

UCP600 ARTICLE 12 IS DEFINITELY AN IMPROVEMENT OVER ITS PREDECESSOR ARTICLE 10 OF UCP500

By Michael Peiris

Six years have passed since the publication of UCP600 and yet it is interesting to read the different views expressed about it by the trade experts from different parts of the globe. Article 12 has been the most widely argued article in UCP600 because of its radical outlook in comparison to its predecessor article 10 of UCP500. Some have been very critical on the wordings of the article. Some have a word of praise for the article because of its precise and definitive language. After having read the views of two experts namely Mr. Bose and Barnes that appeared in the DCinsight Vol.18 No2 April –June 2012, I thought I should also share my views with my members of the Trade Finance Bankers' Association on this very valuable article.

Sub- article 12 (a)

I am also of the view that UCP600 article 12 is definitely an improvement over its predecessor, UCP500 article 10. The visible revolution that article 12 (a) has brought about is, to recognize precisely the nominated bank's freedom of risk taking either with or without the consent of the issuing bank. This in fact in practice is done either at the request of the opening bank with full recourse to it or at the risk of nominated bank itself. However the important point that one should remember in any one of the above situations is that nominated bank does not lose its right to reimbursement. It's no secret that in the past when the global economy was booming and the banks in the developed economies were said to be doing relatively well in the market, the banks in the developing economies to a certain extent were lenient in their approach to risks. In this exuberant environment I have observed that certain banks depending on their appetite for risks, extending "silent confirmations" to letters of credit established by so called financially stable banks.

Silent Confirmation

UCP600 neither in article 12 nor in any other article has stipulated how the expressed agreement or "silent confirmation" should be drafted or should the agreement be irrevocable or revocable. That is, I believe; a matter outside the scope of UCP. From the foregoing it is evident that sub-article 12 (a) has only attempted to formalize a prevalent practice. The article only states that if the issuing bank has not requested the nominated bank to confirm the credit, that nomination does not impose an obligation on the nominated bank to honour or negotiate. On the other hand it also implies if nominated bank on its own has confirmed a credit; it has to honour or negotiate at its own risks. In that sense I believe that article 12 (a) has achieved its objective.

Nominated Confirming Bank's Mandate

Sub-article 12 (b) has added more clarity when compared with UCP500 10 (d). The influence of Banco Santander SA vs Bayfern Ltd. (2000)¹ is quite apparent in the construction of the article 12 (b) of UCP600. The question of authority of Banco Santander to pre-pay/purchase its own deferred payment undertaking emanated from the sub-article 10 (d) in the absence of a specific provision for discounting

or prepayment. Anyone reading this sub-article 10 (d) should realize as observed by the learned judges in the case, that nominated confirming bank had the authority of issuing bank in terms of UCP 500 only to pay, accept and negotiate as the case may be against compliant documents. Nowhere in this sub-article or any other sub-article it has been stipulated that nominated bank has the authority to pre-pay/purchase a deferred payment undertaking. Incidentally, one should remember that UCP400 in its article 10 (b) ii as far back in 1983 has acknowledged the mandate of the nominated confirming bank to pay its deferred payment undertaking. Although the absence of authority in UCP500 was not the only cause for Banco Santander to lose its reimbursement rights against Banque Paribas, I presume the drafters would have realized the importance of re-phrasing the implied (missing) provision in an appropriate manner to fall in line with the judicial perception.

Fraud Exception

The reason for dishonor of the bill presented by Banco Santander was the fraudulent inspection certificate presented by Bayfern. The rest of the arguments with regard to validity of payment made by Banco Santander were examined to ascertain whether the nominated bank had achieved the status of holder in due course as in the case of a negotiation of a bill under an acceptance credit. We all know in a bill of exchange holder in due course get a better title and not even a fraud can defeat the right to reimbursement. However when the beneficiary himself is involved in a fraudulent act, the holder cannot act in the capacity of holder in due course. Therefore there is hardly any possibility to escape from the principle of “fraud exception” based on the well known maxim “Fraud unravels all” or *extripii causa non oritur actio*. This further confirms that courts will not allow their process to be used by a dishonest person to carry out a fraud. In view of the above, I too fully agree that parties seeking the answer to the question of the DPU holder’s freedom from the fraud defense should look to the law because when UCP is silent on the matter, law is where that anyone can find solace.

