US product. Indeed, most standbys are issued by US banks and in countries strongly influenced by US banking, including East Asia.

US banks were then not allowed to issue bank guarantees under US law. Today they may do so, but only to the extent that such guarantees are payable against the presentation of documents (demand guarantees).

Then as now banks wanted to be able to accommodate their customers' demand for this product, but also the earnings potential played a part when US banks developed this type of credit to function as a guarantee. The standby covered these needs and met the rules of law.

20.3 Use of standby letters of credit today

Today standbys are so common in the USA that many US banks and business people find it irrelevant to use a guarantee instead. The use of standbys has gradually spread worldwide, although between

European business partners this instrument is used to a limited extent only.

Standbys have now gained popularity to a degree where more such credits are issued on a world scale than are commercial credits, both in terms of number and amount, and the issuance of standbys by non-US banks has now outnumbered the issuance by US banks. It should be noted, however, that the US branches of both European and Asian banks are included in the former category of banks.

20.4 Commercial standby letters of credit

As denoted by the name, a commercial standby meets various needs to hedge against risks arising in a commercial transaction in the same manner as an ordinary guarantee.

Due to the many different kinds of business transaction it is not possible to outline various types of commercial standby. Each standby must state exactly which documents are to be presented by the beneficiary to obtain payment, by whom the documents must have been issued and their contents, unless specified in the set of rules to which the standby is subject.

The following factors are typical examples of the needs to be covered by a standby:

Bid/tender

The standby is issued at the request of a company submitting a tender for the delivery of goods or services and is to serve as a guarantee to the company inviting tenders that the tenderer acknowledges the order on the terms and conditions contained in the tender. The standby is often issued for 5–10% of the tender and is to cover the expenses incurred by the company inviting tenders when having to find another supplier, should the tenderer fail to enter into the contract.

Delivery of goods

The standby is issued at the request of a company having undertaken to supply the goods and is to guarantee the buyer that the goods are delivered in conformity with the agreement. The standby is often issued for 5–10% of the bid and combined with

a standby pertaining to the bid. The standby covers the expenses incurred by the buyer when having to find another supplier, should the seller fail to supply the goods as agreed.

Performance of work

The standby is issued at the request of a company having undertaken to perform a job and is to guarantee the buyer that the work is completed in conformity with the agreement. The standby is often issued for 5-10% of the contract amount and combined with a standby pertaining to the bid. The standby covers the expenses incurred by the buyer when having to find another contractor, should the work not be performed as agreed.

Repayment of advance

In connection with construction work, and perhaps also the supply of goods, the parties may agree that the contractor or the supplier receives an advance of, for instance, 10% of the contract amount to finance the preliminary work or the purchase or manufacturing of the goods. If the contractor or the supplier does not perform the services agreed, the advance must be repaid. A standby can be issued as security.

Payment

As security for a developer or buyer effecting payment under the contract, a standby can be issued in favour of the contractor or the seller. The amount of the credit will usually equal the contract amount, perhaps less the advances made, if any.

Retention

Particularly in connection with major construction work the developer may wish to retain part of the contract amount, for instance 10%, as security for the work being performed in conformity with the contract and for complaints, if any, being remedied within the warranty period. Such retention is usually agreed to be for the duration of the warranty period. To improve his liquidity the contractor may provide a standby covering the performance of his duties under the contract against payment

of the entire contract amount when completing the entire construction work.

Warranty

Both in connection with the supply of goods and the performance of work, a warranty will usually be provided to the buyer or the developer for a period of, typically, one year from delivery or completion. To render more weight to the warranty, the supplier or contractor may support it by having a standby issued.

Maintenance

In connection with the building or supply of major technical plants or factories, the supplier sometimes enters into a maintenance contract for the duration of an agreed number of years, usually for a much longer period than the warranty. During such period the buyer will often ensure that his own people are trained so that they can take over the maintenance work when the contract expires. A standby may cover the risk that the supplier does not meet the terms of the contract.

Absence of bill of lading

If a consignment of goods dispatched by sea for which a bill of lading is issued arrives at its destination before the buyer receives the bill of lading, he may need to get access to the goods against a declaration or a guarantee. Quite often, the shipowner will not accept the buyer's declaration but will demand a bank guarantee or a standby as security.

20.5 Financial standby letters of credit

Especially in the USA, a large number of the standbys issued are applied to secure financial transactions ranging from loans to mergers and acquisitions.

In connection with financial transactions the rate of interest, of for instance a loan, is an essential factor. Therefore, the standby is also used to improve the applicant's creditworthiness in addition to providing the security required. This may reduce the costs of finance (interest).

Where the wording of both the commercial credit and the commercial standby is typically drafted jointly by the applicant and the bank, it is the practice for financial standbys, usually issued for very large amounts, to be drafted by legal experts.

Each standby must state the documents which the beneficiary must present to obtain payment, by whom they are to be issued and their contents, unless this appears from the set of rules to which the standby is subject.

Particularly in the USA, it is common for standbys to contain elaborate and comprehensive provisions. Often the text states that certain articles of, for instance, the UCP 600 do not apply to the relevant standby.

The financial standby is used in the following situations, among others:

- payment undertaking
- loan
- overdraft facility
- aval (guarantee for payment of a draft)
- obligations under bonds issued
- mergers and acquisitions.

20.6 Direct pay standby letters of credit

The concept of direct pay standby may cause confusion because it may seem self-contradictory. They are usually issued as financial standbys.

As mentioned earlier, the difference between a standby and the more traditional commercial credit is that with the standby, the parties are expected to settle the transaction themselves and, furthermore, it is payable only if disagreements arise between the parties in a default situation.

Much like that of the commercial credit, the purpose of a direct pay standby is to secure payment, for instance at the maturity of a draft. Payment is not expected to take place outside the function of the standby.

Under special circumstances direct pay standbys have been phrased to the effect that the bank would effect payment, even without the beneficiary presenting any document. This variant is

seldom used, and not all banks are expected to be prepared to enter into such arrangement.

20.7 Rules for standby letters of credit

In principle, standbys used to be subject to the same rules as commercial credits (UCP 600). As from 1 January 1999 specific rules for standbys were introduced (ISP98).

Like commercial credits, standbys usually refer to the set of rules to which they are subject. However, by contrast to the commercial credit, the international standby, and especially the financial one, will often also contain reference to venue and choice of applicable law. Also it will generally contain more elaborate legal provisions applying to the standby and/or state that certain articles of the rules to which it is subject do not apply to the relevant credit.

