February 18, 2011

The Reality and Practical Application of a Compliance Standard for Examination of Documents

Jin Ik Chae
Abstract

A documentary credit is a bank's undertaking to pay against presentation of documents which comply with the terms and conditions of a documentary letter of credit. The compliance standard of the documents has in fact been mitigated in recent years, both by the UCP and courts. Especially, the revised UCP 600 was formally adopted and has been in effect for over three years and seven months, there are still a number of issues in it has been operated. Thus, this study is to review the changes, the issues and the reality for the compliance standard for examination of the documents. It is hoped that the results will contribute to the revitalization of a letter of credit regime by reviewing the compliance standard and the practical application for examination of a presentation. This paper will be discussed the relative sub-articles and major issues for the compliance standard under UCP 600 and compared it with the old relative sub-articles of UCP 500. The second is to scrutinize the operation and reality of the compliance principle under the UCP 600. Finally, it also will be presented the problems and implications for practical application of the compliance standard. In relation to this, discussion will be based on documentary research and case law where the long established legal principles from relevant cases will be examined.

Key Words: UCP 600, a Letter of Credit, Compliance Principle, Compliance standard, Standard for Examination of documents, Practical Application of a Compliance Standard
I. Introduction

Although UCP 600 has been in force for over three years, there are still a number of issues in it has been operated. One principle aim of new rules was to remove wording that could lead to inconsistent application and interpretation and to reduce the number of documents being rejected under a letter of credit and thereby to maintain or increase letter of credits' market share as an accepted means of settlement in international trade.1

The UCP 600 is not a legal regime automatically applicable to all letters of credit. They are a voluntary self-regulatory regime devised by the ICC for express incorporation into the letter of credit.2 The rules are binding on all parties thereto unless expressly modified or excluded by the credit. The UCP provides guidance for documentary compliance standard in order to determine whether a presentation is complying or not. The purpose of the letter of credit is to undertake the seller that payment will be performed, if a presentation of documents is complying. They evidence that the beneficiary fulfilled its obligation under the contract of sale.

Two distinct principles uphold the sanctity of the letter of credit, secure the payment transaction, and thus promote the efficiency of the credit transaction. There are the principles of independence and strict compliance in the letter of credit transaction; The letter of credit transaction is conceptually and actually independent from the underlying contracts on which it is based and, therefore, the issuing bank must pay to the beneficiary if documents presented by him are complied strictly with the requirements of the letter of credit regardless of any underlying disputes between the contracting parties. Therefore, the beneficiary’s payment will be guaranteed, so long as the documents strictly comply with the terms and conditions of the letter of credit.

However, the compliance standard of the documents causes the question for application and interpretation of the rules including UCP 600. The compliance standard under UCP 600 does not say how complying is complying. Thus, it is very important to understand the compliance standard of the documents to maximize the utilization and usefulness of the documentary credit transactions.

So, this paper is to study the fundamental principle and theory for the compliance standard of the documents under a letter of credit system, and to also review the reality and practical application of the compliance standard under UCP 600. It will be reviewed and compared with the old UCP 500, and so on. This study will be based on documentary research and case law where the long established legal principles from relevant cases will be examined.

II. Complying Presentation and Main Issues

1. International Standard Banking Practices

The UCP refers simply to “international standard banking practice” as the standard of documentary examination. In 2003, ICC (International Chamber of Commerce) published its first International Standard Banking Practice (ISBP) for the examination of documents under documentary credits which documented international standard banking practices for the examination of documents under the UCP and explained how the UCP rules were to be applied. The introduction of this international banking standard does not limit a bank’s duty to exercise reasonable care when checking documents. It is intended to determine the scope within which reasonable care is to be applied.

Since the introduction of ISBP, there has been a confusing relationship between this document and the UCP. Many banks were of the opinion that banks could refuse documents by claiming a discrepancy based solely on the terms and conditions of a letter of credit and UCP, not the ISBP. Many others thought quite the opposite. They said that because ISBP was clearly an ICC Banking Commission official document on international standard banking practice, presented documents must also obviously comply with these practices.

Sub-article 14(d) of UCP 600 removes the awkward suggestion of UCP 500 sub-article 13(a) that the source of standard international banking practice is the UCP itself, it does not clarify the relationship between international standard banking practice and the International Standard Banking Practice, ISBP(2007), the document adopted by the ICC Banking Commission and re-aligned with UCP 600. Instead, the relationship is left to the similarity of the names and the statements contained in the introduction to ISBP(2007). As reworked, this introduction retreats from the fiction that the ISBP is mere restatement of the UCP that was used to rationalize ISBP(2003). It represents an interpretation of the provisions of the UCP regarding documents.

