2009 HONG KONG ANNUAL SURVEY OF LETTER OF CREDIT LAW & PRACTICE CONFERENCE SUMMARY

Editor's Note: On 13 July 2009, the 10th annual Hong Kong Annual Survey of LC Law & Practice conference was held. The following represents the executive summary report of the event.

ANNUAL SURVEY
OF LC LAW & PRACTICE

Hot Topics

Panelists were first invited to mention hot topics they have recently seen. Among those briefly identified: UCP600 Exclusion Clauses (a continuing nuisance); **Environmental & Social Reputation Policies** (a new phenomenon, one panelist fears "ESR" policies will change the LC landscape enormously as banks conduct certain types of business that conform to such policies); **LC Applicants Issuance of Amendments** (Are they effective and workable? This represents trouble for issuers and confirmers).

The panel took up the hot topic of **extra documents**. Banks should not add into their credits the requirement for additional documents or copies "for their files". Buyer and seller have an underlying agreement. Certain extra documents are unrelated to the underlying agreement and should be removed from the LC requirements. One banker noted some requirements for additional documents are coming from Mainland China.

One type of unwanted document being called for in LCs is a credit report. It is not a document required by the applicant and some panelists view this as another condition with no connection to the underlying agreement. One banker has observed that credit reports are being mandated by Bangladeshi banks who say it is a government requirement. One panelist pointed out the content of such a report need not be extensive. Many banks are choosing to "nominally satisfy" the requirement for a credit report.

Returning to the topic of **UCP600 exclusion clauses**, three examples were displayed at the Annual Survey for discussion. Panelists emphasized their use is

dangerous and confusing. Do those who utilize exclusion clauses mean something different (stronger or weaker standards) than UCP600? Does a clause reiterate UCP or displace it?

The panel then considered the familiar hot topic of **silent confirmations**. If a customer signs a silent confirmation arrangement with you, then presents documents to you subject to this agreement, is this a request for negotiation? The problem is that the beneficiary never authorized you to negotiate and this could adversely effect the bank's reimbursement claim. Panelists noted there are two issues to consider: the silent confirmation agreement and the LC agreement. It was also made clear that silent confirmation is not covered by UCP or Chinese law. One panelist suggested calling the agreement a "definite undertaking to negotiate without recourse" instead of a silent confirmation. One delegate asked if bankers need to prove their status as a negotiating bank. One panelist suggested this be disclosed in the bank's cover letter to negotiate. Another panelist added that banks are not obliged to do so, but many automatically choose to so state.

ICC Opinions

Several recent opinions relating to UCP600 were on the program for discussion at the Annual Survey. **ICC Opinion TA686rev** involved an incorrect translation of a document required by the credit to be issued in more than one language. The ICC concluded there was no discrepancy. Since English was the language of the credit, the nominated bank was not responsible for translation accuracy and could accept the Chinese version on an "as presented basis". One panelist believes the decision to be wrong, contending that the ICC is interpreting the text of the LC and not UCP600.

ICC Opinion TA675rev dealt with whether certain wording on a negotiable bill of lading constituted a discrepancy or only terms and conditions of carriage. The ICC considered the wording to be the latter and therefore would not be examined according to UCP600 Article 20(a)(iv). Some panelists believe the Opinion's reasoning is flawed, but the conclusion is correct.

ICC Opinion TA681rev addressed whether a goods description is required to appear on a bill of lading. Because UCP does not so require, a goods description on a B/L is not mandatory. Some panelists strongly objected to this conclusion, with one panelist suggesting that it represents a low point in ICC issuance of opinions. Bankers' expectation that a bill of lading contains a goods description is so obvious that a requirement is not stated in UCP.

Economic Impact on LCs

Leo CULLEN (Coastline Solutions) first reported on certain findings from **"Rethinking Trade Finance 2009: An ICC Global Survey"**, a 27-question online survey of trade finance departments compiled by Coastline Solutions in early 2009.

One European-based panelist remarked that as banks have refrained from conducting business in high-risk countries, LC fees have dropped dramatically during second quarter 2009. While overall LC volumes have decreased, LC values have climbed. More frequent company mergers contributes

to this trend as banks will have fewer, but more valuable LCs.