UCP 600

As a result of the wide acceptance of the international rules, by far most international standbys are subject to the UCP 600. (For further details on the UCP 600, see Chapter 5.4 ICC Uniform Customs and Practice for Documentary Credits). The UCP 600 further states in Article 1 that these rules apply to standbys as well. Already during the revision of the UCP 400, it was discussed if the reference to standbys should be deleted from the UCP, but that proposal was rejected. The question was also brought up under the revisions of the UCP 500 and the UCP 600 – but with identical outcome: the rules apply to standby credits when the wording of the credit expressly indicates that it is subject to these rules.

Standbys used in the USA are generally subject to the US Uniform Commercial Code (UCC), without reference to the UCP 600.

ISP98

In recent years banks, lawyers and financial institutions in the USA have expressed a renewed interest in and an increasing need for a separate set of rules for standbys. The need is based on the fact that this type of credit is frequently used in connection with financial documents and transactions, and the UCP 600 does not fully cover the requirements made in respect of standbys. Too many articles

were irrelevant (especially those dealing with transport and other documents), while others often had to be replaced by individual texts in the actual standby letter of credit.

As a result US banks and lawyers started working out a set of rules called *International Standby Practices* (ISP). They did so in conjunction with the Institute of International Banking Law and Practice and the US International Financial Services Association (IFSA).

The draft rules were published in 1997 and were completed following cooperation with the International Chamber of Commerce in 1997 and 1998. In April 1998 the ICC decided to endorse the final version, the ISP98, which took effect on 1 January 1999. These rules are published jointly by the ICC and the Institute of International Banking Law and Practice.

The ISP98 and the UCP 600 are much alike in certain fundamental areas, both sets of rules stating that the credit is independent of the underlying legal relationship and that it constitutes an independent obligation for the issuer. In many other respects there are, however, significant differences. A credit issued in accordance with the UCP 600 makes heavy demands as regards commercial documents, and these documents must not, for instance, be inconsistent with one another (Article 14(a) and (d)). As opposed to the commercial documentary credit, the beneficiary's statement concerning the applicant's non-fulfilment of his obligations is considered the most important document with a standby. Therefore, Rule 4.01 of the ISP98 only requires that the documents must not be inconsistent with the standby.

The wording of the ISP98 is also very different from that of the UCP 600. Where the latter is primarily directed to banks, the ISP98 addresses bankers, customers and lawyers alike, including the courts. A large number of the rules are much detailed, and so considered by many bankers to be superfluous.

It is possible that several of the formulations used in the ISP98 will impact on a later revision of the UCP 600. There will probably also turn up discussions about whether a new revision of the UCP 600 should contain the present reference to standbys, since the ISP98 would be an appropriate set of rules for such credits.

Just as the UCP 600, the ISP98 can be combined with the United Nations' Convention and local law.

Where the ISP98 was originally intended to be a set of rules to be applied chiefly in the USA and perhaps a limited number of other countries, it is expected that the participation of the ICC will cause the rules to be used worldwide. These rules apply to each standby by inclusion into the wording of the credit.

Chapter 21

Fraud and forgery

As mentioned earlier, documentary credits are independent of the underlying legal relationship, and when banks are to determine whether the documents presented conform to the credit, they can only base their decision on the credit itself and the documents presented. It is obvious that combined these factors give scope for fraud and for presenting forged documents. And the possibility of misusing the credit instrument does indeed exist.

It is beyond doubt that credits are misused, primarily where banks find documents containing “incorrect information”. However, the occurrence of actual fraud is, fortunately, quite rare.

The UCP 600 does not contain any articles about fraud and forgery nor refer to any rules to be applied when fraud or forgery is detected. Nor did previous versions contain any provisions on the subject.

The UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit contains a provision in Article 19 regarding what actions to take by the banks. This convention does not particularly address commercial credits and the provisions referred to are not very precise.

Even if the UCP 600, and especially and in most detail Article 9(a) and (b), establishes the obligation of banks to pay, provided that complying documents are presented, the banks can, according to incontestable international legal usage, refuse to effect payment.

Since an event of fraud or forgery is determined according to national laws and not on the basis of the UCP 600, judicial decisions vary widely among the different countries. It seems unquestionable, however, that the bank authorised to honour the credit (the nominated bank) is entitled to refuse to pay if it detects fraud or forgery.

According to the general attitude among documentary credit experts, which are also supported by several decisions by courts worldwide, the issuing bank is under an obligation to reimburse the nominated bank if it has honoured documents in good faith. Likewise, an issuing bank that has accepted (and paid for) documents in good faith is entitled to charge such expenses to the applicant.

The essence of this interpretation is that if a bank has trusted the value of a documentary credit and acted in good faith, it is not

supposed to suffer a loss arising from a dishonest commercial transaction between the applicant and the beneficiary.

On the other hand, there have been judgments allowing the applicant to refrain from paying even if the fraud or forgery was not documented until after the honouring or negotiation of the documents. In pursuance of some judgments passed by national courts, the applicant or the issuing bank has in fact been released from paying a draft accepted by the bank or from effecting payment even if it had promised to pay at a deferred date of payment. Most of these judgments have been passed by courts of the lowest or higher instance and a great many of these have been reversed by the supreme court of the relevant country.

21.1 ICC International Maritime Bureau (IMB)

As appears from the above, two important factors must have been clarified in order to prevent a payment under a credit on grounds of fraud or forgery. Firstly, it must be documented that fraud or forgery has been committed. Secondly, the knowledge of fraud or forgery having been committed must exist before the credit is honoured.

The ICC has established a unit in London, the ICC International Maritime Bureau (IMB) specialising in investigating this type of crime, both in connection with transactions in goods and financial transactions. The specialists there are experienced and command a contact network with many ramifications all over the world. Several of these specialists have earlier been employed by Scotland Yard.

21.2 Defences against the goods or the price

Sometimes when a buyer finds out that the goods supplied are not in conformity with the contract or show defects, he tries to induce the court to grant an injunction, claiming forgery, to prevent the issuing bank from effecting payment. There are also examples of buyers who, more or less successfully, make attempts to have an injunction granted, because the world market price of the relevant goods has fallen.

