

A Study on the Problems and Countermeasures Relative to Negotiation Clause under L/C Transactions in the UCP 600

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Abstract

Purpose – The UCP is recognized as the governing law for L/C transactions, but it covers only the general details of the transaction and does not cover all complex practices. In view of this limitation, this paper examines a negotiation transaction which is most actively utilized in L/C transactions via a thorough review of the UCP provisions, analyzes the problems of the negotiation clause in the UCP, and suggests appropriate countermeasures to deal with unnecessary litigation costs. By doing so, the parties involved in the negotiation transaction would be able to avoid financial costs such as having to pay for lawsuits.

Design/methodology – The present study first differentiates the general types of L/Cs (e.g., sight payment L/C, deferred payment L/C, acceptance L/C, and negotiation L/C), explains and the Article 2 and Article 12(b) of the UCP 600 where the term ‘negotiation’ is used, digs into the drawbacks of ‘negotiation’ occurring under the UCP 600, and discusses solutions to the problems found by analyzing the drawbacks descriptively.

Findings – After a review of the UCP provisions on negotiation in detail, several possible problems which may occur in practice were discovered. First, as the UCP stipulates, the negotiating bank will want to delay payment to the maximum extent possible and make payment on the banking day on which the issuing bank reimburses the amount. This may lead the beneficiary towards bankruptcy or put it in financial crisis. Second, when a fraudulent transaction occurs, the negotiating bank can neither request the issuing bank to reimburse nor can it exercise its recourse right against the beneficiary because it has obtained all the rights of the beneficiary by purchasing the documents. Third, there is a practice in which the beneficiary sells the documents to its transaction bank which is not the nominated bank if the nominated bank specified in the credit is located in a third country or the exporter has no relationship with the nominated bank in the credit. In this case, whether to accept this and reimburse the non-nominated negotiating bank entirely depends on the issuing bank’s decision even though such practice frequently occurs in Korea.

Originality/value – There has been little research effort pertaining to negotiation transactions in detail even though negotiation L/C transactions account for around 70% in world trade notwithstanding deferred payment L/Cs and acceptance L/Cs that are also negotiated in practice. Thus, if the negotiations clause under the UCP 600 provisions were reviewed and the drawbacks of the negotiation transactions most actively used in L/C transactions were identified and examined, specific countermeasures could ultimately help smoothen the operation of L/C transactions and prevent financial losses.

Keywords: Letter of Credit, L/C Transaction, Negotiation, UCP 600

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1. Introduction

According to a press release by the Ministry of Trade, Industry and Energy (MOTIE) (2019), Korea's exports in 2018 registered at U.S. \$650.5 billion, exceeding \$600 billion for the first time in history, and ranked 6th in the world in terms of export volume. Despite being ranked 107th in land area and 27th in terms of population, that Korea became the 6th largest exporting country in 2018 was the result of our unceasing effort to produce and export new commodities while overcoming its weakness of having insufficient underground natural resources. In the case of exporters, even if they produce and export excellent products, such efforts will be meaningless if they cannot recover the export costs from the importer. Therefore, the L/C method which is regarded as a safer means of payment than a T/T (Telegraphic Transfer) is selected in order to safely recover the export costs (Chung Yong-Kyun and Jeong Jae-Yeon, 2013).

'Negotiation' is a financial instrument that allows early recovery of export costs. Negotiation under L/C transactions can be utilized not only in negotiation L/Cs, but also for sight payment L/Cs, deferred payment L/Cs, and acceptance L/Cs. Such negotiation transactions have advantages for both exporters and negotiating banks. From an exporter's point of view, he would want to increase productivity and cash liquidity by selling the bill of exchange and/or documents to its bank or the nominated bank even if interest during the period of credit is deducted. Also, from a bank's point of view, there is no reason for it to reject to purchase the bill of exchange and/or documents submitted by the exporter because it could be a main profit source where the bank can earn interest until maturity. In fact, banks purchase bills of exchange and/or documents regardless of the type of L/C in practice (Chae Jin-Ik, 2012).

Letters of credit were not designed by lawyers, but by merchants who actually use them (Byrne, 1991). The Uniform Customs and Practice for Documentary Credits (hereinafter referred to as UCP) established by combining practices in different nations, is recognized as the governing law for L/C transactions, but it covers only the general details of the transaction and has the limitation of not covering all complex practices. For this reason, when disputes arise between trading parties, such dispute will eventually be resolved through the courts, and it is extremely difficult to assume responsibilities between parties living in different countries (Kim Won-Bae, 1999). In addition, after the lawsuit is filed, the extent of the damage can neither be predicted nor can the business relationship between the two be recovered. In this sense, if we consider the negotiation transactions most actively used in L/C transactions, examine the drawbacks of the negotiation clause under UCP recognized as the governing law of L/C transactions, and suggest appropriate countermeasures to such problems, financial losses such as lawsuit costs can be avoided and thus, countermeasure can be undertaken to help smoothen trade operations via L/C transactions.

Therefore, this paper examines the negotiation clause and general matters related to negotiation under the UCP 600 in Chapter 2, analyzes the problems of the negotiation clause in Chapter 3, and come up with the solutions to the problems presented in Chapter 4. This paper expects to contribute to the extant literature by unearthing challenges of negotiation in practice and provide a clue to the perfect revision of the UCP 700 expected to be revised soon.

2. Literature Review and General Consideration on Negotiation

2.1. Literature Review

Usance L/C is highly preferable for importers as he/she doesn't have to settle right away. In addition, there is an advantage in that exporters can recover the export cost early by selling

the draft drawn under L/C transaction to its transaction bank or the nominated bank by the issuing bank. As a matter of fact, there is no reason for the bank purchasing the draft and/or documents to refuse this because it is a major source that can earn interest until the maturity, and in reality, banks purchase the draft and/or documents regardless of sight or usance (Choi Seok-Beom, 2017).

In order to prevent the disputes regarding negotiation, Choi Seok-Beom (2017) analyzed the relating clauses to 'negotiation' in the UCP 600 and took a deep look into the problems and solutions. The problems he came up with his study were, first, it is not clear whether the confirming bank is obliged to negotiate when requested, second, it is not crystal clear whether negotiation could occur under acceptance L/C transactions, third, it is not provided in the UCP whether the negotiating bank could exercise its right recourse, last, it is necessary to specifically define the terminologies as to the freely negotiable L/C.

Kim Dong-Chun (2019a), in his study, examined the meaning of negotiation defined in Art. 2 and 12 of the UCP 600. He concluded that first, in order to meet the requirement of 'negotiation' four conditions must be met, second, banks can even purchase deferred payment undertaking (DPU) freely, third, the beneficiary under acceptance L/C has two choices for recovering payment, which are by discounting the draft accepted or selling it to banks.

