8. International Trade Law

8.1. International Sale of Goods

International trade must work around a fundamental dilemma. Imagine an importer and an exporter who would like to do business with one another. Because of the distance between the two, it is not possible to simultaneously hand over goods with one hand and accept payment with the other.

The fundamental dilemma of being unwilling to trust a stranger in a foreign land is solved by using a highly respected bank as intermediary. In this simplified view, the importer obtains the bank’s promise to pay on its behalf, knowing that the exporter will trust the bank. The bank’s promise to pay is called a letter of credit. The exporter ships the merchandise to the importer’s country. Title to the merchandise is given to the bank on a document called an order bill of lading. The exporter asks the bank to pay for the goods, and the bank does so. The document to request payment is a sight draft. The bank, having paid for the goods, now passes title to the importer, whom the bank trusts. At that time or later, depending on their agreement, the importer reimburses the bank.

Benefits of the System

The three key documents and their interaction constitute a system developed and modified over centuries to protect both importer and exporter from the risk of non completion and foreign exchange risk, as well as to provide a means of financing.

Protection against Risk of Non completion
As stated above, once importer and exporter agree on terms, the seller usually prefers to maintain legal title to the goods until paid, or at least until assured of payment. The buyer, however, will be reluctant to pay before receiving the goods, or at least before receiving title to them. Each wants assurance that the other party will complete its portion of the transaction.

The letter of credit, sight draft, and bill of lading are part of a system carefully constructed to determine who bears the financial loss if one of the parties defaults at any time.

Protection against Foreign Exchange Risk
In international trade, foreign exchange risk arises from transaction exposure. If the transaction requires payment in the exporter’s currency, the importer carries the foreign exchange risk. If the transaction calls for payment in the importer’s currency, the exporter has the foreign exchange risk.
Transaction exposure can be hedged, but in order to hedge, the exposed party must be certain that payment of a specified amount will be made on or near a particular date. The three key documents described in this chapter ensure both amount and time of payment and thus lay the groundwork for effective hedging.

The risk of noncompletion and foreign exchange risk are most important when the international trade is episodic, with no outstanding agreement for recurring shipments and no sustained relationship between buyer and seller. When the import/export relationship is of a recurring nature, as in the case of manufactured goods shipped weekly or monthly to a final assembly or retail outlet in another country, and when it is between countries whose currencies are considered strong, the exporter may well bill the importer on open account after a normal credit cheque.

**Financing the Trade**

Most international trade involves a time lag during which funds are tied up while the merchandise is in transit. Once the risks of noncompletion and of exchange rate changes are disposed of, banks are willing to finance goods in transit. A bank can finance goods in transit, as well as goods held for sale, based on the key documents, without exposing itself to questions about the quality of the merchandise or other physical aspects of the shipment.

**Letter of Credit (L/C)**

A *letter of credit*, (L/C), is a bank’s promise to pay issued by a bank at the request of an importer (the applicant/buyer), in which the bank promises to pay an exporter (the beneficiary of the letter) upon presentation of documents specified in the L/C. An L/C reduces the risk of noncompletion, because the bank agrees to pay against documents rather than actual merchandise.

An importer (buyer) and exporter (seller) agree on a transaction and the importer then applies to its local bank for the issuance of an L/C. The importer’s bank issues an L/C and cuts a sales contract based on its assessment of the importer’s creditworthiness, or the bank might require a cash deposit or other collateral from the importer in advance. The importer’s bank will want to know the type of transaction, the amount of money involved, and what documents must accompany the draft that will be drawn against the L/C. If the importer’s bank is satisfied with the credit standing of the applicant, it will issue an L/C guaranteeing to pay for the merchandise if shipped in accordance with the instructions and conditions contained in the L/C.

The essence of an L/C is the promise of the issuing bank to pay *against specified documents*, which must accompany any draft drawn against the credit. The L/C is not a guarantee of the underlying commercial transaction. Indeed, the L/C is a separate transaction from any sales or other contracts on which it might be based.
To constitute a true L/C transaction, the following elements must be present with respect to the issuing bank:

1. The issuing bank must receive a fee or other valid business consideration for issuing the L/C.
2. The bank’s L/C must contain a specified expiration date or a definite maturity.
3. The bank’s commitment must have a stated maximum amount of money.
4. The bank’s obligation to pay must arise only on the presentation of specific documents, and the bank must not be called on to determine disputed questions of fact or law.
5. The bank’s customer must have an unqualified obligation to reimburse the bank on the same condition as the bank has paid.