Very often the courts refuse to accommodate the buyer's wish on the grounds that the issue concerns contractual discrepancies that cannot rightly be considered as criminal. However, certain

countries are more inclined to grant such, often fairly unreasonable, injunctions in order to protect the imports of the country to the detriment of the reliability of documentary credits

21.3 Fraud

Fraud in connection with documentary credits is said to be growing. Among the most important precautions against fraud are the words, “know your customer”. It is a common misconception that it is possible to safeguard oneself 100% by using a documentary credit. Fraud may be committed by the buyer as well as by the seller or even in cooperation between the parties.

Fraud in the underlying transaction

The typical situation where the beneficiary commits documentary credit fraud is for him to offer the supply of goods in large quantities to obtain a big amount of money at a considerably lower price than that prevailing in world markets. It is often bulk goods like sugar, grain or cement. The aim is to induce an interested buyer to apply for the issuance of an irrevocable credit, which perhaps is to be confirmed by a recognised bank. There have been examples of large quantities of sugar to the extent that the aggregate harvest of the relevant country would not suffice. To collect the amount the “seller” will then present false or forged documents, after which he disappears. When the fraud is discovered, the nominated bank will, therefore, not be able to enforce its claim.

The best way to guard against such credits is, as mentioned, to know one’s counterparty and not to be tempted by an offer that is “too good to be true”. Banks should also be on their guard to unveil that kind of atypical transactions, especially when the beneficiaries are unknown or the goods are not characteristic of the beneficiary. The bank should be on the alert when for instance a machine factory receives a credit covering grain or sugar.

One way for a buyer to get his goods without intending to pay for them is to apply for the issuance of a credit stipulating that the goods are to be delivered direct to him. Furthermore, the credit contains conditions which the beneficiary cannot fulfil: it stipulates documents that must be signed or issued by the buyer after shipment of the

goods. When the documents cannot be honoured on presentation due to discrepancies, the applicant can refuse to approve them, and the issuing bank will then refrain from paying. The buyer can protect himself against legal proceedings only by disappearing or if he lives in a country where the courts will not regard such conduct as fraud.

A variant of this situation is where the buyer refuses the documents, but later accepts taking over the goods at a price considerably lower than the market price.

The buyer and the seller may jointly try to defraud one of the banks involved by the buyer sending a message direct to the seller confirming that he will approve documents containing a specific discrepancy. In this manner he will induce the nominated bank to pay, perhaps under reserve.

Later when the buyer then does not approve the documents after all, the beneficiary has disappeared or gone bankrupt.

Fraud in the documentary credit transaction

The most well-known example of fraud in the credit transaction itself is when the consignment does not contain the goods agreed on, but the boxes are filled with refuse or rubbish and the statement of weight – and the genuine documents – do not reveal that they are not the goods expected.

21.4 False or forged documents

A considerable part of the instances of fraud are based on false or forged documents allowing payment under the credit.

Consequently, it is important to bear in mind Article 34 of the UCP 600. Banks are under no obligation to examine if a document is genuine or if the person signing the document is entitled to do so, and often the bank is not even in a position to do so. Nor can banks be expected to check if a particular vessel has loaded a specific consignment of goods or has left a named port on a given date. The banks will only examine documents with reasonable care to determine on the basis of the documents alone, whether or not they appear on their face to constitute a complying presentation (Articles 2, 7(c), 14(a) and 15(a)).

In addition to the documents that have been falsified with fraudulent intent, documents are also presented to the banks where certain details have been forged, sometimes with the only aim of fulfilling the stipulations of the credit.

Some of these falsifications have no actual bearing on the value of the documents to the buyer, while others are absolutely to the detriment of the buyer in terms of insurance, should the goods be damaged.

21.5 Forgery/fraud committed by the beneficiary or by a third party

There can be no doubt that a beneficiary committing fraud or falsifying documents cannot claim any right to receive payment under a credit, whether it is confirmed or not. Nor can he do so if the forgery or fraud was committed by someone else at the instance of the beneficiary or if he knew of it. Where forgery or fraud is committed by a third party without the beneficiary's knowledge, this gives rise to doubt.

A case has been heard by a court where a carrier had deliberately included a false on board notation. In this case the beneficiary had his claim against the confirming bank sustained. This case seemed not to support the general attitude that forgery and fraud will always be a strong basis for defences to the effect that payment under a credit can be refused.

21.6 Fraudulent documentary credits

It sometimes happens that a beneficiary receives a credit that turns out not to be genuine as it was not issued by the bank stated in the credit. There are two types of fraudulent credit: the commercial credit and the financial standby.

Article 9 of the UCP 600 ensures to a large extent that a fraudulent credit is not advised by the advising bank. However, it cannot guarantee absolutely against a perfect falsification where it is not sufficient for the bank "to take reasonable care" to check the authenticity of the credit.

The problem exists mainly where a beneficiary receives the credit direct from a "bank" claimed to be the "issuing bank" or from another "bank" unknown to him, which has "confirmed" the credit.

A beneficiary receiving such dubious credit should contact his own bank, which will undoubtedly be able to evaluate the authenticity of the credit.

Fraudulent commercial credits

Fraudulent commercial credits have been issued for many years in certain African countries, but they are seen elsewhere as well.

Such credits typically cover luxury goods or goods of a rather high value. These credits will often stipulate that the goods are to be shipped by air. The air waybill is to evidence the “buyer” as consignee. If the seller ships the goods, the fraud will not be detected until the documents are to be honoured.

Fraudulent documentary credits often contain incorrect details for banks (names, addresses etc) or wording, a danger signal suggesting to an expert that something is wrong.

Fraudulent financial standby letters of credit

In recent years an abundance of various forms of strange financial standbys have emerged. They are often for very large amounts and USD 100 million is not exceptional. Sometimes an offer for a financial transaction is received without the specific standby being issued. The offer is about finance, typically for one year and one day, guaranteed by a top world bank the name of which is not stated. The customer is supposed to buy this standby at a price of, for instance, 80. After expiry he is then to receive 100% of the amount.

In rare cases the names of some international banks have been stated. However, each time they have denied being involved in such transactions. The offers and the draft standbys often contain a lot of foreign words and reference to non-existent international rules.

Offers of this kind are frequently sent to companies and individuals known within finance, but seldom to banks. After having consulted their bank, the recipients often succeed in putting a stop to these transactions before they take effect. As a result, the attempts to issue these fraudulent standbys seem to exceed the number of fraudulent standbys actually issued.

As it cannot be ruled out that some of these transactions might be in order, it is impossible to know the exact number of fraudulent standbys issued and the amount of losses suffered.

Appendix 1

JOINT REGULATIONS GOVERNING THE HANDLING OF DOCUMENTARY CREDITS OPENED WITH THE PRINCIPAL COPENHAGEN BANKS.