Han Sang-Hyun (2011) studied the legal relations of concerned parties under Third Party L/C, and suggested the counter measurement for Issuing Bank. As applicant and applicant who appears in L/C differ under third party L/Cs, the issuing bank must thoroughly confirm discernment of transaction before issuing L/C. In addition, he stated that the issuing bank must judge applicant's confidence and prepare sufficient preventive measure for collection when issuing third party L/C.

Kang Jin-Wook (2017) thoroughly analyzed a Japanese court case in which the issuing bank refused to honour L/C transaction. He claimed that when a nominated bank acting on its nomination or the issuing bank can refuse to honour the L/C under negotiation when a presentation is not complying with the terms and conditions of the L/C. Especially, when a fraudulent arises when negotiating, it is necessary to take a legal proceeding as agreed in the contract.

There has been a lot of researches regarding L/C transactions such as Kim Cheol-Soo (2014), Kim Dong-Chun and Nam Kyung-Doo (2018), Kim Dong-Yoon and Lee Yang-Kee (2016), Kim Sun-Ok and Kwak Young-Sik (2014), Kwon Seung-Ha and Park Keun-Sik (2018), Lee Shin-Kyuo (2017), Park Sae-Woon (2013) and Park Suk-Jae (2019) so forth and so on.

2.2. L/C Types Categorized by UCP

In Article 6(b) of UCP 600, a letter of credit is classified into four types and these are sight payment L/C, deferred payment L/C, acceptance L/C or negotiation L/C according to availability of use. Sight payment, deferred payment, and acceptance L/C fall within the category of 'honour' and negotiation is defined separately. When issuing L/Cs through SWIFT MT700, the availability of use must be specified in section 41a, which determines the payment method. SWIFT MT700 41a indicates which banks are available with and how the credit is available by. Therefore, one of these choices [BY ACCEPTANCE / BY DEF PAYMENT / BY MIXED PAYMENT / BY NEGOTIATION / BY PAYMENT] must be selected. This is a mandatory section, and it determines the types of credit which are acceptance L/C, deferred payment L/C, mixed payment L/C, negotiation L/C, and sight payment L/C (The Society for Worldwide Interbank Financial Telecommunication (SWIFT), 2016). These four L/Cs (except for the mixed payment) are classified again into sight payment L/C and usance L/C based on the time of settlement.

2.2.1. Sight Payment L/C

Sight payment means a letter of credit is available by sight payment, under which once the documents complying with the terms and conditions of the credit are presented to the nominated bank (the paying bank), a certain amount is paid in return for those documents. The issuing bank or the bank nominated by the issuing bank (e.g., the main, branch or depository bank of the issuing bank) examines the documents presented by the beneficiary and pays them immediately if they meet the terms and conditions of the credit. Under a sight payment, the nominated bank (the paying bank) does not request the issuing bank for reimbursement. In other words, the paying bank does not pay the beneficiary first and then request the issuing bank for reimbursement later, but withdraws the amount of money from the issuing bank's account right away and deliver it to the beneficiary. Thus, the role of the paying bank is to directly deliver the money to the exporter (Jeon Soon-Hwan, 2013).

Even though UCP 600 uses the term 'sight payment', it doesn't account for what it exactly means. This term seems to be borrowed from the practice in which negotiable instruments are used and its origin is a draft whose tenor is at sight. However, unlike the other terms adopted from the negotiation instrument law, the meaning of 'paying at sight' is somewhat different than 'sight demand draft' (Byrne, 2010). While payment 'at sight' originally refers to presenting the documents at the bank's counter and waiting for the decision to pay or not to be made, in L/C practice now the beneficiary must wait until the bank examines whether or not the documents comply with the credit.¹ It is a rare case where the bank immediately decides to pay or not at the moment of presentation. Moreover, even if the documents are refused by the issuing bank due to the reason of non-compliance, the paying bank cannot exercise the right of recourse to the beneficiary (Kang Won-Jin, 2007).

In the case of sight payment L/Cs, as the UCP 600 does not specify whether a draft must be issued or not, the draft is not issued in principle except in some countries like England that request, as provided by the law, the issuance of a draft. However, if the L/C is issued and a draft (a sight payment draft) is requested, the beneficiary must comply (Jeon Soon-Hwan, 2013). Therefore, the drawee of such draft is the paying bank nominated in the L/C (ICC, 1993).

The banks that can be nominated as the paying bank under a sight payment L/C are either the issuing bank, the advising bank or the third bank, and there are differences in terms of usefulness and effect of each L/C depending on which bank is nominated as the paying bank. For example, if the issuing bank is the paying bank, the place of payment becomes the issuing bank's counter, and, of course, the drawee of the draft, if requested, is the issuing bank. Likewise, if the advising bank or the third bank is nominated as the paying bank, the place of payment becomes their counter and the drawee of the draft, if requested, becomes them (Lee Sang-Pyo, 1993).

In addition, the paying bank to which payment at sight is authorized must be nominated. In other words, the available bank with which the L/C is used in the 41a of SWIFT MT700 must be specified, and that bank will actually have to pay. Therefore, as the paying bank is nominated, it is not allowed in principle for a third bank to negotiate; but, this is not impossible. In the case of a negotiation L/C, the nominated bank commits payment to the issuer, endorser, or holder in due course whereas the paying bank under a payment L/C commits only to the beneficiary (Chae Jin-Ik, 2012). Thus, if a third bank negotiates,² it does

¹ Article 14(b) of UCP 600 allows the bank to spend five banking days from the next day of presentation to make a determination.

² The verb terms 'negotiate' and 'purchase' must be distinguished. Any bank whether nominated or not can purchase the draft and/or documents whereas only the nominated bank by the issuing bank

so at its own risk.³¹) Even though it is not impossible to negotiate this way, the beneficiary under a sight payment L/C can recover the export costs within the five banking days only when the documents comply with the terms and conditions of the credit. Therefore, it would be rare to negotiate while paying the fee following the negotiation.

2.2.2. *Deferred Payment L/C*

Deferred payment L/C is an L/C in which payment is deferred. The deferred payment L/C first appeared in the UCP 400. Its Article 10 states that “With the increasing use of the deferred payment credit without the drawing of a tenor draft as in the case of acceptance credit, it was felt that a specific provision should be made for this type of credit”. Indeed, since the World War II, deferred payment credit had emerged in the Far East, and it began to develop in earnest in Europe such as Italy and Germany to avoid high stamp duty through issuing bills of exchange. In the USA, it had started to be used since the restriction of the Federal Reserve Board to accept the bill of exchange less than 6 months (Kim Kyung-Bae, 2006). In the 1970’s, two-thirds of banks around the world whether developing or developed used deferred credit (Eberth and Ellinger, 1983). The payment by deferred payment is also described in detail in Article 49 of Korea’s Enforcement Decree of the Income Tax Act. Article 49 states that “1. Import by means of a debit letter of credit method by which the bank grants the credit or by means of an import method by the exporter credit method by which the supplier grants credit after a certain period of time from the date of receipt of the shipping document or the goods, or 2. Import when an importer takes over a time-limited draft issued by an exporter, the shipping document or goods shall be delivered to the importer and the importer pays the full amount of the importation of the goods after a certain period of time from the date of delivery of the shipping documents or goods.” In other words, a deferred payment is a transaction in which payment is made after a certain period of time passes after the receipt of the goods.