Commercial letters of credit are also classified as follows:

- **Irrevocable versus Revocable.** An irrevocable L/C obligates the issuing bank to honor drafts drawn in compliance with the credit and can be neither canceled nor modified without the consent of all parties, including in particular the beneficiary (exporter). A revocable L/C can be canceled or amended at any time before payment; it is intended to serve as a means of arranging payment but not as a guarantee of payment.

- **Confirmed versus Unconfirmed.** An L/C issued by one bank can be confirmed by another, in which case the confirming bank undertakes to honor drafts drawn in compliance with the credit. An unconfirmed L/C is the obligation only of the issuing bank. An exporter is likely to want a foreign bank’s L/C confirmed by a domestic bank when the exporter has doubts about the foreign bank’s ability to pay. Such doubts can arise when the exporter is unsure of the financial standing of the foreign bank, or if political or economic conditions in the foreign country are unstable.

Most commercial letters of credit are **documentary**, meaning that certain documents must be included with drafts drawn under their terms. Required documents usually include an order bill of lading, a commercial invoice, and any of the following: consular invoice, insurance certificate or policy, and packing list.

**Advantages and Disadvantages of Letters of Credit**
The primary advantage of an L/C is that it reduces risk—the exporter can sell against a bank’s promise to pay rather than against the promise of a commercial firm. The exporter is also in a more secure position as to the availability of foreign exchange to pay for the sale, since banks are more likely to be aware of foreign exchange conditions and rules than is the importing firm itself. If the importing country should change its foreign exchange rules during the course of a transaction, the government is likely to allow already outstanding bank letters of credit to be honored for fear of throwing its own domestic banks into international disrepute. Of course, if the L/C is confirmed by a bank in the exporter’s country, the exporter avoids any problem of blocked foreign exchange.
An exporter may find that an order backed by an irrevocable L/C will facilitate obtaining pre-export financing in the home country. If the exporter’s reputation for delivery is good, a local bank may lend funds to process and prepare the merchandise for shipment. Once the merchandise is shipped in compliance with the terms and conditions of the credit, payment for the business transaction is made and funds will be generated to repay the pre-export loan.

The major advantage of an L/C to the importer is that the importer need not pay out funds until the documents have arrived at a local port or airfield and unless all conditions stated in the credit have been fulfilled. The main disadvantages are the fee charged by the importer’s bank for issuing its L/C, and the possibility that the L/C reduces the importer’s borrowing line of credit with its bank. It may, in fact, be a competitive disadvantage for the exporter to demand automatically an L/C from an importer, especially if the importer has a good credit record and there is no concern regarding the economic or political conditions of the importer’s country.

**Draft**

A *draft*, sometimes called a *bill of exchange* (B/E), is the instrument normally used in international commerce to effect payment. A draft is simply an order written by an exporter (seller) instructing an importer (buyer) or its agent to pay a specified amount of money at a specified time. Thus, it is the exporter’s formal demand for payment from the importer.

The person or business initiating the draft is known as the *maker, drawer, or originator.* Normally, this is the exporter who sells and ships the merchandise. The party to whom the draft is addressed is the *drawee.* The drawee is asked to *honor* the draft, that is, to pay the amount requested according to the stated terms. In commercial transactions, the drawee is either the buyer, in which case the draft is called a *trade draft,* or the buyer’s bank, in which case the draft is called a *bank draft.* Bank drafts are usually drawn according to the terms of an L/C. A draft may be drawn as a bearer instrument, or it may designate a person to whom payment is to be made. This person, known as the *payee,* may be the drawer itself or it may be some other party such as the drawer’s bank.