DOCUMENTARY credits opened with us will as a rule be advised to the beneficiaries, but it will be stated in such advices that they are non-binding to us. However, we assume no obligation to advise the beneficiaries unless the credit contains a request to this effect. A binding confirmation will not be given by us unless expressly stipulated. In this connection it is pointed out that a documentary credit opened with us as 'irrevocable' will be confirmed by us to the beneficiary, even if we are not expressly requested to do so.

A confirmed credit must contain a definite time limit within which the credit shall be in force. Unconfirmed credits, for which no time limit for the honouring of the documents has been fixed, shall be considered valid until revoked, but not for more than 6 months from the date of the opening of the credit, unless it should appear from the stipulations of the credit that shipment or dispatch of the relative goods may take place at a later date. If a time limit has been fixed for shipment or dispatch of the goods, but not for payment of the documents, the Bank shall be entitled – but not bound – to refuse documents presented later than 14 days after the time limit given for shipment.

Unconfirmed credits may be revoked without reason being given and the Bank shall be entitled at any time to refuse the documents as well as payment, if, at the Bank's discretion, circumstances might warrant such action.

Expressions as 'to', 'until', 'on', and words of similar import, when used in connection with a time limit, will be interpreted to include the date mentioned. Should the time limit for payment be a Sunday or a legal or bank-holiday the Bank will consider the credit expired at the end of the preceding week-day.

The Bank shall be entitled to transfer a credit to a third party, but will only do so in case the credit has been opened 'in favour of or order'; however, the Bank shall not be bound to do so, even if the credit has been opened 'in favour of or order'. The Bank will claim invoice issued by the original beneficiary, but shall be entitled to deviate from this practice in case the credit has been opened as above mentioned.

Should it be desired to have a credit opened with one of our correspondents or another bank, through our intermediary, we reserve ourselves the right to transfer, if required, the entire amount of the credit to the bank in question immediately when opening the credit, and to charge the amount to the account of our principals, without any respon-

sibility on our part for possible refund of the amount. We assume no responsibility for possible errors made by our correspondents.

If no instructions to the contrary be given in the credit, we will accept the following:

- a) Documents for partial shipment, provided a price has been stated in the credit, or the correctness of the amount may otherwise be verified;
- b) Bills of lading reading: 'Received for shipment', or words of similar import; (if shipment by a named vessel has been stipulated, or if a time limit for shipment has been fixed, we will always require a bill of lading showing that the goods have been received 'on board')
- c) Bills of lading showing that the goods, or part of same, have been loaded on deck; in such cases, however, we will require delivery of a policy covering deck cargo;
- d) Bills of lading permitting transshipment;
- e) Bills of lading indicating shipment by other parties than the beneficiaries;
- f) Bills of lading bearing the impression of a facsimile stamp instead of signature;
- g) Insurance certificate in lieu of insurance policy;
- h) Insurance covering the goods on f. p. a. conditions;
- i) Waybill (Railroad B/L) showing that the goods have been dispatched to the address of the purchaser (or the party, for whose account the credit has been opened) provided the credit calls for waybill without stating to whom this should be issued.

Should the credit call for bill of lading we will — unless otherwise instructed — require full set issued to order and endorsed in blank, but we reserve ourselves the right to accept bills of lading issued to our principals or to the purchaser. Should the credit not state the destination of the goods, the Bank reserves its right — but will not be bound — to accept documents showing that the goods have been dispatched to a place other than the domicile of our principals or of the purchaser.

The Bank will not undertake the perusal of the printed wording of bills of lading, insurance policies and/or certificates, etc., but will pay attention only to the particulars filled in and to additional clauses added in writing or type or by stamp impression etc.. As a rule such clauses will not be accepted until the authority of our principals has been obtained, but the Bank considers itself entitled to deviate from this practice in case the clause added is considered of minor importance. The Bank will assume no responsibility whatsoever for its judgment in this connection.

In all cases when a time limit for shipment or dispatch of the goods has been fixed, the date of the bill of lading or waybill shall be considered to be the date of shipment or dispatch. Should a bill of lading read: 'received for shipment', or words of similar import, and bear a subsequent 'on board' endorsement, the date of this endorsement shall be considered to be the date of shipment.

Generally a bill of lading covering a larger quantity than stipulated in the credit will not be honoured even if the beneficiary does not claim payment for more than that part of the quantity for which the credit has been opened; but the right to deviate from this practice is reserved by us.

Should the credit call for 'insurance policy' the Bank will interpret this to mean marine insurance policy. If it is required that other risks should be covered, say war, mines, fire, theft etc., this must be expressly stated. Should a credit call for a policy covering 'all risks' the Bank will accept only a policy purporting to cover 'all risks', but the Bank cannot undertake to define the scope of such general terms.

Should the credit call for warehouse certificate, without specific instructions as to the issue of same, we will require it to be issued by a public institution and in favour of our

principals or the purchaser. Insurance documents will not be required by us unless expressly called for by the credit. Should a delivery order be called for, we shall require same to be issued by a bank or banker, or by the shipowners in question, or their agents.

Should the credit specify certain descriptions of goods, brands, qualities etc. without special certificates being called for, the Bank will consider it sufficient that such descriptions appear on the invoice bearing the beneficiary's receipt.

Should the credit stipulate 'shipping documents' and a f. o. b. or c. & f. price be given, the Bank will require only invoice and a full set of bills of lading, while, if a c. i. f. price be indicated, a marine insurance policy will be required in addition. Should no price be stated the Bank will generally ask for further instructions from its principals before opening the credit.

Should the credit cover periodical deliveries and should one or more of same not have taken place, the Bank will consider itself entitled to honour documents for subsequent periods only.

The expressions below will be construed as follows:

about, approximately etc.: 10% more or less (in amount as well as in quantity);
prompt shipment, immediate shipment etc.: not later than 14 days after opening of the credit;

primo: from 1st to 10th of the month, both dates included;

medio: — 11th - 20th - - - - -

ultimo: — 21st - the end of the month;

first half of a month: from 1st to 16th incl. for any month of 31 days; from 1st to 15th incl. for all other months (including February);

second half of a month: the remaining days;

shipment between two specified dates, say 1st and 10th March: both dates included.

