

Some tips on negotiation

What are the most problematic aspects of negotiation in the respect of documentary credits (DCs) and UCP 500? Pavel Andrie has some pretty staunch theories. He is Secretary to the Banking Commission at ICC Czech Republic, a member of the UCP 500 Revision Consulting Group, and an international trade finance consultant.

The term 'negotiation' is very often misunderstood by documentary credit (DC) practitioners in all parts of the world. This is very clear from

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the many inquiries addressed to the Banking Commission and, of course, from our daily practice when dealing with many banks from different places.

We receive on a daily basis documents with covering letters from many different banks from any corner of the world stating that "we have negotiated the enclosed documents" where it is clear they could not negotiate them (at least in the UCP 500 context) because the DC was not available by negotiation. Sub-article 10(a)(ii) clearly states that: "Mere examination of the documents without giving of value does not constitute a negotiation." I hope that I will not add much to this confusion by this article! What are therefore the most problematic aspects of negotiation in the respect of DCs and UCP 500?

Giving value

The term 'negotiation' is defined in sub-Article 10(b)(ii) as "the giving of value for draft(s) and/or document(s) by the bank authorised to negotiate". Many bankers and other parties involved are still not fully sure what the expression 'giving value' actually means. The Banking Commission endeavoured to clarify this by its Position Paper No2 dated 1 September 1994. It reads: "...for the purposes of UCP 500, the phrase 'giving of value' in sub-Article 10(b)(ii) may be interpreted as either 'making immediate payment' (eg, by cash, by cheque, by remittance through a clearing system or by

credit to an account) or 'undertaking an obligation to make payment' (other than giving a deferred payment undertaking or accepting a draft)."

I am quite sure that we all comprehend what 'making immediate payment' means. But what puzzles me a bit is "undertaking an obligation to make payment other than giving a deferred payment undertaking or accepting a draft."

Would the payment undertaking of the negotiation bank have to be worded clearly differently than the deferred payment undertaking under DC available by deferred payment DC would be? Or would the fact that the payment undertaking was done under a negotiation credit suffice? To be honest I am not sure what this phrase is supposed to exactly mean. However, I assume that the "undertaking an obligation to make payment" under negotiation credit might include for instance wording such as: "we will pay you amount CCY on xx/xx/xx date (fixed date) unless you ask us for the payment before that date". I also believe that "negotiation – giving of value" should always mean "pay first, reimburse yourselves later" (from the banks' perspective). So even if the bank "gives value by undertaking an obligation to make payment", the bank should make the payment before or at latest at the same time as when it reimburses itself. Therefore wording such as "we will pay you on June 28, 2004 if we receive the proceeds from the issuing bank" or "we will pay you after we receive

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proceeds from the issuing bank" or of similar nature do not constitute "giving of value – negotiation" in my view!

Negotiation of documents

UCP 500 clearly defines the negotiation as "the giving of value for draft(s) and/or document(s) by the bank authorised to negotiate" (see article 10b(ii) UCP 500). Consequently we might well have a DC available by negotiation which does not call for a draft(s) to be presented thereunder at all.

We can therefore negotiate 'only' documents presented (as required by the DC). How would we do that?

Does it mean that the documents presented under the DC which is available by negotiation are therefore negotiable?

Some of them clearly are (but not in the negotiable instruments law sense, ie, the transferee can never gain better title than the transferor,

which might be the case in a bill of exchange sense of term 'negotiation') – for instance bills of lading (BL) (if issued in negotiable form), insurance policy – so must they be then endorsed to the order of the nominated (negotiating) bank or blank indorsed for negotiation (transfer) to take place?

And can we negotiate non-negotiable documents as well? These questions may sound a bit odd. However at least in my view, UCP 500 gave the term negotiation a new meaning, which goes beyond the established understanding of what the negotiation usually means. People would not normally expect to negotiate non-negotiable documents but rather 'purchase them'.

