



The Jordanian Bank's Compliance Practice on Custom and Letter of Credit

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Abstract

The Uniform Custom and Practice (UCP 600), has defined letter of credit as: "Any arrangement, however, named or described, that is irrevocable and thereby constitutes a definite undertaking of the Issuing Bank to honour a complying presentation". UCP 600 is subject to four main principles: Strict Compliance, Autonomy, Documents handling and virtue examination. This study aims to identify the fundamental principles governing letter of credit operation under the Jordanian Banks practice. Through a qualitative and doctrinal legal approach, this study analyses the organization of UCP 600 regarding the principle governing L/C and the extent to which Jordanian banks adhere to the principles of UCP 600. It also examines, via case approach the Jordanian court's approach towards this matter. The findings reveal that the Jordanian banks (Conventional and Islamic) with 100% are fully committed to the UCP. Moreover, this study also has found that Although Jordanian legislators did not regulate letters of credit operations under the commercial law, it can be noticed, based on the commercial law, that the autonomy principle is applicable in Jordan, even if it is applied in a different context.

I. Introduction

Letter of credit, whether conventional or Islamic, is governed by the Uniform Custom and Practice (UCP) rules, which stand for 'the uniform customs and practice for documentary credits (Othman et al., 2010). The UCP rules were issued by the international Chamber of Commerce (ICC). UCP rules are constantly updated and the latest version of the UCP is UCP 600 which was issued in 2007 (The Uniform Customs and Practice for Documentary, 2007). The UCP provides the most acceptable rules for letter of credit all over the world, as it provides a uniform mechanism for letter of credit transaction through the involvement of commercial and Islamic banks (Al-Ababna et.

al., 2014). Therefore, the UCP governs the application and operation of the letter of credit, although, it does not have any statute or legal force (Alwi, Sharifah Faigah Syed, Ibrahim, Uzaimah and Sawari, 2013).

The international Chamber of Commerce (ICC) issued the first version of the UCP in 1933. In 1962, the international Chamber of Commerce issued the second version of the UCP (Brochure No. 222). In 1974, the international Chamber of Commerce issued the third version of the UCP (ICC Publication No. 290) (Al Amaren, Emad Mohammad, Che Thalbi Bt Md Ismail, 2021). In 1983, it issued the fourth version of the UCP (ICC Publication No. 400). In 1993, it issued the fifth version of the UCP (ICC Publication No.500). The latest edition is UCP 600, which started to be implemented on the 1st July 2007 (Hashim, 2016).

UCP is subject to four main principles: Strict Compliance, Autonomy, Documents handling and virtue examination. In this study the researchers explain every one of these principles. A qualitative and doctrinal legal method is adopted through a descriptive and content analysis approach to examine the fundamental principles governing letter of credit operation under the Jordanian Banks practice. Furthermore, this paper has used a case approach by analysing the Jordanian court's approach towards this matter (Al Amaren, Emad and Ismail, Che and Nor, 2020).

The UCP 500 is comprised of 49 articles, whereas the UCP 600 (Drafting Group - Commission on Banking Technique and Practices 2006) only has 39 articles. The reduction in the number of articles does not translate to an easier interpretation of the UCP 600. Various experts and industry representative bodies are confused and in disagreement with some of the proposed provisions of the UCP 600. This is evidenced throughout the executive summary of the May meeting of the Commission on Banking Technique and Practice (Department of Policy and Business Practices, 2006), where comments from participants about the proposed rules amounted to more than 150 pages (Kreitman, 2006), and recent public media statements by industry bodies (International Federation of Freight Forwarders Associations 2006). The concern with this situation is that, despite the lack of unity of stakeholders involved in letter of credit transactions, the draft UCP 600 will be subject to "a „yes" or „no" vote at the ICC Banking Commission meeting to be held on October 24/25, 2006 solely based on the content of that draft" (Collyer, 2006). If the majority vote is positive, then the UCP 600 will take effect, most likely, from 1 July, 2007. Whilst the time frame for educational dissemination of the new rules may be acceptable, it is the content of the new articles that continues to cause concern for exporters, transport providers and insurers.

