

# Documentary Credit

# WORLD

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## 16 FEATURE



### ■ *FORTIS BANK v.*

#### *INDIAN OVERSEAS BANK*

Believed to be the world's first reported court decision involving a UCP600 letter of credit, this English case is unquestionably one of the most significant dealing with the UCP600 rules. Roger FAYERS examines the appeal court's judgment, how the court dealt with the arguments raised, and the consequences of the issuing bank's action (or inaction) in light of its approach toward meeting the requirements of UCP600 Article 16. Following FAYERS' analysis, we re-visit the commercial court decision as abstracted by IIBLP at page 20.

## ARTICLE

### ■ 25: "An Accessory Bank Guarantee Appears in International Trade"

by Chang-Soon Thomas SONG

## UCP600 ACTIONS SPOKE LOUDER THAN UCP500 WORDS IN *FORTIS V IOB*

By Roger FAYERS\*

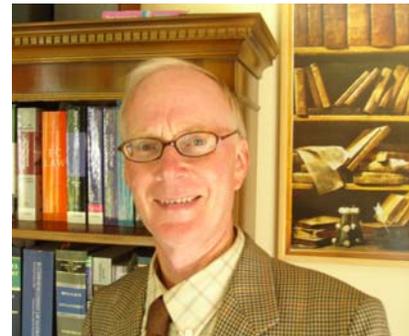
In *Fortis Bank SA v Indian Overseas Bank*<sup>1</sup> the English court of appeal considered in depth and decisively rejected the various arguments advanced by the defendant issuing bank (IOB) to overturn the commercial court's ruling<sup>2</sup> that it had not done what it said it was going to do with a promptness conforming with international practice and so was precluded from claiming that the documents presented to it by the confirming bank (Fortis) were non complying. What then had IOB done (or not done) that deserved such a forensic beating?

DCW readers will be only too familiar with what should happen under UCP600 Article 16 when a confirming bank, having paid out against presented documents, then forwards them to the issuing bank for reimbursement. There were two options open to IOB here if it was going to reject those documents. It could give a notice that it was returning them (a 'return

notice' under UCP600 Art. 16 (c)(iii)(c) or it could give a notice that it was holding them pending further instructions (a 'hold notice' under UCP600 Art. 16 (c)(iii)(a)). What did IOB do? Based on the evidence, having given a return notice, it did not return the documents for a period of between 89 and 104 days and, having given its hold notice upon receiving Fortis' request for it to endorse and return the documents, it delayed doing so for 34 days. Understandably, Fortis sought summary judgment against IOB.

In spite of such tardiness, IOB's argument was that its actions (or inaction) nevertheless did not amount to a failure to act in accordance with the provisions of sub-article 16(c) and so it avoided the sanction under sub-article 16(f) precluding it "from claiming that the documents [did] not constitute a complying presentation".

It may be a surprise that the



case occupied the courts for five days of argument. The bafflement (of this writer anyway) is twofold. First, how, in an international context, anyone could seriously have thought that the UCP wording that required the issuing bank to say what it was going to do could yet be interpreted in a way that then allowed it to ignore what it had said and do nothing for such an inordinate period. Secondly, if a purely semantic approach to the wording did take the bank's obligation outside the scope of UCP, how this could have made its position any better?

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1. [2011] EWCA Civ 58.
2. [2010] EWHC 84. Case abstracted in this issue at 20.

Having fired these general salvos, I turn to the appeal court's judgment and how it dealt with the arguments that IOB raised.

## **The Approach to the Construction of UCP**

After referring to earlier judgments and to discussion in textbooks<sup>3</sup>, the court summarised the position. It is worth setting out a passage from the judgment of Thomas LJ in full:

"In my view, a court must recognise the international nature of the UCP and approach its construction in that spirit. It was drafted in English in a manner that could easily be translated into about 20 different languages and applied by bankers and traders throughout the world. It is intended to be a self-contained code for those areas of practice which it covers and to reflect good practice and achieve consistency across the world. Courts must therefore interpret it in accordance with its underlying aims and purposes reflecting international practice and the expectations of

international bankers and international traders so that it underpins the operation of letters of credit in international trade. A literalistic and national approach must be avoided."