Sub-article 2 of UCP 600 refers to “international standard banking practice.” A specific and direct reference to the ISBP has been avoided. It follows that issues respecting banking practice remain issues of fact. “International standard banking practice” in UCP 600 is far wider concept than that included in ISBP publication. Therefore, International standard banking practice in this context does not mean the ICC publication containing the ISBP. It means international standard banking practice in the broader

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3 For UCP 500, this system of standard international letter of credit practice consists of the rules of the UCP itself, their meaning in the light of prior to revisions of the UCP, the international standard banking practice(ISBP), the Decisions and Opinions of the ICC Banking Commission, DocDex opinions, and relevant court decisions. It is likely that a similar system will come into place for UCP 600. ISP98 is supported by The Official Commentary on the International Standby Practices: Byrne, James E.(2006), "Contracting out of Revised UCC Article 5(Letters of Credit)", Loyola of Los Angeles Law Review, Vol. 40:297, available at Byrne James E. & Byrnes Christopher S.(2007), at 103-104.
sense, which definitely includes, but is not limited to, the ISBP publication.\textsuperscript{10}

However, the number of cases ignoring the international standard banking practice is a major problem. Regrettably, both in the US and in other common law jurisdictions more than a few courts have failed to apply international standard banking practice or have failed to apply any standards other than their own “feelings.” A court sitting in Toronto decided a dispute on the basis of such feelings without regard for the UCP standard.\textsuperscript{11}

\subsection*{2. Compliance on the basis of documents alone}

UCP 600 sub-article 14(a) imposes an obligation on the banks to check only whether documents appear on their face to constitute a complying presentation.\textsuperscript{12} Banks are not obliged to go beyond the face of a document to establish whether or not a document complies with a requirement in a documentary credit or with any requirement in the UCP.\textsuperscript{13} Both banks and courts assume that since banks are not obliged to know the underlying transactions and that the banks are only entrusted with the handling of documents.\textsuperscript{14} Therefore, Upon receipt of documents, a bank must determine on the basis of the documents alone whether or not they appear on their face to constitute a complying presentation.\textsuperscript{15}

Meanwhile, Sub-article 5 of UCP 600 says that “Banks deal with documents and not with goods, services or performance to which the documents may relate.” This sub-article omits that this applies to “all parties concerned” as had been previously included in the UCP 500. The reason is that the beneficiary not only deals with documents but also with the underlying transactions. This clarification is however ambiguous since the beneficiary cannot avail himself of claims and obligations arising from the underlying transaction.\textsuperscript{16}

It holds that the relationship between the seller and the issuing bank in respect of the letter of credit is completely independent from any ancillary agreements between the seller, the buyer, and the issuing bank.\textsuperscript{17} Any dispute regarding the delivery of goods or any other term or condition of the contracts of sale, etc., should be decided separately from the letter of credit transaction.\textsuperscript{18}

Therefore, if a bank determines that the documents are on their face complying on the basis of the documents alone, the bank must honor the credit even though the buyer does not receive the goods for which it contracted. That is, the bank’s obligation is to pay regardless of any disputes between the parties in underlying transaction.

\begin{thebibliography}{18}
\bibitem{10} Supra note 6, at 279 - 280.
\bibitem{13} The UCP 600 Drafting Group(2007), \textit{Commentary on UCP 600}, ICC Publication No. 680, at 62.
\bibitem{14} Thomas Song, Chang-soon(2009), “When discrepancies should and shouldn't matter”, \textit{DCLInsight}, Vol.15, No.3, July-September, at 12.
\bibitem{15} Ellinger, E.P.(2007), \textit{supra note} 8, available at Byrne, James E. and Byrnes, Christopher S.(2008), \textit{supra note} 8, at 156.
\end{thebibliography}
3. “On their face” and genuineness of documents

The phrase “on their face” has now been removed in all places except for UCP 600 sub-article 14(a). The phrase “on their face” had been retained in the key article setting out the bank’s standard for the examination of documents.\(^\text{19}\) This was done to avoid any misconception that UCP 600 has changed the fundamental concept that banks examine documents solely based on the information stated on the presented documents and not otherwise.\(^\text{20}\) The wording “On the basis of documents alone” and later “appear”, which both figure in the new rules, should be sufficient.\(^\text{21}\)

There is a method for examination of documents under the documentary credit which is peculiar to banks. This method attempts to find whether certain statements, terms and conditions appear on the document. The concept of “on their face” is not to be interpreted as meaning either the “face” or the “reverse” of a document,\(^\text{22}\) but extends to the review of data within a document in order to determine that a presentation complies with international standard banking practice and the principles contained in UCP.\(^\text{23}\)

It is well established in law and in the UCP that banks have no obligation to verify the genuineness of the presented documents. A bank must rely solely on the information stated on the presented documents to determine whether they constitute a complying presentation without taking any further steps to verify or confirm the information thereon, unless they are aware that the relevant documents are fraudulent or forged.\(^\text{24}\) A bank need not ask itself whether the documents may perhaps be false, or whether the goods declared to have in fact been shipped, or whether the document may have become worthless after the moment at which it was issued: The actual situation does not concern the bank, except in some cases like fraud (deceit).\(^\text{25}\) They need not, for example, call the insurance company to check whether it has actually issued the marine insurance policy.