Under a deferred payment L/C, the beneficiary without issuing a draft presents the documents complying with the terms and conditions of the credit to the deferred payment bank which could be the headquarters, branch or depository bank that the issuing bank nominates. It is mainly used in countries such as Europe where tax is imposed on bills of exchange, and is also used for transactions such as export of industrial equipment that is settled in a long-term split by the installment method (Kang Won-Jin, 2007). When intending to issue a deferred payment L/C through SWIFT MT700, [BY DEF PAYMENT] in the section 41a must be checked, and in cases where the printed form is utilized, “available by deferred payment” or similar statement must be included (Jeon Soon-Hwan, 2010).

The features of a deferred payment letter of credit (L/C) are as follows:

First, the exporter agrees to receive the export payment after a certain period from the delivery of the documents to the importer (Harfield, 1974). In foreign trade, the goods are exported under an agreement between the exporter and importer in which the parties agree on a deferred payment L/C. Accordingly, the importers request their bank to issue an L/C in favor of the exporter (the beneficiary). When the exporter acquires the deferred L/C, a legal relationship is established between the two parties. As the importers are not obligated to pay the amount upon receipt of the goods, they can settle the account after the imported items are sold. Therefore, the financial burden is less than others. Payment to the exporters are

negotiates (Byrne, 2010).

³ The criterion for distinguishing payment L/C and negotiation L/C depends on the L/C notation in which if negotiation or purchase is allowed, it becomes negotiation L/C. Otherwise, it is regarded as payment L/C (Park Dae-Wi, 1994, 100).

guaranteed not by the importers but by banks with sufficient assets and credit, so the amount can almost certainly be recovered by the expiry date if the documents presented comply with the terms and conditions of the credit. According to *the Korean Seoul High Court* (2006), such an expiry date may be described as “15 days after the presentation of documents,” “30 days from the date of issuance of the shipping documents,” or “within 60 days from the date of presentation of shipping documents.”

Second, deferred payment L/C is a non-notation credit which is not accompanied by a bill of exchange. In other words, it is the same as the acceptance L/C in the sense that it is an overdue L/C (which requires payment at a specific future date but not at sight, or immediately), but it is also different in that the payment is made only against the delivery of documents that meet the terms and conditions of the credit but without a draft. Banks issue a deferred payment undertaking repayment, which cannot be called “acquisitions,” resulting in deferred payments or installment payments (Park Dae-Wi, 1994). Thus, the deferred payment undertaking replaces the bill of exchange as evidence of credit by the bank.

Third, the deferred credit must specify the paying bank authorized by the issuing bank to pay. Thus, an L/C used as the deferred payment method must specify the nominated bank, which examines the documents presented and actually makes payments on the expiry date. Therefore, if an entity uses SWIFT MT700 to issue an L/C, an available bank must be specified in the field 41a which examines the documents presented by the beneficiary and pays on the expiry date.

Fourth, a deferred payment L/C is negotiated only with documents. According to Byrne (2010), it is similar to an acceptance L/C in that the payment is deferred. The only difference is that there is no negotiation instrument (typically a bill of exchange in international transactions). However, there is sharp disagreement on whether receiving the relevant documents and prepaying before the expiry date is a purchase or a simple loan with no purchase. In Europe, exporters do not generally issue drafts in order to circumvent regulations and avoid costs. However, as the UCP does not regulate prepayment for deferred payment L/Cs, the UCP 600 earnestly allowed prepayments for it (Byrne, 2010; *Korean Supreme Court*, 2001).

2.2.3. Acceptance L/C

Traditionally, when a usance⁴ L/C is issued, the beneficiary needs to issue a bill of exchange and present it with the documents specified in the credit (Langerich, 2009). The beneficiary will issue a usance bill of exchange and recover the amount on a specific date in the future. Such a credit is called an acceptance credit (credit available by acceptance). Under an acceptance L/C, the accepting bank (the issuing bank or the branch of the issuing bank or its correspondent bank) accepts the bill of exchange issued by the beneficiary and guarantees payment unconditionally on the expiry date. The bank that accepts the bill of exchange under Art. 2 of the UCP 600 acts as the accepting bank and, at the same time, becomes the paying bank paying the bill at maturity. If the nominated bank has indicated its acceptance (by writing the word “accepted”) on the bill of exchange drawn on it by the beneficiary and returned it to the beneficiary, the bank cannot refuse to make payment, for any reason, when the beneficiary presents the draft on the expiry date because it is governed by the draft law as well as the UCP (Seyoum, 2009). These acceptance credits had led to the emergence of deferred payment credits as follows. With European countries such as Italy and Germany levying fees for the issuance of bills of exchange, deferred payment credits without bills of exchange were introduced as an escape route to avoid these charges. In addition, the bank

⁴ The term “Usance” means the importer does not pay immediately, but pays after a certain period of time.

accepting a bill of exchange would charge an average fee of 1.2% per year for the acceptance, although these charges would differ among banks and according to the credit rating. However, no acceptance fee was charged in the absence of a bill of exchange. For these advantages, deferred payment credits were actively utilized in Europe (McLaughlin, 1990). The characteristics of acceptance credit are as follows.

First, a usance draft must be issued. Bills of exchange issued under acceptance credits are classified into 'after sight', 'after date', and 'fixed date'. The after sight credits expire after a fixed period of time (e.g., 30 or 60 days) from the date the bill of exchange is presented (Park Kwang-So and Kim Byung-Sool, 2007). It would be marked "at 30 days after sight (30d/s)" or "at 60 days after sight (60d/s)". The after date credit refers to a draft expiring after a certain period of time from the date of issuance of a particular payment-related document (e.g., date of issue of the bill of exchange or bill of lading). For example, if the draft is payable "at 90 days after B/L date," the expiry date is 90 days after the issue date of the bill of lading. The fixed date credit is a bill of exchange with a specific payment date (expiry date). For instance, the draft could be made payable at January 23, 2018, which means that the payment must be made on January 23, 2018.

