



DC Insight

Monday, 08 July 2013

Negotiation and the law of contracts - comments

Dear Sir

I read with some interest the article written by Mr. R. Bose. With all due respect I feel obliged to take issue with some of the statements made. In particular the first sentence of the last section viz. “Consequently, ... nothing to do with financing.” is a striking repudiation of the very essence of negotiation as understood by most bankers of my acquaintance.¹

One will I believe find the roots to both the concept and the word itself in the treatment of negotiable instruments². Restricting the focus to Letters of Credit, bills of exchange and shipping documents for the purpose of this response, clearly bills of exchange are by legal definition negotiable instruments. To the extent that BoE have been superseded by deferred payment L/Cs one could say that such L/Cs can also be the object of negotiation with regard to the shipping documents presented thereunder.

One of the functions of international banks engaged in trade finance is to provide finance to its clients, one element of which is to advance funds under L/Cs by means of negotiating (giving value for i.e. buying same from the beneficiary) documents which, in the opinion of the paying bank, conform with the terms and conditions of the underlying L/C. Recourse to the beneficiary will generally only obtain to a bank which has not confirmed a L/C³ e.g. if the negotiating bank were other than the advising and/or confirming bank, in which case it might well obtain recourse on the beneficiary by mutual agreement or otherwise.⁴

¹ refer to M. Bridge, *The International Sale of Goods Law & Practice*, 1st ed. 1999 (Oxford University Press), Art. 6.12 for an example of negotiation (of a bill of exchange)

² refer to *Chitty on Contracts*, Vol. I, 29th ed. 2004 (Sweet & Maxwell, London), Art. 19-084 for a definition of negotiable instruments

³ drawee could exclude this and mark the bill “without recourse” as per Bills of Exchange Act 1882, s 16 (1)

⁴ refer to R. Jack, *Documentary Credits*, 2nd ed. 1999 (Butterworths) Art. 7.9 ff on this topic

To confuse the basic service made available by banks to finance L/C business as outlined above with “performance” or “compliance” with an L/C serves only to obfuscate. Performance as a concept is probably more properly restricted to the underlying contractual obligations of buyer and seller which, as UCP makes very clear, are separate and different from the UCP framework and the process of obtaining payment as consideration for the presentation of compliant documents under a L/C.

Whilst acknowledging that all parties involved in the L/C processing chain are required to “perform” i.e. execute certain acts or fulfil given tasks, this is not the same as the act of advancing, or promising to advance, funds to the beneficiary by a bank “negotiating” a draft and/or documents at the beneficiary’s behest.

Another statement made i.e. “5. By confirming a credit, a confirming bank steps into the shoes of the issuing bank.” is quite simply wrong. The confirming bank’s payment undertaking, if given, is in addition to, and not in replacement of, that implicit in the issuing bank’s decision to issue an irrevocable L/C. Nothing any other bank in the L/C chain does, or fails to do, obviates or voids the issuing bank’s ultimate payment obligation in the event that compliant documents are presented in accordance with its instructions.

It is my personal opinion that the ICC should expunge all reference to bills of exchange from UCP and indeed expressly forbid their use. In part this is because such bills are rarely, if ever, accepted by the drawee and thus lose their efficacy as a means of obtaining, or securing, non-recourse payment for the beneficiary/drawee.⁵ They also represent (potentially) an alternative payment mode and thus merely detract from resp. compete with the L/C as the sole means of providing payment to the beneficiary.

Whilst I can understand and sympathise with Mr. Bose’s desire to eliminate “negotiation” as a function, term and concept from UCP, he does the trade finance community no favours by proposing a definition of the term which fails to impart its true source and purpose.

your sincerely

Peter Sproston
LLM, BSc (Hons), ACIB, MIEEx (Grad)

⁵ Bills of Exchange Act 1882, s 55