

# FRAUDULENT TRANSPORT DOCUMENTS UNDER THE UCP: CONTROVERSIES AND POSSIBLE SOLUTIONS\*

Professor ČASLAV PEJOVIĆ\*\*

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*There is an issue that has been neglected by all leading texts on the documentary credits: deficiencies in the Uniform Customs and Practices on Documentary Credits (UCP) provisions regarding transport documents. This text will attempt to demonstrate that the UCP600 definition of "clean" bill of lading and the effect given to the "said to contain" type of clauses involve two controversies: they contravene the corresponding provisions of the legal regime governing carriage of goods by sea and they may also contribute to documentary fraud. The primary objective of this paper is to highlight the potential problems that may arise from the UCP in light of the risk of documentary fraud arising from those discrepancies and will propose solutions of those problems. The paper will conclude by taking a stance regarding the need to regulate fraud in the next revision of the UCP.*

**Keywords:** *documentary credits; transport documents; documentary fraud.*

## INTRODUCTION

There is one issue related to the UCP that is not easy to explain. Despite some obvious deficiencies in the regulation of the transport documents, none of the leading textbooks on the UCP even mentions this issue. As an illustration, Ebenezer Adodo in his recent book on letters of credit, in an attempt to justify omission of a detailed discussion of transport documents in his text stated that transport

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\*\* Professor of Law, Kyushu University, Faculty of Law; LL.B., Montenegro University; LL.M., Belgrade University; LL.M., Kyoto University; Ph.D., Zagreb University; e-mail: [pejovic@law.kyushu-u.ac.jp](mailto:pejovic@law.kyushu-u.ac.jp)

documents have not been “the subject of serious controversies in the last several decades” and that banks are not “in great need of fresh insights” regarding this theme.<sup>1</sup> The fact is that some of the most common causes of problems and discrepancies in documentary credits are related to transport documents.<sup>2</sup> What is more relevant for this paper, the UCP text has some serious deficiencies regarding its regulation of transport documents.

This text will attempt to demonstrate that the UCP600 definition of “clean” bill of lading and the effect given to the “said to contain” type of clauses involve two controversies: they contravene the corresponding provisions of the legal regime governing carriage of goods by sea and they may also contribute to documentary fraud. It has been stated that the ICC had solicited comments on the provisions related to provisions on clean bills of lading and “said to contain” type of clauses, but received none, which could be interpreted in the way that those provisions worked well in practice.<sup>3</sup> Last year the author of this article sent to the ICC another paper related to transport documents under the UCP that pointed out deficiencies in the text of the UCP with specific proposals how to revise it and the reaction of the ICC was positive and receptive.<sup>4</sup> While the main focus of the previous paper was on discrepancies between the UCP and the rules governing carriage by sea, this paper places its main focus on documentary fraud related to transport documents. The paper will address the deficiencies of certain parts of the UCP that may contribute to fraud to demonstrate that there is still room for new arguments and “fresh insights” in this area of law.

The primary objective of this paper is to highlight the potential problems that may arise from the UCP in light of the risk of documentary fraud arising from those discrepancies and will propose solutions of those problems. The paper will conclude by taking a stance regarding the need to regulate fraud in the next revision of the UCP. It is hoped that this may contribute to debate on the upcoming revision of the UCP.

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<sup>1</sup> EBENEZER ADODO, LETTERS OF CREDIT: THE LAW AND PRACTICE OF COMPLIANCE 7.02 (2014).

<sup>2</sup> According to the ICC introductory note to the UCP 600, approximately 70% of documents presented under letters of credit were being rejected on the first presentation: <http://static.elmercurio.cl/Documentos/Campo/2011/09/06/2011090611422.pdf> (last visited: May 31, 2017).

<sup>3</sup> Oliver Cachard, Discrepant declarations about containerized goods in the middle of a chain reaction, in: *International Trade and Carriage of Goods* (eds. Baris Soyer and Andrew Tettenborn, Informa Law, 2017) 121.

<sup>4</sup> The author was in communication with David Meynell, Senior Technical Adviser to the ICC Banking Commission who provided valuable information regarding background of relevant provisions of the UCP. The previously published text is: Časlav Pejović, Clean Bill of Lading in Contract of Carriage and Documentary Credit: When Clean May not be Clean, 4 Penn. St. J.L. & Int'l Aff. 127 (2015).

## (HOW) CAN THE UCP FACILITATE FRAUD?

While the UCP has refrained for express regulation of fraud, some of its provisions may actually facilitate fraud. There are two such provisions. One relates to the definition of clean bill of lading and another to duty of the bank to accept “said to contain” type of clauses.