Second, the bank authorized to accept the bill of exchange must be designated as the acceptance bank. In other words, under an acceptance letter of credit a bank must be nominated as the accepting bank, which actually accepts the presented bill of exchange and documents and actually pays the amount on the maturity date. "Acceptance" refers to the paying bank's promise that payments will be made on the expiry date. No payee's rights will arise against the payer unless the latter officially marks "acceptance" (Roh Dong-Hwan, 1998). Under acceptance credit, the nominated accepting bank indicates "accepted" on the bill of exchange with a promise to unconditionally pay the bill of exchange, and the bank that expresses its intention should never refuse payment when it is presented on the expiry date. Therefore, if an L/C is issued using SWIFT MT700, the available banks must be specified in the field 41a. If the bank examines the documents presented by the beneficiary and decides that they comply with the terms and conditions of the credit, payment is made on the expiry date.

However, a bill of exchange marked by the accepting bank is a negotiable instrument, and the beneficiary can easily sell it at a discount before its expiry date to another bank (e.g., its own bank or the issuing bank) or in the discount market.⁵

2.2.4. Negotiation L/C

A negotiation credit refers to a credit that is available by negotiation, allowing the beneficiary to obtain the export proceeds by selling the bill of exchange and/or documents to the bank. Thus, the negotiating bank sends the bill of exchange and/or documents to the issuing bank after shipment and makes payment or agrees to make payment to the beneficiary before receiving payment by the issuing bank (Jeon Soon-Hwan, 2013). For a negotiating credit through SWIFT MT700, [BY NEGOTIATION] must be checked in the field 41a (or "available by negotiation" or a similar statement must be mentioned where one fills out the form), and the available bank or any bank must be selected.

The negotiation letter of credit is divided into sight and usance negotiation credits according to the time of payment of the bill of exchange. A sight negotiation credit refers to a credit under which negotiating the bill of exchange issued by the beneficiary is allowed and

⁵ It is called 'discount bill' where a customer sells a bill that has not yet reached maturity to the bank, and receives a deduction (discount) of interest and other expenses from the bill amount to the maturity. This is where the discounted bills are resold. UK and US discount markets are active worldwide (Jeon Bok-Soo, 2001, 45-49).

the issuing bank makes payment to the negotiating bank immediately (a maximum of five banking days).⁶ A usance (term) credit allows the beneficiary to sell the bill of exchange to a bank that offers the most favorable terms (discount rate, bank expenses, among others) before the nominated accepting bank accepts the bill (Jeon Soon-Hwan, 2013). In addition, the negotiation credit is divided into a freely negotiable credit⁷ and a restricted-negotiation credit. A freely negotiable credit authorizes all banks around the world (subject to any exclusions for specific countries or cities) to negotiate, whereas a restricted L/C allows only a certain bank for negotiation. Worldwide, negotiation credits are issued more than other types of credits. According to 2017 Rethinking Trade & Finance issued by the International Chamber of Commerce (ICC) (2017), the share of negotiation L/Cs worldwide accounted for 73.2% of all LC transactions in terms of world trade in 2016, which outpaced other types of L/Cs (i.e. sight L/Cs accounted for 11%; deferred payment L/Cs, 8.7%; and acceptance L/Cs, 6.8%).

It is officially allowed under a negotiation credit to negotiate the bill of exchange and/or documents, and the issuing bank affirms payment to the drawer, the endorser as well as the bona fide holder (holder in due course) of the bill of exchange subject to compliance of the terms and conditions of the credit (Roh Dong-Hwan, 1998). Thus, the issuing bank is obligated to make payment when requested by the accepting bank—the bona fide holder of the bill of exchange and/or documents purchasing them. The prerequisite for negotiation is that the presentation should comply with the terms and conditions of the credit. Since such usance negotiation credits are subject to the usance bill, they are divided into shipper's usance under which the beneficiary bears the interest and banker's usance under which the bank bears the interest. Banker's usance is further divided into domestic banker's usance, where the issuing bank provides credit, and overseas banker's usance, where credit is given by an overseas nominated bank. In practice, domestic banker's credit is called domestic usance, whereas overseas banker's usance is generally referred to as overseas usance (Roh Dong-Hwan, 1998).

The bank issuing a usance negotiation credit irrevocably commits to pay the bona fide holder of the bill of exchange against presentation of all documents issued by the beneficiary in compliance with the credit terms. Simply speaking, the issuing bank irrevocably commits subject to the complying presentation that, first, it would pay to the bank designated by it the amount directly to the bona fide holder who purchased the usance bill from the payee. Second, it will pay the beneficiary directly in case where the nominated bank does not negotiate even though it was authorized to do so.

In addition, under the negotiation L/C, the negotiating bank becomes a legal party, as opposed to a mere agent of the beneficiary. Therefore, it can exercise its recourse right to the drawer (the beneficiary) even if the draft and/or documents which it negotiated are rejected by the issuing bank.⁸ However, the right of recourse cannot be exercised in the event of a negotiation by the confirming bank. Since the confirming bank is a bank with the same status as the issuing bank and is responsible for the final payment, it has no right or recourse to the

⁶ As a matter of fact, the issuing bank may effect the payment on any day within five banking days, which means that it can pay on any day of these five banking days even on the 5th day. However, in practice the payment is made immediately if it gets the signed promissory note from the applicant.

⁷ When a negotiation credit is issued using SWIFT, ANY BANK should be selected if wanting to be used in any bank, but a country or city must be mentioned in option D if selecting any bank in a specific country or city (SWIFT, 2016).

⁸ In a credit transaction, in principle, a recourse right may be exercised even with or without a statement of recourse right in the credit, but it is not possible to exercise the right of recourse if there is an explicit statement that it is a 'without recourse' credit. In Korea, however, 'without recourse' credits cannot be used according to the Article 9 of the Bills of Exchange and Promissory Notes Act (Choi Jung-Ho and Lee Jae-Hyun, 2007).

drawer even if it directly purchased the bill of exchange from the drawer or a bona fide holder (Kang Won-Jin, 2007).

2.3. General Consideration on Negotiation

2.3.1. Honour and Negotiation

It should be noted that “honour” includes “sight payment”, “deferred payment”, and “acceptance”, but does not imply a negotiation (Jung Hong-Shik, 2007). This concept is related to two theories, one borrowed from the UCP 82 (the initial version of the UCP) (Byrne, 2010) and the other from the UCC (Yoo Joong-Won, 2007). Defining “Negotiation”, Article 10 mentions a negotiating bank “negotiating a draft” and Article 45 speaks of “presentation or negotiation of documents or drafts.” According to UCC § 5-102 (h), “Honor” of a letter of credit means performance of the issuer’s undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, “honor” occurs: (i) Upon payment, (ii) If the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment, (iii) If the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance. However, the concept of ‘honour’ used in UCP 82 is presumably borrowed from the UCC, because unlike in the UCP 600, it was only used to describe the performance of the issuing bank’s obligations. Thus, the concept is borrowed from the UCC and follows the definition of the term as an event occurring at the time of sight payment, deferred payment and acceptance.

