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Introduction

Trade finance underpins the expansion of trade in the Americas. One of the most significant recent developments in the private trade finance area has been the revision of the Uniform Customs & Practice for Documentary Credits and the commencement of that revision on 1 January 1994. There has also been case law and new legislation in connection with bills of lading and the position of lending bankers. The market has also not remained static and practices have arisen such as silent confirmations and intermediary arrangements which take correspondent banking relationships into unchartered waters of potential legal liability. This development, which has relevance to bankers and lawyers throughout the Americas, is discussed in this chapter.

I. The Commencement of UCP 500

Almost all international letters of credit are issued subject to the Uniform Customs & Practice for Documentary Credits (UCP) published by the International Chamber of Commerce (ICC). The latest and fifth revision of UCP — known as UCP 500 — was published in 1993 and became operative on 1 January 1994.

UCP 500 which, strictly speaking, is required to be expressly incorporated into a credit in order to govern that credit (Article 1)[2] has made many changes to the law and practice of letters of credit,[3] the most important of which are discussed below.

A. Status of Branches

It is now clear that branches of a "bank" in different countries are considered separate legal entities for the purposes of UCP. This should enable for example, a branch of a bank in one country to advise or confirm a credit issued by one of its foreign branches (Article 2).

In addition, it should follow that the branch of a bank in one country should now be able to issue a credit in favour of one of its foreign branches, a result not contemplated by the drafters of UCP 400.

It should be noted though that UCP continues to provide that only "banks" may issue credits governed by UCP (unless, of course, agreed otherwise by the parties). Whether an

1. Denis Petkovic is a Partner of Stephenson Harwood, London.
2. However, many commentators are coming to the view that UCP 500 is likely to apply to a trade letter of credit even without express incorporation because UCP is said to reflect business practice.
3. The changes made to UCP 400 by UCP 500 are discussed in ICC publication numbered 511, *Cf. UCP 500 and 400* [*hereinafter* ICC 511].

institution is a "bank" depends upon its domestic laws. The ICC did not take the opportunity to expand the range of persons entitled to issue credits governed by UCP to include non-banking financial intermediaries and even companies, notwithstanding that in many other areas of traditional banking business, particularly in the wholesale markets, this is the prevailing trend.

B. Irrevocability Presumption

Credits which fail to specify whether they are revocable or not are now deemed to be irrevocable (Article 6(c)). This change reverses the position under UCP 400 and reflects English common law which interpreted references in documents to a "banker's credit" to mean an irrevocable credit.[4]

C. Advising Banks

UCP 500 clarifies what action an advising bank is required to take when issuing a preadvice in circumstances where it cannot establish the authenticity of the credit. Article 7(b) requires the advising bank to inform, without delay, the bank from which the instructions appear to have been received and where it elects to advise the credit nevertheless, the beneficiary, that it has not been able to authenticate it.

D. Confirming Bank's Undertaking

An issue which has troubled practitioners for some time where a confirming bank fails to pay under a credit, for reasons of insolvency or otherwise, is whether the beneficiary could claim from the issuing bank even though no documents had been presented to that bank by the beneficiary. UCP 500 has resolved this question by emphasising that the confirming bank's undertaking is in addition to that of the issuing bank and that the issuing bank's payment obligation is activated by the presentation of documents to the confirming bank (provided that the terms and conditions of the credit are complied with) (Article 9(b)).

E. Amendments

Article 9(d) of UCP 500 expands the existing rules on amendments. It is now clear that an amendment will not be binding upon a beneficiary "until the Beneficiary communicates his acceptance of the amendment to the Bank that advised such amendment." Thus the argument cannot be raised that a beneficiary's silence constitutes consent to an amendment except in one case: if the beneficiary fails to give notice of his acceptance or rejection of amendments and documents which conform to the amended credit terms are presented to the nominated or issuing bank, such presentation shall be deemed to be notification of acceptance by the beneficiary of such amendments and as of that moment the credit will be amended. The practical message to a beneficiary is very clear: the beneficiary should expressly and promptly accept or reject purported amendments to the credit (Article 9(d)(iii)). In addition, UCP 500 provides that an issuing bank is bound by an amendment when it is notified to a beneficiary (Article 9(d)(ii)) and that a confirming bank is not required to confirm an amendment if it chooses not to do so.