### Definition of Clean Bill

The UCP rules provide specific requirements related to clean bill of lading. Under UCP600 Article 27, a clean bill of lading is defined as “one that bears no clause or notation which expressly declares a defective condition of the goods and/or the packaging”. Banks must refuse bills of lading that contain such clauses or notations, unless the letter of credit expressly stipulates the clauses or notations that may be accepted. As a matter of principle, the bill of lading should be free of all notations with respect to the apparent condition of the goods and packaging. The buyer can give instructions to its bank with respect to the requirements of the documents; if there are no such instructions, the requirements contained in the UCP rules will apply.

The UCP contains rather imprecise guidance regarding definition of the clean bills of lading, which deviates from the rules on clean bills of lading in the law governing carriage of goods by sea. When the meanings of clean bill of lading under the rules applying to carriage of goods and those applying to letters of credit are compared, discrepancies become obvious. All international conventions governing carriage of goods by sea provide that reservations regarding leading marks, quantity, the general nature of the goods, and their condition make a bill of lading unclean.<sup>5</sup> In a clear contrast to the rules governing carriage by sea, the UCP limits the definition of a clean bill of lading to notations declaring defective condition of the goods and/or packages. This definition is in line with some well-known cases.<sup>6</sup> On the other hand, it deviates from other cases that gave effect to notations related to quantity, making such bills unclean under the rules governing carriage by sea.<sup>7</sup>

This fact is clearly stated in all international conventions regulating carriage of goods by sea and is confirmed by numerous court decisions. As an

<sup>5</sup> Hague-Visby Rules, Article. 3(3), Hamburg Rules, Article. 16(1); Rotterdam Rules, Article 40(1) referring to Article 36(1).

<sup>6</sup> *British Imex Indus. Ltd. v Midland Bank Ltd.* (1958) 1 Q.B. 542 (Eng.); *Golodetz & Co. v Czarnikow* (1980) 1 W.L.R 495 (Eng.).

<sup>7</sup> *New Chinese Antimony Co. Ltd. v. Ocean S.S. Co.* [1917] 2 K.B. 664 (Eng.), *Attorney General of Ceylon v. Scindia Steam Navigation Co., India* [1962] A.C. 60 (Eng.); *The Mata K* [1998] 2 Lloyd’s Rep. 614 (Eng.).

illustration, clean bill is defined in *Roberts v. Calmar S.S. Corporation* in the following way:

“However, broadly speaking, it may be said that a “clean” bill of lading is one which contains nothing in the margin qualifying the words of the bill of lading itself”.<sup>8</sup>

In *Restitution Steamship v. Sir John Pirie & Company*, the Court was more explicit with respect to reservations referring to quantity:

“[W]here, for instance, you insert in the margin of the bill of lading the weight or quantity or quality unknown, that is not a clean bill of lading, because that contains a qualification. Where, on the other hand, there is no such qualification inserted in the margin, there the bill of lading is a clean one.”<sup>9</sup>

For some unclear reason, the reservations regarding quantity are omitted from the UCP definition of clean bill of lading. The report on clean bills of lading prepared by the International Chamber of Commerce (ICC) states that clauses relating to quantity “are in a different class, in that they merely reflect a difference of opinion between seller and carrier as to the exact quantity of goods loaded on board.”<sup>10</sup> It is true that these clauses are in a different class,<sup>11</sup> but not merely because they reflect a difference of opinion since the clauses related to condition may also reflect a difference of opinion between seller and carrier. It is notorious that there is often disagreement and negotiation between the shipper and the carrier (or his agent) as to the description of the condition of the goods in the bill of lading, particularly where the master is not sure but only suspects that there is some problem with the condition of the goods.<sup>12</sup> In fact, shipper and carrier are more likely to have “a difference of opinion” regarding condition of the goods rather than regarding quantity. Quantity can be more easily verified when in dispute, while the assessment of apparent condition of the goods is often based on subjective impression. Instead of relying on a “different class” type of argument, a more convincing way would be to rely on a pragmatic argument that omitting quantity in the “clean” definition was motivated by the frequent use of “xxx in dispute” type of clauses by which the carriers refuse to accept the numbers provided by the shippers who may or may not be right. The banks, as always, do not wish to get involved unless specifically instructed.

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<sup>8</sup> 59 F. Supp. 203, 209 (E.D. Pa. 1945).

<sup>9</sup> 61 L.T.R. 330 (Q.B. 1889).

<sup>10</sup> International Chamber of Commerce, *THE PROBLEM OF CLEAN BILLS OF LADING* 14 (1962).

<sup>11</sup> Reservations referring to the quantity deprive those particulars of any evidentiary effect and are considered to be only a declaration of the shipper, but without the carrier’s liability for their accuracy. The carrier is only liable on the basis of the receipt of the goods (*ex recepto*), which means that he must deliver the goods to the consignee as he received them from the shipper. On the other hand, reservations referring to condition of the goods represent *prima facie* evidence that the goods were loaded as described in the reservations.