In the UCP 600 in which the concept of ‘honour’ began to be used in earnest and the International Standard Banking Practice (ISBP) which is used as a supplement to the UCP have a prerequisite that the presented documents must be in line with the credit. In other words, honour is made only when the documents appear on their face to be compliant. Thus, honour is not made when the documents do not appear on their face to be compliant (Byrne, 2010). In addition, honour is considered to be accomplished only when the final payment is made. The concept of honour encompassing sight payments, deferred payments, and acceptance means payment. The payment is made on the presentation of the documents under ‘at sight payment L/C’, on the appointed expiry date under ‘deferred payment L/C’, and on the expiry date of the bill of exchange under ‘acceptance’ L/C. Therefore, for settlement to be established, the documents presented must comply with the terms and conditions of the credit, and be paid by the bank nominated by the issuing bank.

Before discussing negotiation L/Cs, let’s explore the concept of negotiation. The dictionary defines the word “purchase” as an “act of purchasing things,” or “the act of buying goods in a commercial transaction for a certain amount of money” (Naver Dictionary, n.d.). In other words, the ownership of the seller is transferred to the buyer through purchase. The “buyer” purchases the product from an entity who sells it (the “seller”), and the goods sold by the seller become the “object of purchase.” The word “buy” can be used interchangeably with various other English words (typically “purchase”).

When the term “purchase” is used in a letter of credit transaction, the basic concept is the same but the details differ. In international commerce, the term “purchase” is used under a situation where the exporter ships goods under a contract of sale and sells the bill of exchange and/or documents to a bank to recover the costs. In domestic banking practice, the purchase transaction takes place as follows. The exporter completes the shipment of the contracted goods in accordance with the export contract, prepares a bill of exchange and documents based on the shipment, and submits an application form asking the bank to purchase them. The bank purchases the documents presented if they satisfy the L/C terms and prepays exporter before recovering the payment from the issuing bank. Therefore, from the exporter’s

point of view, “purchase” is a smooth self-financing method for early recovery of the export value. The bank handles “purchase” business as a product that generates bank profits such as exchange commission, postage fees, replacement fees, exchange fees, among others. This accounts for a large proportion of bank revenue (Chae Jin-Ik, 2016).

However, banks do not have to unconditionally respond to an exporter’s purchase request. Considering that recovering payment from the issuing bank could become impossible due to the issuer’s insolvency, for example, banks need to hedge against risks by obtaining a mortgage or personal guarantee. If the bank decides to purchase the documents and/or draft on the basis of internal procedures, the importer is asked to sign a foreign exchange transaction agreement and a credit transaction agreement. The working texts of Korean banks define the transaction as an “export negotiation (negotiation) means that the transaction bank discounts and purchases the export draft and all the documents required by the credit after the exporter completes the shipment in accordance with a letter of credit or Documents against Acceptance (D/A), Documents against Payment (D/P) contract, and collects money through foreign branches or correspondent banks. It is a kind of credit act that facilitates easy financing for exporter.” (Roh Dong-Hwan, 1998). Thus, the bank’s position is clear in that the purchase is a loan (the bank lends its credit (money) to the customer). In an L/C transaction, the purchase is usually that of an “export draft.” ‘An export draft’ is not a special bill of exchange, but a documentary draft issued by an exporter designated as the beneficiary of the credit, in which the right of the bill is secured by the credit and/or bill of lading representing goods in transit (*Korean Supreme Court*, 2002).

The purchase of an export draft is an act of collecting goods from the payer specified in the draft after the purchase bank receives the export draft and pays the goods in advance to the exporter. The negotiating bank decides whether to negotiate or not through careful examination of documents and export draft, and receives certain fees and interest in exchange for the purchase (*Korean Seoul High Court*, 2009). This act is called “negotiation” under the UCP and law whereas it is called “nego” or “discount” in practice (Kim Sang-Man, 2011).

L/C transactions are often referred to as conditional payment commitments by the issuing bank (Barski, 1995). In other words, the issuing bank is committed to ensuring that the bank it nominates will pay for the documents that match the terms and conditions of the credit. Therefore, when the nominated bank makes a fair purchase of a complying presentation, it is reimbursed on the expiry date. Negotiation L/C is divided into a freely negotiable credit and a negotiation restricted credit. Under the freely negotiable credit, any bank can purchase it (Byrne, 2010). Thus, any bank that has purchased a bill of exchange and/or documents from a beneficiary may be a nominated bank. It is not requested to specifically describe on the credit, but is determined if [BY NEGOTIATION] and [With Any Bank] are selected in SWIFT MT700S Section 41a. The negotiation restricted credit authorizes purchase by a bank specified in the credit, which can request a payment from the issuing bank as the valid negotiating bank on the expiry date. However, in practice, the exporter sells to its transaction bank the bill or exchange and/or documents if the nominated bank is located in a third country or if the exporter has no business relationship with the bank specified in the credit (Kim Jong-Rack and Yang Eui-Dong, 2009). In this case, the bank purchasing the draft at the request of the beneficiary is a bona fide holder who is transferred the right of the draft, but it is a non-nominated bank under the credit. Therefore, the UCP cannot be applied to purchases made by non-nominated banks and right of recourse. The ICC has also suggested that the issuing bank should respond to reimbursement claims by non-nominated banks if the presentation is in line with the credit (ICC, 1989), but it has not provided detailed reasons for this. In Korea, a non-nominated purchasing bank may request for payment directly from the issuing bank after clearing the nomination for negotiation through a release letter (Lee Jung-

Won, 2012). However, the release letter is issued by agreement between the beneficiary and the nominated bank without the consent of the issuing bank even though the modification of the terms requires the issuing bank's approval. Therefore, one must note that whether to reimburse or not entirely depends on the issuing bank's decision.

2.3.2. Changes in Negotiation Clause under the UCP

The ICC established the UCP in 1933 to alleviate the confusion arising from the divergent use of letters of credit around the world. The UCP has been revised periodically to properly reflect the change in trade environment and to revitalize credit transactions. The UCP 82, issued in 1933, mentioned the term "negotiation" for the first time. This rule did not define "purchase," but the term was first introduced when Article 10 designated a purchase bank for the purchase of a bill of exchange issued for "payment of a purchase." Similarly, the UCP 151 (1951), the UCP 222 (1962), the UCP 290 (1974), and the UCP 400 (1983), as revised since then, had not separately defined the term "negotiation", but used "negotiation" or "negotiate" in the articles.