Under a UCP 500 DC available by negotiation the nominated bank can negotiate the documents presented under it without a need to call for a draft to be presented. The negotiation would not be evidenced by any endorsement on any document presented

under the DC (according to BEA 1882 the endorsement is not a prerequisite of negotiation), the nominated bank "only gives value for the documents" (so effectively purchases them).

So under a DC available by negotiation the negotiating bank gives value – negotiates in the context of negotiation according to article 10 of UCP 500 – all documents presented (negotiable as well as non-negotiable documents). I think that negotiation of 'documents alone' under negotiable DCs is quite a confusing matter. Would the appropriate provisions of negotiable instruments law be applied here? I very much doubt it.

Negotiation by the nominated (non-confirming) bank

The nominated (non-confirming) bank is authorised, not obliged, to negotiate always provided that the presented required documents

comply with the DC terms and conditions.

If the tenor is sight, I suppose that the 'negotiation – giving of value' might be only in the form of 'making immediate payment' (always before the negotiating bank is itself reimbursed).

If the nominated bank is satisfied with the issuing (confirming bank if any) bank risk and the risk of the issuing (confirming) bank domicile country, then it agrees the price for the negotiation with the beneficiary individually (the interest) – many banks state the negotiation charge in the credit advising letter.

The charge would be a margin over cost of funds. Margin itself would be a product of the issuing (confirming) bank and country risk and profit.

If the price is approved, negotiation takes place and the beneficiary receives the respective amount.

The nominated – negotiating bank then sends the documents (and draft) to the issuing (confirming) bank for

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payment. The nominated – negotiating bank now holds the documents in its own right. If the nominated bank is not satisfied with the risks concerned or agreement regarding the price for negotiation could not be reached, negotiation would not take place and the nominated bank would send the documents to the issuing

Negotiation by the confirming bank

The confirming bank is authorised and also obliged to negotiate always provided that the presented documents comply with DC terms and conditions. If the tenor is sight, the confirming bank is supposed to make immediate payment. I suppose that the confirming

charge for making immediate payment and for undertaking an obligation to make payment. As the period for which interest is charged by the confirming bank might be longer, the price (mark-up over the respective interest base rate) might be a matter of concern to the beneficiary. If the beneficiary does not want to pay the price for negotiation

holders, draft(s) drawn by the beneficiary and/or document(s) presented under the credit. And of the confirming bank (9(b)iv): "If the credit provides for negotiation – to negotiate without recourse to drawers and/or *bona fide* holders, draft(s) drawn by the beneficiary and/or document(s) presented under the credit." So clearly the confirming bank, provided documents comply with all terms and conditions of the DC, must negotiate without recourse (the issuing bank must pay without recourse – at sight or at maturity according to the terms and conditions of its DC).

According to negotiable instruments law (if the draft(s) is (are) asked for), unless otherwise the bill states, or the transferee agrees, the drawer (beneficiary) and the endorser (the beneficiary) of a draft is liable for the face amount of the draft to the endorsee – holder (the negotiating bank) or to a subsequent party that has negotiated the draft if the draft is unpaid at maturity. Under negotiable instruments law the drawer of a bill, and any endorser, may disclaim their negotiable instruments obligations by drawing and indorsing "without recourse". By adding such express stipulation to their signatures on the bill those parties would not be liable to compensate the holder in event of dishonour.

It is also worth mentioning that under bills of exchange laws based on Geneva Conventions 1930 the drawer cannot disclaim its liability for the honouring of the draft, ie, any clause disclaiming his liability for the honouring of the draft would be disregarded. Therefore the beneficiary – the drawer of the draft to which bills of exchange law based on Geneva Conventions is applicable would run the risk of recourse in case the draft being negotiated but unpaid by the issuing bank at maturity and the recourse to all endorsers if being available

Pavel Andrlé: What are therefore the most problematic aspects of negotiation in the respect of DCs and UCP 500?

