

arrangements or guides to practice, designed to minimize misunderstanding or dispute.

76. In view of the time needed for the completion of the analysis, the preparation of studies and the con-

sultation with interested organizations, the Commission may wish to defer a decision on the creation of a Working Group on Negotiable Instruments until its next session.

## B. Bankers' Commercial Credits

*Note by the Secretary-General transmitting a study by the International Chamber of Commerce on documentary credits and observations thereon\**

1. The United Nations Commission on International Trade Law (UNCITRAL), at its first session, decided to include in its work programme, as a priority item, the subject of bankers' commercial credits as related to international payments.<sup>1</sup> In view of the interest of, and work done by, the International Chamber of Commerce on this and related topics, the Commission further decided to request the Secretary-General to inquire whether the International Chamber of Commerce would be prepared to undertake a study of the subject.<sup>2</sup> The Secretary-General was also requested to consult with other organizations concerned.<sup>3</sup>

2. In accordance with the Commission's request, the Secretary-General, by a letter dated 21 May 1968, inquired whether the International Chamber of Commerce would be prepared to submit, for transmission to the Commission, a study on the above topic. In response to the Secretary-General's inquiry, the International Chamber of Commerce prepared a study entitled "Documentary Credits", which is reproduced in annex I below.

3. By a letter dated 11 November 1968, the Secretary-General transmitted the study to the organs and organizations listed in annex II to this document and invited them to submit any observations they might wish to make on the subject of bankers' commercial credits as related to international payments, as well as any suggestions on steps which UNCITRAL might usefully take in promoting the harmonization and unification of law in this matter.

4. At the time of writing of this note, replies had been received from the secretariats of the Economic Commission for Europe and the International Institute for the Unification of Private Law (UNIDROIT).<sup>4</sup>

5. The Executive Secretary of the Economic Commission for Europe stated that the Uniform Customs and Practice for Documentary Credits, codified by the International Chamber of Commerce, "appeared to meet fully the requirements of the interested parties" and endorsed the suggestion made by the International Chamber of Commerce in its study that UNCITRAL

should commend the Code to all Member States of the United Nations.

6. The Secretary-General of UNIDROIT qualified the Code as "the most typical example of the efficacy of the unification of law realized through standardization of commercial customs and practice" and advised that UNIDROIT, in collaboration with the international Chamber of Commerce and the Economic Commission for Europe, was preparing for 1969 a round-table conference of interested international organizations on legal problems concerning the international through bill of lading and, particularly, the document of carriage and title to be used in respect of goods shipped in large containers. It was suggested by UNIDROIT that the conclusions reached at that conference might be considered by the International Chamber of Commerce at a future review of the Uniform Customs and Practice for Documentary Credits.

### ANNEX I

#### Documentary credits:

STUDY SUBMITTED TO THE UNITED NATIONS  
BY THE INTERNATIONAL CHAMBER OF COMMERCE

#### Introduction

1. From the viewpoint of the merchants involved international trade can present many problems, not the least being that of providing the "commercial security" desired by both buyer and seller, i.e. ensuring that both the making and receiving of payment for the goods shall be effectively linked with the passing of title to such goods.

2. For nearly a century—and on an increasing scale since the 1920s—internationally operating bankers have been making a major contribution to the solving of this specific problem by providing "documentary credits"—sometimes also referred to as "documentary letters of credit" or "commercial credits" or "commercial letters of credit".

#### Definition

3. Currently, these credits are internationally defined as:

"... any arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and in accordance with the instructions of a customer (the applicant for the credit), is to make payment to or to the order of a third party (the beneficiary) or is to pay, accept or negotiate bills of exchange (drafts) drawn by the beneficiary, or authorises such drafts to be paid, accepted or negotiated by another bank, against stipulated documents and in compliance with stipulated terms and conditions."

4. Basically, therefore, such "arrangement", whether described as a "credit" or a "letter of credit", or as "documentary"

<sup>1</sup> Report of the Commission on the work of its first session, (A/7216), para. 25.

<sup>2</sup> *Ibid.*, para. 28.

<sup>3</sup> *Ibid.*

<sup>4</sup> Comments and observations that may be received hereafter from other organizations are summarized in the addendum to this document.

or "commercial", always involves at least three parties, i.e. the banker issuing the credit, the applicant for the credit (usually the buyer) and the beneficiary of the credit (usually the seller), and results in the banker giving to the seller a conditional undertaking regarding payment at the request and on the instructions of the buyer.