Among Asian LC specialists, a different view was offered. LC fees have increased due to the scarcity of credit, prompting discontent among companies.

Other comments: some delegates have seen draws on standbys; open account deals have slowed down; and collections have increased.

Year in Review

In 2008, **Coastline Solutions** produced new online solutions on advanced training in ISP98 and independent undertakings (ISP Master) and on advanced training in letters of credit (DC Master).

Due to the global economic crisis, there have been no new major developments regarding **Basel II** capital adequacy requirements.

From a banker's perspective, KK YEUNG (JP Morgan) offered comments regarding the **SWIFT Trade Services Utility** (TSU) which has been operational since March 2009. TSU is built for banks to have a role in open account transactions, so therefore banks would like to capture such business. TSU provides dual authentication of the Purchase Order to provide comfort to financing parties, and reduces the 'double' financing risk. It automates the matching process, removes manual intervention to facilitate straight through processing. According to YEUNG, 84 banks have signed up for the SWIFT TSU but very low volume has been generated as of mid-July 2009 with just a few banks having processed live. YEUNG believes that many banks will be active by the end of 2009.

Delegates were also updated on the Certified Documentary Credit Specialist (CDCS) **certification** program. At the start of 2009, CDCS specialists numbered about 6,000 worldwide with the vast majority from China. Some 2,601 individuals were registered to take the exam in 2009, representing the largest class of candidates ever in the CDCS program's 12-year history. The test will be slightly modified in 2009 to take into account the revised URR.

LC Compliance

Use of **sanctions clauses** continues to be a difficult subject and from the point of view of the LC specialist, there are some significant consequences. What if the regulations of different governmental jurisdictions on the same LC conflict? The problem is not just for LC issuers, but also for confirmers, advisers, and other banks. From honoring to returning documents, what actions are banks able to do?

Panelists noted there is a new dimension from within Europe to complicate compliance: checking for "POPs", or **politically opposed persons**.

Banks need to be extra vigilant regarding complex deals, such as those commonly seen in oil trading. Oil from an LC-backed transaction may be traded several times, and possibly to a sanctioned entity, with the bank's name still connected with the deal.

Major LC Cases

A favorite at every Annual Survey, this panel discussion highlights significant cases of the past year with important aspects for active bankers, lawyers, and corporate LC users to consider.

The first case to be addressed was ***Fashion Shop v. Virtual Sales Group*** (2009 ANNUAL REVIEW 422) regarding a disputed documentary collection. In its suit against the Broker, the Manufacturer argued that the Broker's acceptance of the drafts constituted a commitment to pay the invoiced amounts. The Judge rejected this argument because the Manufacturer presented no evidence that the Broker had accepted the drafts in exchange for obtaining possession of the nonconforming goods.

The case illustrates that one

cannot assume release of documents; it is necessary to show cause.

In ***Uniloy Milacron v. PNC Bank*** (Sept 2009 DCW 14), the beneficiary sued the issuer for wrongful dishonor under a commercial standby. One of the stated discrepancies was that the serial number shown on one invoice (N01A0100088) did not match the serial number on the LC (N01A010088). Among the HK Annual Survey audience, there were some delegates who agreed this was a discrepancy. Others pointed out the differential needs to be considered against other documents to determine if it is a discrepancy or a typographical error.

Added a panelist, the differing serial numbers should not be viewed in isolation. Looking at a typical large bank's LC shop, one would expect the bank's first level of examination to flag this as a discrepancy. At the next level, more experienced personnel would then determine it to be a typo.

Another panelist added, however, that certain courts in Mainland China would treat these differing serial numbers as a discrepancy.

Uniloy offered a second discussion point regarding another stated discrepancy that a certificate was not dated as required by the LC. At the Annual Survey, it was noted that bankers and lawyers look differently at the requirement for certificates to be dated. In *Uniloy*, the Issuer felt compelled to prove the significance of the date. The court deemed this was not a discrepancy since date could be determined from other presented documents and that the Issuer could not have been misled by the undated certificate.

The panel then turned to ***Jaffe v. Bank of America*** (Apr 2009 DCW 26) and ***2002 Irrevocable Trust v. Huntington National Bank*** (2009 ANNUAL REVIEW 388) which each involved allegations of fraud. These two US cases demonstrate what one panelist refers to as the "Third Person Phenomenon" where the beneficiary is a surety (lender) and not the mover in the underlying transaction. Other panelists added that the "Third Person Phenomenon" is fairly common in China.