(confirming) bank for payment. If the tenor is usance, the 'negotiation – giving of value' might be effected by 'making immediate payment' or 'undertaking an obligation to make payment'. Of course the beneficiary is likely to be more interested in receiving immediate payment as far as negotiation – giving of value is concerned. But in many cases it might not be the case, the beneficiary might well prefer not to pay the negotiation charge. They might prefer receiving a considerably cheaper (because there is not 'a cost of funds element' within the negotiation charge) 'undertaking an obligation to make payment' with a future value date. If the nominated bank is satisfied with the documents, with the risks concerned and there is an agreement regarding the price for negotiation, then it negotiates – pays (undertakes the payment obligation) to the beneficiary. If the nominated bank is not satisfied with the risks concerned or the agreement regarding the price for negotiation could not be reached, the negotiation would not take place and the nominated bank would send the documents to the issuing (confirming) bank for payment at maturity.

bank should indicate its price for negotiation when adding its confirmation to the DC to the beneficiary.

As the period for which negotiation interest is charged by the confirming bank is not usually long, the price (mark-up over the respective interest base) is not usually a matter of great concern to the beneficiary (but it surely depends on the negotiation amount, respective anticipated period till the negotiating bank receives reimbursement etc). After negotiating the draft(s) and/or documents the negotiating confirming bank sends the documents (and draft) to the issuing bank for payment.

If the tenor is usance, the negotiation – giving of value might be in the form of 'making immediate payment' or 'undertaking an obligation to make payment'.

The beneficiary is likely to be more interested in receiving immediate payment as far as negotiation – giving of value is concerned.

But it would always depend on the respective negotiation charge and so on.

The confirming bank should give the beneficiary a choice of his preferred form of negotiation and inform him so in the credit advice letter. It should indicate its negotiation



in the form of making immediate payment, he chooses negotiation in the form of undertaking an obligation to make payment at maturity. If the confirming bank for whatever reason is not willing to negotiate complying documents by making immediate payment, it should clearly indicate so to the beneficiary in its advising cover letter.

After negotiating the draft(s) and/or documents the confirming bank sends the documents (and draft(s)) to the issuing bank for payment at maturity.

Recourse

One of the most important aspects of negotiation – giving value is the issue of right of recourse.

A) *Right of recourse in case of negotiation of draft(s) and/or documents by confirming bank under a DC*

Article 9 defines definite undertakings of the issuing bank if DC is available by negotiation (9(a)iv): "If the credit provides for negotiation – to pay without recourse to drawers and/or *bona fide*

failed.

To the same risk is the beneficiary – the drawer – exposed in case of the draft being discounted under DC available by acceptance. However the parties – the drawer (endorser) and the endorsee (negotiating bank) may agree that the right of recourse will be waived even outside the draft itself (outside the scope of the negotiable instruments law) and this arrangement would be fully binding.

I strongly believe that the recourse by the holder – negotiating confirming bank. – against the drawer and/or the endorser (the beneficiary) would not be upheld by any court in case of the negotiation of the draft having been effected under a DC subject to UCP 500 even if the bill did not mention words such as 'without recourse', ie, the proven fact that the negotiation of the draft was effected under a DC subject to UCP 500 would be sufficient grounds for refusal of recourse claimed by the confirming bank. (However, the situation might be a bit different if the draft is consequently transferred by the confirming bank – which is very unlikely – to another bank which in case of having been unpaid tries to exercise recourse against the endorser/drawer (beneficiary). It might be therefore advisable for a drawer (endorser) to stipulate such a clause on the bill if negotiated under a confirmed DC).

If the value is given for documents only (DC did not asked for draft(s) to be presented under negotiation credit) by the confirming bank, it has also no recourse.

B) *Right of recourse in case of negotiation by non-confirming bank under a DC*

But what about the nominated – non-confirming bank? UCP 500 is not specific regarding this matter. The issue would be therefore solved according to provisions of the applicable (negotiable instruments) law. It

might be useful to split the question into two parts: recourse in case of negotiation of draft(s) under DC and recourse in case of negotiation of documents under DC alone (without draft).

