Protection afforded by the use of (confirmed) documentary credits

The benfit obtained by using an LC is dependent primarily upon the quality of the documents presented[1] in utilisation of same. This is because banks deal in documents[2] and are expressly held not to be concerned with or bound by underlying contracts.[3] This is a potent shield protecting the contractual parties from the consequences of commercial dispute in the underlying transaction. It also ensures that the banks involved are not drawn into a dispute and can thus make an objective decision based on the "strict compliance"[4] of documents alone. Without this pre-ordained separation of rights and obligations on the part of the banks there would be a clear risk to the "guaranteed" flow of funds foreseen by all parties which is the very foundation for the use of LCs and their continued acceptance as instruments for providing payment to the sellers of goods.

The obverse to this coin is of course that any divergence from the LC terms regarding the form and content of documents to be presented will put payment at risk. The most common means of solving this problem are:

i. discrepant documents are sent forward to the Issuing Bank for acceptance / payment

ii. the Advising / Confirming Bank inform the Issuing Bank by authenticated message of the discrepancy(ies) determined in the documents, asking for authorisation to take up the documents despite same

iii. if the LC is confirmed, the Confirming Bank might agree to impose an "internal reserve" which means that the discrepancy will not be advised to the Issuing Bank but held towards the Beneficiary only. This is usually offered (at the Bank's sole discretion) if the discrepancy is relatively minor or if Beneficiary and Confirming Bank disagree as to the validity of the discrepancy raised and invariably arises from a (frequently heated) discussion on the technicalities of the LC & documents, based invariably upon conflicting interpretations of UCP 600 and/or ISBP.

iv. a less common form of payment "under reserve" concerns an Advising / Confirming Bank taking up and/or paying for documents despite discrepancies noted and advised to the Issuing Bank. These are then sent forward to the Issuing Bank for subsequent acceptance. Should the Advising / Confirming Bank have paid the Beneficiary for such documents it will only be on a "with recourse" basis. This entitles said Bank to reclaim from the Beneficiary the documents' value plus accrued interest should the Issuing Bank subsequently decline to take up the documents. The inherent risks involved in this mechanism ensures that this remains relatively rare in the banking community.

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[1] the creditworthiness and reliability of the Issuing and Confirming Bank are not to be underestimated
[2] UCP 600 Art. 4 a.
[3] UCP 600 Art. 5
[4] Equitable Trust Co of New York v Dawson Partners Ltd. (1926) 27 LI L. Rep. 49

And what about unconfirmed LCs, what security do these offer, can they be discounted? The answer hereto is yes to both. If one has a reputable and solvent Issuing Bank, payment against LC conform documents[5] can be sought. If one has a usance / term LC and the Issuing Bank has taken up documents for payment at maturity, one could ask the advising/nominated Bank to discount the documents. This might be easier if a draft drawn on the Issuing Bank is part of the documents presented. In essence one can ask for a "silent confirmation" to be added post factum for which the advising/nominated bank will take a confirmation and discounting fee. The discount should then be done on a non-recourse basis.[6]

Two aspects which need to be borne in mind with such unconfirmed LCs are: at whose counters is the LC available, the issuing or advising bank and, is the advising bank a nominated/negotiating Bank or not? If the LC is available at the issuing bank's counters and the advising bank is not a nominated bank, then the beneficiary cannot look to the advising bank for support if there is a dispute regarding the documents because the advising bank will have no mandate to check the documents to detemine if same are credit conform or not unless the advising/nominated bank agrees to do so and advises the beneficiary accordingly.[7]

If the LC is available with the advising bank then the best option for the beneficiary is to have a negotiable LC. Why? Because by nominating the advsing bank to negotiate documents, the issuing bank grants an express mandate to the advising / negotiating bank to take up documents on behalf of the issuing bank[8], it thus binds the issuing bank to reimburse the advising / negotiating bank should it consider the documents presented to be credit conform. It has the added benefit of putting the postal risk on the issuing bank / applicant,[9] the effect of which is that reimbursement must be made even if the documents despatched by the advising bank were to be lost in the post[10].

Applicant / Buyer seeks to renege on the payment obligation

Reasons for and the means in support of a buyer's intent to withhold payment under a commercial transaction, as also the seller's defences thereto, are outside the remit of this paper. Fortunately for banks, buyers and sellers using documentary LCs, there is a well established body of (English) law which clearly insulates LCs from the underlying

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[5] this implies issuance of an authenticated statement of having taken up documents by the issuing bank
[6] the Bank, by "giving value" for the draft, becomes a party thereto and thus obtains the right to claim directly against the Issuing/Accepting Bank. The recourse element is/should be waived by the terms of the silent confirmation being added and the discounting (more properly forfaiting) effected thereafter.
[7] UCP 600 Art. 12 a.
[8] UCP 600 Art. 7 a. & c.
[9] UCP 600 Art. 35
[10] UCP 600 Art. 35 para. 2

transaction. This is otherwise known as the autonomy of the credit and was well defined by Jenkins LJ[11] whose analysis is given in Appendix I hereto.