4. Complying presentation and reasonable care

Sub-article 2 of UCP 600 introduces the definition of “Complying presentation” and stipulates that a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice. This definition makes it clear that the


\(^{22}\) *Supra* note 5, at 39.

\(^{23}\) *Supra* note 12, at 62.

\(^{24}\) *Supra* note 19, at 67.

documents do not become “complying” if they are lost while in transit to the issuing bank.26

Sub-article 14(a) of UCP 600 differs from UCP 500 sub-article 13 in that, as a result of the use of the definition of “Complying presentation”, it requires that a presentation comply with the terms and conditions of a documentary credit, which includes complying with the terms and conditions of UCP 600 indicated a documentary credit, which in turn includes being in accord with international standard banking practices.27

Placing comply presentations in an article of its own logically puts it in opposition to the article covering discrepant documents which immediately follows. This allows the discrepant documents article to exclusively focus on what to do about discrepancies, rather than combining this with complying presentations as had been done in UCP 500.28

The standard for the determination of discrepancies was “reasonable care”, which was the application of international standard banking practice. In UCP 600, the words “reasonable care” is deleted, denoting that both the spirit and the letter of “reasonable care” are still in place but with more elaboration.29

In general usage, reasonable means an action that is not excessive or immoderate under the circumstances.30 In applying an obligation of reasonableness at law, reasonableness necessarily entails a context. With respect to letters of credit, Revised UCC Article 5 makes it clear that reasonableness is to be understood in the context of standard international letter of credit practice. Under general common law principles, the determination of reasonableness is the responsibility of the trier of fact.31

5. Linkage between documents presented.

The linkage was covered by UCP 400 sub-article 23 but dropped without any explanation from UCP 500.32 The UCP 500 had been somewhat light of touch on linkage, dealing with inconsistency regarding the description of the goods in sub-article 37(c) and with inconsistency in general in sub-article 13(a). The old sub-article 37 now appears without any substantive change, at sub-article 18(c) and sub-article 14(e) of UCP 600.33

Sub-article 14(e) of UCP 600 restates UCP 500 sub-article 37(c) regarding the descriptions in documents other than the commercial invoice, making it clear that the description need not necessarily be present in all documents, a point that was unclear in UCP 500 formula of “not inconsistent” with “not conflicting.”34 This sub-article specifically addresses the fact that the description of the goods, services

27 Supra note 13, at 62.
29 Supra note 14, at 12.
31 Supra note 2.
34 Supra note 7, at 137.
or performance in documents other than the commercial invoice may be in general terms as long as it does not conflict with the description contained in the documentary credit. By using the words “if stated”, it also emphasizes that there is no need for goods description to appear on every documents. UCP 600 does not refer to, require or imply that linkage is necessary between or among documents.35

Meanwhile, standby practice differs from the documentary credit practice reflected in UCP. Examination of documents against one another is not required because there is not necessarily any one underlying obligation from which the examiner can determine what constitutes consistency.36 On the other hand, URDG(The Uniform Rules for Demand Guarantees) 758(2010) is the same with the spirit of UCP 600. URDG Article 19 says “Data need not be identical to, but shall not conflict with, date in that document, any other required document or the guarantee.”

### III. Principle and Change of Documentary Compliance Standard

#### 1. Customary compliance principle

The legal principle for examination of documents that the bank is entitled to reject documents which do not in strict compliance with the terms and conditions of a letter of credit is conventionally referred to as a principle of strict compliance. Under this approach, the principle of strict compliance must be followed strictly to the extent that the documents must not contain any discrepancies, even minor typographical errors which do not really affect the underlying contract.37

The principle ensures the buyer that the bank will only make the payment if the documents presented comply strictly with the terms and conditions of the credit as stipulated by the buyer, and the seller knows that payment will be received even if the buyer would not pay voluntarily for some reason, provided the terms and conditions of the credit are strictly complied with. Accordingly, the letter of credit exists to ensure payment to the seller. However, if the seller fails to understand and/or follow the rules that determine whether their documents comply, the entire payment is put at risk after the goods have been shipped.38

Prior to UCP 500, common law courts generally applied a strict principle to documentary compliance issues. The UK courts, followed by US and Commonwealth courts held, in line with the much quoted UK judgement by Viscount Summer in 1926, that “There is no room for documents which are almost the same, or which will do just as well.” A former US Supreme Court Justice writing for a circuit court of appeals observed that documentary compliance “is not like pitching horseshoes. No points are

35 Supra note 12, at 64-65.
awarded for being close.”

Documents presented for payment under a letter of credit must be in conformity with the requirements written into the credit, including the particular presenting officer, the language and form of presentation, the physical location, and timing. The rationale for the strict compliance principle is rooted in the need to preserve the commercial vitality of letters of credit by fostering certainty to the greatest extent possible. As one federal appellate court observed, if banks deviate or are allowed to deviate from the terms of the letter of credit, “the certainty that makes this device so attractive and useful may well be undermined, with the result that banks may become reluctant to assume the additional risks of litigation.”