<sup>12</sup> *Sea Success Mar. Inc. v. African Mar. Carriers Ltd.* [2005] EWHC (Comm) 1542 (Eng.).

Notwithstanding the actual reasons for omitting reservations related to quantity, a bill of lading containing a notation that states a shortage of the goods cannot be clean, particularly from the perspective of the buyer's interests. This is so obvious that it does not even require elaboration. Common sense is sufficient.

The failure to include reservations related to quantity in the definition of a clean bill of lading raises the issue of whether this failure can be remedied by other provisions of the UCP. To a certain extent, UCP600 Article 30 may play this role. Under UCP600 Article 30(b) a notation stating shortage of the quantity which is within 5% tolerance would be acceptable to the bank. This provision implicitly confirms that bills of lading containing notations stating shortage of the goods within 5% tolerance represent, in fact, clean bills.<sup>13</sup>

A problem may arise if a bill of lading indicates a shortage within the tolerance defined by Article 30(b), e.g., when it contains a clause stating: "10 tons missing" (if we assume that the total amount is 1,000 tons, a shortage of ten tons is just 1% of the total amount). Should the bank accept such bill of lading? From the position of the buyer, a shortage of the quantity should be valid cause for rejecting documents. On the other hand, under the UCP, the bank would be required to accept such bill of lading, unless specifically instructed not to do so.

A notation that refers to a minor defect may be acceptable to the buyer, but not to the bank because such notation makes a bill of lading unclean under the UCP rules. On the other hand, a notation within the tolerance defined by Article 30(b) would be acceptable to the bank, but not necessarily to the buyer. Would the buyer agree to any shortage that is less than 5%? There have been many cases where a buyer has sued the seller or carrier for far lower percentages of shortage. Article 30(b) may contradict the law governing contract of sale, for the law of each country sets out its own percentage of tolerance. The problem will arise particularly where the law governing contract of sale provides a lower tolerance. This means that UCP600 Article 30(b) may contravene both the rules applying to carriage of goods by sea and those applying to contract of sale.

### **"Said to Contain" Clauses**

Another source of confusion and possible cause of fraud relates to UCP600 Article 26(b). According to this provision, banks will accept bills of lading that contain clauses such as "shipper's load and count", "said by shipper to contain", or words of similar effect.<sup>14</sup> The problems related to "said to contain" kind of clauses have been generated by the use of container carriage and particularly by the practice of delivering goods in sealed containers. The problems are far less likely to

<sup>13</sup> For more details, see, Časlav Pejović, *Clean Bill of Lading in Contract of Carriage and Documentary Credit: When Clean May not be Clean*, 4 Penn. St. J.L. & Int'l Aff. 127 (2015).

<sup>14</sup> See UCP, *supra* note 2, art. 26(b).

occur in the case of "less than container load" (LCL) where the goods are sent to a container freight station and then consolidated with goods belonging to other shippers. Since the carrier is responsible for stuffing the container and cannot rely on the shipper's declarations, "said to contain" type clauses usually do not carry much weight in such cases. The container is typically delivered empty to the shipper where the container is stuffed by him in the practice known as "full container load" (FCL). In such case the bills of lading issued for such cargo are typically qualified by "said to contain" or "shipper's load and count" type clauses, since the carrier is not given an opportunity to verify the accuracy of the shipper's declaration.

The effect of "said to contain" type clauses is typically admitted in cases where the goods are delivered for carriage in sealed containers (FCL), though there are some differences in comparative law.

English courts give effect to general reservations relating to weight or quantity unknown.<sup>15</sup> If a bill of lading states that the weight of goods is unknown, the carrier can rely on it as evidence to contradict the weight recorded in the bill of lading.<sup>16</sup> In such case, no estoppel can be raised against the carrier since he made no representation. In common law the main focus is on the fact of whether a representation is made rather than whether the qualification is true.<sup>17</sup> If the statement of the weight or quantity of goods in the bill of lading is qualified by such words as "weight or quantity unknown", the bill of lading is not even *prima facie* evidence against the carrier of the weight or quantity shipped.<sup>18</sup> Similarly, where goods are shipped in a container and the bill of lading is "said to contain" a given number of packages so that it is plain that the carrier has no knowledge of the contents of the container, the carrier is not estopped from denying that the stated number of packages were in fact in the container. The onus is on the cargo-owner to prove what was in fact shipped.<sup>19</sup>

In the United States, Section 7-301(b) of the Uniform Commercial Code (UCC) recognizes the validity of clauses such as "contents, condition, and quality unknown" and "said to contain" in case of the goods "concealed in packages".<sup>20</sup> Many other jurisdictions have taken a similar stance and this kind of reservations has

<sup>15</sup> *The Mata K* [1998] 2 Lloyd's Rep. 614 (Eng.); *Noble Res. Ltd. v. Cavalier Shipping Corp.* [1996] 1 Lloyd's Rep. 642 [hereinafter *The Atlas*] (Eng.); *The Esmeralda* [1988] 1 Lloyd's Rep. 206 (Eng.).