What this means in practice, assuming a buyer decides to renege upon or simply withhold payment for goods, is that there are two main scenarios:

a. documents presented are discrepant:

This puts the seller completely at the mercy of his buyer. He and/or the issuing bank can reject documents and have same returned unpaid to the seller whose only recourse for the payment would be mutual agreement upon the (revised) price, or arbitration or legal suit.

b. documents presented are credit conform:

Assuming the beneficiary / seller has the benefit of a confirmed LC and the confirming bank has found the documents to be in order, payment is guarantee irrespective of any contractual disputes between buyer and seller. This is the ideal situation for the seller, less so for a buyer who might have to pay for contractually non-conform goods. As the confirming bank will be the issuing bank's nominated bank, the latter is obliged to reimburse the confirming bank once they have taken up and despatched documents. The buyer can at most hope the issuing bank can find a valid discrepancy in the documents and thus withhold payment to the confirming bank. It is at this stage that a buyer/applicant might start to put pressure on the issuing bank to "just find a discrepancy, or otherwise invent one" in order to circumvent it's payment obligations. This is not unknown but it seems to be becoming less common these days as banks seek to burnish rather than tarnish their reputations in the banking community.

It should be remembered that the more complex an LC, and the more documents listed, the greater the chance of discrepancies occuring. In one case[12] documents running to 967 pages had to be presented, all of which had to evidence mutual consistency. Little wonder then that discrepancies could be found. Ergo, keep LC requirements simple!

The legal base for successfully resisting such pressure can be found in a case[13] that established the principle that banks are not required to concern themselves with the goods or matters relating to the underlying contract, but only with the documents relating to and presented under the particular LC, as ever fraud remains the exception to this rule. It reinforced the contractual link between a bank making payment to the beneficiary and being thus entitled to reimbursement from the issuing bank. This case is summarised in Appendix II. Therefore, if documents are compliant the bank(s) will pay and the buyer must seek redress outside of the LC transaction e.g. through arbitration or the courts.

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[11] Hamzeh Malas & Sons v British Imex Industries Ltd. (1958) 2 QB 127
[12] Bankers Trust Co. v. State Bank of India (1991) 2 Lloyd's Rep. 443
[13] United City Merchants (Investments) Ltd. v. Royal Bank of Canada (The American Accord) (1983) A.C. 168, (1982) 2 Lloyd's Rep. 1.

Issuing Bank: resisting pressure to dishonour, rights and obligations

It is an unavoidable fact of commercial life that when economic circumstances are benign and both goods and cash flow freely there is in general less inclination to hinder this flow because the goods are needed and solvent buyers are available to take them. It is equally axiomatic that when this happy confluence of circumstances weakens or collapses, there is a greater emphasis on avoiding risks and liabilities, both by the banks and buyers.

We can be thankful to the ICC for having sought, for many decades now, to insulate the trading parties (sellers / buyers / banks) from this potentially dangerous cyclicality by having banks process LCs subject to UCP rules. Having said this, it is nonetheless true that some banks will be subject to pressure from some of their clients to avoid or reduce their payment obligations. This might be more common where state-owned banks provide banking services to state-owned companies. It might also occur when a bank has an exposure to one or more very large clients who may thus excercise disproportionate influence over the bank's commercial decisions.

Because the nature of LC transactions between banks, sellers and buyers is based upon the contracts that come into being between them, the bank will have recourse both to the Credit Facility and Security Documents which govern the legal relations between itself and its customers, as also the UCP Rules extant at the time. It is perhaps interesting to note here that irrevocable LCs represent an exception to the rule of English law regarding consideration[14] in that: "*Where a banker issues (or confirms) an irrevocable credit, the generally held commercial view is that the banker's promise to the beneficiary is binding as soon as it is communicated to the beneficiary, and before the latter has acted on it in any way*."[15] which concept has the benefit of case law to support it.[16] There had been an effort to plead a lack of consideration for a banker's LC but this was duly rejected.[17] The issue of consideration regarding LCs is given detailed attention by R. Jack.[18]

One aspect which has not been considered, is that where the purchase LC prescribes the presentation of a document(s) which it is only in the power of the applicant to produce. In days of yore this was known as a "Stop Clause" but such have now become much less common and are now generally frowned upon by LC issuing banks. Such a clause(s) renders the autonomy of an LC invalid, making acceptance of the seller's documents

[14] defined as "something of value" being given and received and is thus either some detriment to the promisee or some benefit to the promisor per Chitty on Contracts, 29th ed. at 3-004 pp 217
[15] Chitty on Contracts, 29th ed. at para. 3-179 pp 327
[16] Hamzeh Malas & Sons v British Imex Industries Ltd. (1958) 2QB 127 – see Appendix I for the text
[17] Dexters Ltd v Shenker & Co. (1923) 14 LI L Rep. 586, Greer J stating: "*Now it is clear that, until they got a form of banker's credit which would comply with the terms of the contract, the plaintiffs were not bound to send the goods forward at all; and therefore not having got the banker's credit until there was a substituted arrangement for another credit elsewhere, they were under no obligation to anybody to send forward the goods. Therefore it is quite clear there was full and ample consideration for this undertaking* ...." see also: Benjamin's Sale of Goods (4th ed.) at para 23-099
[18] Jack, Raymond, *Documentary Credits* (2nd ed.) 1993 (Butterworths) paras 5.6 – 5.12

conditional upon the buyer's agreement to do so. An example of this is given in a case turning upon payment of the final 10% due[19] albeit a more common example was the requirement to present an "invoice duly accepted & countersigned by applicant". It can thus be said that an issuing bank has a clear obligation to pay against LC conform documents and has sufficient legal basis for resisting a customer's pressure to unfairly or invalidly reject documents which, on an objective evaluation, are held to comply with the LC terms and conditions.