However, the UCP 500 amended in 1993 defined it for the first time in Article 10 b(ii), which is "Negotiation means the giving of value for Draft(s) and/or document(s) by the bank authorised to negotiate. Mere examination of the documents without giving of value does not constitute a negotiation." Therefore, the bank nominated for L/C transactions subject to the UCP 500 must examine the documents and give value in order to be regarded as a negotiation. Moreover, the UCP 500 used the term "drafts and/or document(s)", which explicitly meant that the bank could purchase documents alone without the bill of exchange by using the word "or" (Byrne, 2010). However, the term "giving of value" used in this article caused much confusion because it raised a question: Is "giving of value" for document negotiation? Or is it possible to provide the documents as collateral without negotiation? In response to this confusion, the ICC stated that the term "giving of value" referred to in Article 10 b(ii) was interpreted as "either 'making immediate payment' (e.g. by cash, by cheque, by remittance through a clearing system or by credit to an account) or 'undertaking an obligation to make payment' (other than giving a deferred payment undertaking or accepting a draft) (ICC, 1991).

The definition of "negotiation" in the UCP 500 caused confusion in practice, so ICC defined it in more detail in the UCP 600 (Kim Jong-Rack and Yang Eui-Dong, 2009). The UCP 600 states that "Negotiation means that the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank" (ICC, 2007). In the revised UCP 600, negotiation is defined as prepayment and transfer of ownership of drafts and/or documents. Therefore, simply loaning drafts and/or document as collateral in the UCP 500 cannot be accepted as a negotiation transaction under the UCP 600 (Kim Jong-Rack and Yang Eui-Dong, 2009).

2.3.3. Elements for Forming 'Negotiation' under the UCP

Four components must be satisfied in order to achieve the modified negotiation requirements.

a) Who Negotiates?

Pursuant to Article 2 of the UCP 600 ("Negotiation"), negotiation can be made only by nominated banks. For negotiation restricted L/Cs, only the negotiating bank designated by the issuing bank can negotiate whereas any bank can negotiate under freely negotiable L/Cs.

When negotiation L/Cs are used in international merchandise transactions, the issuing bank nominates a bank or banks that can negotiate the drafts and/or documents issued by the beneficiary. Often, it issues freely negotiable credits that are available to all banks. Under this freely negotiable credit, the bank chosen by the beneficiary does not recognize that it is nominated until the draft is presented to it. Therefore, the bank is not obliged to comply with the issuing bank's authority unless it explicitly agrees to do so and notifies the beneficiary, but it usually accepts the authorization for the profits involved, such as fees (Dolan, 1991).

Meanwhile, the reason the issuing bank pre-designates the negotiating bank is that there are no correspondent banks other than the specific banks designated, they use the sales policies to improve the branch's performance, or the ability of the bank's in the exporting countries to examine documents is in doubt (*Japanese Osaka District Court*, 1976). However, under these L/Cs, the negotiation by non-nominated banks at the request of the beneficiary may not be recognized as true negotiation but discounting (in practice, this is referred to as "nego"). The reason for this is because "it is recognized as "negotiation" only if the bank that is authorized by the issuing bank has paid for the documents, and in the case of giving of value by the bank without authorization of the issuing bank cannot be referred to as "negotiation" even if payment is made." (*Korean Supreme Court*, 2003). A non-nominated bank, however, does not have the status of the negotiating bank in the credit, but it has a transferee status for the bill of exchange under the bill of exchange law (Huh Hae-Gwan, 2017). However, the ICC, which established the UCP, states that once the issuing bank has designated a negotiating bank but the documents have been sent to the issuing bank through a third bank, the issuing bank should make a payment provided that the documents are complying with the terms and conditions of the credit and arrive before the expiry date (ICC, 1991).

Negotiation by the issuing banks are controversial but are generally considered impossible. In the second revision of the UCP (UCP 290), the issuing bank was allowed to directly pay, accept or purchase documents. That is, the issuing bank could directly purchase without recourse or authorize another bank to purchase the draft drawn on the applicant or others as a payer. However, the UCP 400 allowed payment and acceptance excluding direct purchase, and the UCP 500 and the UCP 600 state that the issuing bank must nominate a bank for negotiation. Thus, the issuing bank can no longer directly purchase the drafts and/or documents (Yoo Hae-Min, 2000).

b) What is Negotiated?

In the UCP 600, Article 2 ("Negotiation") refers to the draft and/or documents as the negotiation object. From the expression "draft and/or documents" in the English version, one can conclude that what can be negotiated consists of a draft or documents or a draft and documents. The issuance of a draft is required and therefore issued for both negotiation credit and acceptance credit, but it is not issued for deferred payment credit, which require only documents (Lee Sang-Pyo, 1993). However, in the case of negotiation credits, the draft may or may not be required as part of the documents to be presented. In the former case, the documents, including the draft, will be negotiated, but in the latter case, only documents will be negotiated. Despite the expression "and/or", in no case is a bill of exchange negotiated without documents. This is because the nominated bank is authorized to purchase from the issuing bank only if the documents presented by the beneficiary comply with the terms and conditions of the credit, whereas no L/C would require only a bill of exchange (Huh Hae-Gwan, 2017). In general, what is purchased is the bill of exchange and/or documents required by the credit, not the credit itself. This means that the credit itself is not a separate instrument of payment, such as a bill or a check, nor is it a negotiable instrument, such as a bill of exchange (*Korean Seoul High Court*, 2008). Therefore, the credit is not subject to purchase, as

is a bill of exchange and/or documents issued on the basis of the credit. In addition, considering that none of the provisions of the UCP 600 specifies that the original L/C must be presented as one of the documents, the original need not be presented for the purchase of the bill of exchange and/or documents. If the copy is authentic, it can be valid (*Korean Supreme Court*, 2009).

c) How to Pay for Negotiation?

As defined by Article 2 (“Negotiation”) in the UCP 600, payment can be carried out by advancing or agreeing to advance funds to the beneficiary. “Advance payment” means the payment of “a certain share of money or goods before something happens” (Naver Dictionary, 2018). That is, the nominated bank advances payment to the beneficiary before the issuing bank or the confirming bank pays the nominated bank under L/C transactions. In the UCP 600, “advance payment” is an act under “purchase” according to the terminology used in Article 2 (“Negotiation”). In other words, “advance payment” occurs as a subordinate act of “purchase.” In the case of “prepay” which is utilized in Articles 7, 9, and 12, however, the nominated bank that is obliged to pay pays the debts early (Byrne, 2010). Although the term “advance payment” does not imply an authority to pay for but rather to “purchase” the draft and/or documents presented by the beneficiary, the nominated bank pays or undertakes to pay before the reimbursement of the issuing or the confirming bank.

