

AVAILABILITY OF CREDIT AND NEGOTIATION

Availability is the soul of each letter of credit. It defines the rights and obligations of each party involved in an L/C transaction. Unfortunately, the definitions of the four types of availability stated in UCP 500 are not entirely clear.

This has led not only to confusion but also inconsistent court decisions in various jurisdictions, though the judges all were referring to the same UCR

Market demand

Many trade finance practitioners believe the confusion and the many conflicting court decisions could have been avoided if each L/C had stipulated the following three issues in a clear manner:

1. Tenor- is it a sight or usance L/C?
2. Drafts- are drafts required under the L/C?
3. Negotiation is negotiation of the draft(s) and or documents presented under the L/C permissible?

The majority view of the ICC Consulting Group on the UCP revision is that L/Cs are financing

the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents, by either advanc

It is worth to mention that many bankers today view an acceptance L/C as negotiable, and this view is supported by the judgement delivered in the *Banque Paribas Vs Banco Santander* case mentioned above.

If the above analysis reflects the intention of the UCP Drafting Group, it follows that only L/Cs available by negotiation (either sight or usance) are negotiable and can be used as financing instruments. Accordingly, L/Cs available by deferred payment and by acceptance would not perform any financing function, but would only act as payment undertakings. Note that based on the definition of negotiation" stated above, it follows that negotiation of presented documents with-out a draft is permissible. Therefore, banks in countries where drafts are subject to stamp duty may issue usance negotiation L/Cs without calling for a draft. This could retain the financing nature of an L/C but would eliminate the stamp duty problem.

This explains why many scholars have repeatedly proposed that the four types of availability should be eliminated, and that instead it should be stipulated in each L/C whether or not negotiation is allowed. If that were done, it would be crystal clear to the exporter's banker whether he can negotiate the presented documents and whether he is entitled to be reimbursed by the issuing bank. (Note that a negotiating bank may also be immune from the fraud exception in various jurisdictions. which is an added protection to the financing banks) And the so-called scholars believe there is no need to retain the four types of availability in the new UCP if the tenor, draft requirement and negotiability conditions can be stipulated in each L/C.

Definition of negotiation

Defining negotiation is a controversial issue⁵, as it appears that there is no universally accepted definition. For instance¹, some judges have refused to recognize that a bank has negotiated the documents solely on the ground that payment after the despatch of documents to the issuing bank and/or that the negotiation proceeds do not represent the full value of the drawing.

This situation creates a worrying lack of certainty for many bankers and trade finance legal practitioners. To minimize L/C litigation and the ambiguities of L/C availability and negotiation, a suggested definition for negotiation would read: "Negotiation means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents, by either advancing or agreeing to advance funds to the beneficiary at any time before the issuing/nominated bank settles its payment obligations under the credit in the amount agreed between the beneficiary and the negotiating bank."

Reduced use of L/Cs

Many banks in different countries state that, in terms of percentage of trade volume, L/C use in international trade is tending to decrease. One of the reasons been pointed out is that banks are too picky in checking documents in order to charge discrepancy fees. This could frustrate many beneficiaries by the high rejection rate which not only cost them money, but also defeats the purpose of getting a payment security from issuing banks. This trend might lead to a scenario that companies begin transacting on open account terms or obtaining commercial standby L/C guaranteeing the maximum open account credit limit granted to the importers.

The trade practitioners and experts in the field have recommended ICC to do a worldwide campaign when the new UCP is promulgated, re-emphasizing that L/Cs are a means of payment, not a means of rejection. Otherwise trading parties will stop using L/Cs and banks will lose a good source of income, further they say.

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References: DCInsight, Leading Court Cases on L/Cs by King Tak Fung, UCP 500, UCP 600(draft), www.iccbooks.com