Confirming Bank: insulation from underlying contractual obligations

The UCP 600 clearly states that the confirming bank (as indeed is the case with all other banks involved in the LC chain) deals in documents only and has not to concern itself with the underlying transaction and commercial contract.[20] The nature of the confirming bank's role, having been chosen by the beneficiary to handle his documents, should lead to a more objective assessment of the documents presented. Notwithstanding this, the confirming bank is still obliged to seek reimbursement from the issuing bank and thus has an imperative to ensure in good faith that the documents are on their face LC compliant.

One of the reasons a beneficiary is prepared to pay for the LC confirmation is to protect himself from the (mis)perceived arbitrariness or bias of the issuing bank in checking his documents, other reasons being to lay off the political and transfer risks as also to gain the opportunity to discount the proceeds of a usance LC if needed and the bank agrees.

Once the confirming bank has found the seller's documents to be in order, payment can be expected immediately (for a sight LC) or, if a usance LC is used, it might be possible to have the bank discount documents the and give value on a sight basis. A major benefit of doing so is that, whether payment is obtained at sight or on a discounted basis, proceeds are disbursed on a non-recourse basis. Thus is payment for the goods (by the bank) separated from the (buyer's) underlying contractual obligations duly perfected i.e. the buyer's payment obligation is assumed and effected by the confirming bank. Any commercial disputes are handled outside the LC mechanism without, ad interim, endangering the non-recourse nature of the bank's payment made to the seller.

Even if the documents are subsequently held not to be compliant by the issuing bank and/or applicant, this alone is insufficient to oblige the seller to return the funds already paid out or, if proceeds were not discounted, to forfeit receipt of same at due date. The irrevocable nature of the banks' payment undertaking protects the seller from any subsequent recourse on the part of the banks involved. This stance appears to be supported in *Benjamin on Sale of Goods*[21] regarding mistake as to the documents and is expressly held to be so by UCP.[22]

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[19] *The Royan* (1991) 2 Lloyd's Rep. 443, now partially codified in UCP 600 Atr. 16(b) per Todd at 9.54 ff
[20] UCP 600 Art. 4 a.
[21] 4th edn para 23-123
[22] UCP Art. 7 and 8

Escalation Clauses

What is the purpose of such clauses? As the name suggests, they have the effect of increasing the LC value subject to external pricing mechanisms. The logical counterpart to such clauses is the De-escalation (i.e. reduction) Clause which reduces the value of the LC (or more commonly Stand.by LC) by the same means. Hence these are invariably paired to ensure an equitable pricing outcome for both buyer & seller. This will be found *inter alia* in metals and oil products transactions whereby the former will usually fluctuate according to the relevant LME prices prevailing over a certain period (usually linked to the bill of lading date) often as a so-called "wrap around" being anything from 3 days to 3 weeks around the BL date, month of shipment, as also to the month prior to, of, and after shipment. Regarding oil products the pricing basis might be a formula using one or more 3rd party pricing publications e.g. Platts / ICIS / Argus etc. as a mutually acceptable and independent means of determing the value to be paid but using mainly the same or similar wrap-around terms indicated above.

One sees such clauses especially in Swap LCs used as a means of hedging exposures. Some banks decline to issue such instruments or LCs / SBLCs including same as their payment obligation cannot be assessed at the time of issuance, being dependent upon the marked to market (M2M) pricing movements during the LC validity. Thus the maximum liability remains unknown until conclusion of the pricing period. This could result in a customer's credit line being exceeded with obvious consequences regarding internal controls, collateral security etc.

The issuance of such LCs can however be avoided, or supplemented, if the bank's customer does his hedging through a recognised clearing broker / intermediary with whom he has a credit line and which account is duly pledged to the financing bank under the terms of a Tripartite Agreement entered into between the bank, broker and customer. In this scenario margin payments outside of the line (variation margin) will be due to the broker but settled by the bank as a means of securing the price risk. Usually the Credit Facility will include a sub-facility for such payments or permit same to be handled outside the Credit Facility so that the customer can continue his commercial activities without undue constraints upon his cashflows / liquidity. Such a facility is essential in times of great price fluctuation as it avoids a line being consumed by margin calls which in turn limit the bank's customers from fully engaging in his market activities. It needs to be borne in mind that failure to meet a clearing broker's margin call(s) within the prescribed period may result in the hedge(s) being unilaterally unwound which in turn could have dire or catastrophic consequences for a bank's customer as the physical leg of a deal would no longer have its profit margin locked in thus exposing both the bank and client to a potentially loss-making scenario since market pricing volatility is no longer mitigated.

