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Shipping & International Trade

## Bills of Lading and the UCP 600

### Introduction

Letters of credit attempt to address a wariness in sellers and buyers of goods in international sales. That wariness may be captured as follows:<sup>1</sup> Sellers are circumspect of shipping to buyers they do not know, in some far-off country, who might never make payment. Buyers, on the other hand, are wary of paying for goods that might never arrive.

To address that wariness, banks – using letters of credit – have placed themselves as intermediaries between sellers and buyers. Thus, sellers can look to a bank for payment, provided that the *documents* evidencing the sale are in order. Therefore, sellers need not worry about the financial standing of an unknown buyer. Buyers, on the other hand, have the satisfaction of knowing that payment will be made only once the goods are in the hands of a carrier for transportation to the buyer.

It is estimated that up to 15% of all international trade today, totalling over US\$1 trillion per year,<sup>2</sup> is financed by letters of credit. It is further estimated that almost all these credits are subject to the *Uniform Customs and Practice for Documentary Credits* ("**UCP**").<sup>3</sup>

This Update will examine the relationship between the holy trinity of commercial trade: the sale contract, the carriage contract and the financing arrangements. This examination will be done in the context of a recent judgment of Malaysia's apex court.<sup>4</sup>

### The Takeaway

Banks play an important role in the international sale of goods. Their role in letter of credit transactions – in particular – ensures that both buyers and sellers have a reliable intermediary in the sale transaction.

It is important therefore for banks to familiarise themselves with the workings of letters of credit and the version of the UCP (if any) applicable to the transaction. This is especially so given the tight timelines that must be complied with and the narrow margin for error in the transactions.

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<sup>1</sup> William Hedley and Richard Hedley, *Bills of Exchange and Bankers' Documentary Credits* (4<sup>th</sup> edn, LLP Professional Publishing 2001) para 16.2.

<sup>2</sup> Anders Grath, *The Handbook of International Trade and Finance* (4<sup>th</sup> edn, Nordia Publishing Limited 2016) 56.

<sup>3</sup> Paul Todd, *Bills of Lading and Bankers Documentary Credits* (4<sup>th</sup> edn, Informa Law 2007) para 1.40.

<sup>4</sup> *Malayan Banking Berhad v Punjab National Bank* [2022] 4 MLJ 758 (Federal Court).

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### The Facts

#### *The Sale Contract*

The Sellers, SIMS Copper Sdn Bhd, sold 250 metric tons of copper wire to the Buyers, Sara International Limited, for US\$1.9 million. The goods were continuous cast copper wire priced at US\$7,850 per metre.

#### *The Financing Arrangements*

The sale was financed by an irrevocable letter of credit ("**LC**") with Punjab National Bank ("**Punjab Bank**") acting as the issuing bank. The LC was governed by the UCP 600 and it allowed for negotiation by any bank in Malaysia.

The documents that had to be presented under the LC included a "*Full set signed clean on board ocean bill of lading*". Further, the LC stipulated at Field 47B Para G that : "*Short form, blank back, stale, freight forwarder, house of bill of lading is not acceptable, charter party bill of lading is acceptable*".

Sellers presented the documents specified in the LC to Maybank Banking Berhad ("**Maybank**"), which acted as the nominated bank. Upon satisfying itself that the documents were in order, Maybank paid the Sellers the US\$1.9 million purchase price. Maybank then presented the documents to Punjab Bank, seeking reimbursement of the US\$1.9 million.

#### *The Dispute*

Punjab Bank, however, concluded that the presentation was not in compliance with the terms of the LC. It refused to reimburse Maybank.