Answers

1) *Right of recourse in case of negotiation of draft(s) by non-confirming bank under a DC*

As explained above, the negotiation of a draft is usually done with recourse to the transferor unless the bill states, or the transferee agrees, otherwise.

Under negotiable instruments laws the holder in due course has recourse to all endorsers and a drawer unless they clearly exclude their liability within their endorsement. Does the right of recourse in case of negotiation of a draft under non-confirmed DCs remain the same as it is under negotiable instruments laws as discussed above?

In my opinion it does.

However, some experts argue "that it is the nominated bank which does the paying, accepting, incurring a deferred payment obligation, or negotiation" and "UCP 500 article 9 defines the duties of the credit issuer under four types of credit: payment, acceptance, deferred payment, and negotiation. The UCP assumes, they think, and this assumption is virtually always case in international commercial letter of credit transactions, that a nominated bank will satisfy the issuer's obligations under the article 9" (John F Dolan, *Negotiation Letters of Credit*, 2003 Annual Survey of Letter of Credit Law & Practice, p32).

Not surprisingly there are many who do not agree, for instance Professor Ellinger (*ibid*, p33). It appears "that the widely accepted practice of international bankers is not taking the seller's drafts without recourse" (*ibid*, p34). Therefore, unless stated or agreed otherwise the nominated (non-confirming)

bank under a DC available by negotiation will negotiate draft(s) with recourse to the beneficiary (in case the draft(s) is (are) not accepted or paid by the confirming/issuing bank at maturity).

The right of recourse surely covers situations when the confirming/issuing bank fails to pay because of insolvency or for similar reasons, but does it also include the cases when the issuing/confirming bank refuses to take up the documents in line with provisions of articles 13 and 14 of UCP, ie, for valid discrepancies?

Again the position is not 100% clear. We might well argue that the spirit of UCP 500 suggests that the discrepancy risk is to be held by the negotiation bank. Raymond Jack writes in his book on documentary credits law: "In short, the negotiating bank will normally be entitled to recover from the beneficiary what it has paid with interest in the event that the bill is dishonoured because

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However, I also believe that the negotiation bank may "negotiate with recourse in case the documents are unpaid because of the discrepancies not picked up by the negotiating bank". If this is a term of their negotiation agreement with the beneficiary or it is otherwise clearly communicated to the beneficiary, it would be enforceable in my view.

2) *Right of recourse in case of negotiation of documents without draft(s) by non-confirming bank under a DC*

The question of recourse in case of 'negotiation of – giving value for' documents only (no draft is negotiated) is different from the case where the bank negotiates the draft (or draft and documents – whatever that means).

If the bank negotiates a draft, its right of recourse would be based on the respective negotiable instruments law (see above) and other terms (the contract) expressly agreed with the beneficiary, if any.

Would the appropriate provisions of negotiable instruments law be applied here? I very much doubt it ;

the documents are rejected as not complying with the credit, or for any other reason not the fault of the negotiation bank" (Raymond Jack, *Documentary Credits*, Butterworths, 1993, paragraph 7.10, p137).

I believe that if the negotiating bank declares to the beneficiary that it found the documents to be compliant with the terms and conditions of the DC, then its right of recourse in case of the documents being then refused by the confirming/issuing bank for valid discrepancies according to articles 13 and 14 UCP 500 is very unlikely. I would see this as a "fault of the negotiating bank" to quote from the above mentioned statement.

However, if the bank negotiates only the documents (in the sense of UCP 500), then it cannot of course rely on any negotiable instruments law in respect of its right of recourse. Therefore it is advisable, even critical, to clearly communicate the terms and conditions of the negotiation to the beneficiary or even conclude an express agreement in writing if the negotiating bank wishes to be in position to exercise recourse.

In the absence of any express terms it is suggested that the position would be uncertain (Jack, *ibid*). To do so it might be also well advisable in the case of negotiation of a draft for the sake of clarity.