Most banks fight shy of issuing instruments incorporating an escalation clause. One reason is simply that the bank cannot *a priori* determine its potential exposure in the event a claim is made. Because the bank has capital allocation rules to meet, based on the face value of its conditional payment obligations, this can of course be a problem

albeit not insurmountable, as there are internationally active trade banks that can issue such instruments, however one suspects the creditworthiness of the bank's client will play an important role in determining whether they will countenance such issuance. Another possible reason is pecuniary. Commission is taken on the max. face value of the instrument issued. If this can only be determined in the event of a claim, it is possible that the bank has been providing its payment undertaking at a discount to its obligo.

The most common means of overcoming this conflict of interests is to issue an instrument incorporating an escalation clause but capping the bank's max. payment obligation. The market value of the underlying goods at the time of issuance is taken as a benchmark but with a cap set at an agreed percentage in excess of same. The seller may have the right to call for an adjustment to the instrument's value during its validity to compensate for any upward price movements in excess of the original fluctuation band.

The Fraud Exception

Having referred several times above to this matter, it might be helpful to expand upon it here. *Todd*[23] pp 260 ff deals with this in detail and the following is based thereon.

As Interim Injunctions in Spain, Italy & India are discussion items on the ICC 4th Global Conference agenda, it is incumbent upon me to reiterate that the following comments and points are based upon English Law and might thus have little bearing upon or relevance to the decision-making process applied in other jurisdictions.

Probably in recognition of the essentially autonomous nature of documentary LCs and the various contractual relations ancillary thereto, it is held to be very difficult for a plaintiff (LC applicant or beneficiary) to obtain an interlocutory injunction to prevent a bank from effecting or sueing it to enforce payment for documents (to be) presented under an LC. This despite the fact that fraud is a civil rather than criminal event, with proof required for the former being the "balance of probability" rather than being "beyond reasonable doubt" as required in the latter.[24]

Timing, as so often, is very important for, if a bank has paid against documents which on their face are held to comply with the LC terms then it would appear not to be in breach of its mandate.[25] This principle was further applied when, at the time that documents were presented to the bank for payment the bank was not, nor had been made aware of, any fraud with regard to same.[26]

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[23] Todd, Paul, *Bills of Lading and Bankers' Documentary Credits* (4th ed.) 2007 (Informa, London)

[24] The Grecia Express (2002) 2 All E.R. (Com.) 213, 227 viz; "*the more serious an allegation is the more intrinsically unlikely it is to be true and therefore the stronger the evidence that is required to establish that it is more probable than not that the allegation is true*"

[25] Gian Singh & Co. Ltd. v Banque de l'Indochine (1974) 1 W.L.R. 1234

[26] Sztejn v J. Henry Schroder Banking Corp. (1941) 31 N.Y.S. 2d 631 (Supreme Court of New York) which decision was approved by Lord Diplock in *United City Merchants* (stated above)

The logical corollary to the above is that if the bank's attention has been brought to an alleged fraud before receipt of documents or at least prior to payment for same has been effected, then it behoves the bank to seriously consider its position.[27] All the more so as the claimant/plaintiff need only demonstrate that "*... there is a serious question to be tried (the threshold test), and that the balance of convenience test favours the granting of the interlocutory remedy*."[28] This principle derives from a dictum by Lord Diplock[29] who appeared to admit that in a previous case[30] this principle had been applied too narrowly thus it now appears that courts are empowered to grant injunctions to prevent a party from committing unconscionable conduct.[31]

What then is an applicant/buyer to do if he is aware, and can provide plausible proof of, a fraud committed by the beneficiary/seller? It would appear that it will prove all but impossible for the buyer to restrain a bank from effecting payment with which he has no direct contractual relationship e.g. the confirming bank.[32] He can at most seek to restrain the LC issuing bank from making payment to the advising/confirming bank or the seller. A means of establishing whether the threshold test is met would be *per* Ackner L.J.; "*We would expect the Court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. In general, for the evidence of fraud to be clear, we would also expect the buyer to have been given an opportunity to answer the allegation and to have failed to provide any, or any adequate answer in circumstances where one could properly be expected. If the Court considers that on the material before it the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case of fraud.*"

To support this view, it was held that: "*... the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests upon the uncorroborated statement of the customer ...*"[33]

Having thus addressed the issue of the threshold test, the balance of convenience appears to present an even higher hurdle to a buyer/applicant seeking to protect himself. The dicta of Kerr J. in Harbottle[34] refers and is reproduced in full in Appendix III. In essence this holds that if the bank is in breach of its mandate by debiting the plaintiffs' account then they will have recourse to damages against that (presumably solvent) bank whereas if the bank, by not paying, exposed itself to a claim for damages it is possible they would be unable to reclaim the full value of the costs thus incurred from their client/plaintiff.