5. It thereby assures the seller of due payment by substituting the credit-worthiness of the bank for that of the buyer, enabling the seller, subject to compliance with the "stipulated terms and conditions", to get his money from a bank—usually in his own country—instead of himself seeking the exact settlement of his invoiced price from a remote buyer who might well be hampered by exchange controls and their attendant red tape. At the same time it interposes that bank's expertise on behalf of the buyer to ensure that the documents presented are in compliance with the credit, and, where the documents presented are documents of title to the goods, to ensure for him "constructive delivery" of the goods. It is, however, a fundamental principle of such a banking instrument that the bank shall only be concerned to see that the documents "appear on their face to be in accordance with the terms and conditions of the credit" and that the bank shall not need to concern itself with the content of the underlying business transaction.

6. This principle is important, for the complete and deliberate separation of the bank's commitment to the beneficiary from the rights and liabilities arising from the "sale and other contracts" on which the credit is based enables it successfully to play its dual economic role, that of providing both credit and security—although, from the viewpoint of the seller, the security aspect, i.e. the assurance of receiving payment, may well seem to be the factor of major importance throughout the three stages in a documentary credit operation.

#### *Operation*

7. Thus, in the first stage, the issuing of the credit, the issuing bank, acting by order and for account of its customer (the applicant for the credit, usually the buyer) gives its unilateral undertaking to a third party beneficiary (usually the seller) to pay him a certain sum of money subject to his compliance with certain stated terms and conditions.

8. The undertaking may be "revocable", i.e. NOT constituting "a legally binding undertaking between the bank or banks concerned and the beneficiary", since it "may be modified or cancelled at any moment without notice to the beneficiary". More usually, however, it will be "irrevocable", i.e. as "a definite undertaking on the part of the issuing bank" it will constitute "the engagement of that bank to the beneficiary". Or it may provide for that "engagement" of the issuing bank to be "confirmed", i.e. to be reinforced by the addition of a similar undertaking of another bank, thereby binding that bank also.

9. The undertakings, however, are all subject to the beneficiary complying with the stated terms and conditions, and these are likely to cover such matters as the method and place of payment (e.g. in cash against a sight draft, or by acceptance of a tenor draft providing for payment at a future date), the documents required and the shipment to which they are to relate (e.g. an invoice showing what the goods are and their value, an insurance policy or certificate covering the goods against loss or damage whilst in transit, and a document of carriage—such as an ocean bill of lading—representing them whilst in transit and giving rights to them on arrival at destination), and the expiry date, i.e. the latest date by which the terms and conditions must be complied with and payment claimed.

10. However, although the beneficiary has to meet these requirements if he wishes to be paid, he does not incur any liability to the bank(s) if he fails to do so. He merely, in effect, releases the bank(s) from the undertaking(s) given.

11. The second stage in the documentary credit operation therefore calls for the beneficiary to send the right documents to the right bank at the right time, for the bank to examine the "documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit", and for the bank then to honour its payment undertaking, either by direct payment of the sum involved or by the acceptance—or negotiation—of tenor drafts, according to whether they are required to be drawn on the bank or on a third party.

12. In the third stage the issuing bank's client, the applicant for the credit, is required to reimburse the bank for the monies it has paid out, plus its commission. Because it is basic that "in documentary credit operations all parties concerned deal in documents and not in goods" the applicant for the credit cannot refuse to meet the demand for reimbursement so long as the documents "appear on their face to be in accordance with the terms and conditions of the credit". Consequently, he cannot oppose the bank's demand for reimbursement on grounds relating, for example, to such matters as the quality of the goods, or the way in which the underlying business transaction has been carried out, but he can refuse to accept the documents and reimburse the bank on the grounds that it had made payment to the beneficiary against irregular documents, or in violation of a term or condition of the credit.

#### *Uniform Code*

13. It is on these grounds that difficulties, friction and even litigation can arise—and have arisen—for, since traders are merchants rather than legal or financial experts, and because outlook, understanding, knowledge and experience can vary from country to country, from bank to bank and from merchant to merchant it is possible for there to be misunderstandings regarding the precise meaning of terms used and for disputes to develop over the exact nature of obligations imposed.

14. This uncertainty with regard both to specific terms and conditions and to the essential nature of this banking operation and its legal implications, together with a lack of international uniformity of banking practice, led the International Chamber of Commerce to attempt to standardize the customs and practice relating to these credits, in order that a clear and acceptable code might be established.

