

## ***MANIPULATION OF THE ICC/UCP400***

The International Chamber of Commerce (ICC) Uniform Customs and Practice for Documentary Credits (UCP) Publication No. 400 was the 1983 Revision in force as from 1 October 1984, and was then, the universally accepted and recognized set of rules governing letters of credit. This was the bankers' "bible", so to write. It was to be not only the guide line for banking associations and individual banks but this 1983 Revision was to help clarify some nebulous areas in the previous revision of 1974. In fact, it did precisely that. Yet, there were still some other areas where crafty opportunistic businessmen, who had studied the ICC 400, had just enough leeway to manipulate the system around this new 1983 revision.

Following are a few examples of such manipulations that occurred during that era through modalities of nuance and deception.

Excerpt from the ICC 400 (\*):

### **B. FORM AND NOTIFICATION OF CREDITS**

#### Article 7

- a. Credits may be either
  - i. revocable, or
  - ii. irrevocable
- b. All credits, therefore, should clearly indicate whether they are revocable or irrevocable.
- c. In the absence of such indication the credit shall be deemed to be revocable.

#### Article 8

A credit may be advised to a beneficiary through another bank (the advising bank) without engagement on the part of the advising bank, but that bank shall take reasonable care to check the apparent authenticity of the credit which it advises.

#### Article 9

- a. A revocable credit may be amended or cancelled by the issuing bank at any moment and without prior notice to the beneficiary.

---

### ***EXAMPLE ONE***

COMMENT: During the 1980's and as recently as January 1994 with the ICC 500 Revision in force as of that date, dishonest persons could issue a Documentary Letter of Credit (DLC) to an inexperienced or uninformed supplier (beneficiary) and purposely would not state whether it was revocable or irrevocable in the text of the credit. Therefore, it would be revocable in accordance with 7, c above. Once a

shipment was enroute to the buyer (applicant) the buyer would request that his bank “revoke” or cancel the letter of credit unbeknown to the beneficiary.

When the beneficiary went to the bank to encash the DLC he was told that he credit had been revoked. The buyer might concoct a story that his clients had cancelled their contract to buy the merchandize and therefore, he would no longer want the shipment.

The supplier having already incurred the costs of transportation, perhaps \$5-20,000 for one to four twenty or forty foot seagoing containers, would be willing to bargain with the buyer since he would incur an additional \$5-20,000 if he had to return the shipment to himself.

The buyer would then ask the supplier to discount the transportation costs from the original contract invoice (\$10-40,000 for the return transportation) otherwise the buyer would not accept the shipment.

In many instances, the supplier would be willing to negotiate with the buyer in order to save the transportation costs and thus saving the original contract in the process.

This was a clever ploy used by sophisticated and fraudulent buyers who would take advantage of the uninformed and inexperienced suppliers who were not knowledgeable of the ICC 400.

---

## **EXAMPLE TWO**

COMMENT: Another clever and dishonest scenario has been structured in the following manner by buyers who were knowledgeable of the following in the ICC 400 and interpretation of the section on *Expiration Date and Presentation*.

### EXPIRATION DATE AND PRESENTATION

#### Article 46

- a. All credits must stipulate an expiry date for presentation of documents for payment, acceptance or negotiation.

#### Article 47

- a. In addition to stipulating an expiry date for presentation of documents, every credit which calls for a transport document(s) should also stipulate a specified period of time after the date of issuance of the transport document(s) during which presentation of documents for payment, acceptance or negotiation must be made. If no such period of time is stipulated, banks will **refuse** documents presented to them later than 21 days after the date of issuance of the transport document(s). In every case,

however, documents must be presented not later than the expiry date of the credit.

Some clever and corrupt businessmen who were knowledgeable of the ICC 400 oftentimes contrived the following scenario.

- 1 They knew of the Independence Rule (Articles 3, 4 and 6) which appears below.
- 2 They knew of the Rules on Expiration and Presentation (Articles 46 and 47).

They, the buyers, the issuers of the DLC, would sign a contract with their supplier, the beneficiary. The **contract** would state specifically that the supplier would not present his documents to the bank for payment until, say perhaps, 30 days after shipment had been made. The language in the DLC opened by the buyer would not address it and also remain silent on this point. Therefore, the documents that would be presented to the bank 30 days after the issuance of the shipping documents, would have exceeded the 21 days as stipulated in Article 47,a, and the bank would refuse payment on the DLC. Hence, the buyer now has in his possession the merchandize, legally his, albeit illegally obtained. He just duped his supplier.

The paying bank rightfully refused the transport documents as they were now stale, having exceeded the 21-day period.

The supplier's side contract with the buyer is irrelevant and non-applicable due to the Independence Rule.

### INDEPENDENCE RULE

#### Article 3

Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit.

#### Article 4

In credit operations all parties concerned deal in documents, and not in goods, services and/or other performances to which the documents may relate.