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[27] Edward Owen Engineering Ltd. v Barclays Bank International Ltd. (1978) Q.B. 159; (1978) 1 Lloyd's Rep. 166, CA
[28] *Todd* at 9.116 on pp 263
[29] American Cyanamid Co. v Ethicon Ltd. (1975) A.C. 396, 406; "*It is no part of the court's function at this stage of the litigation to try to resolve conflicts of evidence on affidavit as to facts on which the claims of either party may ultimately depend nor to decide difficult questions of law which call for detailed argument and mature considerations. These are matters to be dealt ith at the trial*."
[30] The Siskina (1979) A.C. 210
[31] South Carolina Co. v Assurantie NV (1987) A.C. 24, 40 per Lord Brandon
[32] this assumes that the principles elucidated in *The Siskina* are applicable to the case in question
[33] Bolivinter Oil SA v Chase Manhattan Bank (1984) 1 Lloyd's Rep. 251, 257
[34] Harbottle (Mercantile) Ltd. v National Westminster Bank Ltd. (1978) Q.B. 146

As between the banks, reversing the result of *Santander*, UCP 600 has brought the time forward at which the confirming bank must become aware of a fraud to the point at which payment is made to the beneficiary.[35] The confirming bank is thus treated as if it had negotiated a draft, taken free of equities, drawn on the issuing bank, thus obliging the issuing bank to reimburse the confirming bank even if, after the time of negotiating the draft and its receipt by the issuing bank, a fraud were indeed to come to light.

It will be fairly clear from the above that the buyer/applicant, depending on the voyage duration and/or time given to present documents, will have very little time to provide the "corroborative evidence" if payment is due against a sight LC. Only if there are deferred payment terms prevailing will he have a reasonable chance of furnishing the requisite evidence to a court and also have given the putative defendant/fraudster a reasonable time to rebut the claim(s) made by the buyer. Hence, as so often, time is here of the essence!

Fluctuating Prices – a case study

Volatility in commodity prices has become an everyday experience. The causes are manifold and need not be expounded upon herein, however linkage between currencies (e.g. USD / JPY carry trade) and commodities (e.g. USD / Gold / Crude Oil) as also the investment criteria of hedge funds, institutions, sovereign wealth funds, private equity and investors et al can lead to a disconnect between fundamental underlying economics and the prevailing prices of commodities at any given time. The dynamics of global capital and investment flows are complex hence the need to protect oneself, as much as possible, from unexpected and oft inexplicable price fluctuations.

The need for protection against adverse price movements is not new, hedging, whether for commodities or currencies, has been a standard tool for a long time. The increasing price volatility as divorced from market fundamentals is perhaps more recent.

One might think that the main risk is in a market of falling prices. This is however only really true for sellers, exposed to the potential risk of buyers reneging on contracts and covering themselves at the lower, prevailing prices. There is also a risk in a rising market to the extent that a seller might wish to re-allocate goods to a more profitable spot sale and seek means of escaping his delivery obligations.

As we are dealing here with LC related transactions, we shall concentrate on the former risk, that of falling prices. At this point it is worth noting that reneging upon, or seeking to avoid, LC payment obligations, is an act limited initially to the banks, seller and buyer bound as they are by current UCP rules. Avoiding payment due to the presentation of non-compliant documents under the LC does not necessarily (depending upon the nature of the discrepancy(ies) found in the documents)[36] free the buyer from his contractual

[35] UCP Art. 7 (c) on issuing bank's reimbursement obligo & Art. 12 (b) authorising prepayment / purchase
[36] e.g. late shipment, delivering non-contractual goods (breach of contract), backdating the BL (fraud) etc.

obligations, these would have to be pursued in litigation / arbitration. Thus, although the primary source of payment (under the LC) may be endangered, the secondary course of obtaining satisfaction will still be available, the variants being the time and uncertaintly concomitant upon obtaining and then enforcing a court judgment in one's favour.

Whilst there are several cases to choose from, one which I remember clearly due to the immediate impact it had in banking circles (when I still belonged to this happy elite) is *Glencore International AG v Bank of China*[37] being, an illustration of the decision to take advantage of discrepant documents when linked to a fall in market prices.

The LC issuing bank, Bank of China, alleged inter alia two discrepancies. One relating to the goods description (an expanded version was used in the documents which the court did not consider to be a discrepancy) and that copy, instead of original, certificates stating that one full set of non-negotiable set of documents had been despatched to the buyer had been tendered. The market for the underlying goods, aluminium ingots, was falling at the time documents were rejected.

The issuing bank contended that (under UCP in force at that time) the documents in question, whilst signed, were not originals as called for. The relevant Article[38] read thus:

> "Unless otherwise stipulated in the Credit, banks will also accept as originals document(s) produced or appearing to have been produced:
>
> i. by reprographic, automated or computerized systems;
> ii. as carbon copies;
>
> provided that it is marked as original and, where necessary, appears to be signed."

Whilst the certificates were signed they were not marked as original. The Court of Appeal considered that the documents appeared to be originals but they came to the conclusion that they must be construed as authenticated copies (by virtue of the signature appended thereto) and were therefore discrepant. The documents in question were of no commercial value whatsoever but assumed a disproportionate importance because the issuing bank sought out a technical discrepancy which the applicant declined to accept.

Thus could the buyer avoid payment of goods for the sake of a missing stamp! From this time on, and still today, documents produced in the same manner (i.e. reprographically) are religiously stamped as original, to avoid the same trap. A case like this shows both the strength and weakness of the "strict compliance" concept for to demand of a bank that it use its discretion in defining what is compliant or not might appear to be fair in precluding such rejections, it puts us on the slippery slope of potential abuse of the latitude necessarily granted to banks that this right implies.