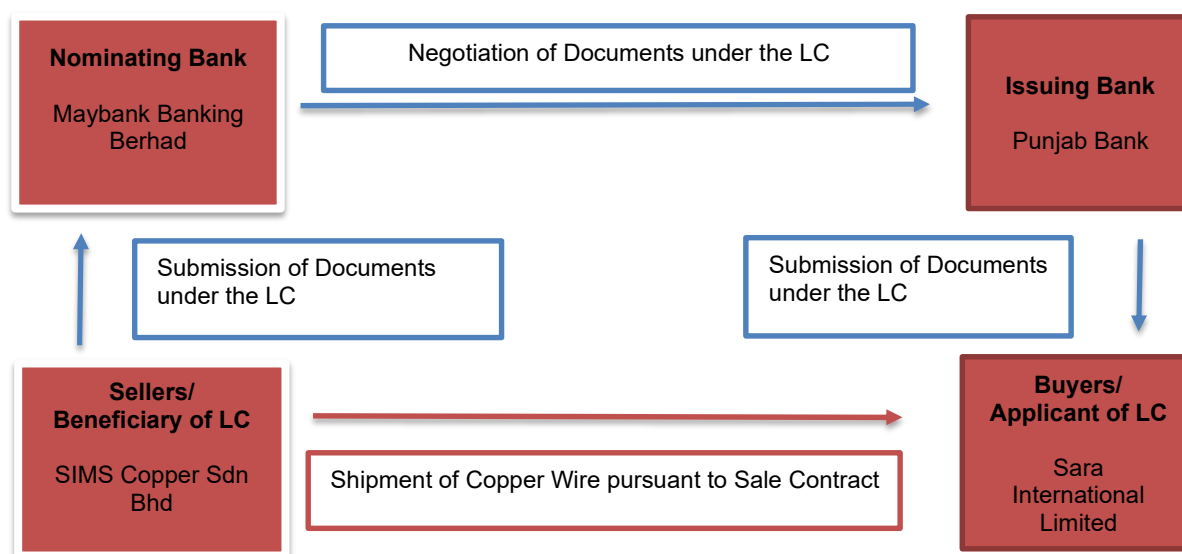
The reason behind Punjab Bank's stand was that the bill of lading presented was a "*freight forwarder bill of lading*" and thus allegedly did not meet the requirement stipulated at Field 47B Para G. Maybank went on to ask Punjab Bank to seek a waiver of the alleged discrepancy from the Buyer, but the Buyer was not willing to acquiesce to this.

Maybank then initiated proceedings against Punjab Bank seeking reimbursement of the US\$1.9 million on the basis that the bill of lading indeed complied with the requirements of the LC.

The Federal Court held that Maybank was entitled to reimbursement and that the bill of lading was in fact in compliance with the requirements of the LC.

The diagram below attempts to explain the flow of documents under the LC transaction.

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## Setting the Scene

Before we analyse the decision of the Court, it might be worth setting out the commercial practice prior to the advent of letters of credit. Setting this scene may lend a better understanding to the evolution of international trade and the role of letters of credit and the UCP 600.

### *Before Letters of Credit*

The opening paragraph of this Update captured a wariness in sellers and buyers prior to the coming of letters of credit. To be sure, however, even before the advent of letters of credit, sellers had *some* protection against the non-payment of a buyer. This protection arose from sellers retaining the bill of lading, which allowed them to claim the goods at the port of discharge and to re-sell them.<sup>5</sup>

This protection, however, came with two disadvantages. Firstly, sellers were unlikely to be keen to claim the goods at the port of discharge. This is because the goods would be in a foreign country and difficult to re-claim, given the sellers' unfamiliarity with the rules of that foreign country. Secondly, re-selling the goods would only be worth the hassle if the market remained buoyant. It would be a very different situation in a falling market.<sup>6</sup>

The earliest versions of letters of credit came about in the late 1800s, about 50 years after the development of CIF (Cost, Insurance and Freight) contracts. But even then, it was some time before the

<sup>5</sup> Paul Todd, *Bills of Lading and Bankers Documentary Credits* (4<sup>th</sup> edn, Informa Law 2007) para 1.29.

<sup>6</sup> Paul Todd, *Bills of Lading and Bankers Documentary Credits* (4<sup>th</sup> edn, Informa Law 2007) para 1.29.

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credits were irrevocable. This was due to banks' reluctance to insure against the insolvency of its customer, the buyer. Thus, the modern form of irrevocable letters of credit came about only when it was clear that bills of lading were indeed transferable.<sup>7</sup> This transferability gave banks constructive possession of the goods that the bills of lading symbolised.

### *The UCPs*

The UCP was designed to bring uniformity to the laws and practice of letters of credit. Originally published in 1933 by the International Chamber of Commerce, the most recent revision – and the version discussed in the judgment – is the UCP 600.<sup>8</sup>

The UCP 600 has been described as a "*conservative and moderate document*"<sup>9</sup> that is "*a code of rules for bankers.*"<sup>10</sup> It has the force of law only if incorporated into the letter of credit transaction. Even then, it is not comprehensive and does not govern all aspects of the transaction.

## Analysis of the Court's Decision

The key issue to be decided by the Court was whether the bill of lading presented under the LC was in keeping with the requirements of the UCP 600.

In the course of argument, however, a number of sub-issues were canvassed, all worth discussing.

### *The Notice of Refusal*

Punjab Bank took the position that the issuing bank need not issue a notice of its refusal (pursuant to Article 16 of the UCP ("**Article 16**")) to negotiate the LC if there was a fundamental breach of the LC.

Punjab Bank's stand was that the non-production of an ocean bill of lading did not amount to a mere discrepancy (where a notice under Article 16 must be issued). Instead, it amounted to a fundamental breach of the terms of the LC, and therefore no notice under Article 16 needed to be issued.

The reason – it may be surmised – that Punjab Bank took this stand was because Article 16 (if applicable) required a notice to be given "*no later than the close of the fifth banking day following the day of presentation.*" However, Punjab Bank's notice of refusal to honour the LC was received by Maybank only some 14 days after the documents were presented to Punjab Bank.