The strict compliance principle plays a pivotal role in the letter of credit transactions since it is estimated that as many as half of all presentments are discrepant. However, the customary principle of strict compliance owes its origin not to UCP but to an English court decision in *Equitable Trust Co. v. Dawson Partners Ltd.* In 1927, because UCP never expressly says “strict compliance” and ISBP 645 clarifications indicate strict compliance is not the intent of UCP. In short, “strict” is not UCP expression, but “judicial interpretation.”

There is no doubt that strict compliance principle is beneficial to the issuing bank for the following reasons. First, it minimizes the bank’s exposure to claims by the applicant maintaining that documentary credit payment has been illegally obtained. Second, it prevents the bank from being dragged into a conflict between the two sides. Lastly, it enables maximum efficiency in the work process, as the process is simply technical in nature.

The principle has in fact been relaxed in recent years, both by the courts and the UCP. The revised UCP 600 implies that the strict compliance principle stands softened.

## 2. Change and scope of compliance standard

The basic duty of any bank participating in the documentary credit transaction arises when it determines that a presentation is complying. If the presentation is not complying, the bank cannot make payment, unless the applicant agrees otherwise. But the obvious compliance standard does not

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39 Supra note 11.
43 *31 NYS (2d) 631 (1941).*
47 Supra note 44.
prescribe a specific standard to which a bank should require that a presentation comply.\textsuperscript{49} In this case, how does the bank determine compliance? In the meanwhile, most legal systems had been upheld the strict compliance principle with a great degree of sanctity.\textsuperscript{50} However, today, the approach taken by judges seems to be much broader and is open to a more liberal interpretation.\textsuperscript{51} UCP 600 Article 14(d), (e) and 18(b) imply the mitigation of the compliance standard for examination.

The UCP itself shows a more flexible approach, especially in the two versions, UCP 500 and 600. Sub-article 2 of UCP 600, “Definition” states that a “complying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.”\textsuperscript{52} This Definition omitted the final clause “as reflected in these article” in UCP 500. UCP 600 widened the scope so that standard banking practice is now a part of the test of compliance, even if some of these practices are beyond those related to examination of documents in the rules and that appear instead in the ISBP (ICC Publication No. 681). This broader scope leaves more room for discretion than the strict compliance approach. Another important clause which already showed an easing of the strict compliance approach appeared in UCP 500 sub-article 37(c) (now changed into UCP 600 sub-article 14(e)). UCP 600 sub-article 14(c) and 14(e) adheres to this more lenient approach.\textsuperscript{53}

Some bankers believed the choice of language of UCP 600 sub-article 14(e): “In documents other than the commercial invoice, the description of the goods, services or performance, if stated, may be in general terms not conflicting with their description in the credit” when compared with sub-article 18(c): “The description of the goods, service or performance in a commercial invoice must correspond with that appearing in the credit” meant that the intention of the UCP Drafting group in 18(c) was to mandate a “mirror image” of the merchandise description in the commercial invoice. They were relieved to learn that “correspond” does not mean mirror image.\textsuperscript{54} The change also in this wording includes a reference to “services” or “performance”, reflecting the position that documentary credits do not only cover the shipment of goods.

Especially, the revised UCP 600 Article 14(d) adopts a new and general formula for the required level of compliance, requiring that it “not be identical to, but must not conflict with” data in that or another required document or the credit.\textsuperscript{55} While UCP 500 sub-article 13(a) states that documents appearing “on their face to inconsistent with one another” were to be considered discrepant. This part has been replaced by a new form of words in UCP 600 sub-article 14(d).\textsuperscript{56} This formula appears to have provided a standard in a context that is much broader than the UCP 500 reference to consistency. The phrase “not conflict with” must have a different meaning than does “inconsistent.”\textsuperscript{57} The reference to “not identical”, indicating that literal a replication was not required.

\textsuperscript{50} Supra note 40.
\textsuperscript{51} Supra note 37
\textsuperscript{52} Supra note 2, at 151.
\textsuperscript{53} Supra note 45, at 14.
\textsuperscript{55} Supra note 7, at 136.
\textsuperscript{56} Supra note 33, available at supra note 2, at 133.
\textsuperscript{57} Supra note 7, at 136.
The new standard of “not conflict with” relates the data contained in the documents to what was required by the letter of credit, to what is stated in any other stipulated documents and to international standard banking practice, some of which is contained in the ISBP, Publication No. 681, goes beyond the practices contained in this publication and also includes additional practices of the industry that have become standard. These may include practices carried out by document checker on a daily basis that are articulated in this publication. In addition, it must be recognized that the ISBP does not cover every type of document called for under a documentary credit.58