4. Giddens v. Anglo African Produce Co. Ltd. (1923) 14 L1 L.R. 230.

F. Negotiation Credits

It is not unusual for the undertaking to make payment in a letter of credit to be framed as an undertaking not merely to the beneficiary but to any person or simply a designated person who may be negotiating the seller's drafts; this type of credit has traditionally been known as a negotiation credit. In more recent times, a practice has developed of dispensing with references in credits to bills of exchange and allowing banks to "negotiate" or pay against documents on the basis of an undertaking in the credit that the issuing bank will pay, for example, within a certain period of the presentation of documents to the advising bank or from the issuance date of shipping documents. These credits are known as deferred payment credits and also fall into the category of negotiation credits if they permit other banks to "negotiate" or pay against shipping documents. In recognition of the increasing use of such credits UCP 500 has included, in Article 10(b)(ii), a definition of "negotiation" as the "giving of value for drafts and/or documents." This meaning is peculiar to credits and UCP and is distinct from the concept of negotiability under, say, bills of exchange law. It is not entirely clear what constitutes the giving of "value" under Article 10(b)(ii). Clearly the making of a payment would qualify but would the giving of a promise to make payment (which under English law constitutes consideration sufficient to support a contract) qualify?

G. Preliminary Advices

A new rule has been introduced designed to discourage issuing banks from issuing preliminary advice credits or amendments. Article 11(c) of UCP 500 provides that such an advice may only be given "if such bank is prepared to issue the operative credit instrument or ... amendment." This rule is intended by the ICC to promote certainty and prevent preliminary advices being "exploited by other parties [e.g. fraudsters] intent on having the banking industry provide the appearance of certainty of issuance or amendment or subsequent payment."[5]

H. Examinations

(a) **Unstipulated Documents:** Under UCP 400, banks were required to examine all documents they received with reasonable care to ascertain if they conformed with the terms and conditions of the credit. A new rule has been introduced by UCP 500 providing that documents not stipulated in the credit are not to be examined by banks and should be returned to the presenter or passed on without responsibility (Article 13(a)). Thus if there is an inconsistency between such a document and documents stipulated in the credit which do conform, the set will be deemed to conform with the credit.

(b) **A Maximum of Seven "Banking" Days for Examination:** Now no examination of documents presented under a credit may exceed seven "banking days" following the date of receipt of the documents by the relevant bank (Article 13(b)). Unhelpfully, UCP 500 does not define what a "banking day" is — does it, for example, include a Saturday in financial centres such as Hong Kong and Singapore where banks are open for business for half days? On this point the drafting of UCP 500 is not satisfactory particularly as ICC 511, in commenting on this time period, treats it as if it referred to a period of seven calendar days

5. ICC 511, *supra* note 3, at 32.

rather than seven working days.[6] It may be prudent for banks concerned with this issue to insert an appropriate definition of "banking day" in their credits so as to exclude Saturdays.

Whilst UCP 500 sets a "long stop" date beyond which an examination may not extend it should be noted that this time period will not necessarily be appropriate for all examinations. This is because banks are required (by Article 13(b) of UCP) to examine documents within a "reasonable time" (not to exceed seven banking days) which period will be determined subjectively according to such factors as the complexity of the credit, the size and resources of the bank conducting the examination and local conditions. Individual transactions will thus continue to determine what is a "reasonable time" and in the case of simple credits this period will be considerably shorter than that for complex credits. It would thus be imprudent to rely on the view of some commentators, who suggest that banks now have seven banking days to examine a credit since in financial centres such as London, where three working days is considered the norm, it is unlikely that UCP 500 has changed existing practice.

(c) **Non-Documentary Conditions:** A rule has been introduced entitling banks to disregard non-documentary conditions in credits for the purposes of an examination (Article 13(c)). This was one of the major goals underlying the revision of UCP 400 and sits well with the fundamental principle of autonomy underlying letter of credit law and specified in Article 4, UCP 500, namely that "[i]n Credit operations all parties concerned deal with documents, and not with other performances to which the documents may relate."

(d) **Examination Function:** The examination duty is reflected in Article 13 of UCP 500 which requires banks to examine "all documents stipulated in the Credit with reasonable care to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit ... Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in accordance with the terms and conditions of the Credit."

This reflects a change in wording between UCP 400 and 500. Documents must no longer be "in accordance" with the credit; they should be "in compliance" with it.