<sup>16</sup> *The Atlas*, 1 Lloyd's Rep. at 646.

<sup>17</sup> RICHARD AIKENS, RICHARD LORD & MICHAEL BOOLS, *BILLS OF LADING* 4.32 (2006).

<sup>18</sup> *Conoco (UK) Ltd. v. Limai Mar. Co.* [1988] 2 Lloyd's Rep. 613 (Eng.) [hereinafter *The Sirina*].

<sup>19</sup> WILLIAM TETLEY, *MARINE CARGO CLAIMS* 351 (4th ed. 2008).

<sup>20</sup> *Transatlantic Marine Claims Agency v. M/V IBN Zuhr*, Civ. A. No. CV 493-292, 1994 WL 654548 (S.D. Ga. May 27, 1994); *Recumar Inc. v. S/S Dana Arabia*, 83 Civ. 6486 (BN) (JES), 1985 WL 479 (S.D.N.Y. Apr. 5, 1985); *Aetna Ins. Co. v. General Terminals*, 225 So.2d 72 (La. Ct. App. 4 1969); THOMAS SCHOENBAUM, *ADMIRALTY AND MARITIME LAW* § 10-22 (4th ed. 2004).

been upheld as valid in several of court decisions in a number of different countries (Germany, Italy, Belgium ...).<sup>21</sup>

In the context of the UCP, this provision can be justified by the fact that these clauses do not expressly declare a defective condition of the goods and therefore do not make bills of lading unclean under the UCP rules.

The situation, however, can be different in contract of carriage.

In contracts of carriage clauses, "shipper's load and count" or "said by shipper to contain" are often not given effect by the courts when they are pre-printed in bills of lading. In such cases, UCP600 Article 31(ii) would not cause problems. However, under certain conditions, these clauses can have effect under the rules governing carriage of goods and render a bill of lading unclean. Where the goods are carried in containers packed and sealed by the shipper, the carrier has no duty to open them to check their contents. In this case it is clear in *re ipsa* that the carrier cannot check the contents due to the conditions of carriage. This means that there is no need for the reservations to be specific and the carrier can insert reservations such as "said by shipper to contain" or simply "said to contain".

It is obvious that there is a clear discrepancy between the UCP and the laws governing carriage of goods by sea. Namely, under the UCP, clauses such as "said to contain" do not affect the status of a bill of lading which remains clean and acceptable by banks. On the other hand, similar clauses may have an effect under carriage by sea rules, making bills unclean. The reason for this discrepancy may be the fact that banks prefer not to get involved in potential disputes regarding "said to contain" type of clauses (same as in case of reservations regarding quantity).

### **Risk of Fraud**

Both notations related to condition of the goods and those related to quantity indicate that there may be some problems with the contents of the bill of lading. Of course, the carrier inserts those notations to protect his own interests, but those notations also serve to protect the interests of the buyers/third holders of bills of lading. From the perspective of the buyers, notations stating shortage of the goods may be even more important from those indicating defects in condition of the goods and packaging.

The real risk for the buyer is that this provision requires the bank to pay against a bill of lading which contains express reservation regarding shortage of quantity, where the shortage is within the tolerance of 5%. An unscrupulous seller may simply deliver for carriage the goods with shortage of less than 5% to ensure that the bank will pay against such document. The carrier will normally qualify such bill of lading

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<sup>21</sup> Časlav Pejović, *Clean Bill of Lading in Contract of Carriage and Documentary Credit: When Clean May not be Clean*, 4 Penn. St. J.L. & Int'l Aff. 127 (2015).

but as long as the clauses do not reach 5% of shortage, the bank will accept such bills. While such shortage is acceptable to banks, it would most likely not be acceptable for the buyer.

“Said to contain” type of clauses create an even higher risk of fraud. The UCP’s unreserved acceptance of “said to contain” type clauses can easily make the buyer a victim of fraud if the seller as shipper furnishes the carrier with a false description of the goods loaded in a container (e.g., the bill of lading states that music records are loaded when in fact some garbage is loaded), and the carrier inserts in the bill of lading the clause “said by shipper to contain.”<sup>22</sup> In such a case the bank will pay against such a document, the carrier will not be liable for wrong description of the goods, and the seller may “disappear” or become insolvent. By imposing a duty on banks to accept bills of lading with “said to contain” type clauses, UCP600 Article 26(b) increases the risk of fraud acting as a kind of default rule. Many traders may not be aware of this risk.