This sub-article must meet the following requirements; the data must not conflict with (a) other data in the same document; (b) data in other stipulated documents; and (c) terms and conditions of the letter of credit.59 Technical problems not conflicting with their description in the wording of the documents presented should be allowed if a reasonable judgement of the presentation leads to the sure result that the purpose of a letter of credit will be reached.60 The Compliance of the documents turns on a comparison with the document as a whole and not isolated data in it using in general words that not conflicting the meaning after taking into account the transactional context of the credit. The requirements of the documentary credit, the structure and purpose of the document itself and international standard banking practice need to be assessed, understood and be taken into consideration in determining compliance of a document.61

This sub-article has an effected on article 19(b) of URDG 758(2010). It says that “Date in a document required by the guarantee shall be examined in context with that document, the guarantee and these rules. Data need not be identical to, but shall not conflict with, date in that document, any other required document or the guarantee.” So, URDG also introduces the standard for the required level of compliance, requiring that it “not be identical to, but shall not conflict with.”

3. “Reasonable time” and “five banking days”

When a bank completes examination of the presented documents within a reasonable time depends on the facts of each case.62 The revised sub-article 14(b) of UCP 600 sets the maximum time at five banking days and removed reference to “a reasonable time” within which to examine documents.63

UCP 500 sub-article 13(b) gave each bank involved in the credit a “reasonable time, not to exceed seven banking days following the day of receipt of the documents” to examine the documents.64 It is well known that the UCP wording was incorrectly interpreted by many banks to read just “seven banking days” until some of them suffered a penalty for that interpretation in court cases.65 The reason was due to the lack of a standard application of this concept globally and a number of banks considered

58 Supra note 13, at 64.
59 Supra note 20, at 71.
60 Supra note 40.
61 Supra note 13, at 64.
63 Supra note 28, available at supra note 6, at 193.
64 Supra note 56, available at supra note 2, at 131.
65 Supra note 6.
a reasonable time to be the full seven banking days following the day of receipt of the documents.66

The removal of “reasonable time” for examining documents and its replacement by five banking days should speed the process and make letter of credits more attractive in the market.67 Especially, the deletion of “reasonable time” may have resolved some differences of interpretation.68 The intention behind revising this provision was to replace the troublesome “reasonable time rule.”69 It also seems to be simply a confirmation that the bank each has five banking days within which to examine the documents presented to draw down the credit - even if the expiry date or last date for presentation occurs during that five banking day period.70

It is unclear, however, whether this change substitutes a fixed period of five days for the more flexible standard of UCP 500 or replaces the phrase “reasonable time” with a different standard. Now many fear that the phrase “a maximum of five banking days” might be interpreted to mean a reasonable time not to exceed five banking days.71

Despite the removal of the term “reasonable time” from UCP 600, many letter of credit practitioners still have concerns that the word “maximum” implies that the issuing or confirming bank may not have a total of five banking days to determine the compliance of each presentation. The insertion of “maximum” is there to make it clear that banks should effect payment as soon as the document examination has been completed.72 This article has to be read in conjunction with sub-article 15(a). A bank must honor when it decides that the documents comply. UCP600 Article 14(b) does not imply that a bank has to accelerate its examination of a presentation due to an impending expiry date. Asked if a safe harbor is implied by UCP600 Article 16(b), TAYLOR said yes but would not refer to it as a “safe harbor.” However, just because “reasonable time” has been removed from UCP does not change the concept that you really do have reasonable time.73

For example, what if a bank decides on the second day that the documents are compliant? Can the seller insists on payment on that second day or must the seller wait until the fifth day for payment? UCP 600 Sub-article 14(b) gives the bank five banking days “to determine if a presentation is complying.” Sub-article 15(a), however, says that “when an issuing bank determines that a presentation is complying, it must honour” and Sub-article 15(b) and (c) applies to the same rule to confirming and nominated banks. Moreover, sub-article 16(d) states that notice of its refusal to pay must be given.74

And suppose the facts show that the presentation was obviously discrepant but that the presenter did not know about the damage. The paying bank would not have five banking days to delay notifying the presenter of the discrepancy. Why? To allow the bank not to notify the presenter until after the expiry would, under these circumstances, be obviously unfair. It would be manifestly unfair for the paying

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66 Supra note 13, at 62-63.
68 Supra note 33, available at supra note 2, at 132.
69 Supra note 6.
70 Wunnicke, Brook(2009), “Sub-article 14(b):can there be ‘unreasonable conduct’?”, DCInsight, Vol.15, No.3, July-Sept., at 8.
71 Supra note 7, at 132.
72 Supra note 62.
74 Supra note 33, available at supra note 2, at 132.
bank to take advantage of all the five banking days, or the expiry date or the last presentation date that the sub-article 14(b) allows for document examination. Although the principles of equity may provide a favorable result for the presenter, that result is available only after seeking help from a court.\textsuperscript{75}

For this problems, the writer’s opinion is that The new rule stating a maximum of five banking days means exactly what it says, that is, banks have, in any particular case, up to five banking days - in other words, they can exercise the full five banking days for examination of documents.\textsuperscript{76} In reality, banks have been exercised the full banking days for examination of the documents regardless of the meaning of “reasonable time” in the workplace. Moreover, it is practically difficult for banks to determine “a reasonable time” within “a maximum of five banking days” on a case-by-case basis. Otherwise, its meaning must be defined through the practical revision of UCP. Anyway, the removal of “reasonable time” and the five banking day time were limited in UCP 600 seem to be obviously more improved than the previous UCP 500 versions.