In substance there should be no difference in meaning between the word "compliance" used in UCP 500 and the word "accordance" used in UCP 400: indeed, the *Shorter Oxford English Dictionary* suggests the words interchangeable! However in practice, the courts in different jurisdictions applied different tests when interpreting Article 15 of UCP 400. The approach of some American courts has been less rigid than that of the English courts when considering the standard required in respect of compliance and certain of the American cases suggest that wherever possible the credit should be construed in a manner that would uphold the entire transaction rather than defeat it. This differs somewhat from the classic doctrine of strict compliance under English law which holds that "There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines."[7]

The new wording included in Articles 13 and 14 of UCP 500 is thus an attempt to try to create more uniform standards in considering the issue of documentary compliance. This is backed up by a statement in Article 13 of UCP 500 that "[c]ompliance of the stipulated documents on their face with the terms and conditions of the credit shall be deter-

6. ICC 511, *supra* note 3, at 40.
7. Equitable Trust Co. of New York v. Dawson Partners Ltd. (1927) 27 Ll.l Rep 49.

mined by international standard banking practice as reflected in [UCP 500]." This wording is clearly an attempt to have courts in different jurisdictions pay regard to some uniform "international standard banking practice" when judging documentary compliance with credit terms.

(e) Role of Applicant in Examinations: Article 14(c) sanctions the practice of an issuing bank approaching an applicant to seek a waiver of discrepancies. Any such approach will not extend the time period which an issuing bank has to conduct an examination and which is set by Article 13(b). It should be noted that any such approach may only be made after the issuing bank has determined that the documents appear on their face not to comply with the terms and conditions of a credit. The issuing bank may not, therefore, consult with the applicant on the question of compliance — only on the question of waiver.

(f) Drafting Defect Corrected: Articles 16(b) - (e) (inclusive) of UCP 400 contained a major drafting defect. These, the most important Articles in UCP 400 dealing with payment, only expressly covered the position of the issuing bank and failed to refer to confirming banks. This point was considered in the recent case of *Seaconsar Far East Ltd. v Bank Markazi Jomhouri Islami Iran*.[8] The new wording included in Article 14 of UCP 500 does cover confirming banks and other nominated banks, who now have an express duty to exercise reasonable care when examining documents and to otherwise comply with the examination provisions of UCP.

I. Signed Documents

The rules on what constitutes a signed document for the purposes of UCP have been liberalised. A new rule has been included entitling banks to accept as a "signed document" any document signed by handwriting, by facsimile signature, by perforated signature, by stamp, by symbol or by any other mechanical or electronic method of authentication (Article 20(b)). Chop marks used in the People's Republic of China and other Asian countries now constitute a "signature" under UCP.

J. Transport Documents

Rules have been introduced specifying in what circumstances banks may accept non-negotiable seaway bills, charterparty bills of lading, air, road, rail, inland waterway or multimodal transport documents under credits (Articles 23-30). Rules governing the acceptance of courier and post receipts under credits have also been redrafted. These extensive changes have been brought about because there has been an increasing trend towards the use of documents other than the traditional bill of lading in transport. Therefore, individual articles have been inserted covering the range of transport documents likely to be called for under letters of credit and if the requirements specified in these articles are satisfied this will result in particular transport documents being acceptable to the relevant bank. A common theme running through the various articles dealing with acceptability of such transport documents is that the relevant document should appear on its face to be signed or authenticated by the carrier, master or their named agent (as appropriate).

8. __ Lloyds Law Rep. 236 (1993).

K. Place for Presentation

All credits are now required to stipulate a place for presentation of documents for payment, acceptance or negotiation (except for freely negotiable credits) (Article 42).

L. Thirty Day Shipment Rule Abolished

Previously where a credit used expressions such as "prompt," "immediately," "as soon as possible," and the like, banks were to interpret such stipulations on the basis that shipment was to be made within thirty days from the date of issuance of the credit by the issuing bank (Article 50(c), UCP 400). Now such expressions are to be disregarded entirely (Article 46(b)).

M. Transfer of Credits

Two points of note arise in connection with this topic.

First, Article 48(a) introduces a definition of "Transferring Bank." Such a bank is a bank "... authorised to pay, incur a deferred payment undertaking, accept or negotiate ..." or in the case of a freely negotiable credit, the Bank specifically authorised in the Credit as a Transferring Bank. Freely negotiable credits should now thus designate a transferring bank and the argument asserted previously by some banks that they could transfer any freely negotiable credit which they were willing to negotiate is discredited.

Second, Article 48(d) specifies that when the first beneficiary requests a credit to be transferred he must advise the transferring bank if it may advise amendments to the second beneficiary(ies) without his approval. If the transferring bank consents to the transfer under this condition it must, at the time of the transfer, advise the second beneficiary of the first beneficiary's instructions or amendments. All parties, therefore, will know from the outset whether the first beneficiary reserves his right of objecting to the transferring bank notifying the second beneficiary of proposed amendments.