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[37] (1996) 1 Lloyd's Rep. 135; (1996) 5 Bank. L.R. 1; C.L.C. 111; (1998) Masons C.L.R. Rep. 78, *The Times*, November 27, 1995, CA

[38] UCP 500, Article 20 (b)

Chain Sales

Unequal terms of sale

In a perfect world, chain sales would comprise perfectly matched parameters spanning the entire chain. Whilst this is probably often the case (once a chain has been identified) it is not always thus. Consider the logistical complications arising from a mixture of LC, CAD, Acceptance (of a draft), open account terms, then stir in sight versus usance terms and one obtains a melange of conflicting contractual terms guaranteed to ensure a few sleepless nights.

Payment terms are probably the easiest to manage provided one has a bank(s) involved prepared to discount usance / deferred payment LCs whereby one can discount proceeds thus obtaining essentially sight terms. The financial costs[39] need to be taken into account but otherwise the procedure is simple. The same applies to sales against draft acceptance albeit the forfaiting market is not as liquid as it once was and quotes, if available, can be somewhat higher.[40] CAD sales are not so manageable as there is always the residual risk that documents will not be paid, or only paid at an indeterminate future date. It also has the disadvantage of requiring inter alia presentation of full set of bills of lading, which itself can delay the movement of documents along the chain unless only the end-buyer is involved. In essence therefore, one can say that any terms of sale requiring presentation of documents to a bank will delay the passage of same along the chain.

A common means of solving the problem of presenting (original) shipping documents through a bank(s) is the use of an LOI (Letter of Indemnity) for missing documents. This is invariably linked to a fax / telex invoice which can be for either a provisional[41] or final value. This enables the seller to obtain immediate payment against the quid pro quo of a promise to present the original shipping documents, or bill of lading, at a later time. Such an LOI might have to be countersigned by the seller's bank which effectively assumes the seller's liability should the agreed documents not be tendered within due time.

One bill of lading to serve multiple buyers

This issue has already been touched upon above. Other factors here could be the manner in which the BL has, or has to be issued. Without the involvement of banks, the chain members could agree upon a simple "to order blank endorsed" BL which, being a bearer title document, could be passed along the chain unchanged bar the requisite endorsements being appended during the movement of documents for the attendant transfer of title.

[39] these will comprise the LC confirmation commission, relevant cost of funds and the discount rate
[40] this is understandable as the forfaiteur bears the risk on a commercial entity, not a bank
[41] this is frequently necessary if the pricing mechanism is based on a formula (mean of ICIS, Platts etc.) or a "wrap around" linked to an agreed period, this might be a wrap around the BL date e.g. week before, of, and after BL date, the month of or before / after shipment etc.

It is however often the case that a bank will call for a BL to be issued to its order.[42] This has the following disadvantages (for the parties to the chain) namely: the BL must be presented to that bank in order for it to endorse the BL as required by the next buyer, it takes longer and there is the ever-present risk that the BL is wrongly endorsed or indeed not endorsed at all. If this scenario is repeated along the chain, then the risk of delay in getting the original BLs to the ultimate buyer prior to vessel's arrival at disport is greater. If the BL were to be issued as a "straight" BL this could also complicate title transfer.[43]

Other complicating factors could be the shipper[44] and notify[45] details, the description of goods[46] (this can change according to buyer and occurs regularly in the petrochemicals sector and can cause problems with both vessel owners (viz IMO regulations) as also banks subject to UCP rules) whether transhipment is permitted by all parties in the chain or not and freight stipulations e.g. whether prepaid, payable at destination or as per charter party. This latter point is not to be dismissed lightly for, in a chain subject to charter party(ies) the head and sub-charters might not be exactly similar with regard to payment of freight. The owner might allow freight payable at destination for a strong counterpart whereas another, perceived to be of lesser financial standing, freight might be demanded in advance of shipment with the shipment of goods resp. issuance of the BL being made subject to receipt of same. Freight per se can be a complex theme, readers are referred to *Baughen*[47] and *Carver*[48] for further elucidation.

Transferring title, delays in furnishing title document, indorsements, LOIs

Title transfer / passing property is itself is a multifaceted issue and not limited to merely indorsing and passing on the BL. The delivery terms agreed (whether Incoterms 2000 or not) as also the intent of the contracting parties will play a role in determining when title passes. This will for instance apparently not be the same for FOB[49] & CIF[50] sales albeit property would appear not to pass prior to shipment of the goods.[51]

One issue of particular pertinence is passing of property in an undivided bulk, a common situation in both grain and oil cargoes. Sections 16 to 20 of the Sale of Goods Act 1979 cover this issue most comprehensively and are recommended reading.