In any case, the Court held that Punjab Bank's position was incorrect. The Court explained that nothing in the language of Article 16 allowed for the interpretation forwarded by Punjab Bank. Indeed, the language of Article 16 is unequivocal in requiring a notice to be issued by the issuing bank if it refuses (for whatever reason) to negotiate the LC: "*When ... the issuing bank decides to refuse to honour or negotiate, it must give a single notice to that effect to the presenter.*" The reason for the refusal to

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<sup>7</sup> Pursuant to s1 of the United Kingdom's Bills of Lading Act 1855.

<sup>8</sup> Being the 600<sup>th</sup> publication of the ICC.

<sup>9</sup> Paul Todd, *Bills of Lading and Bankers Documentary Credits* (4<sup>th</sup> edn, Informa Law 2007) para 1.106.

<sup>10</sup> Paul Todd, *Bills of Lading and Bankers Documentary Credits* (4<sup>th</sup> edn, Informa Law 2007) para 1.107.

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negotiate is irrelevant; nothing in the terms of the LC draws a distinction between a discrepancy and a fundamental breach. To boot, the Court pointed out that Punjab Bank's position was not supported by any legal authority.

Further, Punjab Bank's refusal to reimburse was given as "*FREIGHT FORWARDER BILL OF LADING NOT ACCEPTABLE AS PER LC CLAUSE 47B-G*". Therefore, it was clear that Punjab Bank's refusal to negotiate was "*premised solely on the claim that the Documents contained discrepancies.*" Thus, a notice pursuant to Article 16 should have been issued timeously.

### *The Type of Bill of Lading to be Presented*

Punjab Bank said that the bills were issued and signed by a freight forwarder, Diffreight Agencies (M) Sdn Bhd ("**Diffreight Agencies**"). The bills were therefore "*freight forwarder bill[s] of lading*" and thus did not meet the requirement at Field 47B Para G.

The Court, however, said that the bills of lading did not show that they were issued and signed by a freight forwarder. On their face, the bills of lading were signed by Diffreight Agencies (M) Sdn Bhd "*as agent on behalf of the carrier Diffreight.*" Indeed, no evidence was led by Punjab Bank that Diffreight Agencies was in fact a freight forwarder.

At any rate, the Court held that the fact that the bills of lading were signed by Diffreight Agencies on behalf of the carrier Diffreight indicated that the bills of lading were indeed ocean bills of lading. Therefore, the bills of lading met the requirements of the LC.

In rounding up its holding on this issue, the Court took note of the role of banks when faced with a presentation of documents in a letter of credit transaction. The Court noted that, whereas banks hold themselves out as experts in handling documents, they hold out no expertise in the handling of goods or in the underlying factual situations.

Indeed, Article 5 of the UCP provides: "*Banks deal with documents and not with goods, services or performance to which the documents may relate*". This gels with the requirement in Article 14 (a) of the UCP, concerning the standard for examination of documents, that banks must "*determine, on the basis of documents alone, whether or not the documents appear on their face to constitute complying presentation.*"

### *Manner of Negotiation of Documents*

Punjab Bank's third complaint was that Maybank should not have paid the Sellers prior to seeking reimbursement from Punjab Bank.

The Federal Court dismissed this argument by holding that nothing in Article 7(c) of the UCP (which sets out the obligations of the issuing bank in the face of a complying presentation) requires this. In keeping with a leading decision on this issue,<sup>11</sup> the Court held that "*the precise manner of negotiation of the documents must be a matter for the negotiating bank.*" Therefore, if Maybank "*wishes to make payment under the credit in anticipation ... of submission of a compliant document in lieu of one that is*

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<sup>11</sup> *China New Era International v Bank of China (HK) Ltd and Ors* [2010] HKC 82 (CA), [51] - [57].

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*not compliant ... it does so at its own commercial risk...*" In other words, the nominated bank is free to effect payment prior to making a 'complying presentation' to the issuing bank.

### Practical Advice for Banks

In light of the issues that arose in the decision, it might be prudent for banks involved in letter of credit transactions to bear in mind the following points:

- At the risk of stating the obvious, banks must be able to determine promptly if the documents presented under the letter of credit are in compliance with the terms of the credit. This is so given the "five banking days" timeline to determine if a presentation is in compliance and to issue a notice of refusal (if the documents are defective).
- If the documents are in any way defective, bank should contemplate seeking an indemnity from the beneficiary prior to paying out. The indemnity should be "no wider in its application than is necessary to protect the bank from the dangers it foresees, and sufficiently clear so as not to expose the beneficiary to a limitless degree".<sup>12</sup>
- When facing difficulty in deciding whether to reject or not, the paying bank may pay "under reserve". In other words, if the issuing bank subsequently rejects the documents, repayment of the money can be claimed from the beneficiary (i.e. the seller) since the bank has made its position clear in reserving its rights.<sup>13</sup>
- Banks might also explore the option of seeking clarification from the applicant of the credit (i.e. the buyer). The applicant might be prepared to accept documentation which is technically non-conforming, especially where the discrepancy is minor and there is nothing wrong with the goods. This move is especially advantageous in a rising market, where it will be more expensive to buy replacement goods than to accept the documents tendered (even if defective). If the bank does not consult with the applicant, it may have no option but to reject even in many cases where the applicant would prefer to keep the credit alive.<sup>14</sup>