**Negotiable Instruments**

If properly drawn, drafts can become *negotiable instruments.* As such, they provide a convenient instrument for financing the international movement of the merchandise. To become a negotiable instrument, a draft must conform to the following requirements (Uniform Commercial Code, Section 3104(1)):

1. It must be in writing and signed by the maker or drawer.
2. It must contain an unconditional promise or order to pay a definite sum of money.
3. It must be payable on demand or at a fixed or determinable future date.
4. It must be payable to order or to bearer.
If a draft is drawn in conformity with the above requirements, a person receiving it with proper endorsements becomes a “holder in due course.” This is a privileged legal status that enables the holder to receive payment despite any personal disagreements between drawee and maker because of controversy over the underlying transaction. If the drawee dishonors the draft, payment must be made to any holder in due course by any prior endorser or by the maker. This clear definition of the rights of parties who hold a negotiable instrument as a holder in due course has contributed significantly to the widespread acceptance of various forms of drafts, including personal cheques.

**Types of Drafts**

Drafts are of two types: *sight drafts* and *time drafts*. A sight draft is payable on presentation to the drawee; the drawee must pay at once or dishonor the draft. A time draft, also called a *usance draft*, allows a delay in payment. It is presented to the drawee, who accepts it by writing or stamping a notice of acceptance on its face. Once accepted, the time draft becomes a promise to pay by the accepting party (the buyer). When a time draft is drawn on and accepted by a bank, it becomes a *banker’s acceptance*; when drawn on and accepted by a business firm, a *trade acceptance*.

The time period of a draft is referred to as its *tenor*. To qualify as a negotiable instrument, and so be attractive to a holder in due course, a draft must be payable on a fixed or determinable future date. For example, “60 days after sight” is a fixed date, which is established precisely at the time the draft is accepted. However, payment “on arrival of goods” is not determinable since the date of arrival cannot be known in advance. Indeed, there is no assurance that the goods will arrive at all.

**Bankers’ Acceptances**

When a draft is accepted by a bank, it becomes a bankers’ acceptance. As such it is the unconditional promise of that bank to make payment on the draft when it matures. In quality the bankers’ acceptance is practically identical to a marketable bank certificate of deposit (CD).

The holder of a bankers’ acceptance need not wait until maturity to liquidate the investment, but may sell the acceptance in the money market, where constant trading in such instruments occurs. The amount of the discount depends entirely on the credit rating of the bank that signs the acceptance, or another bank that reconfirmed the bankers’ acceptance, for a fee.

**Bill of Lading (B/L)**

The third key document for financing international trade is the *bill of lading* (B/L). The bill of lading is issued to the exporter by a common carrier transporting the merchandise. It serves three purposes: a receipt, a contract, and a document of title.
As a receipt, the bill of lading indicates that the carrier has received the merchandise described on the face of the document. The carrier is not responsible for ascertaining that the containers hold what is alleged to be their contents, so descriptions of merchandise on bills of lading are usually short and simple. If shipping charges are paid in advance, the bill of lading will usually be stamped “freight paid” or “freight prepaid.” If merchandise is shipped collect—a less common procedure internationally than domestically—the carrier maintains a lien on the goods until freight is paid.

As a contract, the bill of lading indicates the obligation of the carrier to provide certain transportation in return for certain charges. Common carriers cannot disclaim responsibility for their negligence through inserting special clauses in a bill of lading. The bill of lading may specify alternative ports in the event that delivery cannot be made to the designated port, or it may specify that the goods will be returned to the exporter at the exporter’s expense.

As a document of title, the bill of lading is used to obtain payment or a written promise of payment before the merchandise is released to the importer. The bill of lading can also function as collateral against which funds may be advanced to the exporter by its local bank prior to or during shipment and before final payment by the importer.

**Characteristics of the Bill of Lading**

The bill of lading is typically made payable to the order of the exporter, who thus retains title to the goods after they have been handed to the carrier. Title to the merchandise remains with the exporter until payment is received, at which time the exporter endorses the order bill of lading (which is negotiable) in blank or to the party making the payment, usually a bank. The most common procedure would be for payment to be advanced against a documentary draft accompanied by the endorsed order bill of lading. After paying the draft, the exporter’s bank forwards the documents through bank clearing channels to the bank of the importer. The importer’s bank, in turn, releases the documents to the importer after payment (sight drafts); after acceptance (time drafts addressed to the importer and marked D/A); or after payment terms have been agreed upon (drafts drawn on the importer’s bank under provisions of an L/C).