The documents to be taken up under the credit will be honoured entirely for account of and at the risk of our principals, and the Bank will not assume any responsibility whatsoever for the genuineness, validity or possible irregularities of the documents. Neither will the Bank be responsible for the description, quantity, quality or condition of the goods, for strikes, lock-outs or force-majeure of any description, nor for the beneficiaries' fulfilment of their obligations of any kind whatsoever.

Further, the Bank will not assume any responsibility for the transmission of the documents honoured. Should the documents be delayed or lost in transit the amount will still have to be paid by our principals in accordance with our statement.

Telegrams dispatched by the Bank, at the request of our principals or in their interest, will be dispatched for their account and risk and the Bank will not be responsible for possible consequences of a telegram not reaching its destination, being delayed in transit or arriving in a mutilated condition, or for wrong interpretation etc.

The Bank reserves its right to communicate with its principals before opening the credit, in case the instructions are deemed insufficient or for any other reason. The Bank will not be responsible for possible consequences of delay in opening the credit, arising therefrom.

Copenhagen, January 1928.

PRIVATBANKEN I KJØBENHAVN
AKTIESELSKAB

DEN DANSKE LANDMANDSBANK
HYPOTHEK- OG VEKSELBANK
AKTIESELSKAB

AKTIESELSKABET
KJØBENHAVNS HANDELSBANK

Appendix 2

Paper-based application form



To Nordea Bank Danmark A/S
Trade Finance
P.o. box 850
DK-0900 Copenhagen C

Documentary credit application

Beneficiant	The China Export Corporation, Exim Street 999, Beijing		To be advised through	Bank of Export, Beijing
Amount	<input checked="" type="checkbox"/>	About +/- 10% DKK - 555.500,00		
Available	<input checked="" type="checkbox"/>	At sight valid until 12.12.2007 in country China		
Period of time for presentation of documents	Not later than 15 days after the issue of shipping documents. If left blank, 21 days will apply, as stipulated in the UCP 600.			
Terms of delivery	(cif, cfr, fob etc) and place: FOB China port <input checked="" type="checkbox"/> Incoterm 2000			
Shipment of goods	Place of shipment/not later than 1.12.2007			
	Partial shipment: <input checked="" type="checkbox"/> allowed		Transshipment: <input checked="" type="checkbox"/> allowed	
The DC is payable against presentation of the following documents:	<input checked="" type="checkbox"/>	Full set of marine bills of lading	<input checked="" type="checkbox"/>	issued to order, endorsed in blank and showing me/us as notify party
	<input checked="" type="checkbox"/>	Multimodal transport document	<input checked="" type="checkbox"/>	issued to: order of beneficiary
	<input checked="" type="checkbox"/>	endorsed on board		
		3 Invoice		
		3 Packing list		
		3 Export license		
		3 Certificate of origin	3	GSP certificate of origin, form A
	<input checked="" type="checkbox"/>	Insurance policy/certificate for CIF/CIP amount plus %, covering the following risks:		
Description of goods	123 pcs. spare parts for packing machines according to contract no. 6CDE922222 of 21.1.2007			
Please issue:		An irrevocable DC confirmed by your correspondent	<input checked="" type="checkbox"/>	a transferable DC
	<input checked="" type="checkbox"/>	An irrevocable DC without your correspondent's confirmation		

Commission and charges

Nordea's commission and charges are for:
 Our account

The correspondent's commission and charges are for:
 The beneficiary's account

General terms and conditions for issuing documentary credits

Rules governing documentary credits

The documentary credit is subject to the international rules on documentary credits in force on the date of issuance.

The "International rules on documentary credits" means the International Chamber of Commerce's publication "ICC Uniform Customs and Practice for Documentary Credits".

Insurance of the goods

If, in accordance with the information overleaf, the applicant takes out insurance of the goods, Nordea (the "Bank") may demand that the insurance not be cancelled without the Bank's consent and that the insurance document be presented to the Bank.

Examination and forwarding of documents

Unless otherwise agreed in writing, the Bank will forward the documents received for the account and risk of the applicant.

Upon receipt of the documents the applicant shall without delay examine these. In the event of any discrepancies in the documents as compared with the documentary credit application or any subsequent amendment which the applicant cannot approve, the applicant shall inform the Bank immediately.

If the applicant intends to refuse the documents, it may not deal with the documents or the goods concerned without the Bank's consent. The documents shall be returned to the Bank immediately.

The Bank assumes no liability for the consequences, if any, of the applicant's non-compliance with the above-mentioned conditions relating to refusal of documents.

Release of the applicant from its liability

If an unutilised or partly utilised documentary credit expires, the Bank will not release the applicant from its liability until the Bank itself has released by its correspondent.

Commissions and charges

If the Bank cannot charge the beneficiary for its charges and commissions, the applicant is liable to pay such charges and commissions even if the documentary credit application stipulates that all charges and commissions are payable by the beneficiary.

Payment for documents taken up

The applicant shall pay for the documents taken up under the documentary credit as soon as the Bank has received a demand for payment from its correspondent.

The applicant's payment obligation remains even if the documents have not been received by the Bank, whether this is due to delays or because the documents have been lost in the mail.

Force majeure

The Bank is not liable for any loss caused by statutory provisions, measures adopted by any governmental or other authority, actual or imminent war, insurrections, civil commotion, terrorism, sabotage or Acts of God.

Reimbursement for the amount of the documentary credit

If the Bank's correspondent demands that cover be transferred in connection with the issuance of the documentary credit or at any other date, the applicant shall on demand reimburse the Bank for the amount of the documentary credit. The documentary credit amount is transferred for the account and risk of the applicant and the Bank assumes no liability for the arrival of the funds or for any exchange rate differences arising in connection with such transfer.

If an unutilised or partly utilised documentary credit expires, the Bank is entitled, at the request of the applicant, to sell and request the reversal of any amounts reimbursed. But the Bank assumes no liability for the reversal of such amount or for any exchange rate difference in connection with the reversal.

Any amount reimbursed is held in the Bank's name with its correspondent in the relevant country at the applicant's risk. Operations of the account by the applicant are subject to the same restrictions as apply to the Bank from time to time.

Pledge

The applicant declares that it consents to the following:
- all funds transferred in security of and/or in cover of the documentary credit;
- all documents under the documentary credit; and
- all goods and their sums insured, if any, and all that may replace such goods by sale or otherwise shall serve as security, by way of pledge, for any amount that is or may become due to the Bank from the applicant.

The applicant authorises the Bank to endorse or give receipt for the documents with binding effect for the applicant.

The realisation of the goods may take place by auction or by private sale for the account of the applicant without observance of the provisions of Danish legislation governing pledges.

