



Banning the use of Bills of Exchange in UCP 700

Why would one wish to declaim such a break with long-standing tradition? Bills of exchange (B/E) have been an integral part of UCP rules and thus documentary letters of credit since their inception in the 1930's. Why the call for their banishment now?

Let us consider for a moment the character of these two separate payment instruments:

Paraphrasing UCP 600 (Art. 4) we see that a documentary letter of credit (LC) is a separate transaction from the sale or other contract on which it may be based. From this flows the inevitable conclusion that both buyer and seller agree that the primary¹ means of payment² is deemed to be the LC assuming that the documents presented thereunder are duly taken up by the paying bank(s) concerned. Further, we are told that (viz. Art. 6 c.) a credit must not be issued available by a draft drawn on the buyer. From this, as also other pertinent Articles, we must conclude that only a bank(s) is/are expected to pay under the LC subject, as ever, to presentation of LC compliant documents. We are told (Art. 2) that the LC is irrevocable and constitutes a definite [payment] undertaking to honour a complying presentation.

We thus have an irrevocable payment undertaking from the issuing bank and, if applicable a negotiating/confirming bank to pay against LC compliant documents, regardless of any issues and/or disputes pertaining to the underlying contract.

We now have the B/E to consider. The Bills of Exchange Act 1882 (Act) Part II § 3 (1) defines this as follows: "A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or to bearer." § 17 (2) states *inter alia* that; "An acceptance is invalid unless it complies with the following conditions, namely: (a) It must be written on the bill and be signed by the drawee. The mere signature of the drawee without additional words is sufficient."

¹ This presupposes presentation of documents through the banking chain per *Soproma SpA v Marine and Animal By-Products Corp* [1966] 1 Lloyd's Rep 367 – concerning the LC as a conditional as opposed to an absolute payment condition *WJ Alan & Co Ltd v El Nasr Export and Import Co* [1972] 1 Lloyd's rep 156 refers

² If the LC fails to provide payment as foreseen, the seller obtains the right to seek payment direct from the buyer per *Newman Industries Ltd v Indo-British Industries*, [1956] 2 Lloyd's rep 219 see also *W.J. Alan & Co Ltd v El Nasr Export and Import Co* [1972] 2 Q.B. 189, 209-212, 221

We are informed by M. Bridge³ that; “When the bill is accepted by the drawee (who now becomes the acceptor), he becomes liable on the instrument to the payee⁴ or any lawful holder of the instrument. Where the drawee dishonours the bill, or indeed never accepts it in the first place, the drawer of the bill is personally liable on it the lawful holder.⁵

Expanding upon the foregoing the Act states at § 27(2) that “Where value has at any time been given for a bill the holder is deemed to be a holder for value as regards the acceptor and all parties to the bill who became parties prior to such time.” We may infer from this that a B/E, accepted by a confirming or issuing bank, subsequently returned to the drawer would, if forfeited/discharged to a third party for a money consideration, impose upon the acceptor a payment obligation towards the holder presenting the B/E at maturity. This payment obligation would perforce arise in addition to that incurred by the bank(s) taking up credit compliant documents presented under a documentary credit.

To summarise, we have the following situation under a L/C available by acceptance:

- a) the L/C which per legal opinion⁶ and UCP 600 is entirely separate (viz. “abstract” below) from the underlying transaction that foresees payment being triggered purely by presentation of compliant documents, and;
- b) a B/E drawn upon the issuing, confirming or negotiating bank which itself, as shown above, also represents an abstract payment obligation once it has been accepted.

We surely have one abstract payment obligation too many? Not really. The B/E will never be accepted by the drawee or returned to the drawer or thereafter negotiated/discharged to a third party. How can one make such a categorical statement? Because all banks in the L/C chain are fully aware that their payment obligation arises exclusively under the L/C and not against the B/E. No bank wants to be put in the situation of having to pay against L/C compliant documents and a B/E presented at maturity by a holder in due course. So why does the L/C or indeed UCP 600 allow for presentation of a document that *ab initio* will never become a viable or legally enforceable instrument? Why indeed!

This issue is discussed regularly and *ad nauseum* in a trade finance forum, comprising some 20'000 participants, of which I am a member and regular contributor. Virtually all persons that persist in avowing the utility of a B/E in the scope of L/C based transactions are active in S.E. Asia. What is very clear from the comments in support of B/E is a lack of understanding of the true purpose of this particular payment undertaking (i.e. in its own right and outside of L/C flows) and the inherent risks attached to its use in connection with L/C related documents. May I humbly submit that the ICC would do the L/C world a huge service by expunging the use of the B/E in the next UCP 700 revision. It would eliminate in one stroke a huge source of confusion and simultaneously eradicate a troubling and potentially costly anachronism.

³ Michael Bridge, *The International Sale of Goods Law and Practice* 1st ed. (Oxford Press, 1999) at para. 6.11 pp 240

⁴ i.e. the beneficiary / seller on a B/E drawn on the issuing bank or another paying bank under a L/C

⁵ Bills of Exchange Act 1882, s 55 – this puts the drawer/seller/beneficiary in the unenviable position of becoming potentially liable on a B/E that the drawee never has the least intention of accepting or honouring.

⁶ Prof. Roy Goode in an essay published in 1991 considers the L/C to be an abstract payment obligation which is then defined as; “A money promise which is independent of the transaction that gives it birth and which is considered binding when received by the beneficiary (or sometimes even when issued by the promisor) without acceptance, consideration, reliance or execution in solemn form.”