Payment can be made immediately (e.g. by cash, by cheque, by remittance through a clearing system or by credit to an account) or by undertaking an obligation to make payment on a specific date (*Korean Supreme Court*, 2017). However, “undertaking an obligation to make payment” can be controversial. For example, consider a case in which the negotiating bank undertook to pay because it determined that the documents are complying, but the issuing bank determined that they are not complying. Regardless to say, the issuing bank would reject to reimburse because it does not have to pay for not complying presentation. This is due to the independence and abstraction that characterize L/C transactions. The L/C is independent of the underlying contract on which the L/C issuance is based, and the payment is determined only by the documents, and not by the goods contracted (Park Suk-Jae, 2014). Therefore, the nominated banks and issuing banks only consider whether the documents presented by the beneficiary comply with the terms of the L/C, and pay only if the presentation is complying.

However, although international rules exist on the standards of document examination, such as the ISBP and UCPs, it is highly likely that the bank’s subjective judgment will play some role. In addition, the same documents may lead to different conclusions among banks (Kang Jin-Wook, 2017). Thus, if the negotiating bank determines that the presentation is complying but the issuing bank responsible for final payment finds it non-complying, a malicious negotiating bank may break its undertaking to pay on the ground of the issuing bank’s refusal to reimburse. Of course, the issuing bank may approach the applicant for a waiver of discrepancies, but such an approach for a waiver to the applicant only applies to the issuing bank, and cannot be imposed by the negotiating bank (Park Suk-Jae, 2012). Therefore, the issuing bank may deem it advantageous to refuse to pay, for example, if the applicant goes bankrupt and payment is impossible, or if the international prices of traded goods fall sharply. Even a refusal to pay the debt cannot be ruled out (Park Sae-Woon, 2010). For those reasons, it would be wise for the beneficiary to seek ways to receive immediate payments.

d) When to Pay for Negotiation?

The negotiation price must be paid on or before the banking day on which reimbursement of the issuing bank is due to the nominated bank. The payment under negotiation L/C is

different from “Bill collection”, in that the payment can be made at any time on or before reimbursement of the issuing bank. Under “Bill collection”, the remitting bank does not purchase the documents presented by the beneficiary, but sends it to the collecting bank and asks for collecting money to be paid back to the beneficiary (Roh Dong-Hwan, 1998). However, this negotiation L/C is somewhat similar to documents against payment (D/P), but has an advantage over the collection in that the negotiating bank may require the issuing bank to fulfill its obligations under the UCP after sending the documents (Wunnicke and Turner, 2000).

In a trade transaction, the negotiation proceedings apply after the beneficiary ships the goods in accordance with the credit and presents the documents and/or bill of exchange supporting the shipment. If the bank decides to negotiate, the negotiating bank will pay the purchase price after entering into a purchase agreement that stipulates the right of appeal with the beneficiary (Chae Jin-Ik, 2012). According to Article 2 (“Negotiation”) of the UCP 600, the negotiating bank can pay the beneficiary either on the date of negotiation, immediately after determining that the documents presented by the beneficiary comply with the terms of credit, before the banking day of reimbursement from the issuing bank, or on the date of reimbursement from the issuing bank.

3. The Drawbacks of ‘Negotiation’ Occuring under the UCP 600

3.1. Time to Pay for Negotiation

According to the UCP 600, the negotiating bank must pay the beneficiary “on or before the banking day when the issuing bank pays off the nominated bank.” Following the UCP provisions, there are three major instances when a negotiating bank can pay. First, it can pay on the date of purchase immediately after determining that the documents presented by the beneficiary are complying; second, it can pay before the banking day on which the reimbursement is due; third, the payment can also be made on the day of the banking day on which the reimbursement is made.

In general, the timing of payment is usually determined by an agreement between the beneficiary and the negotiating bank or under a purchase agreement, but the provisions of the UCP do not allow the rule to be excluded because the L/C is governed by it. Therefore, one party would want to interpret and apply the rule in a way that favors it. In other words, the beneficiary would prefer to request for a purchase and receive payment immediately. The main reason for exporters to sell the documents even though it is not allowed is to improve productivity and increase cash flow, surrendering the interest up to the expiry date if necessary (Kim Dong-Chun, 2019a). Thus, if the exporter is a major customer with irresistible bargaining power, the bank will have no choice but to comply.

On the other hand, the negotiating bank will want to delay payment to the maximum extent possible and make payment on the banking day on which the issuing bank reimburses the amount. In the case of shipper’s usance, the beneficiary pays interest until maturity, so the negotiating bank pays the beneficiary after deducting interest until the expiry date. The issuing bank reimburses the L/C amount in full to the negotiating bank on the expiry date. In this case, it would be most advantageous for the negotiating bank to delay the payment as much as possible. In other words, as the interest burden until the maturity is responsible for the beneficiary, it will be most favorable for the negotiating bank to pay excluding interest until the maturity after receiving the full amount from the issuing bank including interest deductible up to the maturity. As the UCP stipulates, it does not matter that the negotiating bank holds sizeable funds as the intermediary between the beneficiary and the issuing bank

and makes payment just before the issuing bank reimburses it. However, these regulations can pose substantial problems in practice. In other words, if the beneficiary believes that the payment will be made immediately and requests the purchase, but the negotiating bank does not do it immediately because of the UCP regulations, the beneficiary will have to wait until the expiry date, which may lead to bankruptcy or cause it trouble (Kim Dong-Chun, 2019b).

3.2. Recourse Right of Negotiating Bank under Fraud Transactions

Since the L/C is a documentary transaction, payment is made only if the documents presented comply with the terms of the L/C. However, as seen in many cases, a malicious beneficiary presents fraudulent documents and asks the negotiating bank to buy them. Purchasing from the beneficiary is a major source of revenue for banks (Chae Jin-Ik, 2016), so it is actively used, but in the case of fraudulent transactions, if the issuing bank determines that the documents are not complying, an issue may arise if the negotiating bank can exercise the right of recourse to the beneficiary. In other words, since an L/C is a documentary transaction, if a recourse right is exercised for the beneficiary on the basis of a mismatch of the documents determined to be complying at the time of purchase, the beneficiary may be reluctant to ask for negotiation.

Since a L/C is essentially a documentary transaction and is not related to the underlying contract, the bank pays considerable attention to confirm that the documents are in line with the terms of the L/C regardless of whether the actual goods have been shipped or not and so forth and so on. However, if the document is forged by the beneficiary and the negotiating bank is involved in or aware of the fraud, the L/C is nothing more than a fraudulent transaction that can no longer be protected by independent principle. The negotiating bank is the party to which the beneficiary's rights have been transferred and which acquires all the rights of the beneficiary against the issuing bank, including the right of recourse (Chae Jin-Ik, 2012). Thus, the negotiating bank can ask the issuing bank to reimburse on the expiry date of the draft as the beneficiary's rights. The UCP 600 states that a credit transaction is a documentary transaction, so the negotiating bank cannot exercise its right of recourse against the beneficiary when a fraudulent transaction occurs, as the issuing bank will not pay. In this case, the negotiating bank is likely to be in trouble and will not participate in negotiating.