Otherwise the Bank's general terms and conditions are applicable.

Debiting

When you are notified of transactions under the documentary credit or at maturity of the draft, please debit:
Sorting code:Account no: 1111-123456

Remarks:

Transport document must either be B/L - or MMTD showing that goods are shipped on board
All documents to be issued in English
All documents must evidence that goods are sent to Lilleby

Contact: Peter Hansen

I declare that I have read the [General Conditions](#) hereby apply for the issuance of a documentary credit on the above-mentioned terms and conditions.
Place and date

The stamp and binding signature of the applicant.

To be filled in by the account-holding branch

Approved by
 The branch
 The Credit Department

Place and date

Collateral
 Approved by
 Pledge of the goods
 Other security

The stamp of the branch and the signature and stamp of the account manager

Appendix 3

Documentary credit issued by SWIFT

SWIFT-MT : 700 NORMAL
SWIFT-DEST : ADVISING BANK'S SWIFT ADDRESS.
SENT TO :
BANK OF EXPORT
HEAD OFFICE
BEIJING- CHINA

070319

:27: SEQUENCE OF TOTAL
1/1

:40A: FORM OF DOCUMENTARY CREDIT
IRREVOCABLE TRANSFERABLE

:20: DOCUMENTARY CREDIT NUMBER
559-0901-001234567-A2

:31C: DATE OF ISSUE
070219

:40E: APPLICABLE RULES
UCP LATEST VERSION

:31D: DATE AND PLACE OF EXPIRY
071212 IN CHINA

:50: APPLICANT
LILLEBY MASKINEXPORT APS
LILLEBY HOVEDGADE 13
DK-2222 LILLEBY

:59: BENEFICIARY
THE CHINA EXPORT CORPORATION
EXIM STREET 999
BEIJING, CHINA

:32B: CURRENCY CODE, AMOUNT
DKK555500,

:39A: PERCENTAGE CREDIT AMOUNT TOLERANCE
10/10

:41D: AVAILABLE WITH

ANY BANK
BY NEGOTIATION

:42C: DRAFTS AT
AT SIGHT

:42D: DRAWEE
ISSUING BANK

:43P: PARTIAL SHIPMENTS
ALLOWED

:43T: TRANSSHIPMENT
ALLOWED

:44E: PORT OF LOADING
CHINESE PORT

:44F: PORT OF DISCHARGE
DANISH PORT

:44C: LATEST DATE OF SHIPMENT
071201

:45A: DESCRIPTION OF GOODS
+123 PCS SPARE PARTS FOR PACKING MACHINES
ACCORDING TO CONTRACT NO. 6CDE922222
DATED 21 JANUARY 2007.
+ F O B CHINESE PORT (INCOTERMS 2000)

:46A: DOCUMENTS REQUIRED
+ INVOICES IN 3 FOLD
+ PACKING LIST IN 3 FOLD
+ FULL SET ON BOARD MARINE BILLS OF LADING ISSUED TO ORDER, BLANK
ENDORSED, NOTIFY APPLICANT MARKED FREIGHT COLLECT
+ CERTIFICATE OF ORIGIN IN 3 FOLD
+ GSP CERTIFICATE OF ORIGIN FORM A IN 1 FOLD
+ EXPORT LICENCE IN 3 FOLD

:47A: ADDITIONAL CONDITION
+ THIS LETTER OF CREDIT IS ONLY TRANSFERABLE WITH ADVISING BANK.
+ FINAL DESTINATION LILLEBY. MUST BE STATED IN THE TRANSPORT DOCUMENT
+ MULTIMODAL TRANSPORT DOCUMENTS ACCEPTABLE EVIDENCING SHIPMENT
ON BOARD ON A NAMED VESSEL
+ PLEASE NOTE THAT A FEE OF DKK 500,00 OR EQUIVALENT WILL BE
DEDUCTED FROM THE AMOUNT PAID, IF WE HAVE TO CONTACT APPLICANT
IN ORDER TO WAIVE DISCREPANCIES IN THE PRESENTED DOCUMENTS.

:71B: CHARGES

ALL COMMISSION AND CHARGES OUTSIDE NORDEA BANK DANMARK ARE FOR BENEFICIARIES ACCOUNT.

:48: PERIOD FOR PRESENTATION

15 DAYS

:49: CONFIRMATION INSTRUCTION

WITHOUT

:78: INSTRUCTIONS TO THE PAYING/ACCEPTING/NEGOTIATING BANK

ON RECEIPT OF MAIL ADVICE OF NEGOTIATION WE SHALL COVER AS PER INSTRUCTIONS RECEIVED

:72: SENDER TO RECEIVER INFORMATION

PLEASE FORWARD DOCUMENTS IN ONE LOT BY COURIER TO NORDEA BANK DANMARK AS, CHRISTIANSBRO, STRANDGADE 3, 0900 COPENHAGEN C, DENMARK.

Appendix 4

Advice of confirmed credit available by acceptance



REGISTERED AIRMAIL

Lilleby Maskinexport ApS
Lilleby Hovedgade 13
2222 Lilleby

16 August 2007
REINHARD LÄNGERICH
Phone No. 33 33 33 33

Dear Sirs

Advice of Documentary Credit - our Documentary Credit no DC 56789-10

Documentary credit amount: USD 76.000,00
Confirmed by us: USD 76.000,00
Applicant: Mr Big & Co., Pistol Street, X-Town
Expiry date: 31 December 2007
Place of expiry: DENMARK
Issuing Banks ref. no: IMP/12345
Issuing Bank: BANK OF IMPORT, X-Town

The documentary credit is available by acceptance at our counters.

We have confirmed this documentary credit. We undertake to honour documents which are presented to us within the expiry date, and which conform to the terms and conditions of this documentary credit.

It is not necessary to present the draft called for in the documentary credit.

An export documentary credit covering letter can be completed and printed from www.nordea.com/tradefinance

Nordea Bank Danmark A/S

www.nordea.com

Business registration number 13522197 Copenhagen Denmark

Continuation no 223-11-0002391

SETTLEMENT OF THE DOCUMENTARY CREDIT AMOUNT IN FOREIGN CURRENCY WILL BE EFFECTED AT OUR BUYERS RATE OF EXCHANGE BASED ON A RECOMMENDED RATE OF EXCHANGE SET BY THE DANISH CENTRAL BANK WITH REGARD TO AMOUNTS OF DKK 3 M OR MORE SETTLEMENT WILL BE EFFECTED AT A FIXED RATE. IN CASE OF A FIXED RATE AGREEMENT WITH OUR FOREIGN EXCHANGE DEPARTMENT PLEASE INFORM US ACCORDINGLY OTHERWISE WE SHALL ARRANGE FOR THE FIXED RATE ON YOUR BEHALF. PLEASE INFORM US IN WRITING AT TIME OF PRESENTATION OF DOCUMENTS. IF THE AMOUNT IS TO BE USED TO COVER FORWARD CONTRACT OR IS TO BE CREDITED A FOREIGN CURRENCY ACCOUNT.

