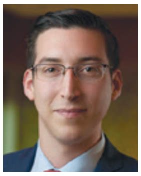
LC Beneficiaries Beware: Failing to Comply Strictly with Documentary Requirements May Leave You Empty Handed

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Letters of credit are an important risk mitigation tool for trade creditors seeking to ensure payment for the goods or services they sell to their customers. A letter of credit (LC) issuing bank must pay the LC beneficiary (creditor) if or when the beneficiary presents all of the documents required for payment under the LC.

One of the central tenets of LC law is the doctrine of strict compliance. A beneficiary seeking payment of an LC must strictly comply with all of the LC's documentary requirements. As illustrated by the recent decision of the U.S. District Court for the Eastern District of New York (District Court), in *MAM Apparel & Textiles Ltd. V. NCL Worldwide Logistics USA, Inc.* (*MAM Apparel*), an LC beneficiary that fails to present all of the documents required by an LC risks nonpayment of its LC draw. Bottom line: The strict compliance requirement regarding a beneficiary's presentment of documents to an issuing bank for review and payment of an LC draw should not be taken lightly.

Overview of Letters of Credit

Trade creditors frequently rely on LCs to facilitate payment of their claims or as a backstop to protect them from a default in their transactions with their customers. An LC arrangement typically involves three parties and three independent contracts.

The first contract is between the creditor and the customer, often arising out of the sale of goods or provision of services to the customer. A seller may require its customer to apply for and obtain an LC in the seller's favor as a condition to selling goods or providing services on credit terms.

The second contract is between the bank and the purchaser of goods or services, where the purchaser applies for and the bank agrees to issue an LC. This contract includes the terms governing the LC, the applicant's obligation to reimburse the bank for the bank's payments to the beneficiary upon the presentation of conforming documents, the collateral securing payment of the applicant's reimbursement obligation to the bank, and all fees and other charges in connection with the LC that the applicant owes to the bank.

The third contract is the LC that a bank issues in the beneficiary's favor (in this context, the goods seller or service provider). When a beneficiary submits documents to the issuing bank, the bank's only duty is to examine the documents and determine whether they comply with the LC's documentary requirements. When an issuing bank determines that the beneficiary has presented all of the documents the LC requires, the bank must pay the amount requested by the beneficiary. If the bank rejects a beneficiary's presentation of conforming documents, the bank is in breach of its obligation to pay on the LC and is subject to the beneficiary's assertion of a wrongful dishonor claim.

Each of the three contracts in an LC transaction is independent of one another. As a result, an issuing bank must honor the beneficiary's request for payment where the beneficiary presents all of the documents required by the LC, regardless of the existence of disputes between the seller/beneficiary and the customer/applicant in their underlying transaction, and/or between the customer/applicant and the issuing bank, including the customer's/applicant's inability to reimburse the issuing bank for all sums due with respect to an LC. And if the issuing bank makes payment to the beneficiary based upon the beneficiary's presentation of noncomplying documents, the bank's customer/applicant is not obligated to reimburse the bank for that payment.

There are two types of LCs. The first is a documentary or commercial LC, where the LC beneficiary looks solely to the bank for payment. This type of LC is frequently used in international trade and was at issue in the *MAM Apparel* case. The documents that a beneficiary must present usually include invoices, shipping documents, packing lists, insurance-related documents and other documents evidencing the beneficiary's sale and delivery of goods or provision of services to the customer/applicant.

The second type of LC is a standby LC. Unlike a documentary or commercial LC, the beneficiary of a standby LC must first look to its customer for payment. A standby LC serves as a backstop for the customer's obligation to pay the beneficiary. The beneficiary can draw on a standby LC if the purchaser fails to timely pay its obligations to the beneficiary. As such, a standby LC should contain simpler documentary requirements than those contained in a documentary LC. These requirements can be as simple as the beneficiary presenting a statement to the issuing bank that the customer/applicant has outstanding indebtedness to the seller/beneficiary.

The *MAM Apparel* decision involved a beneficiary's wrongful dishonor claim, and, therefore, focused on whether the beneficiary had presented documents to the issuing bank that complied with the LC's documentary requirements. If the beneficiary presents documents that comply with the LC, then the bank must pay the beneficiary. However, if the documents do not comply, the bank must timely notify the beneficiary of the noncompliance and cannot make payment to the beneficiary (unless the applicant agrees to waive the discrepancies and the bank has no issue with making payment). Most courts follow the strict compliance standard in determining compliance: The presented documents must strictly comply with the LC's documentary requirements before the issuing bank is required to pay the beneficiary. The *MAM Apparel* case serves as an important reminder of the impact of the strict compliance standard because the *MAM Apparel* Court rejected the beneficiary's wrongful dishonor claim and upheld the issuing bank's refusal to pay LC draws as a result of the beneficiary's failure to present conforming documents.

Background of the *MAM Apparel* Decision

MAM Apparel & Textiles Ltd. (MAM) is a foreign corporation that conducted business in Bangladesh. In or around February 2017, MAM received an order from its customer, Express Trade Capital, Inc. (Express), to purchase approximately 69,000 pieces of apparel in two shipments, totaling $96,530.25. MAM and Express negotiated for the issuance of an LC issued by Bank Leumi USA (Bank Leumi) for MAM's benefit as the means for payment of the purchase price for the goods. Thereafter, MAM had timely delivered the apparel to Express in two separate shipments.

