

STANDARDS FOR EXAMINING DOCUMENTS UNDER A LETTER OF CREDIT: BENEFICIARIES BEWARE

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1. Introduction

Letter of credit is a payment mechanism established to finance an international transaction and it is commonly applied in cases where the parties involved are from different jurisdictions. It provides the parties with the opportunity to ensure that the opposite party's performance is completely fulfilled. There are usually four different stages to be distinguished where the payment is arranged by a letter of credit. First, the seller and the buyer agree in their main contract that the payment shall be made under a letter of credit. Secondly, the buyer (the applicant), usually at his place of business, applies to a bank (issuing bank) to open a credit in favor of the seller. Thirdly, the issuing bank arranges with a bank (advising bank) at the business place of the seller, to advise the buyer about the opening of the credit. The fourth step is that the seller (the beneficiary) will be informed of the opening of the credit by the advising/confirming bank. There are also further stages of a letter of credit transaction but the previously stated ones are the vital ones to open the credit in effect. After being informed by the advising bank, the seller will ship the goods, provided that the letter of credit complies with the terms of the underlying contract and will obtain documents as required under the credit and present them to the advising or confirming bank. The bank will affect the payment unless the documents strictly comply with the terms of the credit.

The procedure that the payment takes place after the presentation of the documents is acknowledged as an institution which removes or at least minimizes the major risks and problems of international trade where the buyer has no chance of inspecting the goods. Seller on the one hand is entitled to obtain the payment after submitting the documents to the authorized bank, whereas buyer on the other hand is ensured that the payment shall not take place unless it is for certain that the documents comply strictly with the credit terms.

In a letter of credit transaction, the key condition for the beneficiary is to meet all the requirements of the issuing bank in order to obtain payment. The whole payment mechanism is based solely on the documentation and the beneficiary is obliged to tender complying documents in order to receive a payment, which is free of incumbencies. In a great majority of the cases, it appears that the beneficiaries fail to meet this criterion, and due to bad tenders, the number of rejections keeps rising. The situation seems that the sellers prefer to deal with letters of credit for the benefit of securing payment but end up with not getting paid due to non-complying documentation, which appears to be undermining the whole system.

2. Examination of the Documents under Uniform Customs and Practice for Documentary Credits (UCP) and International Standard Banking Practice (ISBP)

2.1 UCP

UCP was first introduced to remove different applications by individual countries and to avoid endorsing national rules on letter of credit practice. The first set of rules was published in 1933 which has been updated throughout the years, UCP 600 being the most up to date version. It should be noted that the previous version, which is UCP 500 is still often encountered in practice as it is the parties' choice to choose which set of rules governs the credit transaction. The position in Turkey is that there is no specific regulation in domestic law with regards to letters of credit¹ and in almost every case, UCP rules are applied. UCP 600 regulates the standards for examination of the documents in article 14, which should be taken into consideration together with ISBP.

2.1.1 A comparison of UCP 500 and UCP 600 regarding the examination of the documents

- Bank's duty while examining the documents under UCP 500 was limited to exercise a degree of reasonable care. The wording attracted huge amount of debate since to weigh up the amount of reasonableness is not easy to determine, thus the wording was removed from the UCP 600 for causing ambiguity.
- UCP 500 stated that the banks should examine the documents "on their face" which indicates that the documents should be regular on their face and should not attract any further enquiry or litigation. The phrase was found in various articles in UCP 500 and the final decision was to remove the phrase from other articles but to maintain it in article 14 of UCP 600 with regards to the examination of the documents.
- UCP 500 was merely providing that documents should be consistent with one another, whereas UCP 600 states "data in a document need not be identical to, but must not conflict with data in that document, any other stipulated document or the credit."
- The requirement for examining the documents in a "reasonable time" in UCP 500 is replaced by UCP 600 with a fixed period of five banking days.

2.2 ISBP

ISBP was published by ICC as a detailed standardized guidance for the examination of documents under a letter of credit with the intention of reducing the amount of documents rejected by banks owing to discrepancies. This publication reflects international standard banking practice for all the parties to a documentary credit under UCP. The ISBP touches on the general principles as well as providing specific assistance on particular issues, such as the requirement of a signature on a particular document. If the parties wish ISBP to form a part of their contract, they do not have to incorporate it into their contracts, unlike the position with UCP. ISBP appears as a companion to the UCP and explains in great detail how the practices articulated in UCP 600 should be applied by documentary practitioners.

3. Doctrine of 'strict compliance'

¹ U.S. stands as one of the few countries to have sophisticatedly regulated letters of credit in its domestic law.

UCP 600 clearly states that the banks deal in finance and not in goods listed in Article 5, which is the very basis of the doctrine of strict compliance. According to this doctrine, every single party under a letter of credit transaction is required to tender strictly complying documents in order to be entitled to receive payment. The underlying ground for this doctrine is that the letter of credit is established on an agent collaborated transaction, thus the principal should be entitled to disown the act of its agent. Additionally, the banks are not expected to have any proficiency in a particular trade. Instead, in order to sustain the credit transaction, banks are required to check the compliance of the documents with the credit terms.

The doctrine was first established in 1927 by English courts with the well-known words of Lord Sumner in **Equitable Trust Company of New York v Dawson Partners Ltd** as; *“There is no room for documents which are almost the same, or which will do just as well... if the bank does as it is told, it is safe; if it declines to do anything else, it is safe; if it departs from the conditions laid down, it acts at its own risk”*. Lord Sumner’s argument was based on the fact that the banks know nothing regarding the underlying transaction they financed thus they cannot distinguish between which document will do well enough and which will not. He also emphasized that if banks were to be concerned with the underlying transaction as well, it would be unlikely for business practice to proceed.