15. Its initial "Uniform Regulation on Documentary Credits" adopted at its Amsterdam Congress in 1929 was, however, only put into practice by the banks in France and Belgium. Complete revision was therefore deemed necessary and its first "Uniform Customs and Practice for Documentary Credits", adopted at its Vienna Congress in 1933, became accepted by banks throughout Continental Europe. The post-war need to take note of American practice and the desirability of altering certain matters of detail in the light of experience led to a further revision, adopted at the 1951 Lisbon Congress, this version securing the collective adherence of the banks in some thirty countries.

16. The need was still for wider support, for agreement on a common code of practice, formulated as a written set of rules likely to be both universally adopted and uniformly interpreted. This need was not effectively met until the 1962 revision, completed with the full and active co-operation of the British banking system, produced its brochure No. 222, "Uniform Customs and Practice for Documentary Credits", giving a code which the banks and banking association of one hundred and eighty States and territories, including both capitalist and socialist economies, voluntarily have agreed shall govern their documentary credit operations.\*

\* Additionally, the individual adherence of banks in a further forty or so countries was registered.

*Brochure No. 222*

17. This Code which, being "the only set of international trade rules applied globally, may be deemed to represent commercial usage in the legal sense of the term", commences with "General Provisions and Definitions", which include the definition of credits given above, and prepares the ground for the basic principle stressed throughout the Code's forty-six articles, that the duty of the applicant for the credit is to give complete and precise instructions to the issuing bank — for writing fully into the credit document itself — so that there can be no grounds for doubt or uncertainty at any stage in the chain between the applicant for the credit and the beneficiary of the credit by reason of incompleteness or ambiguity.

18. It then deals with the "Form and Notification of Credits", explaining the different forms of documentary credits, i.e. revocable, irrevocable and confirmed — and the distinguishing features of each — so as to avoid, as far as may be possible, future misunderstandings and dissatisfactions. In this section article 6 serves to stress the basic principle that it is the duty of the applicant, who is the party knowing exactly what is needed, to ensure the effective operation of the credit by giving clear and complete instructions.

19. Proceeding to "Liabilities and Responsibilities" the Code develops a second basic principle, following naturally from the first one. This, as set out in article 8, is that it is the bank's duty to comply strictly with the terms and conditions of the credit when taking up documents, and to reject — and withhold payment for — those which are not in accordance with such terms and conditions, unless the applicant for the credit should sanction acceptance of — and payment against — those irregular documents. In this latter case the bank has the right to demand reimbursement from the applicant for payments made under the credit because the applicant has, in effect, "amended" the original credit terms to fit the documents presented, which, expressed in reserve, means that the documents presented now meet the credit (including "amendments") terms and conditions.

20. The third part, "Documents" stresses that it is for the applicant to specify what he wants in the way of documents, and not for the banker to guess, and goes on to define the conditions which, in the absence of any specific requirements laid down by the applicant, the documents prescribed must fulfil. In particular, it gives a simple and specific definition of a "clean" bill of lading, previously a cause of much friction and dispute.

21. Fourthly, it groups, as "Miscellaneous Provisions", definitions and interpretation of terms which, lacking such

definitions and uniformity of interpretation, have in the past hampered the smooth working and successful operation of documentary credits.

22. Finally, it uses its article 46 to deal clearly, precisely and comprehensively with the "transfer" of credits; a special form of passing all or part of the benefit of a credit to a third party, previously a steady source of supply of problems.

*Review*

23. The International Chamber of Commerce, without underestimating the importance — and success — of its past endeavours in this specialist sphere, does not overlook the need to make sure that its Code as set out in brochure No. 222 does not drop behind current changes in international trade and shipping practice. The Code is therefore kept under constant review, and queries which are from time to time raised from various parts of the world are considered at the half-yearly meetings of its Commission on Banking Technique and Practice, a body which is already looking ahead to the need for certain alterations to be internationally agreed and written into these rules when agreement is eventually reached in connexion with the document of carriage and title to be used in respect of goods shipped in large "containers".

*Legal aspect*

24. Such reviews, necessitated by changes in trade practice, can be agreed, and written into the Code as specific amendments more speedily and with less friction when the Code is accepted internationally by voluntary agreement than when the rules are written specifically into any national, statutory law.

25. It is for this reason that the whole Code is written into each application for the bank to issue a credit, as well as into the credit itself, so that these rules form part of the "finance" contract ancillary to the "purchase and sales contract".

26. It would, however, be of considerable help to have the United Nations, through UNCITRAL, commend this Code to all Member nations, including, if possible, those where these rules are not yet applied.

**ANNEX II****List of organs and organizations to which the study of the International Chamber of Commerce was transmitted**

[Annex not reproduced. The names of the respondent organizations are given in the summary of comments in document A/CN.9/15/Add.1 which follows.]