The Jordanian Civil Code is based on Sharia law and some elements of French Civil law that are consistent with Sharia principles. The Jordanian Sharia law has influenced many Arabic countries such as the United Arab Emirates, Sudan and Kuwait (Corre, 2000). Jordan is the researcher's home jurisdiction where he practices law and has contacts. The Jordanian jurisdiction system is a hybrid system of Civil law and Common law. Thus, it is based on formal codes and precedents of the highest court (i.e. Court of Distinction).

Only the decisions of the Court of Distinction, (which is known in France and Egypt as the Court of Cassation but is referred to in this research as the Court of Distinction, since it is the correct translation from Arabic), are binding on all courts (Zoaby, 2008). The Court of Distinction is not an appeal court for factual disputes, but rather it is an appeal court for disputes in respect of the position at law. However, as a matter of documentary credit's law, Jordanian law has few detailed and precise rules dealing with documentary credits, and it is – as are other Arabic laws - currently heavily reliant on a single out of date commentary text. In the context of documentary credits, English common law is a hegemonic legal order that influences many legal orders including Jordanian law and the UCP itself (Hwaidi, 2015). The fact that Jordanian law is a hybrid legal order enhances its ability for the adaptation of hegemonic foreign functional doctrines (Plessis, 2006).

This of course sets the platform of how Jordanian doctrines interact with such objective needs and interests in responding to documentary credit issues. The benefit is to postulate functional doctrines as to the legal positions under Jordanian law. Also the empirical analyses inform the conceptual model particularly in respect of the various objective needs of documentary credit parties with emphasis on the Jordanian banking community.

II. The Uniform Custom and Practice (UCP 600) Main Principles

A. The Principle of Documents Handlings

Letter of credits are designed to facilitate the absolute certainty level needed in letter arrangement. Any attempt to involve the issuing bank in any of the performance problems in the underlying sale contract between the buyer and seller, definitely disturbs the absolute nature of the payment obligation by the bank towards the seller. Therefore, letter of credit is a transaction, which depends entirely on documents (Thier, 1981).

Article 2/4/1 of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) sharia standard for letter of credit stated that “Dealing in documentary credit takes place on the basis of the documents alone and is executed without reference to the goods” (AAOIFI, 2017).

Furthermore, article 5 of the UCP 600 states: “Bank deals with documents and not with goods, services or performance to which the documents may relate” (The Uniform Customs and Practice for Documentary (UCP 600), 2007).

Clearly, article 5 of the UCP 600 states that letter of credit is based solely on the documents (Chatterjee, 2015). Even, in cases in which disputes raise between the buyer and seller on goods, services or performance under the sale contract, the bank is still obligated to pay the value of the goods if the later finds that the documents are in a compliance with terms and condition of the credit (Che Hashim et al., 2012). The researcher concludes that all parties in letter of credit

transaction (buyer, seller, issuing bank), are concerned with the documents that represent the good and not the good itself.

This could be seen clearly, in article 7/a of the UCP 600, which says: “The stipulated documents are presented to the nominated bank or to the issuing bank, and as long as they constitute a complying presentation, the issuing bank must honor” (The Uniform Customs and Practice for Documentary (UCP 600), 2007).

According to article 7/a of the UCP 600, documents submitted by the seller are the only reason for banks to pay the value of the credit or not. Hence, Jordanian seller is recommended to know, study and prepare the documents needed to activate the payment. Sometimes requesting for excessive numbers of documents or long description and detailed documents could lead the Jordanian seller to face the risk of rejection. Nevertheless, there was a famous case in 1991 (*Bankers Trust Company v State Bank of India*, 1991), where 967 documents were requested to be presented by the seller according to the credit terms and condition (Hashim, Rosmawani Che; Othman, 2011).

In other words, for the issuing, conforming or nominating bank to activate payment, they should only consider the submitted documents. While, the condition of the goods is out of the bank consideration. This is because the bank is not a part of the underlying sale contract concluded between the buyer and the seller, according to article 4/a of the UCP 600.

B. The Doctrine of Strict Compliance

Article 18/c of the UCP 600 highlights the elements of the doctrine of strict compliance. It states that: “The description of the goods, services or performance in a commercial invoice must correspond with the one that appears in the credit”.

This article expressly requires that all the information in commercial invoice must comply with the terms and conditions of letter of credit.