In the current UCP 600, banks process presentations within the normal flow of business transactions and are not responsible for expediting examination because the documentary credit is about to expire. It is the responsibility of the beneficiary to ensure that documents are presented in sufficient time so that if there are correctable discrepancies, it may have time to correct these and represent the documents.\textsuperscript{77} The maximum period of time for determining compliance is not curtailed or affected by the date of expiry or latest date for the presentation falling within this period (UCP 600 sub-article 14(b)).

\section*{IV. Reality and Practical Application of Compliance Standard}

1. Reality and roles of compliance principle

(1) Practical operation of compliance principle

The UCP 600 no longer bears such a prescriptive approach on the description on the documents, thereby allowing banker a greater degree of flexibility in part(UCP 600 sub-article 18(b) and lowering the standard for examination that should result in fewer documentary discrepancies and rejections.\textsuperscript{78} Especially, a new approach for compliance of UCP 600 sub-article 14(d), requiring that it “not be identical to, but must not conflict with”, appears to be provided a standard in a context that is much broader than the relative sub-article in the UCP 500. It is somewhat less demanding than the customary strict compliance standard.

In reality, this new trend has placed the burden of discretion on the banks in order to determine where there is room for flexibility. Therefore, even today, it is not a simple matter to unify the different approaches and to arrive at the ideal solution concerning the compliance principle. Of course, the ideal

\textsuperscript{75} Supra note 70, at 8-9.
\textsuperscript{76} Supra note 6.
\textsuperscript{77} Supra note 13, at 63.
situation would be one in which the buyer, the seller and the issuing bank were all protected. There is no
doubt that the strict compliance principle (a technical approach) protects both the applicant and the bank,
especially in times of crisis.79

Under UCP 600, “When read in context” as an additional qualification of “not in conflict”. For
example, data concerning the consignee in a certificate of origin that differs from the consignee data in
the bill of lading would not be considered as being in conflict. The consignee may well be a bank that
takes an interest in the goods as a security for its financing or is indicated as consignee to prevent the
applicant from claiming the goods without presentation of an original bill of lading. The consignee
stated in the certificate of origin is there for customs purposes, whereas the consignee in the bill of
lading refers to the function of the document as a document of title. Both parties are named "consignee"
but serve different purposes for different addressees in the documents.80

The data shown in two documents can be inconsistent but the documents may still not be in conflict
with each other. For example, suppose a letter of credit calls for X feet of cloth, but the test certificate
states Y yards of cloth (with the X feet converted into yards). Provided the length of the cloth indicated
in both documents is exactly the same, either in feet or yards, there would be no “conflict” between the
documents. Under UCP 500, the packing list and the test certificate might be considered to be discrepant,
since they are obviously inconsistent in that the unit of measurement in the two cases is different.
However, under UCP 600, the two documents would be likely not to be considered discrepant, since
there is no conflict: the length of the cloth indicated in the two documents is exactly the same. This new
UCP 600 language is a positive step toward reducing discrepancies and minimizing occasions in which
documents are refused on highly technical grounds.81

Ultimately, it is of my opinion that the application of the compliance principle should be not only
advantageous to all the parties concerned participating in letter of credit transactions but also
contributable to the promotion and efficiency of the credit transactions.

As already stated, the compliance principle has in fact been relaxed in recent years, both by the courts
and the UCP. Thus, it is clear that the main changes of the revised UCP 600 imply the introduction of
substantial compliance principle as an official standard for document examination. In order for this
system to establish and improve, it seems necessary to set up a reasonable standard to differentiate
between marginal discrepancies that do not justify refusal of payment and discrepancies that do justify
such refusal.

(2) Bank’ responsibilities and roles

Even though the revised UCP 600 means that the substantial compliance principle was actually
introduced, it is evident that application of the new compliance standard does not imposes on the
bankers the burden of performing an examination beyond the documentary field. The principle, of
course, means the substantial compliance of the documents on the basis of the documents alone but not
the actual goods. It is why in general, banks are not lawyers or experts concerning goods and
international business; they do not have the specialized knowledge to investigate and judge about goods
and the business procedure, and they cannot review the terms and conditions of business transactions

79 Supra note 45, at 14.
80 Supra note 13, at 64.
81 Supra note 20, at 71.
between the applicant and the beneficiary.

However, the bank should be kept in mind that it can play a more active role in the examination of the documents. In this system, bank’s examiners may also have their discretion to determine whether to take up or refuse the documents, whereas they may need more competency and judgment for deciding the compliance of a presentation than that under UCP 500 because it is so difficult for them to examine all the documents as the case may be. Determination of compliance on the basis of substantial compliance principle is, unlike mirror image compliance, difficult because it requires skill and depth knowledge for deciding what error to accept, what to disregard. The principle may demand intervention of the experienced senior management level banker for decision making. Therefore, it is my opinion that the banks need to have the relative knowledge and actual experience to determine the importance of seemingly insignificant and minor discrepancy. Especially, the examiners of banks will act not based on feelings and fear, but the basis of information and knowledge.