#### Article 6

A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant for the credit and the issuing bank.

### EXPIRY DATE AND PRESENTATION

Article 46

- a. All credits must stipulate an expiry date for presentation of documents for payment, acceptance or negotiation.

Article 47

- a. In addition to stipulating an expiry date for presentation of documents, every credit which calls for a transport document(s) should also stipulate a specified period of time after the date of issuance of the transport document(s) during which presentation of documents for payment, acceptance or negotiation must be made. If no such period of time is stipulated, banks will refuse documents presented to them later than 21 days after the date of issuance of the transport documents(s). In every case, however, documents must be presented not later than the expiry date of the credit.
- b. For the purpose of these articles, the date of issuance of a transport document(s) will be deemed to be:
  - i. in the case of a transport document evidencing dispatch, or taking in charge, or receipt of goods for shipment by a mode of transport other than by air – the date of issuance indicated on the transport document or the date of the reception stamp thereon whichever is the later.

---

**EXAMPLE THREE**

**COMMENT:** The following scheme, although somewhat complicated, has been applied and perpetrated in Saudi Arabia. It deals with the reading and interpretation of transport documents within the scope of DLC as referenced in the ICC 400.

The reference is as follows:

**DOCUMENTS**

Article 22

- a. All instructions for the issuance of credits and the credits themselves and, where applicable, all instructions for amendments thereto and the amendments themselves, must state precisely the document(s) against which payment, acceptance or negotiation is to be made.

Article 25

Unless a credit calling for a transport document stipulates as such document a marine bill of lading (ocean bill of lading or a bill of lading covering carriage by sea), or a post receipt or certificate of posting:

- a. banks will, unless otherwise stipulated in the credit, **accept** a transport document which:
- b. Unless otherwise stipulated in the credit, banks will **reject** a document which:
  - i. indicates that it is subject to a charter party, and/or
  - ii indicates that the carrying vessel is propelled by sail only, and/or

#### Article 28

- a. In the case of carriage by sea or by more than one mode of transport but including carriage by sea, banks will **refuse** a transport document stating that the goods are or will be loaded on deck, unless specifically authorized in the credit.

**COMMENT:** This trick or scheme would evolve into something like this.

The buyer (account party) in Saudi Arabia would request of the supplier (beneficiary) to have the merchandize **drop shipped** in Bahrain or the United Arab Emirates (UAE). His contrived story would state that some of his customers live in Bahrain or the UAE and he would deliver some of the supplies to them there, personally. He would arrange for the remainder of the shipment to Saudi by himself.

**The buyer's DLC clearly stated that the shipment would have Saudi as its final destination.**

The buyer would arrange for the shipment to be taken by Dhow (an Arabian ship propelled by sails only, somewhat similar in appearance to a Chinese Junk) across the Arabian Gulf. He would alert his bank in Saudi of two factors:

- 1 The goods would be loaded/unloaded "on deck" from one vessel to the other (which is prohibited by Article 28, a).
- 2 The final leg of the journey across the Arabian Gulf would be by Dhow (which would be in violation of the terms of the DLC and therefore the paying bank would have to reject the transportation documents: Articles 25,c and 26, c).

The purpose for this manipulation was to put the buyer in a strong negotiating position with the supplier. And, in order to straighten out this problem, because he now had the shipment in his possession and the supplier (beneficiary) could not present the DLC for payment, he usually **politely** demanded a significant discount.

This would be in breach of Articles 25,c, 26,c and 28,a as indicated above and the paying bank would **reject** the transport documents.

Even though the supplier and buyer had a contractual agreement to drop ship the supplies to Bahrain or the UAE, the Independence Rule protected the buyer in his scheme and simultaneously allowed the bank to reject the transport documents.

---

#### **EXAMPLE FOUR**

**COMMENT:** A similar type of fraud and deception was applied to Standby Letters of Credit (SLC).

For example, an individual (applicant) would borrow or take out a loan from an uninformed entity. He would guarantee repayment after a certain prescribed term, say perhaps, in 12 months. He would have his bank issue a SLC guaranteeing the repayment. As in the above example, the borrower would have the bank issue the SLC which would not state whether it was revocable or irrevocable, thus rendering it revocable. A short time after the SLC was issued he would instruct his bank to revoke or cancel the credit without informing the beneficiary as per Article 7,c above.

At the time specified in the SLC for the beneficiary to present the drafts attached in the SLC to the bank because the applicant had defaulted he would then be informed that the SLC had been revoked.

There was little or no recourse by the beneficiary to collect from the bank or from the borrower even though he had a contract with the borrower (Independence Rule, above).

---

#### **EXAMPLE FIVE**

**COMMENT:** Another clever act of deception with Standby Letters of Credit is as follows.

First, one must understand the definition of a Notation Credit. (The UCC S.5-108(1) states: "A credit which specifies that any person purchasing or paying drafts drawn or demands for payment made under it must note the amount of the draft or demand on the letter or advice of credit is a "notation credit".)