Strict compliance doctrine indicates that, the obligation of the issuing, conforming or nominating bank to honour the payment takes place only after the beneficiary presents documents in a compliance with the terms and condition stipulated in the credit (Alavi, 2017). Furthermore, the origin of strict compliance principle has developed from the general principle of the agency theory, which indicates that the individual who acts as an agent has the right of reimbursement from his principal only if he/she acts in accordance with the principal instructions. Hence, the issuing bank according to agency theory receives reimbursement from the applicant after he performs his obligation in honouring the credit against complying documents.

The reason behind the existence of the doctrine of strict compliance is to protect the interests of the applicant in letter of credit because letter of credit

process requires first the shipment of the contracted goods by beneficiary before honouring the payment.

Another reason behind the existence of the principle of strict compliance in letter of credit transactions is that, banks are not normally experts in goods. In most cases, the bank does not know what exactly the contracted cargo between the parties is. This is in consistent with the virtue examination principle which does not oblige the bank to look beyond the virtual match of the documents.

As it is stated above, the principle of strict compliance indicates that presented documents should be in a compliance with the terms and condition of the credit. "reasonable care" which was a term in former version of UCP (500) has been deleted in UCP 600. This shows for the first glance that strict compliance is only the main criteria for reimbursement of a bank by the applicant (Alavi, 2017). Nevertheless, reading word by word, strict compliance is not fully required by UCP 600. Majority of time, the non-essential, typographic mistakes and minor defects are not considered as incompliance through the examination of documents.

In Jordan, The Jordanian court of cassation stated about the principle of strict compliance in the case No.1050/2006 the following; Since the L/C is subject to the lawsuit, it can be amended with the agreement of all the parties. The conclusion is that the correction of the errors in the L/C about the specific weight of the corn material to follow the terms of sale between the plaintiff and the defendant does not constitute an amendment in the sense to be agreed between all parties. It is a material error that does not make an impact if the plaintiff knows that the specific weight of corn is 58 and not 57.

By analyzing the decision No.1050/2006 of the Jordanian Court of Cassation, it is clear that the Jordanian Court of Cassation clarified the standard of conformity in the documents, as the standard used is substantial compliance and not strict compliance. The court decided to overlook some material errors that do not affect the commercial process, based on prior knowledge of the parties about the required specifications of the goods and that the change that occurs does not affect the quality or quantity of the goods. The Jordanian Court of Cassation sees that this is an irrelevant irregularity with no effect on independence principle and strict compliance principle.

Another case took place in Iran. The letter of credit stipulated that all submitted documents should contain the credit number and buyer's name. Nevertheless, one of the submitted documents by the seller did not contains the credit number and buyer's name. The Lloyd LJ pointed out that the bank has the right to reject the presentation, but the seller argues that the absence of the credit number and buyer's name are not essential elements of the document (Alavi, 2017). By applying the test established by the Iranian courts regarding the

compliance of the documents, letter of credit process would be slower and not effective due to this an irrelevant irregularity with no effect on principle of strict compliance. What really courts have to look is the material and fundamental discrepancies that directly affect the authenticity of the documents and their compliance with the credit terms and conditions.

Flexibility is one of the most notable features in current commercial transactions. For that, courts nowadays attempt to differentiate between simple discrepancies and essential discrepancies in letter of credit in order to decrease the rejection rate of letter of credit. Hence, discrepancies in letter of credit can be divided into two categories: irrelevant irregularities with no effect on strict compliance doctrine, and material or genuine discrepancies which involve a violation to the doctrine of strict compliance and which will be resulted in the rejection of submitted documents by the bank (Alavi, 2016).

Based on the international standard banking practice (ISBP) and the uniform customs and practice for documentary credits (UCP), the bank is the only party in the transaction chain that determines whether the presentation complies with the terms and conditions of the letter of credit or not.

All Jordanian banks (Conventional and Islamic) with 100% follow the rigid strict compliance. From the interviews that the researcher conducted with the Jordanian banks, Jordanian banks do not distinguish between irrelevant irregularities and material or genuine discrepancies as they follow a rigid compliance only. Furthermore, all answers that the researcher collected about whether the bank follow strict compliance or apply a substantial compliance, were almost the same, that is, rigid strict compliance is only applied.