**Common forms of international sales contracts**

In relation to the sale of goods contract, the whole spectrum of possible delivery terms are available to the parties. But in practice, the contract is likely to fall under one of the recognized standard types. The letters are a summary or shorthand of the terms of the contract: usually a price term and also signifies the delivery point.

But even the shorthand standard form contracts eg fob, cif, are often modified by the express or implied agreement of the parties. Roskill LJ in *The Albazero* [1977] AC 774, 809:
“It is a trite observation that what is sometimes called a true f.o.b. contract or a true c.i.f. contract is a comparative commercial rarity. Contacts vary infinitely according to the wishes of the parties to them. Though a contract may include the letters f.o.b. or c.i.f. amongst its terms, it may well be that other terms of the contract clearly show that the use of those letters is intended to do no more than show where the incidence of liability for freight or insurance will lie as between buyer and seller. But is not to denote the mode of performance of the seller’s obligations to the buyer or the buyer’s obligations to the seller. In other cases, though the letters c.i.f. are used, other terms of the contract may show that the property is intended to pass on shipment and not upon tender of and payment against the documents so tendered, or though the letters f.o.b. are used, other terms may show that the property was not intended to pass on shipment but upon tender and payment, the seller by he form in which he took the bills of lading intending to reserve his right of disposal until he was paid against the shipping documents.”

Attempts have been made to standardize or harmonize international sales law. In particular:
(a) many parties now also incorporate Incoterms 2010 (Produced by the International Chamber of Commerce);
(b) attempts have been made to establish standard terms on a supranational basis by international treaty. This is potentially more powerful as this involves the issue of uniform rules of a general character intended to apply to all types of international sale, and which are intended to have the force of law. The most important of these is the Vienna Convention 1980 (United Nations Convention on Contracts for the International Sale of Goods “CISG”). But whilst ratified by some 70 states and thus will apply when the contract is governed by the law of any of those states – not ratified in the UK.

The abbreviations we will be considering eg fob, cif, reflect both the delivery point and are also a price term: ie it signifies the extent to which the transportation of the goods is covered by the contract price and is thus at the seller’s expense and also indicates the point at which the seller’s delivery obligation is considered to be fulfilled. They also have implications for the passing of property and risk in the goods.

The range of contracts reflect the range of possible delivery points running from the seller’s premises at one end to the buyer’s at the other. In between the two the main choice is between a dispatch contract (ie the seller must ship the goods from his own country for delivery them to a carrier but thereafter has no responsibility for them) or an arrival contract (where the seller’s duty is to deliver the goods to the buyer at an agreed destination point in the buyer’s country and the seller is responsible for them up to that point).
Thus the four main forms of contract we will be considering.

<table>
<thead>
<tr>
<th>Seller’s country</th>
<th>Carrier</th>
<th>Buyer’s country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ex works</td>
<td>fob</td>
<td>cif</td>
</tr>
<tr>
<td></td>
<td></td>
<td>delivery duty paid</td>
</tr>
</tbody>
</table>

**Ex works contracts**
Essentially the seller simply makes delivery at or near his own place of business, as he might do to a local buyer, and everything else is up to the buyer.

Property, possession and risk will normally pass at the point of delivery.

**Delivery duty paid**
Where a seller undertakes to “deliver, duty paid” in contrast, it is his business to get the goods all the way to the point of delivery in the buyer’s country, and his position will be little different from that of a buyer under a domestic purchase in that country.

**Fob contracts**
In an fob contract the seller’s duty is to place the goods “free on board” a ship to be named by the buyer.

Port named = port where goods to be loaded.

It is the buyer’s business to make all the arrangements regarding the shipping (including selecting the date and port, nominating a ship and give notice to the seller) and insurance of the goods. The seller’s obligations extend to all charges incurred before shipment, including loading charges, but not freight or insurance.

At the conclusion of the loading of the goods, the consignor (the seller) is issued with a document called a “mate’s receipt”, which acknowledges receipt of the goods. The seller receives this document on behalf of the buyer. If the price is payable under the contract in exchange for this document the buyer will shortly afterwards surrender the mate’s receipt to the carrier and receive in its place the bill of lading which will be made out in the buyer’s name. Alternatively, the contract may provide for the seller to procure the bill of lading, in which case he will retain the mate’s receipt and have the bill of lading issued in either his own name or that of the buyer (depending on the terms of the contract) and receive payment in exchange for the bill itself.