This creates an opportunity for dishonest sellers to defraud buyers in a rather simple way. The seller as shipper can simply furnish the carrier with a false description of the goods loaded in a container (e.g., the bill of lading states that computers are loaded, but some garbage is loaded instead); the carrier inserts in the bill of lading the clause “said by shipper to contain”.<sup>23</sup> The bank will pay against such bill of lading, the carrier will not be liable for a wrong description of the goods, while in case of fraud the seller will usually disappear. The fraud victim may realize that the transport documents are fraudulent only after he presents the document to receive the goods from the carrier and then finds out that the goods are wrong, defective, or even do not exist.

The bank may reject a document stating the true condition of the goods, such as minor defects, even though this would be acceptable by the buyer, because such document would not qualify as clean document under UCP600 Article 27. On the other hand, the bank would accept the document which falsely states that the goods are in good condition, when the goods are, in fact, very badly damaged where this defect was concealed because the goods were loaded in a container sealed by the shipper and the bill contains a “said by shipper to contain” clause. The fact that banks are bound to examine merely whether the documents on their face comply with the terms of the credit and assume no responsibility if documents are fraudulent makes it even easier for dishonest sellers to commit fraud.

The risk of fraud should not be underestimated, as even large companies may be defrauded under the existing system.<sup>24</sup> A recent case which is now pending at the Thai Commercial Arbitration can serve as an illustration of the potential risk of

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<sup>22</sup> *Discount Records Ltd. v Barclays Bank Ltd.* [1975] 1 W.L.R. 315 (Eng.) 4.

<sup>23</sup> *Id.*

<sup>24</sup> *See, e.g., Discount Records Ltd. supra* note 23; *Daewoo Int’l.*, 196 F.3d 481.



fraud even in case of large and experienced companies. One of the largest companies in Thailand bought steel scrap from a U.S. company. The goods were shipped in containers sealed by the shipper. Carrier inserted "said by shipper to contain" clause in the bill of lading and the bank made payment pursuant to the UCP. After the containers were opened it was found that 80% of the cargo was soil and not scrap. The lawyers of the buyer are aware that there is no valid claim against the carrier or bank. The only chance is to sue the seller, who seems to be without significant assets, so even if successful, the award may not be enforceable. Still worse, the buyer in this case may have to bear all arbitration costs, since the seller failed to reply to any communications related to this case, raising doubts regarding the likelihood of recovering even the arbitration costs.<sup>25</sup> An even worse situation can result where the cargo inside containers is hazardous waste, in which case the consignee may be obligated by domestic law to properly destroy such hazardous waste which will definitely be costlier than destroying the ordinary one.<sup>26</sup>

## PROTECTION AGAINST THE FRAUD

Under the existing UCP600 rules, buyers can still protect their interests and ensure that banks will not accept transport documents that are not acceptable to them. In case of risk related to shortage of goods, in order to avoid the risk the buyer should specifically instruct its bank to reject clauses that refer to a shortage of goods. To avoid the risk imposed by "said to contain" type of clauses, buyers are advised to include in the letter of credit requirements obligating the beneficiary (seller) to produce the packing list or a survey report where goods are to be carried in containers sealed by the shipper. Less experienced traders may not be familiar with these protective devices, but such problems may happen even to large companies.<sup>27</sup> This kind of trouble is ultimately caused by a defect in the UCP and not merely by

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<sup>25</sup> This case is brought to my attention by a former student who provided legal advice to this Thai company. It is highly likely that there are many cases like this one that have never been reported.

<sup>26</sup> While this issue is beyond the scope of this paper, in practice there are often problems with another kind of documentary fraud related to mislabeling hazardous waste sent in sealed containers to other countries, particularly to developing countries. As it was documented in one Filipino case involving the mislabeling of the cargo shipped inside containers by a Canadian company, this may even cause disputes between countries. In this case the cargo was declared as recyclable plastic scrap materials. However, an inspection by customs police found inside containers "used, mixed and unsorted or heterogeneous plastic materials, including household garbage and even used adult diapers." <https://globalnation.inquirer.net/125889/what-went-before-canadian-trash> (last visited: May 31, 2017)

<sup>27</sup> In the example of the Thai company mentioned above, it seems that the practice was to arrange for the random survey, which can be risky. Many companies may not employ a surveyor's services to verify condition of the scrap cargo.

failure to engage a surveyor.<sup>28</sup> Moreover, having a survey report does not guarantee protection of the buyer's interests, particularly if the surveyor is selected by the seller (also, the quality of services provided by some surveyors is questionable).