**Addendum to the note by the Secretary-General on bankers' commercial credits\*****INTRODUCTION**

1. In his note A/CN.9/15 the Secretary-General reproduced the study on documentary credits submitted to the United Nations by the International Chamber of Commerce, together with a summary of the comments which had been received from the Secretariats of the Economic Commission for Europe (ECE) and the International Institute for the Unification of Private Law (UNIDROIT).

2. The present addendum contains a summary of the comments which have been received since the circulation of document A/CN.9/15.

**SUMMARY OF COMMENTS SUBMITTED BY ORGANS AND ORGANIZATIONS ON BANKERS' COMMERCIAL CREDITS**

3. The Executive-Secretary of the United Nations Economic Commission for Latin America informed the Secretary-General that the commercial banks of the countries of Latin America follow the rules of the Uniform Customs and Practice for Documentary Credits, prepared by the International Chamber of Commerce, in documentary credit operations with banks which are their agents in foreign countries.

4. The secretariat of ECLA suggested that "it would be useful for some specialized body of the United

\* A/CN.9/15/Add.1.

Nations to be made responsible for supervising not only the existing code of practice and usage, but also any amendments to it that may be made in the future as a result of the work of the ICC Commission on Banking Technique and Practice. This United Nations supervision would be permanent in character and would automatically constitute a form of approval of what the ICC agrees at the private level. This suggestion is prompted by the fact that, in matters of such great importance, uniform standards to be applied by all should be subjected to legal review at a more comprehensive level than is possible with a private organization. For this purpose, it would be advisable for the United Nations commission or committee carrying out the review to be composed of representatives of the monetary authorities to ensure the greatest possible amount of technical support and flexibility."

5. The reply from ECLA emphasized that in reviewing and unifying existing provisions, special attention should be paid to practices that might affect transactions of the banking institutions of developing countries. It was further suggested that it would be useful to consider the "possible effect of these comprehensive and widely applied rules on the efforts of regional integration groups to co-ordinate their international payments systems, and also into the possible emergence of new and different practices and procedures, particularly with regard to documents and guarantees".

6. The secretariat of the International Monetary Fund drew attention to the use of advance import deposits which the authorities of the Fund members may require of importers in connexion with the opening of letters of credit. These "arrangements raise the issue of Fund jurisdiction if they operate through the exchange system, making payments or transfers for current international transactions subject to the deposit requirement. It is generally Fund policy to discourage the use of such

advance deposit arrangements in view of their restrictive and sometimes discriminatory *effects on import*. Accordingly, the Fund favours the elimination or reduction in reliance on these arrangements, whenever this is possible without adverse effects on the prevailing monetary and balance of payments position of its members."

7. The general secretariat of the Organization of American States stated that none of the organs of the Organization, including the Inter-American Juridical alterations in the ICC rules might be necessary in Committee and the general secretariat, have so far dealt with this specific subject. It was suggested that certain connexion with the document of carriage and title to be used in respect of goods shipped in containers.

8. According to the Secretary-General of the Commission of the European Communities "*l'extension d'usages uniformes dans le domaine des crédits commerciaux bancaires semble être un des moyens les plus appropriés pour la promotion du commerce international.*" ("the extension of uniform practices with regard to bankers' commercial credits seems one of the most appropriate means of promoting international trade.")

9. The secretariat of the European Free Trade Association reported that the Association has not yet had the occasion to consider the subject of banker's commercial credits. Although all practical obstacles to the free movement of trade between the Member States are regularly reviewed by the Committee of Trade Experts, there have not been any complaints of difficulties in this regard.

10. The Vice-President of the African Development Bank stated that the Bank "highly appreciates the objectives of the study and concurs with the view that it would be very helpful if a greater degree of uniformity in international practice in this field could be achieved. It would serve in its own way to facilitate and promote world trade."

### C. List of relevant documents not reproduced in the present volume

| <i>Title or description</i>  | <i>Document reference</i> |
|--|---------------------------|
| Preliminary study of guaranties and securities as related to international payments  | A/CN.9/20 and Add.1       |
| Bank guaranties: proposal by the Hungarian delegation concerning the preparation of uniform rules and practice relating to bank guaranties | A/CN.9/L.13               |
| Guaranties and securities: note by the Secretary-General   | A/CN.9/37                 |
| International payments banker's commercial credits: report of the Secretary-General  | A/CN.9/44                 |
| Guaranties and securities: note by the Secretary-General   | A/CN.9/45, Add.1          |