Difficult issues may arise as to who is party of the contract of carriage. If the buyer is the party to the contract of carriage *ab initio* there may be no privity of contract between sellers and
shipowners. This may cause difficulties where goods are damaged in the course of loading by
the shipowners before risk and property have passed to the buyers.

In *Pyrene v Scindia Navigation* [1954] 2 QB 402, Devlin J said that this problem could be solved
in two possible ways. He held either:

(a) that the sellers had “participated” in the contract of carriage sufficiently for them to be
bound by the Hague rules:
“...I think the inference irresistible that it was the intention of all three parties that the seller
should participate in the contract of affreightment so far as it affected him. If it were
intended that he should be a party to the whole of the contract his position would be that of
an undisclosed principal and the ordinary law of agency would apply. But that is obviously
not intended; he could not, for example, be sued for the freight. This is the sort of situation
that is covered by the wider principle; the third party takes those benefits of the contract
which appertain to his interest therein, but takes them, of course, subject to whatever
qualifications with regard to them the contract imposes.”

(b) Or that was a “collateral” contract between the parties into which the rules could be
incorporated:
“...By delivering the goods alongside, the seller impliedly invited the shipowner to load them,
and the shipowner by lifting the goods impliedly accepted that invitation. The implied
contract so created must incorporate the shipowner’s usual terms; none other could have been
contemplated; the shipowner would not have contracted for the loading of the goods on terms
different from those which he offered for the voyage as a whole.”

**Passing of risk and property in an fob contract**

**Risk** passes on shipment ie as soon as the goods “cross the ship’s rail.” This is because the
seller’s duty to deliver the goods fob: once they are on board, the seller has delivered them to the
buyer and it is natural that they should thereafter be at the buyer’s risk. This rule applies even if
goods remain quasi-specific (*Sterns v Vickers* [1923] 1 KB 78).

As to the exact point at which risk passes, two views are possible:

(a) risk literally passes as the goods cross the ship’s rail (see *Pyrene Co Ltd v Scandia
Navigation Co Ltd* [1954] 2 QB 402, 414); alternatively

(b) risk passes when the goods are safely loaded on board the vessel (*Schmitthoff’s Export
Trade* 10th ed para 2-013).

As to the passing of **property**:

- property does not pass before shipment
- secondly, property passes on shipment, unless the seller has reserved a right of
disposal over the goods.
In modern times, any general presumption that property passes with risk on shipment has probably largely disappeared. The practice of treating the shipping documents as security for the price is now so well established that terms requiring payment against the shipping documents is probably now the norm in fob contracts. Where payment is only to be made against documents, the seller will normally have himself named as consignee in the bill of lading (that is, the goods will be deliverable under the bill of lading to, or to the order of, the seller.

See, for example, *Mitsui & Co v Flota Mercante Grancolumbiana SA* [1989] 1 All ER 951.

**Cif contracts**

In this type of contract price includes “the cost of the goods plus insurance plus freight”. Thus, the point of delivery is moved further down the process to a time after the goods have been shipped.

Port = anticipated port of destination.

The main features of a cif contract were described by Lord Wright in *Smyth & Co Ltd v Bailey Son & Co Ltd* [1940] 3 All ER 60, 67-8:

“The contract in question here is of a type familiar in commerce, and is described as a c.i.f. contract. The initials indicate that the price is to include cost, insurance and freight. It is a type of contract which is more widely and more frequently in use than any other contract used for the purposes of sea-borne commerce. An enormous number of transactions, in value amounting to untold sums, are carried out every year under c.i.f. contracts. The essential characteristics of this contract have often been described. The seller has to ship or acquire after that shipment the contract goods, as it which, if unascertained, he is generally required to give a notice of appropriation. On or after shipment, he has to obtain proper bills of lading and proper policies of insurance. He fulfils his contract by transferring the bills of lading and the policies to the buyer. As a general rule, he does so only against payment of the price, less the freight which the buyer has to pay. … In this course of business, the general property remains in the seller until he transfers the bill of lading …

By mercantile law, the bills of lading are the symbols of the goods. The general property in the goods must be in the seller if he is to be able to pledge them. The whole system of commercial credits depends upon the seller’s ability to give a charge on the goods and the policies of insurance”.