Buyers should be particularly cautious when the price offered by the seller is a bargain and below market prices. The experience teaches us that cheap prices often turn out to be expensive.

## PROPOSAL FOR UCP700

After identifying problems under the present UCP text, it may be useful to give a few proposals on how to correct its existing shortcomings. In fact, there are two issues regarding the text of the UCP: one relates to corrections of the existing text, while another is related to the need of regulating fraud.

The UCP needs a revision of some parts of its text to avoid potential risks, confusion, and problems arising from the discrepancy of rules regarding the definition of a clean bill of lading. Present definition is limited to reservations expressly declaring a defective condition of the goods or their packaging. Serious problems may arise in case of reservations regarding the quantity of the goods, since the UCP lacks clear guidance in such situations. Reservations stating shortage of the quantity are normally not acceptable to the buyers and it is difficult to understand why the UCP has ignored this. The solution can be to adopt the same rule as in carriage of goods and expand the meaning of "uncleanliness" to cover reservations regarding quantity.<sup>29</sup>

Cachard argues that UCP600 Article 26(b) has support of "the whole trade community" as it established a balance where carriers benefit from the admission of the effects of the "said to contain" clause in their relation with shippers and consignees in exchange for lower freight rates and faster transportation which obviously benefits shippers and carriers.<sup>30</sup> In this balance banks also benefit by being immune of the risk as they can freely accept "said to contain" clauses.<sup>31</sup> Beneficiaries also benefit because they can easily obtain payment from the bank, while applicants can protect their interests by employing a surveyor to supervise stuffing of containers.

Several questions can be raised in relation to these arguments. First of all, the carrier is unaffected by the UCP, including Article 26(b). Carrier's liability is governed by the

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<sup>28</sup> It is important to note that reliance on surveyors may not be perfect. In practice, disparity of standards and quality of surveyors can be significant. Problems for the buyers are more common when the surveyor is appointed by the seller, but even the surveyor appointed by the buyer is no guarantee that the job will be properly done.

<sup>29</sup> Hugo Tiberg, *Carrier's Liability for Misstatements in Bills of Lading*, in *MARITIME FRAUD* 71 (1983).

<sup>30</sup> Cachard, See note 3, at 123.

<sup>31</sup> *Ibid.* 121.

carriage by sea rules which are in clear contrast to the UCP. Deleting Article 26(b) will not affect the position of the carrier nor the freight rates. The position of the banks would also not be affected by deleting Article 26(b) since banks have to inspect the surveyor's certificates anyway, as suggested by Cachard, and even without Article 26(b), banks would have to do the same. Just the level of security of banks would be higher, as the risk of payment against fraudulent documents would be reduced. On the other hand, the position of beneficiary would change, as he may face difficulties in obtaining payment due to possible discrepancies in documents. However, this change would reduce the risk of fraud and applicants would benefit from such change. So, the main change in balance would be reflected in the different positions of beneficiaries and applicants. If we assume that applicants require a surveyor's certificate we can come to the conclusion that, in fact, nothing will change by deleting Article 26(b). Just the risk of fraud would be reduced by avoiding the "default" rule under which the banks now have to pay against transport documents with the "said to contain" clauses.

The existing rule has been justified by the need to avoid delays and additional expenses that would arise from checking goods in the containers. This practice relieves carriers and banks from liability, while allowing the beneficiaries to obtain payment against such documents. Obviously, one party is placed at risk by such practice: the applicant. One possible protection is to employ a surveyor to supervise the stuffing of containers. This would be the most practical solution: Carriers and banks would be exempted from liability and beneficiaries spared of problems related to rejection of "unclean" transport documents, while applicants could protect their interests by paying a surveyor. An alternative would be to delete Article 26(b) which would not change the position of carriers as they would still not be liable under 'said to contain' type clauses, while banks would still accept bills with such clauses, unless instructed otherwise by the applicant.

In the context of the risk of fraud, the main controversy derives from Article 26(b) and different standards regarding the legal effects of "said to contain" type clauses. This clause may make a bill of lading unclean under the carriage by sea rules, but will never do so under UCP. In fact, Article 26(b) imposes on banks the duty to pay against transport documents that contain such clauses, thus exposing buyers to great risk. Particularly vulnerable are inexperienced traders who may not even be aware of this risk. Experienced traders normally know how to protect their interests against such risk. But is it really necessary that the parties have to take measures to defend their interests due to a loophole in the UCP? Would it not be better to avoid this risk by closing the loophole?