The LC provided for payment to MAM, as beneficiary, upon the presentation of the following documents: (1) a commercial invoice; (2) an ocean bill of lading; (3) a signed telefax; and (4) an authenticated SWIFT message stating that an authorized representative had inspected the goods prior to shipment and authorized the shipment. The LC also was governed by UCP 600, the latest version of the Uniform Customs and Practice for Documentary Credits, a set of rules established by the International Chamber of Commerce to govern LCs.

On April 9, 2017, MAM (through Basic Bank, MAM's advising bank in Bangladesh) sent Bank Leumi a bill of exchange, commercial invoice, packing list, air way bill, inspection certificate, and certificate of origin, with originals and copies, for the first shipment to Express. Approximately five calendar days later, on April 14, 2017, Bank Leumi sent a SWIFT network message to Basic Bank identifying discrepancies in the documents presented and did not pay the LC draw. Specifically, Bank Leumi stated that copies of a telefax and authenticated SWIFT message were not presented, the inspection certificate did not conform to the LC's requirements, and the air way bill evidencing shipment by air did not comply with the LC, which required presentation of an ocean bill of lading.

On April 17, 2017, MAM (again through Basic Bank) transmitted documents for the second shipment that were substantially the same documents MAM had presented for the first shipment, despite the discrepancy notice Bank Leumi had presented with respect to the first shipment. Approximately eight calendar days later, on April 25, 2017, Bank Leumi sent to Basic Bank a substantially similar SWIFT message, which indicated that the documents presented for the second shipment also were nonconforming, and also did not pay the LC draw.

On May 16, 2017, Basic Bank sent a SWIFT message to Bank Leumi inquiring about the payment status of the LC. Bank Leumi never replied; and on May 23, 2017, the LC expired. On June 16, 2017, Bank Leumi advised Basic Bank that it was discharging the LC and returning the shipping documents for both shipments, without having disbursed any funds to MAM.

On June 27, 2019, MAM filed a complaint that asserted wrongful dishonor and fraud claims against Bank Leumi. On October 25, 2019, Bank Leumi filed a motion to dismiss the complaint, contesting MAM's wrongful dishonor claim because MAM did not present conforming documents (in order to prove a wrongful dishonor claim, the plaintiff must provide evidence of presentation of conforming documents), and also argued that MAM had failed to adequately plead any fraud-based claim. MAM opposed dismissal of the complaint, contending it had provided conforming documents, and that Bank Leumi had "shirked its responsibilities" by failing to adequately and timely notify MAM of Bank Leumi's dishonor of the LC draws and ignoring communications from MAM and Basic Bank until after the LC had expired.

The District Court's Opinion

The District Court concluded that MAM did not present conforming documents to Bank Leumi and that Bank Leumi had timely and properly notified MAM about the discrepancies, and thereby granted Bank Leumi's motion to dismiss MAM's complaint. The District Court noted that MAM had presented an air way bill instead of an ocean bill of lading, as the LC required. Additionally, MAM did not submit the required signed telefax and authenticated SWIFT message and inspection certificate as the LC required. As a result, the documents MAM had submitted to Bank Leumi as part of MAM's LC draw did not strictly comply with the LC's documentary requirements. Though the District Court acknowledged exceptions to the strict compliance standard for "minor variations," such as for immaterial typographical errors, the discrepancies in the documents MAM had presented were not minor—MAM had failed to present all of the documents the LC had required. As a result, MAM could not prove its wrongful dishonor claim.

The District Court also rejected MAM's argument that Bank Leumi had failed to provide timely notice of dishonor of MAM's draw based on the noncompliant documents presented. The District Court noted that under the UCP 600, Bank Leumi was required to send notice of dishonor to MAM and to identify the applicable discrepancies within five banking days after MAM's presentation of the documents. The notice provided with respect to the first shipment was clearly sufficient, since the documents were sent to Bank Leumi on April 9, 2017, and Bank Leumi timely sent MAM a SWIFT message to notify MAM (through Basic Bank) of the discrepancies five calendar days later, on April 14, 2017. With respect to the second shipment, the District Court held that presentment occurs when the presented documents are actually *delivered* to the issuing bank; therefore, the District Court inferred based on the LC's overnight delivery requirement that the documents that MAM had sent on April 17, 2017, were *presented* on April 18, 2017. As a result, the District Court concluded that Bank Leumi's April 25, 2017, SWIFT message notifying MAM/Basic Bank of the discrepancies was sent timely, within five banking days.

Finally, the District Court held that MAM's fraud allegations were wholly conclusory and were not pled with any particularity. As the District Court concluded, "Nonpayment occurred at the fault of [MAM]."

Conclusion

The *MAM Apparel* decision illustrates the risk of an LC beneficiary's failure to strictly comply with an LC's documentary requirements. The decision also illustrates that the burden of any noncompliance will fall squarely on the beneficiary's shoulders if the issuing bank properly and timely provides notice of the noncompliance to the beneficiary. Even if a court potentially may make exceptions for extremely minor discrepancies, a creditor/beneficiary should not count on that as a life raft. When entering into an LC transaction, a creditor/beneficiary should be able to comply strictly with the LC's documentary requirements when presenting documents to the issuing bank for payment. Otherwise, the LC beneficiary risks being left empty handed without receiving any payment under its LC.