The seller must:

(a) ship goods or buy goods already shipped. Stipulations as to the time and place of shipment as specified in the contract must be strictly complied with and are almost always treated as conditions (*Bunge Corp v Tradax* [1981] 1 WLR 711). The seller must also insure the goods at his own expense.
(b) make a contract for the carriage of the goods to, and for their delivery at, the cif destination.
(c) tender to the buyer proper shipping documents (ie (a) the seller’s invoice for the price; (b) the bill of lading and (c) the insurance policy).

The main differences between CIF and FOB contracts were summarized by the House of Lords in Scottish & Newcastle International Ltd v Othon Ghalanos Ltd [2008] 1 Lloyd’s Rep 462.

The bill of lading must:
- be in transferable form (either by being indorsed if an order bill of by mere delivery is a bearer bill).
- provide continuous documentary cover eg Hansson v Hamel and Horley [1922] 2 AC 36, 350 tons cod guano CIF Kobe/Yokohama, shipped from Norway. Transshipped from Kiev to Atlas Maru in Hamburg. BL did not impose contractual obligations on carrier in relation to first leg, therefore invalid tender.
- state that the goods have been shipped not just received for shipment.
- be clean ie one that does not contain any reservation as to the apparent good order and condition of the goods at the time of shipment. Eg The Galatia [1980] 1 WLR 495 : notation on BL recording damage and discharge after shipment (as a result of fire on board) since it related to post-shipment events did not prevent bill being clean.

Generally the buyer must pay the price against these documents (although in practice, payments will often be made through a bank by means of a letter of credit in which case the documents are sent to the bank not the buyer).

**Passing of property and risk in cif contracts**
The modern presumption is that property is transferred when payment occurs. Largely an application of s 19(2). Generally the seller wishes to retain property as security for the payment of the price.

But of course passing of property is always subject to the intention of the parties. Eg in The Albazer [1977] AC 774, the buyer and seller were associated companies whose commercial interests were not directly opposed. Further the sale was expressly made on credit terms. It was agreed at all stages of the litigation that the property passed as soon as the BL was presented to the buyer even though no payment had been made then: documents were not being used with traditional security function.

**Risk on** the other hand passes from the moment of shipment or appropriation. Thus, the seller fulfils is obligations and must be paid if he delivers the documents even if he knows the goods have already been lost: Mambré Saccharine Co Ltd v Corn Products Ltd [1919] 1 KB 198. McCardie J:
“I conceive that the essential feature of an ordinary cif contract as compared with an ordinary contract for the sale of goods rests in the fact that performance of the bargain is to be fulfilled by delivery of documents and not by the actual physical delivery of goods by the vendor. …

InArnhold Karberg & Co v Blythe, Green, Jourdain & Co Scrutton LJ, when a judge of first instance, described a cif contract as being a sale of documents relating to goods and not a sale of goods. But when the Court of Appeal considered that case Bankes LJ and Warrington LJ commented on the language of Scrutton J and indicated their view that a cif contract is a contract for the sale of goods to be performed by the delivery of documents. But I respectively venture to think that the difference is one of phrase only. For in reality, as I have said, the obligation of the vendor is to deliver documents rather than goods – to transfer symbols rather than the physical property represented thereby. If the vendor fulfils his contract by shipping the appropriate goods in the appropriate manner under a proper contract of carriage, and if he also obtains the proper documents for tender to the purchaser, I am unable to see how the rights or duties of either party are affected by the loss of ship or goods, or by knowledge of such loss by the vendor prior to the actual tender of the documents. … The contingency of loss is within and not outside the contemplation of the parties to a cif contract.”

But whether the same principles apply if the goods are lost after the contract is entered into but before the goods are appropriated remains controversial.