THE DOCUMENTARY CREDIT IS SUBJECT TO THE ICC UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (ICC'S PUBLICATION NO 600, 2007 REVISION) WE ARE ONLY AUTHORIZED TO HONOUR DOCUMENTS THAT CONFORM TO THE TERMS AND CONDITIONS OF THE DOCUMENTARY CREDIT.

PLEASE CAREFULLY EXAMINE THE DOCUMENTARY CREDIT IN ORDER TO ASCERTAIN THAT YOU CAN FULFIL ALL THE CONDITIONS. IF YOU NEED AMENDMENTS TO THE LETTER OF CREDIT, PLEASE CONTACT YOUR CUSTOMER.

AT TIME OF PRESENTATION OF THE DOCUMENTS PLEASE ALSO RETURN TO US THIS LETTER, THE DOCUMENTARY CREDIT AND ANY AMENDMENTS FOR ENDORSMENT.

DO NOT HESITATE TO CONTACT US SHOULD YOU HAVE ANY FURTHER QUESTIONS IN CONNECTION WITH THIS DOCUMENTARY CREDIT.

Yours faithfully

Nordea Bank Danmark A/S
Trade Finance

Nordea Bank Danmark A/S

www.nordea.com

Business registration number 13522197 Copenhagen Denmark

Appendix 5

Advice of unconfirmed credit available by negotiation



REGISTERED AIRMAIL

Lilleby Maskinexport ApS
Lilleby Hovedgade 13
2222 Lilleby

16 August 2007
REINHARD LÄNGERICH
Phone No. 33 33 33 33

Dear Sirs

Advice of Documentary Credit - our Documentary Credit no DC 56789-10

Documentary credit amount: USD 77.000,00
Applicant: Mr Big & Co., Pistol Street, X-Town
Expiry date: 31 December 2007
Place of expiry: DENMARK
Issuing Banks ref. no: IMP/12345
Issuing Bank: BANK OF IMPORT, X-Town

The documentary credit is available by negotiation.

We have not added our confirmation to this documentary credit.

An export documentary credit covering letter can be completed and printed from
www.nordea.com/tradefinance

Nordea Bank Danmark A/S

www.nordea.com

Business registration number 13522197 Copenhagen Denmark

Continuation no 223-11-0002391

SETTLEMENT OF THE DOCUMENTARY CREDIT AMOUNT IN FOREIGN CURRENCY WILL BE EFFECTED AT OUR BUYERS RATE OF EXCHANGE BASED ON A RECOMMENDED RATE OF EXCHANGE SET BY THE DANISH CENTRAL BANK WITH REGARD TO AMOUNTS OF DKK 3 M OR MORE SETTLEMENT WILL BE EFFECTED AT A FIXED RATE. IN CASE OF A FIXED RATE AGREEMENT WITH OUR FOREIGN EXCHANGE DEPARTMENT PLEASE INFORM US ACCORDINGLY OTHERWISE WE SHALL ARRANGE FOR THE FIXED RATE ON YOUR BEHALF. PLEASE INFORM US IN WRITING AT TIME OF PRESENTATION OF DOCUMENTS. IF THE AMOUNT IS TO BE USED TO COVER FORWARD CONTRACT OR IS TO BE CREDITED A FOREIGN CURRENCY ACCOUNT.

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PLEASE CAREFULLY EXAMINE THE DOCUMENTARY CREDIT IN ORDER TO ASCERTAIN THAT YOU CAN FULFIL ALL THE CONDITIONS. IF YOU NEED AMENDMENTS TO THE LETTER OF CREDIT, PLEASE CONTACT YOUR CUSTOMER.

AT TIME OF PRESENTATION OF THE DOCUMENTS PLEASE ALSO RETURN TO US THIS LETTER, THE DOCUMENTARY CREDIT AND ANY AMENDMENTS FOR ENDORSMENT.

DO NOT HESITATE TO CONTACT US SHOULD YOU HAVE ANY FURTHER QUESTIONS IN CONNECTION WITH THIS DOCUMENTARY CREDIT.

Yours faithfully

Nordea Bank Danmark A/S
Trade Finance

Nordea Bank Danmark A/S

www.nordea.com

Business registration number 13522197 Coenhaoen Denmark

Appendix 6

Assignment



Littletown Machinery Export Ltd

Nordea Bank Danmark A/S
Trade Finance
P. O. Box 850
0900 Copenhagen C

Littletown, 21 October, 2007

Assignment

Documentary Credit No. 12345-6 issued in our favour by Bank of Import, XYZ Town, expiring on 30 January 2009 and advised and confirmed by Nordea Bank Danmark A/S, Copenhagen, under its ref. 6789-8

We hereby assign an amount of

DKK 125.000,00, say: Danish Kroner one hundred and twenty five 00/100

from the proceeds of the above credit to:

Big Machinery Ltd.
P. O. Box 14
Bigtown

We request Nordea Bank A/S on our behalf to notify the issuing bank of this assignment

All charges related to this assignment and its notification is for our account. Please debit such charges to our account no. 1111-12569 in your Littletown Branch.

Littletown Machinery Export Ltd

Peter Smith

Appendix 7

Irrevocable payment order



Littletown Machinery Export Ltd

Nordea Bank Danmark A/S
Trade Finance
P. O. Box 850
0900 Copenhagen C

Littletown, 21 October, 2007

Irrevocable Payment order

Documentary Credit No. 12345-6 issued in our favour by Bank of Import, XYZ Town, expiring on 30 January 2009 and advised and confirmed by Nordea Bank Danmark A/S, Copenhagen, under its ref. 6789-8

We hereby irrevocably instruct you to pay – when you have honoured the above credit - an amount of

DKK 125.000,00, say: Danish Kroner one hundred and twenty five 00/100

from the proceeds of the above credit to:

Big Machinery Ltd.
P. O. Box 14
Bigtown

provided that document covering “1 (one) packing machine, type XOY” are presented and approved by you.