Conforming what Housing Bank for Trade and Finance stated above, the house of lord in England in 1927 developed a statement regarding the bank's duty in examining the documents linked with strict compliance principle, in which it stated the following; "There are no room for documents which are almost the same, or which will do just as well". In general terms, banks cannot concentrate on goods and ignore the documents. As banks do not have enough knowledge and experts to check the validity of the goods, and further, it cannot outline the terms and conditions of the sale contract between the buyer and the seller.

Through analyzing the Jordanian banks - Islamic and conventional - practice, it's clear that the Jordanian banks follow seems not identical to what the UCP 600 stipulated regarding checking the documents. It is obvious that Jordanian banks do not follow what the UCP 600 stipulated regarding the role of banks to accept or reject the documents as they rely on the acceptance of the applicant on the discrepancies in the documents. Although of this contradiction with the UCP 600, from the researcher point of view, this practice followed by

Jordanian banks is safer for their position in the transactions and would avoid them to involve in any future litigation with the applicant. The strict compliance doctrine, which harmonies with the autonomy principle of the letter of credit, means that the beneficiary must comply with the documentary requirements laid down in the letter of credit, far away from the goods which the documents represent.

C. The Doctrine of Autonomy

The third fundamental principle that governs letter of credit process is the principle of autonomy. The principle of autonomy is the running engine (Alavi, 2017), central (Mann, 2000), backbone (Davidson, 2003), cornerstone and foundation (Buckley, 2003) behind letter of credit transaction. Moreover, it is demonstrated as equal as 'cash in hand' (Hashim, Rosmawani Che; Othman, 2011). In terminology science, autonomy term is defined as self-governing. The autonomy term roots are from a Greek word, '*Autonomia*' which means 'independent' (Collier, 1999).

Autonomy in letter of credit context means that the bank's obligation is separated and independent from the base contract between the buyer and the seller. The essence of letter of credit contract prohibits the bank from interfering in the underlying contract between the buyer and the seller (Hashim, Rosmawani Che; Othman, 2011). In simple words, letter of credit is just a method of payment which is solely concerned with documents only, and their compliance is the main condition to activate the payment in the favor of the beneficiary.

Further, autonomy principle is one of the fundamental features under the law of letters of credit (Buckley, 2003). Article 4/a of UCP 600 states that; "A credit by its nature is a separated transaction from the sale or other contracts on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference is included in the credit. Consequently, the undertaking of a bank to honor, to negotiate or to fulfil 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 the beneficiary" (Uniform Custom and Practice, 2007).

Under the US law, autonomy principle is regulated in article 5-103/d of the UCC (Uniform Commercial Code (UCC)). Furthermore, autonomy principle is recognized under the United Nation Convention on independent guarantees and standby letters of credit (United Nations Convention on Independent Guarantees and Standby Letters of Credit, 1996).

In one hand, the beneficiary benefits from autonomy principle stipulated in article 4/a of UCP 600, that he/she has a guarantee that enables him/her to obtain payment from the bank depending solely on the submitted documents.

Explicitly, banks cannot refuse to honour the presentation due to reasons related to the performance of the sale contract. Hence, even if the beneficiary does not perform his/her obligation under the underlying contract, the issuing bank has to pay the value of the goods to the beneficiary after presenting the complying documents. Then, the applicant has to seek remedy by litigating him/her for the breach of the sale contract. On the other hand, the bank benefits from autonomy principle in that it is not trapped in any disputes raised between the account party and the beneficiary under the sale contract.

The independent nature of the bank's obligation combined with the strict compliance principle in letter of credit represent the lungs through which letter of credit breathes, and give it the two feet, to stand among other payment methods, and to be the most valuable payment method in international trade.

In Jordan, the legislators did not regulate letters of credit operations under the commercial law. One of the reasons behind that is the absence of the use of letter of credit in Jordan when the commercial law was drafted in 1966. Remarkably, article 121 of the Jordanian commercial act number 12 of the year 1966, stipulated a general reference to financial credits as follows: "If a financial credit is issued to guarantee a second party's rights and the bank in its role authorizes such a credit, withdrawal or amendment to this credit is no longer legal without authorization from the second party in question. In such a credit, the bank is obligated to execute the credit once the documents are submitted".