[42] the bank's collateral security requirements may demand this resp. the client's facility letter might not include a sub-limit permitting this obligation to be waived e.g. no unsecured transactions being allowed
[43] this being "consigned to a named party" and cannot strictly be endorsed, only assigned to another party
[44] of particular significance if the cargo is subsequently lost re. appropriation of same, furthermore some LCs require the applicant to be shown as shipper which, in a chain, might prove prolematic
[45] especially since UCP 600 with its more stringent demands regarding same if this is the LC applicant
[46] this was an issue in *Glencore International AG v Bank of China* referred to above
[47] S. Baughen, Shipping Law, (Cavendish Publishing) 2004, 3rd ed. p. 222
[48] Carver on Bills of Lading, (Sweet & Maxwell, London) 2005, 2nd ed. p. 155, 4-046 ff
[49] in general it is presumed that property passes when goods have been shipped but see Concordia v Richco
[50] here it is presumed that constructive delivery occurs upon tendering of shipping documents & payment
[51] Carlos Federspiel & Co. SA v Charles Twigg & Co. Ltd. Q.B. (Comm.) (1957) 1 Lloyd's Rep. 240 in which it was held that property for the goods, although paid for, did not pass until shipped

Routing documents through multiple banks, inconsistent LC terms

Assuming that the banks involved will be LC issuing and advising banks, one of the major problems will getting the LCs strictly “back to back” which is rarely easy and perhaps impossible if the sequence of issuance does not match the flow of the chain e.g. one party cannot open his LC until the “backing” LC has been issued to him, thereafter defining and getting amendments that are needed to ensure a compliant presentation etc. As noted above, it is easier to use stand-by LCs or, failing this, documentary LCs which allow for availment against LOI (for missing documents) and (fax) invoice to ensure the flow of shipping documents can continue virtually unhindered outside the LC banks.

Defining the ultimate port of discharge, as this can change during the voyage if the last buyer needs to have the vessel rotation changed and, if an LC is used, require a further string of amendments (contractual as well as to the LC(s)) to permit all parties to obtain payment against the bill of lading finally required can be another problem. Some banks will neither issue nor advise an LC until the ports of loading and discharge are known to comply with internal contraints concerning various sanctions on blacklisted countries.

A regular problem is the time constraint in getting a final version of the bill of lading agreed, knowing that once goods are discharged this will be almost impossible, an “accomplished”[52] bill of lading could be used but most banks will reject such a document as it no longer provides collateral security.

One more potential issue regards proving an insurable interest, the time when property and risk is/are transferred in order to define liability and who has a valid claim for loss and/or damage and of course to whom the claimant should address his claim.

Chain Sales – a case study

For the purpose of this example, we shall use a bulk commodity. Goods of a specific nature (e.g. plant / machinery produced to particular specifications for a given buyer) present their own problems are unlikely to become part of a chain, whereas bulk goods (grain / oil etc.) are by their nature more likely to engender interlinked sales, in part due to the sheer volumes involved (comprising the majority of all goods moved by sea).[53]

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[52] an original bill of lading being accordingly stamped, duly voiding it as a document of title
[53] ca. 2/3 per Martin Stopford in *Maritime Economics*, table 11.2, pp 422 based on statistics for 2005 resp. “nearly ¾ of the total world tonnage” per Todd at 1-048 on pp 49

How do chains / string sales actually come about? How does one know that one is part of a string in the first place? To summarise M. Bridge[54] (full text in Appendix IV) in grain transactions, because circles are more common and indeed expressly provided for in the GAFTA 100 contracts, traders are more aware of what to look for. Prior to notice of appropriation being given this may be quite difficult, but as noted below, seller, loadport, vessel and laycan when known will usually be the starting point for establishing a circle.

My colleagues in the petroleum products sector inform me that strings can become circles by various means. One can actively search for a circle amongst the market players based upon open deals or one becomes apparent by virtue of the loadport / supplier / vessel name / reference no. which, when compared to one's trading book, indicates that a circle can be made. This can be useful when product is scarce by leaving only true physical deliveries on the book and eliminating the rest. Settlement is usually done at mid- or end-month giving 5 working days notice to allow parties to the chain to fulfil their LC issuance obligations. This can be effected by either full invoicing and money transfers or based on differentials, but usually (if open credit terms have not been granted) LCs are opened to secure the payment obligations. Contrary to the GAFTA circles, full payment or differentials are based on a stand-alone, contract price basis, at least for ARA (Antwerp, Rotterdam, Amsterdam) business. It appears that in Korea the market players are known to agree a mutually binding circle price analog to the GAFTA practice described in Appendix IV.

FOB terms are the most common because under these terms delivery is to the ship, not to a named destination, thus facilitating the trading of floating goods, constructive delivery being made (also under CIF terms) by transfering the shipping documents between the parties. To give an idea of the length of such chains, it is averred that these can involve up to 50, indeed over 100 counterparties[55] in the mineral oil trade. I have myself seen a bill of lading, plus several riders, liberally plastered with endorsements presented under a documentary credit ca. two years after the actual date of shipment.

For greater consistency and transparency the entire chain of sales should apply similar shipping terms e.g. FOB or CIF. Whilst the latter has well established roots[56] the former is apparently older[57] and enjoys a more flexible range of uses[58] and indeed, if Incoterms are not uniformly applied then there might even be different interpretations of the FOB terms[59] depending upon the contract as also the intentions of the contracting parties as defined by the court.