N. The ICC "Position Papers"

Although the changes introduced by UCP 500 have generally been well received, there have been difficulties caused by differing interpretations of certain of the new provisions. This has led the ICC, in September 1994, to take the unprecedented step of issuing four "Position Papers" setting out what the ICC claims to be the "correct" interpretations of the provisions in question. The ICC has announced that "Failure to interpret the subArticles as indicated, in future, should be seen as in violation of the principles of UCP 500," although what this precisely means and the general status of the Position Papers is uncertain. For example, do they constitute an amendment to UCP 500? They do not purport to be but this raises the question of how a bank not complying with the Position Papers can be in violation of UCP 500? This approach of augmenting UCP through the Position Papers appears not to have been entirely well thought through.

(a) Amendments (Article 9(d)(iii)): In their Position Paper No. 1, the ICC are most critical of banks who interpreted this Article as allowing them to issue credits containing wording that any amendments would be automatically effective unless rejected by the beneficiary within a specified time. Such an interpretation, said the ICC, challenges the very nature of an irrevocable letter of credit and conflicts with the clear wording of Article 9(d)(i): "an irrevocable credit can neither be amended nor cancelled without the agreement

of the Issuing Bank, the Confirming Bank, if any, and the Beneficiary." However, a credit is a contract between the Issuing Bank/Confirming Bank and the Beneficiary. If those parties agree to a mechanism for amendments in that contract, as they are entitled to do under Article 1, then that express stipulation should override UCP 500. On this point the Position Paper does not sit well with the other provisions of UCP 500 or general principles of freedom of contract under English law.

(b) Negotiation (Article 10(b)(ii)): The concept of the "giving of value" has been subject to varying interpretations. The ICC's Position Paper No. 2 now makes it clear that "undertaking an obligation to make payment" is included within this definition. The Paper also confirms that a beneficiary is not obliged to have credits negotiated and that a failure to do so will not effect the obligations of the various banks concerned.

(c) Non-Documentary Conditions (Article 13(c)): In their Position Paper No.3, the ICC express their strong disapproval of non-documentary conditions and remind banks that any such conditions may be disregarded. However, where a condition can be clearly linked to a document stipulated in the letter of credit, for example where the goods are to originate from a certain country and a Certificate of Origin is one of the stipulated documents, it will not be deemed to be nondocumentary.

(d) Identity of the Carrier on Transport Documents — Articles 23-26: Position Paper 4 clarifies the formalities required in this regard. First, the name of the carrier must appear as such on the front of the document. Additionally, where the document is signed by an agent for the carrier, the names of the agent and the principal should be indicated in one of the ways prescribed in the Paper. Where an agent signs on behalf of the master of a vessel, both the agent and the master should be named.

II. Recent Market Practices

The markets are not static and undergo constant change and innovation. Two recent developments which raise interesting legal issues are the increasing use of silent confirmations and the development of correspondent arrangements between banks, which might be termed 'Intermediary Arrangements.'

A. Silent Confirmations

Increasingly banks are being asked by beneficiaries to "silently" confirm a credit which has been advised through a bank on the basis that such bank would not add its confirmation. This practice seems to have arisen for a number of reasons:

(a) prestige: some issuing banks will not allow their credits to be confirmed, feeling that their own undertaking is enough. A beneficiary/seller may nevertheless still be hesitant not to have an undertaking from a local bank and so will approach a local bank independently to "silently confirm" the credit;

(b) cost: any confirmation fee is usually factored into the invoice price and so is ultimately paid by the buyer. Where the fee is in a foreign currency, which may be scarce, the buyer will negotiate it away. In addition, where political risk weighting factors cause the confirmation fee to be high, some buyers will be reluctant to pay it or permit the figure to be factored into the price. So the seller/beneficiary will approach a local bank to "silently confirm" the credit and also pay the confirmation fee.

(c) country risk: in practice, a confirming bank pays out to the beneficiary before it is paid by the issuing bank and as such is temporarily exposed to the issuing bank in the issuing bank's home country. Such an exposure is usually one of the factors involved in an assessment of country risks by banks and may prompt particular banks not to add their confirmation and the beneficiary to approach other banks to add theirs "silently."

The practice of confirming credits is normally governed by Articles 9 and 10 of UCP 500. Article 10(d) states that "By authorising ... another bank to add its confirmation the Issuing Bank authorises such bank to pay ... and undertakes to reimburse such bank in accordance with the provisions of [UCP 500]." Moreover Article 9(b) states that a "confirmation of an irrevocable credit ... constitutes a definite undertaking of the Confirming Bank ... to pay ..."