As a result, only the fraudulent act of the beneficiary/lender should be relevant from an LC perspective. From the facts, there seems to be little doubt that yacht building company engaged in fraud but, barring collusion with the builder, it is far less clear that the beneficiary/lender acted fraudulently.

Panelists pointed out to Hong Kong delegates that there is a US statute (US Revised UCC Section 5-109) that lays down criteria for fraud. For the courts in these cases to fail to refer to this statute is "shocking", according to one panelist. Nonetheless, some experts would lay blame with the bank's lawyers. Courts expect the lawyers of the parties to lead them through applicable law. These cases show that one cannot assume that all lawyers are competent in LCs.

In the Hong Kong case, ***Cowealth Medical Science v. World Capital Pacific*** (2009 ANNUAL REVIEW 415), a buyer which refused payment to the seller had argued that an agreement had been modified by oral agreements. The Judge, referencing UCP500 Article 3 which provides that an LC is independent from the underlying agreement, rejected this claim.

As a bank or beneficiary, one expects that once payment is made, it is final. After having honored a commercial LC, can an issuer act against the beneficiary for a false statement? The Singapore High Court found from a required document (the delivery order) that there was deceit and granted judgment in favor of issuer. For experts which track LC litigation, this is the first instance outside the

US which allows for judgment of deceit and therefore is a decision that should garner attention.

Other panelists added that they do not view this as an LC case, but as a case for the tort of deceit. In China, arriving at this decision would be a problem as PRC law has no provision for warranty.

UCP600 Issues

Attention returned to ICC Opinions for discussion of those involving UCP600 issues.

Is an unsigned courier receipt discrepant where the document had no signature space? **ICC Opinion TA668rev** suggests that an original courier receipt that is not a document related to transport of goods should be signed based on a previous ICC Opinion (TA654rev), but that the structure of a courier receipt is not governed by UCP. The Opinion concluded that the receipt is acceptable.

The receipt in question did contain a bar code. In the opinion of one panelist, a bar code constitutes a signature plus there is no requirement for a signature. One cannot impose a signature on a document that is not required by UCP. Rather, one should look at the terms of the LC to make sure the courier receipt need not be signed.

ICC Opinion TA662rev addressed a query describing three different documents and whether each document should be treated as charter party bills of lading. Panelists agreed with the opinion that any one the three documents would satisfy the requirement for a charter party bill of lading.

In **ICC Opinion TA683**, the query asked whether a requirement for presentation of the "respective" charter party modifies or excludes UCP600 Article 22(b). The Opinion concluded that such a requirement does not modify or exclude this sub-article. In the query, a document checker had observed that certain data in the respective charter party did not match with that stated in the charter party B/L. One Hong Kong Annual Survey panelist agreed that most banks' doc checkers would flag this for senior staff to decide whether or not it is a discrepancy.

ICC Opinion TA666rev involved whether a dated on board notation is required. The query posed four cases containing certain pre-printed wording on different forms of multimodal transport documents. The Opinion concluded in all four instances posed that each transport document requires a dated on board notation. Panelists noted that all these problems were caused because the issuing bank was not clear in what it expected. If an issuer wants on board notation, then it should call for an on board multimodal transport document.

Open Forum

During this brief session to conclude the Annual Survey, delegates posed questions to the panel.

Banks in this region have encountered problems with the **"negotiating bank"** in the Middle East and South Asia when they nominate a reimbursing bank in their LC. The "negotiating bank", it may not actually negotiate, claims reimbursement from the reimbursing bank when it forwards documents to the issuing bank. The documents received by the issuing bank are, in fact, discrepant. Issuing bank rejects by sending a valid notice of refusal and asks for refund. However, the "negotiating bank" may choose to be silent or refuse to refund. The issuing bank has difficulty to get the money back once the reimbursement is made.

Another question concerned sound **independent guarantee issuance**. Panelists suggested the issuers need to consider the choice of law and choice of forum provisions for their instruments. If one cannot control these provisions, then you need to ask whether you want such business. ■