Bills of lading should provide security to the buyer and that security may be undermined if banks accept bills which would not be acceptable to the buyer. UCP600 needs a revision of its text to avoid potential risks, confusion, and problems arising

from the discrepancy of rules applicable to “said to contain” type clauses. One possible solution is simply to delete Article 26(b) and leave parties to deal with these issues on a case-by-case basis. By deleting Article 26 the situation would be clear and the risk for the buyer would be reduced. If Article 26(b) is deleted, several issues may arise. For example, who should bear the additional costs? It would depend on bargaining power. The certificate of control expense may enter into price - if the buyer needs certainty, he should pay for that. Of course, if he wishes so, the buyer may avoid this cost by not asking for a certificate, but in that case he would bear the risk of fraud. In fact, not much would change, since a similar situation exists at the moment. The bank’s position would also not change much, as even now banks would have to follow the instructions regarding documents, including certificate of control. In a sense, the situation would become more clear since there would be no default rule under which that bank has to pay against a certain type of document. One obvious advantage of deleting UCP600 Article 26(b) is that the confusion caused by inconsistent rules between carriage by sea and letters of credit would disappear. Harmonizing letter of credit rules with those rules applying to contract of carriage would reduce legal uncertainty and problems that arise in practice.

Deleting UCP600 Article 26(b) would not solve the problem unless UCP600 Article 27 is also changed. Banks would still continue to accept bills of lading with ‘said to contain’ clauses, since the “said to contain” clauses does not indicate a defective condition of the goods or their packaging. Thus, it is also necessary to revise the definition of “clean” bill in Article 27 in accordance with the rules on “clean” bill as applied in carriage of goods. An alternative and more radical option may be to simply delete the term “clean” from Article 27 and replace it with a different term, for example “acceptable bill of lading”. In this way the existing confusion caused by conflicting terminology could be avoided; the legal instruments should refrain from giving the same name to concepts that are not the same.

With regard to qualifications related to the quantity of goods, there is an obvious deficiency in the text of the UCP that may create serious problems in practice. While banks normally have no problem with accounting, why should banks bear a duty to calculate the percentage of shortage and then determine whether the shortage is within the tolerated amount? Would it not be more practical to simply adopt the same rule as in carriage of goods? That is, any reservation regarding quantity makes the bill of lading unclean. The tolerance of shortage should not be prescribed as a standard in the UCP, but it should be an exception agreed upon by parties to the contract of sale. If the parties agreed to a certain degree of tolerance, the buyer should arrange to have this condition in the letter of credit so as to override the default 5% tolerance. In such case the applicant should expressly instruct the bank in the letter of credit that specified tolerances may be allowed. If the instructions are silent on this matter, there should be no tolerance. As shown above, there are plenty of

arguments speaking in favor of expanding the UCP definition of clean bill of lading so as to include notations regarding quantity.

## NEED TO REGULATE FRAUD

The existing divergence regarding the fraud exception creates legal uncertainty. For a trader from Japan or China, it may be puzzling to learn that the standards in the US are different from those in Canada or that English and Singaporean courts may adopt different approaches and standards.<sup>32</sup> Is it possible to adopt a general rule that would be acceptable to all?

The issue of fraud is absent from the UCP. This approach may be supported by a number of arguments, but there are also counter arguments speaking in favour of regulating fraud in the UCP700.

One simple and clear rule on fraud may be useful. The rule would simply state that a bank should not pay against fraudulent documents. This standard should be objective and it should not involve investigation of responsibility for fraud. Simply, when the fraud is proven and the bank obtains evidence that documents are fraudulent, the bank should reject payment. The UNCITRAL Convention on Independent Guarantees and Standby Letters of Credit, 1995 provides useful guidance.<sup>33</sup> UN LC Convention Article 19 provides that no payment is due when it is “manifest and clear that [a]ny document is not genuine or has been falsified”. This standard addresses the key issues related to fraud – it establishes an objective test and it does not require establishing the state of mind of the beneficiary which is the most controversial issue under the existing system. The bank should not be expected to undertake a fraud investigation to establish the identity of the party liable for fraud – that is beyond the bank’s mandate. If the fraud is manifest and clear, the bank should reject payment.

Despite convincing arguments speaking in favor of the need for rules on fraud in UCP700, there are also strong counter-arguments. One is related to the character of the UCP. Regulating fraud would go against the UCP’s core purpose. The role of the UCP is to state customs and practices, and not the law; the fraud rules are not based on customs and practices and it may be better to leave them to national laws. This argument has substantial weight, even though some of the UCP’s provisions may not be really based on uniform customs and practices.

Another serious obstacle is the lack of uniformity. Rules on fraud can hardly be construed as “uniform customs and practices”. They are not even uniform because

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<sup>32</sup> For example, such differences exist in case of fraud committed by a third party and not by beneficiary.