**Relationship between the documents and the goods**
The documents play a crucial role in cif contracts. But “that does not mean that a cif contract is a sale of documents and not of goods. It contemplates the transfer of actual and confirming goods in the normal course. If the goods are lost, the insurance policy and bill of lading contract – that is, the rights under them – are taken to be, in a business sense, the equivalent of the goods”. Smyth & Co Ltd v Bailey Son & Co Ltd [1940] 3 All ER 60, 70 per Lord Wright.

The buyer under a cif contract has two rights of rejection (*Kwei Tek Chao v British Traders*):

(a) if the documents are not in order, he may refuse to take them up and treat this as a repudiatory breach by the seller.

(b) Even after he has accepted the documents, he has a right to reject the goods, if, on arrival, they prove not to be in conformity with the contract. Confirmed in *Berger v Gill & Duffus*: per Lord Diplock: it is trite law for which I do not find it necessary to refer to any other authority than the judgment of Devlin J in *Kwei Tek Chao v British Traders and Shippers Ltd*, that when a buyer under a cif contract accepts the shipping documents which transfer the property in the goods to him, the property in the goods that he obtains is subject to the condition subsequent that it will revest in the seller if upon examination of the goods themselves upon arrival the buyer finds them to be not in accordance with the contract in some respect which would entitle him to reject them, and he does in fact reject them.
So the buyer can still reject the goods, even if he has accepted conforming documents, if the seller is in breach of a condition of the contract of sale.

Conversely, if the buyer rejects the documents when they are apparently in order, the seller may elect to treat this as a repudiation on the part of the buyer, and is relieved from the duty of delivering the goods themselves (Gill & Duffus). Lord Diplock:

“it is, in my view, a legal characteristic of a cif contract so well established in English law as to be beyond the realm of controversy that the refusal by the buyer under such a contract to pay the seller, or to a banker nominated in the contract if the contract so provides, the purchase price upon presentation at the place stipulated in the contract, of shipping documents which on their face conform to those called for by the contract, constitutes a fundamental breach of contact, which the seller is entitled to elect to treat as rescinding the contract and relieving him of any obligation to continue to perform any of his own primary obligations under it…."

There are only very limited exceptions to the principle that the buyer must pay even though he knows goods do not conform:

- Fraud ie seller knows the statements are false
- Probably fundamental breach or if no goods shipped at all (because then BL would be false and would be a nullity)

On the assessment of damages see Kwei Tek Chao v British Traders and Shippers Ltd [1954] 2 QB 459.

**Ex ship or arrival contracts**

Under an arrival contract, the buyer is bound to pay the price only if actual delivery of the goods is made to him at the port of delivery, the seller bearing all the costs up to but not including unloading costs and import duties. Property and risk will pass with delivery of possession. It is not sufficient that the seller tenders documents; the buyer is entitled to the goods themselves. Eg in Comptoir d’Acat et de Vente SA v Luid de Ridder Limitadad (The Julia) [1949 AC 293] the plaintiffs bought a quantity of rye “cif Antwerp”, but the sellers retained the bill of lading and the insurance policy under the contract, and they also guaranteed the condition of the goods on arrival. It was held by the House of Lords that these terms were inconsistent with a true cif contract and that in fact the contract was for the sale and delivery of goods ex ship. Consequently, the seller’s failure to deliver the goods through the outbreak of war enabled the buyers to recover the price as on a total failure of consideration.
8.2. Letters of credit and other forms of settlement

What is Documentary credit?

‘Documentary Credit’ has two meanings. First, it refers to a document of undertaking issued by a bank at the request of an applicant (a buyer) to pay to the beneficiary (a seller) a sum of money under specified conditions (for example, the beneficiary provides compliant documents for the purpose of transferring property in goods or possession of goods to the buyer). Secondly, it refers to an arrangement for effecting payment in a transaction, under which a bank acts as intermediary between the seller and buyer, a provider of finance for the applicant (if applicable) or a guarantor to the beneficiary. The expression ‘documentary credit’ is interchangeable with the expression ‘letter of credit’, but ‘documentary credit’ is preferred by the International Chamber of Commerce (ICC) particularly in the UCP.

UCP is the Code to standardise conditions under which bankers are prepared to issue documentary credits and the interpretation of documentary credit practice. Credits subject to the Code include a clause to that effect. Everyone concerned with documentary credits and the preparation of relevant documents should be familiar with the provisions of UCP.