A "silent" confirmation falls outside UCP 500 since, by virtue of Articles 9 and 10, UCP 500 only covers confirmations authorised or requested by an issuing bank: UCP 500 cannot determine the obligations of an unauthorised confirmer.

In the light of Articles 9 and 10 of UCP 500 and the fact that many L/Cs which are sought to be silently confirmed include a prohibition on confirmation (for example, advising banks are, as mentioned previously, asked to advise a credit "without adding your confirmation"), the market practice which has developed under UCP 400 of drafting the agreement between the silent confirmer and the beneficiary as an independent guarantee by the silent confirmer of the issuing bank's payment obligations should continue.

The agreement takes the appearance of a guarantee or, more correctly, a payment undertaking, rather than an agreement under which the wording of Article 9(b) of UCP 500 is repeated. As such the terms of any such payment undertaking may be freely agreed between the silent confirmer and the beneficiary. Banks should not simply issue advices saying "we silently confirm this L/C" as it is not clear what this means. Some banks still issue silent confirmations in a form whereby they state that they "hereby add their confirmation to the credit," but this practice is dangerous unless, perhaps, the credit is a negotiation credit which has been negotiated by such bank.

What are the dangers of silent confirmations? Unlike a confirmation governed by UCP, there is no contractual relationship between the issuing bank and the silent confirmer in cases where the silent confirmer issues an independent payment undertaking. Moreover, Article 10(d) of UCP 500 will be of no application and the issuing bank will have no obligation to reimburse the silent confirmer upon the silent confirmer making payment to the beneficiary under the silent confirmer's payment undertaking.

In such cases, the silent confirmer's greatest risk is of accepting documents which do not conform with the original credit. To avoid this risk, good market practice is for the silent confirmer's undertaking to be worded so as to entitle it to withhold payment where discrepant documents are presented under the original credit and/or where the issuing bank rejects the documents presented. Moreover, the silent confirmer's undertaking allows it to withhold making payment for a period of time (or "wait period") during which time the documents required under the original credit may be transmitted to the issuing bank, which will either raise issues of discrepant documents or may be able to confirm that the documents are in conformity with the original credit. If the necessary confirmation is received, the silent confirmer should make payment under its separate undertaking. Also included in such undertakings are provisions on amendments and assignments of the proceeds as security to cover amendment risk and the risk of the insolvency of the beneficiary of the credit.

The ultimate aim of all drafting of "silent confirmations" is to ensure that the risks to which the silent confirmer remains open are no more than the risk of the issuing bank becoming insolvent or of supervening political developments making it impossible for the silent confirmer to obtain payment from the issuing bank. The silent confirmer should not be required to make payment in cases where discrepant documents are presented by the beneficiary or where fraud is alleged by the issuing bank unless, of course, it expressly agrees to do so and takes account of this in pricing its silent confirmation fee.

B. Intermediary Arrangements

Recently a number of banks, in emerging markets in particular, have provided the service to institutional customers, such as other banks, of issuing letters of credit on behalf of a customer of another bank. In such cases, the application received by the intermediary or issuing bank is that of the institutional customer, although this is not always the case.

Some banks have offered a similar service to foreign banks who may not have branches in a particular location but who require the L/C to be issued in that location. Economic circumstances may be a driving factor for this development, coupled with the effects of technological development. This is because:

> "Most leading international banks are retrenching to their core domestic base and are in the process of disposing of overseas branch networks. This means that there is less scope for financial institutions to "internalise" cross-border transactions through their own branches, and a heavier reliance is being placed on the correspondent banker."[9]

This development and the fact that banks can now send instructions to other banks to issue credits on their behalf by Swift, without going through the cumbersome procedures of issuing a credit which is then confirmed by a correspondent bank, confirm that the "humble letter of credit still has plenty of life in it as the most versatile instrument of trade finance yet to be devised."

Documents for such intermediary arrangements need to address two key issues. First, what will the intermediary bank do in the event that it receives conflicting instructions from a named applicant of the credit (with whom it has previously had no contact) and the original institution. In most cases intermediary documents are drafted on the basis that the instructions of the institution will prevail and must be adhered to. For this reason indemnity wording is of extreme importance to the bank acting as an intermediary. Secondly, an issuing bank acting as an intermediary probably owes a duty of care to an applicant, even though the instructions received by the intermediary bank do not come directly from the applicant. In such cases, and in particular if the intermediary bank is to comply with the instructions of the institution and not the applicant, there is a high risk of a claim from the applicant, which must be covered by strong indemnity wording from the institutional customer.

9. Euromoney October 1993, at 88.