Which documents are to be disregarded and which ones are to be accepted remains as a tentative ground for a bank, to which UCP 600 provides little guidance that is ambiguous. Thus, lack of certainty gave rise to different court interpretations in different jurisdictions.

3.1 Examining the documents “on their face”

The standards for the examination of the documents are specified in Article 14 of the UCP 600, which obliges the bank to examine all the documents stipulated in the credit, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.

UCP 600 states that the banks should examine the documents submitted by the seller on their face only. It is for this reason that banks are not concerned with whether the documents are counterfeit, complete or valid. However it is no defense for banks to deny liability for accepting documents which are absent or defective explicitly on their face. The indication with the term `on their face` was that the documents should not attract any further enquiry or litigation. It follows that the bank shall be obliged to pay even the shipped goods have been defected or don’t exist, provided that the documents conform.

3.2 Linkage of the documents

Every single document tendered to the bank must undoubtedly and unambiguously refer to the same goods. The tender should be considered a bad tender if the link relating the goods to the documents is an ambiguous one. It doesn’t however mean that the documents themselves should necessarily be linked by mutual references. Article 14 of UCP 600 provides that the documents need not be identical between each other but must not conflict with any other

document. Article is considered as a step to reduce the number of rejections as it allows non-identical documents by clarifying how similar the documents must be.

4. The approach of Turkish Supreme Court regarding the examination of the documents

To find the primary trails of letter of credit decisions in Turkey, it can be traced back to 1964 where the Turkish Supreme Court made a ruling on the subject of letters of credit, their legal character, varieties and influence². Plaintiff was claiming indemnification on the basis that goods were defective and alleging as a reason that the bank should not have paid the credit worth. Supreme Court disallowed the appeal and emphasized on the fact that the bank is by no means a party to the underlying sales contract. It was also held that the bank is concerned merely with the documents but not with the underlying contractual relationships between the parties. The court went on to state that the standard for the examination of the documents by the banks is not a comprehensive one, reasonable examination³ would release them from reimbursing the applicant.

In another decision⁴ the court found the bank liable for not examining the documents sufficiently. Bank was found in fault for paying upon documents which were not in strict compliance with the credit terms. What was held as the basis for this decision was “not examining the documents sufficiently” rather than “non-compliance of the documents with the credit terms”. However UCP 600 (also the previous version, UCP 500, which was in force when the judgment was made) clearly indicates that the documents should be in strict compliance on their face with the credit terms. Therefore reasoning of this decision appears to be a departure from what exactly UCP rules require from the banks.

As to the issue of how courts apply the doctrine of strict compliance in Turkey, there have not been many disputes recorded in case law. Amongst the few ones is E. 1979/2362⁵, yet it doesn't represent much of assistance for distinguishing the absolute extent to how strictly should the compliance be applied. In that case, the payment was made available despite the credit was calling for a specific document which was not submitted. Looking at the rest of the documentation, the absence of the particular document appeared to be an insignificant one. Thus, that insignificant matter was not taken to overrule the requirement of strict compliance.

5. Remaining issues and advices to parties

The situation shows that the rules are in some way causing ambiguity and have resulted in different applications by the courts. As to the banks' situation, it has been illustrated that they are applying the requirement as strict as they can, to protect their customers' interests, therefore securing their own interests as a result of different interpretations of the courts. Additionally, the latest version of UCP in this context shows that the recent updates are of

² Turkish Supreme Court, 11th Civil Division, E. 1964/962 E., 1964/637 K.

³ It should be noted that the references to 'reasonable care' in Article 13 of UCP 500 was removed in the UCP 600 for being ambiguous. UCP 600 however was not in force when the judgment in this case was made.

⁴ Turkish Supreme Court, 19th Civil Division, 1999/6490 E., 1999/7594 K.

⁵ Turkish Supreme Court, 11th Civil Division, 1979/2362 E., 1979/3338 K.

little assistance to clear ambiguity and still not satisfactory. The attempt of ICC to bring ISBP into the scene as a rather detailed set of guidance has failed also in satisfying the concerns of the parties' altogether. The current position reflects the need for an optimal document examination standard, which would provide a consistent interpretation by all parties.

It would be of great benefit for the parties to take some measures and pay extra attention to the problematic areas. Some practical advises to the banks and the parties involved might be as follows,

- Banks should insist on precisely clear credit instructions from their customers in order to issue credits without any ambiguity. However, if they receive ambiguous instructions, they should claim a waiver from their customers to prevent any possible discrepancies. Beneficiaries on the other hand should always check the credit terms vigilantly before tendering the documents to decide whether they can provide complying documents.
- To reduce the number of the rejections due to deviation in the description of goods in commercial invoices, all the parties should try to keep the description as simple as possible. If banks at the time of issuing the credit, applicant at the time of instructing the bank, and the beneficiary at the time of accepting the credit act exceptionally cautious, there would be no room left for rejection of the documents. Furthermore, the most secure way is to make sure that the issuer of the invoice in fact copies the description of goods from the credit to the invoice, because sometimes only such identical corresponding can satisfy the courts.

Beneficiaries seem like carrying a rather greater burden in this picture, however, in a credit transaction their interest is the largest one and they should be the ones showing extra effort to obtain full and speedy payment.