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[54] The International Sale of Goods Law & Practice, M. Bridge (Oxford University Press) 1st ed. 1999 p.356
[55] "Bills of Lading: Changes to the English law and the Commercial Implications" April 2 & 3, 1990, Brian Davenport Q.C. "The chains may be long. A banker once told me that he had seen a chain of 104 buyers."
[56] Tregelles v Sewell (1862) 7 H & N. 574, 158 E.R. 600 at 602, perhaps 1st expressly defined CIF contract
[57] first reported case being Wackerbarth v Mason (1812) 3 Camp. 270
[58] Pyrene Co. Ltd v Scindia Navigation Co. Ltd. (1954) 2 Q.B. 402 at 424, Devlin J. defines three forms of FOB contract, these are however by no means exhaustive and allow for additional variants on the theme
[59] viz Carver on Bills of Lading, 2nd ed. (Sweet & Maxwell, London) 2005 at pp 123 para. 4-011 ff

Concordia Trading BV v Richco International Ltd.[60]

This was an interesting case which comprised both a circle and a string for the sale of 26'250 mt Argentine soya beans sold initially by Richco to another who then sold the goods to Concordia who thus became the 3rd buyer in the original string which then became a circle i.e. with Richco being at the beginning and end of the circle. Concordia then agreed to sell the same cargo to Richco on the same terms and thus created a string, Cargill and Exportchleb being the last two parties to the string, Richco and Panchaud being the 1st & 2nd parties respectively.

In this case, the market value of the goods began to rise the closer the vessel came to the discharge port. The complication arose when Panchaud, to whom Richco had sold the goods, declared insolvency during the goods' transit leaving Richco without a binding contract to secure its sale value. Whilst Richco eventually sold the goods down the chain to Cargill, this was presumably at a loss thus causing Richco to seek means of mitigation as the market value had fluctuated during transit, falling then rising again later on.

During all this time Richco had retained possession of the shipping documents. Despite this fact, Richco sued Concordia for breach of contract for failing to deliver the shipping documents. Arbitrators upheld this claim which then went to court. As so often, timing was the disputed issue as the date of the breach would determine the quantum of damages to which Richco would be entitled for the (undisputed and proven) breach of contract.

Concordia maintained that the breach (non-delivery of shipping documents) occurred in August (shipment having taken place during 25-29th July, 5 August being the assumed date the bill of lading would have been available in London) when the market price was below the contract price, whereas Richco considered the breach to have occurred immediately prior to the date of the vessel's arrival at disport, when the price was higher.

It was held by Evans J. that Richco were correct in their assertion holding that a FOB seller was obliged to tender the shipping documents "forthwith" (with all reasonable despatch)[61] and thus sent the case back to the G.A.F.T.A. Board of Appeal who also found in favour of Richco, the reason being that the documents could have been bought in the market at any time up to the date of discharge of the goods at Odessa.[62]

What do we learn from this decision? That in both FOB and CIF[63] contracts, assuming the contract is silent concerning the time of tender, and regardless of whether a chain has

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[60] Queens's Bench Division (Commercial Court) (1991) 1 Lloyd's Rep. 475

[61] applying Sanders v Maclean (1883) 11 QB.D. 327 and Sharpe v Nosawa (1917) 2 K.B. 814

[62] the Board's conclusion at para. 4:6 being: "*With regard to the date of default; Sellers were not in default until the day it was no longer possible for them to purchase the documents for the goods in order to fulfil the Contract, which was 28th September 1987 …… and we are supprted in this by the fact that negotiation to purchase the documents were taking place up to 28th September*."

[63] as supported per Benjamin on *Sale* (3rd ed.) par. 1663 at p. 1061 stating that once the goods have been allocated documents must be tendered "as soon as possible after the goods have been shipped" albeit under no obligation to do before arrival of the ship.

been created or not, the seller is obliged to tender documents to his buyer "forthwith" and that a failure to do so would infer breach of contract.

In general, bulk goods such as crude oil, grains etc. do not involve LCs and would often be subject to trade rules e.g. GAFTA 64 / 100 for the latter. For other types of bulk goods this might not be the case (from personal current experience in petrochemicals LCs are in fact very often used) although chains or circles are often built, especially for benzene. It is of course possible, once the end of the chain has been established (the end-buyer) for all participants to agree on a mutually acceptable date of payment and to have the first member of the chain deal directly with the last member thereof. This is usually easier said than done, especially if one / more LC-based sales intervene. For such events, it may be possible to agree on LOIs (Letter of Indemnity) for missing documents, this being the modus operandi for virtually all crude oil transactions. This enables payment to be made against an LOI and (fax) invoice, original shipping documents being presented later when same are available, which can be quite a long time afterwards, indeed perhaps long after the underlying goods have been consumed or processed.

It is possible that not all parties to a chain are interested in, or even financially capable of, taking physical possession of the underlying goods, being involved for purely speculative purposes. Such will have very different priorities and be far less willing to cooperate in getting documentation issues resolved, perhaps being more inclined to invoke contractual breach than any consumers in the chain. Indeed, in any chain there will only ever be one actual supplier and one ultimate buyer, all others will effectively be trading paper resp. price differentials, moving documents along the chain in the hope of making a profit.