### Conclusion

The Federal Court's decision on this dispute is in keeping with the body of judgments and academic writings on letters of credit and the UCP 600. Therefore, this decision is a welcome addition to Malaysian jurisprudence and is likely to inspire confidence in international sale transactions involving Malaysian entities.

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<sup>12</sup> William Hedley and Richard Hedley, *Bills of Exchange and Bankers' Documentary Credits* (4<sup>th</sup> edn, LLP Professional Publishing 2001) para 17.43.

<sup>13</sup> William Hedley and Richard Hedley, *Bills of Exchange and Bankers' Documentary Credits* (4<sup>th</sup> edn, LLP Professional Publishing 2001) para 17.44.

<sup>14</sup> Paul Todd, *Bills of Lading and Bankers Documentary Credits* (4<sup>th</sup> edn, Informa Law 2007) para 9.34.

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If you have any queries on bills of lading, letters of credit or the UCP 600, please feel free to contact the writer of this Update, [Clive Navin Selvapandian](#), who is both a member of the Malaysian Bar's Shipping and Admiralty Law Committee and Treasurer of the International Malaysian Society of Maritime Law.

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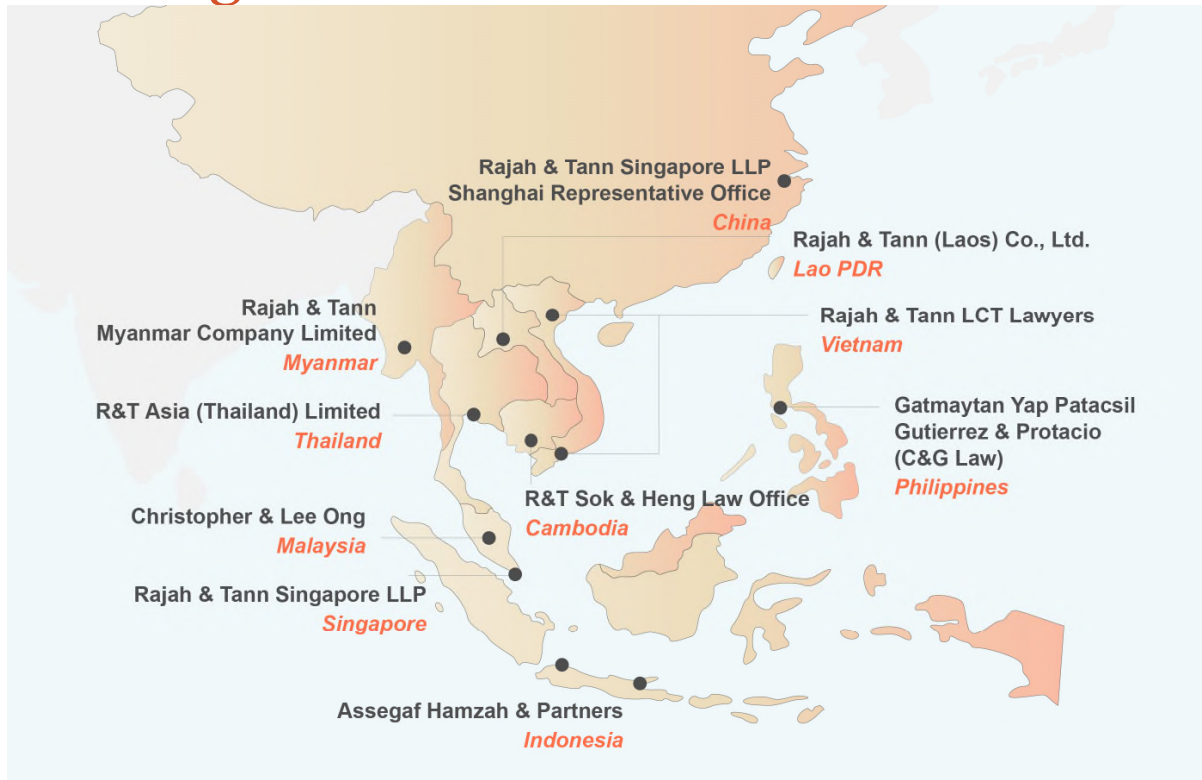
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