Validity of Assignment

However in a genuine transaction where the financial commitment is settled via a letter of credit subject to UCP, I do not foresee any difficulty in getting reimbursed by the nominated bank/beneficiary. UCP600 unlike its predecessor UCP500 now acknowledges the nominated bank’s mandate to pre-pay/purchase its own deferred payment undertaking. As pointed out in a preceding paragraph of this article, it was questioned by the judges in the court proceedings the authority of the nominated confirming bank to discount its own DPU under UCP500. The procedure Banco Santander followed was to discount its undertaking. That was not questioned at all as a legal hindrance. For both UCP500 (article 49) and UCP600 (article 39) accept the beneficiary’s right to assign any proceeds in accordance with the provisions of the applicable law. The problem of establishing the “proper law” (Applicable law) of contracts involving letters of credit are fundamentally the same (as those involving bills of exchange).ⁱⁱ However it is a known fact that DPU is not a negotiable instrument and therefore it does not have the protection of bill of exchange act. Nevertheless “to assign money, or any other kind of property which one cannot claim by physical possession, one needs to execute a document (usually called “an assignment”), and give notice to the holder of the money or the property that the assignment has been made, so that he must now hold the property to the order of someone else – that is the assignee”. This I

believe is a “thing in action” or “chose in action” which Channell J described as follows: “Chose in action” is known legal expression used to describe all personal rights of property which can only be claimed or enforced by action, and not by taking physical possession”.ⁱⁱⁱ In that sense the assignment has the protection both under UCP and the applicable law.

Negotiable Instrument

I would not subscribe to the opinion that application of the peculiarities of negotiable instruments law, either directly or by analogy, is a poor substitute for developing and relying on the peculiarities of L/C law based on the “independence” of L/C.^{iv} We all know that the principle of autonomy embodied in letters of credit is well recognized by courts and the success of UCP can mainly be attributed to the judicial thinking and accepted customs and practices that have been incorporated in the articles of UCP. Furthermore I do not see an attempt by UCP600 to undo the court decision on Banco Santander’s independent rights for reimbursement. UCP600 has in fact quite affirmatively stated the right of reimbursement of the nominated bank in a deferred payment credit that was lacking in its predecessor UCP500 as pointed out by the commercial court as well as the appeal court.

Conclusion

We might in future do away with negotiable instruments when e-commerce becomes fully functional. Yet I strongly believe that we need to have an equally strong law in place for e-commerce to gain worldwide acceptance. If we do not have a strong legal backing for the international trade instruments, it’s unlikely that we achieve the transition that we are eagerly awaiting for. Imagine a situation where one argues that technically his negotiation of a bill under a letter of credit is different to that of a negotiation of an ordinary bill of exchange that both in all aspects conform to the bill of exchange act. In such a situation negotiating bank only has a protection under the L/C (under contract) but one has to remember that UCP cannot supersede the national laws. Nevertheless in my opinion the strong legal position of the negotiating bank as the holder in due course or holder for value as the case may be, should remain undiluted irrespective of whether the draft is drawn under a letter of credit or not. During the expected transition period from paper based trade to paperless, it might have been thought by the drafters of UCP that changing the interpretation of some of the existing widely accepted terminology like “Negotiation” instead of introducing new one altogether would provide for trouble free adaptation of e-commerce rules. However my view is that it would have been more beneficial to the trade if UCP600, without upsetting the apple cart, had defined “negotiation” in two different contexts, namely paper based and paperless trade.

ⁱ Lloyd’s Rep Bank 165 (Gutteridge and Megrah’s Law of Bankers’ Commercial Credits)

ⁱⁱ Bill of Exchange and Banker’s Documentary credits – William Hedley, MA, LLB (1994 Page 229)

ⁱⁱⁱ -do- (page 230)

^{iv} DCInsight Vol 18 No2-April June 2012 Negotiable Instruments Law.....