Although Jordanian legislators did not regulate letters of credit operations under the commercial law, it can be noticed, based on article 121 of the commercial law, that the autonomy principle is applicable in Jordan, even if it is applied in a different context. Article 121, represents the notion of the autonomy doctrine in Jordan, even if it is not intended to be applied in letter of credit.

Regarding the Jordanian judiciary position towards autonomy principle, it is obvious that the Jordanian judiciary has expressly applied the principle of independence in different cases heard by the Jordanian courts, such as; decision number 1554/1999 issued by the court of cassation, which expresses that: The bank's obligation in letter of credit is independent and is separated from the underlying sale contract between the account party and the beneficiary.

It is obvious from analyzing the Jordanian banks practice that, all Jordanian banks (Conventional and Islamic), have applied the principle of independence in all letter of credit transactions.

III. The Principle of Virtual Examination in Letter of Credit

The fourth and the last fundamental principle that governs letters of credit process according to the uniform customs and practice about documentary credits is the principle of virtual examination. The principle of virtual examination stands for the obligation in

which the bank checks the presented documents by seller (Al-Ababna, Mahmoud and Al-Nosour, 2014).

As it is stated above, in letter of credit transaction, the seller (beneficiary) has to submit documents to the bank. In its turn, the bank examines the submitted documents to determine, solely on documents, whether the documents are in a compliance with the terms and condition of the credit (Krazovska, 2008).

The standard for the examination of documents has been set in article 14 of UCP 600 :“A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank must examine the presentation to determine, based on the documents alone, whether the documents appear, to constitute a complying presentation”.

Further, Article 14/d provides: “Data in a document, when read in context with the credit, the document itself and international standard banking practice, do not need to be identical, but must not conflict with data in that document, any other stipulated document or the credit” (Uniform Custom and Practice, 2007).

International standards for banking practices related to the examination of documents (ISBP) should be taken into account, as well as, the UCP 600, which is issued by the International Chambers of Commerce. This publication and the UCP should be read in their entirety and not in isolation. This publication has evolved into a necessary companion to the UCP for determining compliance of documents with the terms of letters of credit (The Uniform Customs and Practice for Documentary (UCP 600), 2007).

Any statement in a document in any circumstances, does not have to be exactly the same, but at the same time, it should not conflict with the data in that document, or in any other required document or with the credit. The bank has to examine all the documents stipulated in the letter of credit contract, based on the documents alone, in order to ascertain whether their appearance conforms to the terms of the credit (Al-ekhesherwem, 2009). The standard adopted by the UCP and ISBP is not the standard of strict conformity of the documents.

The purpose of the examination is to look carefully at the details, and the deep examination that is done by a bank certified and specialized on the criterion of examination with normal logical care. The purpose of the examination is to confirm to the bank that the documents are identical, and the examination will not lead to this confirmation unless it is so deep that the bank makes sure that the documents appear to be identical to the credit. The statement “on its face” in fact belongs to the documents, not the examination, and this is the correct interpretation of the text.

The Jordanian court of cassation has expressed the role of the bank about the virtual examination of the documents through several decisions issued by it, such as decision No 2653/2002 which expresses the principle of virtual examination by saying: The bank's obligation is to examine the documents submitted to it by the beneficiary. The failure of one of the conditions of letter of credit, even in one paper, must lead to the rejection of all documents by the bank including the documents that are not defective. The reference

in the examination of documents are three points; the first is the conditions of the credit itself, because in some cases the customers except some of the prescribed material, the second is the UCP 600 and the third is the ISBP.

It is obvious from analyzing the Jordanian banks practice that, all Jordanian bank (Conventional and Islamic) applied the principle of virtual examination and they strictly follow the UCP 600 and ISBP in that matter.

IV. Conclusion

This study has found that of all Jordanian banks (Conventional and Islamic), 100% are fully committed to the UCP. Furthermore, this study found that all Jordanian banks follow rigid, strict compliance. Jordanian banks do not distinguish between irrelevant irregularities and material or genuine discrepancies as they follow rigorous compliance only.

Moreover, this study has found that all Jordanian banks applied the principle of independence and virtual examination, and they strictly follow the UCP 600 and ISBP. In this matter, and when the banks receive the documents from the seller, they consider several conditions: The documents are submitted during the period of validity of the credit, all the documents specified in the contract have to be submitted to the bank, the documents are the same as stipulated in the contract, and there is no conflict between these documents.

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