This payment order is irrevocable on our part. Please inform Big Machinery Ltd. of this payment order. Please note that the issuing bank is not to be notified of this payment order.

All charges related to this assignment and its notification is for our account. Please debit such charges to our account no. 1111-12569 in your Littletown Branch.

Littletown Machinery Export Ltd

Peter Smith

Appendix 8

Glossary of terms

The below terms are typically used in connection with a documentary credit or have a special meaning in that context.

Acceptance

The drawee's written undertaking on the face of a bill of exchange (draft) by which the drawee undertakes, pursuant to the statutory rules on bills of exchange, to pay the amount of the bill of exchange on its maturity date. His signature alone is sufficient.

Advising a documentary credit or amendment

The forwarding of a documentary credit or amendment to the beneficiary by the advising bank in compliance with the instructions of the issuing bank.

Advising bank

The bank that advises the credit at the request of the issuing bank.

Applicant

The person or company on behalf of whom the documentary credit is issued.

Application

The applicant's request to the issuing bank to issue a documentary credit.

Banking day

A day on which a bank is regularly open at the place at which an act subject to the UCP 600 is to be performed.

Back-to-back documentary credit

A documentary credit issued on the basis of another documentary credit that will constitute security for the back-to-back credit.

Beneficiary

The party in whose favour a documentary credit is issued. For a commercial documentary credit this will typically be the exporter. The beneficiary must present the documents stipulated.

Bill of lading

A transport document issued in connection with transport of goods by sea. A bill of lading is a document of title and a receipt for transporting goods.

Carrier

The person or company that assumes the responsibility for the transport of the goods.

Certificate

A document to be issued in compliance with the terms and conditions stipulated in the documentary credit. The certificate must be signed.

Collection

Method of payment by which documents are forwarded to the buyer for approval. To avoid confusion and misunderstanding, this term should not be used in connection with documentary credits. Instead phrases such as “forwarded for approval under the documentary credit” or “forwarded for payment under the documentary credit” should be used.

Complying presentation

A presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of the UCP 600 and international standard banking practice.

Confirmation

A definite undertaking by the confirming bank to honour or negotiate a complying presentation. This payment undertaking is in addition to and independent of that of the issuing bank.

Confirming bank

The bank that adds its confirmation to a credit upon the issuing bank's authorisation or request.

Contract

Binding agreement between two (or more) parties. In connection with a documentary credit the agreement will typically be made between the buyer and the seller. The terms and conditions of the contract have no effect on the terms and conditions of the documentary credit or on their interpretation.

Credit (or documentary credit)

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

Deferred payment

A type of documentary credit whereby payment to the beneficiary is effected at a date later than the presentation of the documents.

Discrepancy

Error or defect, according to the bank, in the presented document compared with the documentary credit, the UCP 600 rules or other documents.

Documentary credit

See Credit.

Documents

The documents to be presented as stipulated in the documentary credit. The documentary credit itself, including amendments, if any, is not usually termed document.

Draft

A bill of exchange before it has been accepted by the drawee.

Drawee

The party on whom a bill of exchange is drawn and who is expected to accept the bill.

Drawer

The party drawing the bill of exchange. In connection with a documentary credit the drawer is usually the beneficiary.

Duplicate

The second original of a document. A duplicate serves the same purpose as the original.

Expiry date

The date on which the documentary credit will cease to have effect.

Forwarding agent

The person or firm arranging transport on behalf of the seller. In connection with a documentary credit the transport documents must be issued by a carrier, unless the documentary credit stipulates otherwise.

Honouring

The issuing or the nominated bank's examination of documents and settlement in accordance with the terms and conditions of the documentary credit (payment, deferred payment undertaking or acceptance).

ICC

International Chamber of Commerce, headquartered in Paris.

Instrument

The documentary credit itself, including amendments, if any, and the notice of confirmation.

Inward clearance

Clearance through the customs of goods imported.

ISP98

A set of international rules for standby letters of credit issued jointly by the ICC and Institute of International Banking Law and Practice, Inc., USA.

Issuing bank

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

Maturity

The date on which a bill of exchange or deferred payment undertaking under a documentary credit is to be paid by the party assuming the undertaking.

Negotiation

The purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

Nominated bank

A bank authorised by the issuing bank to honour documents on its behalf.

On board notation

A notation on a bill of lading stating the date on which the goods have been loaded on board a named vessel.

Original document

As distinguished from a copy, the original document has binding effect.

Payment

Final payment of an amount in connection with the honouring of documents under a documentary credit.

Payment order

The beneficiary's instruction to a bank to pay an amount to a third party in connection with the honouring of documents.

Payment under reserve

A bank's notification to the beneficiary to the effect that it has honoured the documents under the documentary credit despite the fact that it has not found the documents in order, and that it reserves the right to demand repayment of the amount if the documents are refused by the issuing bank.

Presentation

Either the delivery of documents under a credit to the issuing bank or nominated bank or the documents so delivered.

Presenter

Beneficiary, bank or other party that makes a presentation.

Recourse

The right to claim a refund of an amount paid in connection with the negotiation of a documentary credit or the discounting of a bill of exchange. Recourse is based on the statutory rules on bills of exchange.

Refusal

A bank's notice to the effect that it does not approve the documents presented and therefore will not take up the documents.

Reimbursement

Refund of a payment made by a party liable under the documentary credit, such as the applicant's payment to the issuing bank or the issuing bank's payment to a nominated bank.

Standby letter of credit

A guarantee undertaking in the form of a documentary credit and, therefore, payable against presentation of documents.

SWIFT

A generally used abbreviation of Society for Worldwide Interbank Financial Telecommunication, headquartered in Brussels. SWIFT constitutes the international telecommunications network for banks and offers a very high degree of security.

Transfer

Transfer of a documentary credit to a second beneficiary in accordance with the UCP 600.

Transport document

Document showing the mode of transport, place of dispatch, destination, description of the goods etc. In connection with a documentary credit these documents are usually to be issued by a carrier.

Triplicate

The third original of a document. A triplicate serves the same purpose as the original and the duplicate.

UCP 600

ICC Uniform Customs and Practice for Documentary Credits, ICC Publication No. 600. International rules for handling documentary credits (including standby credits).

Waybill

Transport document that is a receipt for goods, evidencing that the goods have been sent and stating the consignee. The waybill is not a document of title and goods will be released to the consignee stated in the waybill.