With this understanding, the concept of a notation credit is that partial drawings are permitted under the credit. It contains the provision for the recording on the credit specific and separate amounts paid under the credit and allows for the remaining amount to be paid.

It is essential for a provision for partial drawings be included in Standby Letters of Credit. With this provision allowing beneficiaries to make partial draws, if the account party makes payments outside the credit that are in sum less than the total amount owed, the beneficiary can still make draws for the remaining unpaid balance.

Here is the example of an act of deception by crafty individuals.

Let's say a standby letter of credit is issued and partial payments are not permitted. The credit is for \$100,000 and requires for the beneficiary to submit a statement upon presentment that the account party has failed to pay the total amount of \$100,000 due.

Here is the deception: The account party makes certain payments directly to the beneficiary outside the credit, say in the amounts of \$5,000 and \$10,000. Having accepted these sums from the account party the beneficiary cannot meet the requirement of submitting a statement for payment of the total amount due of \$100,000 since the account party has already made partial payments outside the credit.

---

### **EXAMPLE SIX**

**COMMENT:** The *Independence Rule* cited in Example Two, above, is sometime combined with the *Strict Compliance Rule*. Although the *Independence Rule* (ICC400, articles 3,4 and 6) appears in the ICC400, the *Strict Compliance Rule* is a standard that comes down to us from federal jurisdictions and state courts.

The Uniform Commercial Code (UCC) 5-114 (1), which is also law, states, "An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary...".

The Strict Compliance Rule is that the beneficiary must make presentment in strict compliance with the terms and conditions of the credit. According to H. Harfield, a leading expert and pioneer in letter of credit law declared, "In letter of credit transactions, the parties deal in written representations and not in facts." And, a classic statement attributed to a Lord Sumner, "There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines." An American court also stated, "Compliance with the terms of a letter of credit is not like pitching horseshoes. No points are awarded for being close."

Here is a typical scenario with a breach of Strict Compliance.

The account party (the buyer of materials) agrees with the beneficiary (the seller) that he would prepay the inland transportation (freight) charges once the shipment arrived in the jurisdiction of the buyer.

The letter of credit would clearly state that the beneficiary (shipper) had to present certificates showing freight charges were paid up to the destination of the buyer. This he could not demonstrate because the account party had prepaid for the inland transportation.

Strict Compliance of the letter of credit had been breached and the paying bank would be under no obligation to honor the letter of credit since the freight forwarder could not provide documents indicating the shipper had paid him for the inland transportation.

---

### **EXAMPLE SEVEN**

**COMMENT:** With A Negotiation Credit the beneficiary is allowed to negotiate to third parties his right to payment under the letter of credit through the purchase by the third party of the ***draft*** or other ***document of demand*** cited in the letter of credit.

This is the key to the deception.

*A letter of credit is not a negotiable instrument. The draft for payment under the credit usually is.*

Following is a typical example of a negotiation clause:

*We agree with the drawers, endorsers, and bona fide holders of drafts drawn under and in agreement with the terms of this letter or credit that such drafts should be duly honored upon presentation and delivery of documents as specified.*

The crafty and deceitful beneficiary would sell his ***letter of credit***, (which is a non-negotiable instrument) to a third party when the letter of credit had no provision stating that it was transferable. What he was ***not*** selling were the drafts to the credit.

---

### **EXAMPLE EIGHT**

**COMMENT:** The issuance of a Standby Letter of Credit with ***extrinsic*** facts or conditions was another ploy of deceitful businessmen.

Relevant to the ***Independence Rule*** and ***Strict Compliance Rule*** is well-contrived language stating that payments on a Standby Letter of Credit would be contingent upon ***extrinsic*** facts. Such as: "... funds would be available to pay the beneficiary

after they have been successfully collected from the sale of equipment or derived from proceeds received from another contract.”

The important paragraph in the letter of credit would read something to the effect:

*“This is your authorization to draw a draft for payment of proceeds which have been collected by Mr. XYZ, account party, from the sale of equipment on behalf of Mr. ABC, beneficiary. Funds drawn from this letter of credit shall be limited to only those funds received by Mr. XYX, account party, from the sale of equipment that belongs to Mr. ABC, beneficiary, with the provision allowing for the deduction of any outstanding liens.”*

This language implies two extrinsic factors, one, that the draft is for the payment of proceeds that have been collected when the equipment was sold, and two, the equipment was sold on behalf of the beneficiary.

As we understand from the ***Independence Clause*** that the credit must stand-alone and not be conditioned upon any side agreements, non-documentary **extrinsic** facts are also not permitted in proper letters of credit.

---

(\*) The Uniform Customs and Practice for Documentary Credits ICC 400 is published by the International Chamber of Commerce, 38, Cours Albert 1, 75008 Paris, France.