2. Compliance principle and misapplication of discrepancies

There is often a significant difference between how the letter of credit should work in theory and how it works in practice. A large number of documents still do not comply, and one potential consequence of presenting discrepant documents is that payment will never be received. What is the point of paying for security when one does not actually receive it? Letter of credit document examination is a risky business; if a discrepancy is missed, a loss may have to be booked.

If the documents presented under the letter of credit do not appear, on their face, to be entirely consistent with the terms and conditions of the credit or entirely consistent with each other, but there is no conflict amongst them, the document shall not be considered as discrepant. This expressly recognizes the compliance standard of documents adopted by ICC and confirms that “strict compliance” is not equivalent to “identical” or to a “mirror approach.” This is in line with the general principles established by ICC regarding document examination.

Allowing that the rationale for the strict compliance principle is rooted in the need to preserve the commercial vitality of letters of credit by fostering certainty to the greatest extent possible, the strict compliance principle might distort the efficiency and promotion of a documentary credit system and international trade as the case may be.

In general, approximately 70 percent of documents presented under letters of credit are presented with discrepancy. Despite the high rate discrepant presentations, almost invariably the beneficiary receives payment, as long as buyer still wants to take delivery. That is why a discrepancy may not affect the

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82 UCP 600 sub-article 18(b).
85 Supra note 20, at 201.
86 Supra note 42.
value or merchantibility of the goods, and may thus appear merely technical. In such a case, a bank would nonetheless be obliged to found the documents acceptable.88

If a bank is obliged to ask the applicant for approval even in obvious cases, a situation can occur where the customer tries to exploit the situation by requesting a discount of the price or other benefits from the seller.89 What is worse, it is the case the buyer does not take up the relative documents under the pretext of trivial discrepancy even though goods are in perfect condition. But insignificant discrepancies not caused troubles to the work must not be an emergency exit for buyers who regret their decision to buy.

From the issuing bank’s standpoint, it will try to find any minor discrepancies irrespective of the importance in bad faith, thereby refusing to take up the documents at the slightest pretext as far as possible if the applicant is under threat of bankruptcy or insolvency, or when it becomes evident that the buyer will not pay for goods due to “deterioration” in the financial standing.

Then, in some cases, even though the documents will finally be accepted, such insignificant discrepancies may be used as documentary excuses for delaying payment to escape the worsening of temporary financial situation in their business relations. In my opinion, it can be not justified that minor discrepancy is used as a pretext for avoiding their duties or temporary economic difficulties.

When banks are busily looking for self-protection, one consequence is that, at times, the UCP rules may be overlooked. There are more and more cases involving bad banking practice, such as wrongful dishonor, delayed payment, and so forth.90 If discrepancy is insignificant and irrelevant, a rejection will not be justified. The revision of UCP 600 is timely and reasonable in this respect. A documentary compliance must be substantially complied with the requirements of a letter of credit.

Thus, technical problems such as spelling errors, trivial or small discrepancies and general terms not conflicting with their description in the wording of the documents presented should be allowed if a reasonable judgement of the presentation leads to the sure result that the purpose of the requirements of a letter of credit will be reached.91

3. Misuse and effect of Economic situation

This strict compliance principle may also be wrongfully used according to economic situations. For example, the global recession may prompt issuing banks and their applicants to question the compliance of a seller’s presentation, and documentary compliance, which has not been a problem in recent years, may become more of a problem now. Falling markets sometimes prompt buyers and their banks to look carefully for documentary excuses to dishonour the seller’s draft or demand for payment. Thus, a few thoughts on the documentary compliance rules, especially as they apply in common law countries, may be in order. Some recent cases are not encouraging to those who see the letter of credit as a payment mechanism.92

88 Jack, Raymond(1993), Documentary Credits, Butterworths, at nr. 8.20.
91 Supra note 40.
92 Supra note 11.
In documentary credit transactions, approximately 70 percent of documents presented under letters of credit are rejected on first presentation. But many of the rejected documents are later accepted by the applicant, as long as the market is stable and the buyer still wants to take delivery. Therefore, the 70 percent rejected rate is really the nominal rate, while the real rate is much lower.\textsuperscript{93} But in economic recession, once the buyer promised to accept the documents despite the documents with discrepancy as it did many times before, later it may reject them as a reason for the discrepancies such as late shipment, late presentation, different loading port, and so on, or as excuses for insignificant discrepancies on a market claim basis.