The ICC, UCP 500 and UCP 600

Today documentary credits are regulated under the Uniform Customs and Practices for Documentary credits (UCP) which are a body of rules compiled and published by the International Chamber of Commerce (ICC). The UCP is binding on banks, the applicants for credits and their beneficiaries.

Upto July 2007, the UCP in operation was the 1993 UCP 500. As from 1st July 2007, the applicable rules are found in UCP 600. All banks in Sri Lanka have adopted the UCP 600.

The International Chamber of Commerce (ICC)

The International Chamber of Commerce (ICC) which was established in 1919, has as its primary objective, facilitating the flow of international trade at a time when nationalism and protectionism posed serious threats to the world’s trading system. It was in that spirit that the UCP were first introduced – to alleviate the confusion caused by individual countries promoting their own national rules on letters of credit practice. The objective, since attained, was to create a set of contractual rules that would establish uniformity in that practice, so that practitioners would not have to cope with a plethora of often conflicting national regulations.

It is important that the UCP represents the work of a private international organization, not a governmental body. Since its inception, ICC has insisted on the central role of self-regulation in business practice. These UCP rules, formulated entirely by experts in the private sector, have validated that approach.
UCP 600
The UCP 600 of 2007 is not only an update but has made major changes to UCP 500. It contains 39 comprehensive Articles which are binding on all parties to a credit unless expressly modified or excluded. It is unlikely that any bank in Sri Lanka will deal with a credit unless the UCP 600 is made applicable.

Read : Articles of UCP 600

**Autonomy or Independence principle**
The Autonomy principle which is fundamental to documentary credit means that a letter of credit is a separate transaction from the sale or other contract on which it may be based and banks are in no way concerned with or bound by such contracts, even if the letter of credit contains reference to such contracts. All parties concerned, deal in documents only, not in the goods, services or other performance requirements of the underlying contract.

**Credits v Contracts**
A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfill any other obligation under the credit is not subject to claims or defenses by the applicant resulting from its relationships with the issuing bank or other beneficiary. A beneficiary can in no case avail himself of the contractual relationships existing between banks or between the applicant and the issuing bank.

**Documents v Goods, Services or Performance**
Banks deal with documents and not with goods, services or performance to which the documents may relate. Where a contract for the sale of goods provides for payment to be made by a banker’s letter of credit, it is the buyer’s duty (applicant) to arrange with his bankers (issuing bank) for a documentary credit to be issued in favour of the seller (beneficiary) in the currency specified (as indicated by the price.)

In a case concerning the liability between the issuing and confirming bank in case of non-conforming documents, the English Court of Appeal held that the UCP required the issuing bank to examine the documents as they were and did not allow the issuing bank to send them to the buyer for the purpose of identifying the discrepancies. Here, the Bankers Trust failed to comply with the requirement to give timely notice to the negotiating bank of the alleged discrepancies and the negotiating bank was held entitled to claim reimbursement from the State Bank of India. *Bankers Trust Co. Ltd v State Bank of India* [1991] 2 Lloyd’s Rep 443.
8.3. Export credit Insurance

The exporter who insists on cash or an L/C payment for foreign shipments is likely to lose orders to competitors from other countries that provide more favorable credit terms. Better credit terms are often made possible by means of export credit insurance, which provides assurance to the exporter or the exporter’s bank that, should the foreign customer default on payment, the insurance company will pay for a major portion of the loss. Because of the availability of export credit insurance, commercial banks are willing to provide medium- to long-term financing (five to seven years) for exports. Importers prefer that the exporter purchase export credit insurance to pay for nonperformance risk by the importer. In this way, the importer does not need to pay to have an L/C issued and does not reduce its credit line.

Competition between nations to increase exports by lengthening the period for which credit transactions can be insured may lead to a credit war and to unsound credit decisions. To prevent such an unhealthy development, a number of leading trading nations joined together in 1934 to create the Berne Union (officially, the Union d'Assureurs des Credits Internationaux) for the purpose of establishing a voluntary international understanding on export credit terms. The Berne Union recommends maximum credit terms for many items including, for example, heavy capital goods (five years), light capital goods (three years), and consumer durable goods (one year).