This approach itself, I suggest, sealed IOB's fate. How could a court answer the two questions I posed above otherwise than against IOB? The evidence of banking practice of acting in accordance with a notice once given (that is to say, either holding the documents in accordance with the instructions of the presenter or returning them promptly and without delay) was clear. Indeed, there was no difference on this as between the parties themselves. The issue that did divide them was one of construction, that is to say whether the obligation to act in accordance with that notice was to be found in article 16 at all because only if it did so could Fortis then rely on preclusion under that article.

## **Did UCP600 Article 16(c) Contain an Obligation to Act?**

The court gave short shrift to IOB's arguments that the sub-paragraph did not contain

an obligation to act in accordance with the notice. It provided a number of reasons.

First, it was fundamental to the operation of letters of credit that, when an issuing bank determines that the documents do not conform, it may reject them. If it does, then it cannot be entitled to retain them since it is implicit in rejection that it has refused to accept them. It must then either hold them at the disposal of, or in accordance with the instructions of, the presenter. Alternatively, it must return them. Therefore, once an issuing bank has rejected the documents it cannot do anything else but act in accordance with its chosen option. It followed from this that it was not necessary to spell out in sub-article 16(c) the issuing bank's obligation to act in accordance with the notice. This was implicit in the wording of the sub-paragraph.

Secondly, the practice with respect to the rejection and retention of documents has to function appropriately for international bankers and traders. For letters of credit to work in practice the presenter must be able to deal with the goods that are represented by the documents that the issuing bank has rejected. If the

3. Eg, the judgment of Bingham MR in *Glencore v Bank of China* [1996] 1 Lloyd's Rep 135 at page 148 and to Schutze and Fontane's *Documentary Credit Law throughout the World* (2001, ICC), paragraph 2.2.4, Brindle and Cox on the Law of Bank Payments, paragraph 8-005, and Dr Kurkela's *Letters of Credit and Bank Guarantees under International Trade Law* at paragraph V.1.4.

issuing bank has no right to retain the documents it is impossible to understand what it is entitled to do other than to return them or hold them at the disposal of the presenter or pending instructions. It would make no commercial sense if, having elected to return the documents, the issuing bank was then not obliged to do anything. Furthermore, as UCP is intended to be a self-contained code of practice for the areas it covers, it would make no sense to interpret it in such a way that the obligation to act in accordance with the notice was omitted from its scope.<sup>4</sup>

A third reason the court gave for concluding that the obligation was contained in article 16 rested on the wording of the article itself. The provisions of sub-article 16(e) were only necessary if the article was construed in this way. This sub-article was only necessary if an obligation to act in accordance with the notice was imposed by sub-article 16(c). Sub-article 16(e) permitted the issuing bank, having given notice under (a) or (b) that it was holding the documents, to act in a different manner; this provision would not have been necessary if the issuing bank was under no obligation whatsoever.

## The Revision of UCP

A further submission was made by IOB based upon a comparison between the wording in the corresponding UCP500 article and UCP600. Whereas UCP500 Article 14(e) had contained the words “and/or fails to hold the documents at the disposal of, or return them to the presenter” these words were omitted from the revision of UCP that produced UCP600 Article 16(f). This omission, it was argued, showed that the drafters intended that not only was there no obligation to act in accordance with the notice given but preclusion did not in any event arise if there was a breach of that obligation.

The court observed that neither article had spelt out an obligation to act in accordance with the notice. The most that could be said was that it must have been implicit from the terms of UCP500 Article 14(e) that there was an obligation to act in accordance with the notice. However, there was (and could be) no suggestion that the practice in relation to rejection had in any way changed; it was, on the contrary, common ground that practice was unchanged. Accordingly, the court saw no reason to read UCP600 Article 16 as making any different provision to that in UCP500

Article 14 as to the obligation to act in accordance with the notice. Viewed in this way, the omission in UCP600 Article 16(f) of the words in UCP500 Article 14(e) in no way changed the content of the obligation to act in accordance with the notice contained in UCP500 Article 14 and UCP600 Article 16.