Banks have been rightly concerned that in a falling market, buyers or their banks might be tempted to invoke the strict rule in bad faith in order to avoid market loss. For years, moreover, the percentage of compliant presentations was low, but that applicants waived the defects and issuing banks paid the sellers anyway.\textsuperscript{94} This situation led to the exploitation of marginal discrepancies on the part of buyers, in order to escape payment for goods that were purchased at a high price, the value of which had declined. Under the strict compliance approach, there is nothing easier than clinging to minute discrepancies in order to refuse documents.\textsuperscript{95}

In another case, A European bank confirmed a letter of credit (covering stainless steel) issued in favor of one of its best customers. The bank negotiated the documents without recourse to the beneficiary. The presentation was refused by the issuing bank, which cited a valid discrepancy overlooked by the bank. From the time the letter of credit was issued to the time of delivery of the goods, the commodity price for stainless steel dropped as a result of the financial crisis. As a result, the buyer would only waive the discrepancy against a considerable price reduction, and the European bank to accept a loss of 15 per cent of the document amount.\textsuperscript{96}

In many cases, it is common practices for issuing banks not to examine all the presented documents. Especially, in Republic of Korea, upon receipt of the documents, the issuing banks inform buyer of that facts and inquire whether the documents are accepted or not. The banks start to examine them only if buyer will not accept the documents. After that, if any discrepancies were found, the bank will notify refusal of taking up the documents giving the reasons. Of course, if the buyer will later accept them, the bank will approach buyer to obtain a waiver of the discrepancies.

In the worst case, when the buyer was on the verge of insolvency or bankruptcy, the issuing bank will struggle to find any minor discrepancies in order to avoid to honour payment to seller in bad faith.

So, bank’s documents checkers are compelled to be more careful than usual during an economic recession or the buyer’s financial difficulties.

\section*{V. Conclusions}

\begin{itemize}
\item \textsuperscript{93} Supra note 90.
\item \textsuperscript{94} Supra note 11.
\item \textsuperscript{95} Supra note 45, at 14.
\item \textsuperscript{96} Supra note 86, at 5.
\end{itemize}
The Compliance principle of documents ascertains the success of a Letter of Credit transaction. The basic principle of the strict compliance is that the documents must strictly comply with the requirements of the letter of credit. However, the compliance principle appears to have already been mitigated in recent years, both by the courts and the UCP and developed to meet the needs of the times. The main changes of the UCP 600 including sub-article 14(d)/(e) and 18(b) imply the change of the compliance standard for examination of documents and have an effect on the revision of URDG(The Uniform Rules for Demand Guarantees) 758.

The UCP 600 is bringing in important changes in relation to the compliance standard for examination of a presentation. Especially, UCP 600 sub-article 14(d) introduced a more relaxed standard for the compliance, requiring that it "not be identical to, but must not conflict with" that is much broader than the UCP 500 reference to consistency. It is somewhat less demanding than the customary strict compliance standard.

Even so, it is evident that application of the new compliance principle does not impose on the banks the burden of performing an examination beyond the documentary field. It should be kept in mind that banks can play a more active role in the examination of the documents. Banks may also have discretion to determine whether to accept or refuse the documents(UCP 600 sub-article 18(b), whereas, they will need more competency and judgment for deciding for deciding what error to accept, what to disregard; what document to accept, what to disregard.

On the other hand, allowing that the rationale for the strict compliance principle is rooted in the need to preserve the commercial vitality of letters of credit by fostering certainty to the greatest extent possible, the compliance principle can be uncomfortable and may interfere with dealing between the parties concerned as the case may be. There is no doubt that the compliance principle protects both the applicant and the bank, especially in times of crisis. But in reality, this strict compliance principle may be wrongfully used according to economic situations or due to others.

In general, many of the rejected documents are later accepted, as long as the market is stable and the buyer still wants to take delivery. Such insignificant discrepancies may be wrongfully used as documentary excuses for delaying payment to escape the worsening of temporary financial situation in their business relations. Furthermore, in a falling market or a bad economic situation, buyers or banks might be tempted to invoke the strict rule in bad faith in order to avoid market loss.

Ultimately, it is of my opinion that the application of the compliance principle should be not only advantageous to all the parties concerned participating in letter of credit transactions but also contributable to the promotion and efficiency of the credit transactions. In order for the compliance principle to operate efficiently and economically, it is very important to prevent to be misused the compliance principle by any parties concerned. Thus, Banks have to develop the system and to cultivate professionals for examining the documents to prevent all disputes and troubles which may arise between the parties concerned with respect to the standard for examination of documents. While ICC should develop and establish the clear and reasonable standard for examination and constantly complement the relative rules.

97 Koller(1990), Dokumentenstrenge/Treu und Glauben, at 293.
98 Supra note 44.
99 Supra note 41.
100 Supra note 95.
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