<sup>33</sup> For more details, see, P. Buckley & Xiang Gao, *The Development of the Fraud Rule in Letter of Credit Law: The Journey so far and the Road Ahead*, U. Pa. J. Int’l. Econ. L. (2002) 663, 707.

of divergent rules in various jurisdictions. National jurisdictions differ widely as to what constitutes fraud and the type of fraud required (eg. whether fraud in the transaction is a ground for refusing payment). Since courts will most likely want to preserve their own jurisprudence, there is a risk that they would disagree with a UCP formulation and thereby undermine the authority of the UCP.

The issue of regulating fraud by the UCP is delicate not only because of the nature of the UCP, but also because of differences among national laws. Adopting an objective standard of fraud may not be acceptable in jurisdictions that link the fraud exception to a subjective standard. Under the existing circumstances, it may be better to refrain from an attempt to regulate fraud in UCP.

## CONCLUSION

This paper attempted to demonstrate that some of the rules in UCP600 are not sufficiently clear, some are in conflict with the rules governing carriage by sea, and some may even facilitate fraud.

Several provisions of UCP600 are controversial. The omission of quantity from the definition of a clean bill is difficult to explain. This definition deviates from the rules governing carriage by sea as contained in all international conventions and national legislation. Another controversy is related to the legal effect of the "said to contain" type clauses which contradicts their legal effect under the carriage by sea rules; this misalignment of rules may even facilitate fraud.

Legal certainty and predictability are of essential importance in trade and laws should strive to achieve these goals. This paper has shown that the present text of UCP has failed to reach these goals in a number of provisions, some of which even create the opportunity for unscrupulous beneficiaries to abuse the system established by the UCP rules. While it may be possible to resolve some ambiguities by direct contacts and discussions among the parties, as a matter of principle it is better to minimize ambiguities, since the parties sometimes tend to exploit them violating the principle of good faith and fair dealing in international trade. Part of the problem is that some provisions of UCP rely on trust instead on verification. The way LCs function and the degree of their reliance on trust creates opportunities for those who are not to be trusted. This creates the risk of fraud and lead to problems that can be very difficult to resolve.

Revisions to UCP suggested by this text are aimed at remedying certain kind of problems. Suggested revisions would not be difficult to draft and would not cause serious problems in implementation. Of course, if the defects in UCP do not cause problems in practice there would be no incentive nor reason to make changes to the

text. It will be up to the drafters of UCP700 to make decisions about what is the best path the new UCP should take.

In order to improve the text of UCP, discussion is of essential importance. This also applies to ideas expressed in this text which were aimed at raising several questions. Would the proposals made here contribute to a more efficient use of UCP in practice? Could they reduce the risk of fraud? Would it be better to leave things as they are, or to make changes in the text of UCP? The answers to these questions can be obtained through meaningful discussion. The main objective of this paper is just to contribute to such discussion.<sup>34</sup>

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<sup>34</sup> I am aware that it may be difficult to get improvements of the UCP without actively taking part in the discussions. Being an outsider, I have decided to share my views in informal contact with the ICC Banking Commission and the reaction was receptive and positive. I was informed that some of my previous texts have been distributed by the ICC. I was also in contact with the ICC National Committee of Japan which has also shown an interest in my proposals. I hope that some of the ideas from this text may eventually be incorporated in the next revision of the UCP.

**Sažetak:**

**PRIJEVARA U PRIJEVOZNIM ISPRAVAMA  
PREMA JEDNOOBRAZNIH PRAVILIMA ZA DOKUMENTARNE  
AKREDITIVE: KONTROVERZE I MOGUĆA RJEŠENJA**

*Postoji jedan problem kojeg su svi vodeći tekstovi o dokumentarnom akreditivu propustili obraditi: manjkavosti u odredbama Jednoobraznih pravila i običaja za dokumentarne akreditive koje se odnose na prijevozne isprave. Ovaj tekst pokušava pokazati da odredbe Jednoobraznih pravila iz 2007. godine (UCP600) koje se odnose na definiciju čiste teretnice i pravni učinak klauzula tipa "said to contain" sadrže ozbiljne manjkavosti: obje ove odredbe su suprotne odgovarajućim pravilima koja se primjenjuju u prijevozu tereta morem, a osim toga mogu biti zloupotrijebljene u cilju dokumentarne prijevare. Glavna svrha teksta je da ukaže na postojeće probleme koji mogu proizaći iz navedenih odredbi teksta Jednoobraznih pravila, kao i da predloži rješenja tih problema. U završnom dijelu autor iznosi svoj stav o tome da li bi dokumentarna prijevara trebala biti regulirana u narednoj reviziji Jednoobraznih pravila.*

**Ključne riječi:** *dokumentarni akreditiv; prijevozne isprave; dokumentarna prijevara.*