## Outside UCP but What Then?

It is perhaps of interest to pose a question: How far would it have taken IOB had, as it argued, the actual dealing with documents after refusal fallen outside the ambit of UCP? The judge at first instance had noted that it did not appear that this question had been discussed in any publication except by Professor James Byrne in his commentary on UCP600 Article 16 in *THE COMPARISON OF UCP600 & UCP500*. However, whilst observing that “the removal of this provision arguably takes it outside of the UCP600 preclusion rule”, it did not venture any firm or reasoned view on its correctness. Our intrepid editor did nevertheless recognise the question. So, inside or outside UCP, what is the difference?

Clearly Fortis could only rely upon preclusion under

4. It was significant that the expert called by IOB could not think of any reason why the issuing bank should not be obliged to act in accordance with the notice it had given under sub-article 16(c).

UCP600 Article 16(f) if the obligation to return arose under article 16. On the question as to how preclusion could yet have arisen outside the UCP, I hazard the thought that it might be by way of an analogy with the law relating to sale of goods. In such cases it is quite clear that a party becoming aware of a breach of a condition has a reasonable time to consider what he will do. Thus a buyer does not lose his right to reject goods if he exercises his right within that time. But if, for example, he retains them beyond what in the circumstances can be considered a reasonable period, he may be held to have lost his right to reject and his retention to be an acceptance. He is taken to have waived his right to reject or, to put it another way, he is precluded from saying that he has not accepted the goods.<sup>5</sup> Similarly, an issuing bank that realised that documents were non conforming but which then retained them and neither said anything about them nor did anything with them for an unreasonable length of time would lose its right to reject them.

## Two Further Points

First, implied terms. When it became apparent that there were substantial difficulties in maintaining the position that an issuing bank was under no obligation to return, IOB raised an alternative argument. If there was an obligation to return, then that obligation should be implied in the letters of credit as distinct from the UCP, the scope of which did not extend that far. Again, as an attempt to deny Fortis any reliance upon preclusion under UCP600 Article 16(f), one wonders how far it could have helped IOB. However, the court rejected the argument. There was nothing in the letters of credit before the court that differentiated them from other letters of credit as regards the obligation to return. It would, therefore, be a wholly uncommercial result to conclude that, even though an obligation to return had to be implied as a matter of necessity, it did not form part of the UCP obligations under article 16, for the reasons mentioned above.

The commercial court judge had been prepared to hold, in the event that he was wrong about the construction of

article 16, that a term should be implied into the UCP. In light of its view on the construction of article 16, it was unnecessary for the appeal court to express its view on this point. However, Thomas LJ did say that there would be real difficulties in using a rule of national law as to the implication of terms (if distinct from a method of construction) to write an obligation into the UCP.

One other point may be of particular interest to US readers. IOB argued that the wording in UCP500 Article 14(e) that was missing from UCP600 Article 16(f) was superfluous as the problem had never arisen. In fact it had. In the case of *Ammwest Security*<sup>6</sup>, the District Court in Missouri was concerned with a letter of credit subject to UCP500. US UCC Revised Article 5-108-(h) (which had been incorporated into the law of Missouri) contains a specific obligation, on dishonour, to return the documents or hold them at the disposal of the presenter pending instructions, in addition to giving notice to that effect. The court held that the effect of UCP 500 and Rev. Art. 5-108 was the same – the bank had an obligation to return. ■

5. In the words of the UK Sale of Goods Act 1979, section 35(4): “The buyer is also deemed to have accepted the goods when after the lapse of a reasonable time he retains the goods without intimating to the seller that he has rejected them”.

6. 248F Supp 2d 867 (2003). Case abstracted in Feb. 2004 DCW, p. 11.