3.3. Negotiation by Non-nominated Bank

If a non-nominated bank purchases the documents, the question of whether this bank's status is a legitimate one could arise. L/C transactions are often referred to as "conditional payment commitments of the issuing bank" (Barski, 1995). Thus, the issuing bank is committed to payment on the complying presentation by the bank nominated by itself. Thus, the issuing bank will pay the price only when the bank designated by it duly purchased the documents. A negotiation credit is divided into 'freely negotiable credit' and 'negotiation restricted credit'. The former authorizes any bank to purchase and does not designate a particular bank (Byrne, 2010). Therefore, any bank that has purchased the draft and/or documents may be a nominated bank. A freely negotiable credit is not required to be specified in the credit, but is determined by selecting [BY NEGOTIATION] and [With Any Bank] in SWIFT MT700 Section 41a. The latter authorizes a bank specified in the credit to purchase the documents. As a legitimate negotiating bank, it can ask the issuing bank to reimburse the amount paid by it. However, there is a practice in which the beneficiary's transaction bank purchases the documents if the nominated bank specified in the credit is located in a third country or the exporter has no relationship with the bank in the credit (Kim Jong-Rack and Yang Eui-Dong, 2009). In such a case, the bank that purchases at the beneficiary's request is

a bona fide holder and is normally assigned the beneficiary's rights under the bill of exchange but it is a non-nominated bank. Therefore, the UCP regulations, including the recourse right, cannot be applied in the case of purchase made by a non-nominated bank. The ICC has also suggested that the issuing bank should answer to a request for reimbursement if the documents purchased by a non-nominated bank is complying with the terms and conditions of the credit (ICC, 1989), but a detailed reason was not provided. In Korea, a non-designated purchasing bank may request a reimbursement directly from the issuing bank after clearing the negotiation designation from the nominated bank through a release letter (Kim Ki-Sun, 2007). However, this is regarded as the change in the terms of the credit, which requires the consent of the issuing bank, but the release letter is issued by agreement between the beneficiary and the nominated bank. Whether or not to agree with this negotiation without the approval of the issuing bank entirely depends on the issuing bank's decision.

4. Countermeasures to the Problems

4.1. The Countermeasure for Time to Pay for Negotiation

Regarding the timing of the payment, it would be advantageous for the beneficiary to be paid immediately on the day of negotiation. However, some banks do not pay the purchase amount immediately on the basis of the UCP 600 Article 2 ("Negotiation"), but purchase on condition that payment would be made on the same day in which the issuing bank reimburses the amount. That is, since the UCP allows the nominated bank to advance funds before the banking day of the issuing bank's reimbursement, it does not have to make payment immediately. However, since "negotiation" is a type of trade finance that provides credit, it would serve the purpose of "negotiation" for the bank to immediately make payment (Wang Xue-Hui, 2010). In other words, immediate payment of the purchase price will be advantageous to the beneficiary in terms of early cashing of the export price. For banks, the earlier the payment, the more interest they could earn until maturity (*Korean Seoul District Court*, 1995). Therefore, for Korean banks, the purchase amount must be paid on the day of purchase under a "bill of exchange purchase agreement." As stipulated, "If the bank decides to purchase an export bill of exchange, the bank shall pay the purchase payment for the export draft to the seller's account designated by the seller at the scheduled purchase date" (Citi Bank Korea, n.d.). The UCP is a norm that establishes international common standards on a reasonable basis based on international practices conducted over a long period of time in international trade, designed to organize, shape, and clarify controversial practices. Therefore, to eliminate unnecessary interpretative problems between the beneficiary and the bank, it is necessary to delete the "on" in the "on or before" referred to Article 2 ("Negotiation") of the UCP 600 and revise it to "before maturity" or "on the day of negotiation." Removing such unnecessary interpretative confusion will allow the beneficiary to participate more actively in international trade transactions by recovering the payment (even though the negotiating bank can have five bankings day at most).

4.2. The Countermeasure for Right of Recourse of Negotiating Bank under Fraud

The question is whether the negotiating bank, which purchased the bill without recognizing the fraud by the beneficiary, will be recognized as a holder in due-course. Considering that the negotiating bank obtains the full rights of the beneficiary, including the right to claim reimbursement from the issuing bank, it is not a bona fide holder but merely a transferee who

has received the beneficiary's status. Therefore, it cannot counter the issuing bank's reimbursement request. In other words, if the beneficiary's status is transferred, the party that committed the fraud is the beneficiary, and the issuing bank or the applicant can plea with the beneficiary through all possible reasons. In fact, the Industrial Bank of Korea purchased documents in good faith, without knowledge of the beneficiary (Ilkyung)'s fraudulent exports. The issuing bank refused to pay the L/C on this ground, and the Industrial bank lost the case (*Korean Supreme Court*, 2003). The question to be considered is at what point in time the goodwill or malice of the negotiating bank was determined. The reference point at which the negotiating bank knows that the document has been forged or falsified, or whether there was a good reason to doubt it is at the time of the negotiating bank's purchase. Therefore, any knowledge of such facts after completion of the purchase would have no effect on the good faith of the negotiating bank. In this case, the burden of proof of whether the purchase was made in good faith or in malice must be borne by the issuing bank, which refused to reimburse. However, even if it is a fraudulent transaction, if the position of the negotiating bank is legitimate, the issuing bank must respond to the reimbursement request. Therefore, even if there were fraudulent transactions, it would be necessary for the negotiating bank to take all necessary steps to acquire the status of a legitimate negotiating bank to properly request reimbursement from the issuing bank.

Negotiating banks can exercise their recourse rights agreed at the time of signing a purchase contract, but if the beneficiary is their primary customer, they would hesitate to exercise the right. Therefore, the negotiating bank should ensure that there are no missing documents through consultation with the beneficiary and consider export insurance as well. Export credit guarantee (after shipment) is a system that banks can actively use to insure against non-payment risk on export bills of exchange. If the beneficiary's bank decides to purchase the documents, the recourse right is generally agreed upon at the time of purchase agreement. So, if the export draft is dishonored, the negotiating bank can ask the beneficiary to reimburse the amount paid with its recourse right. However, there may be cases in which exporters may not be able to comply with the repayment request as they may have invested their funds in exports (e.g., labor and material costs). In such a case, the Korea Trade Insurance Corporation (K-Sure), as the guarantor in export trade, will reimburse the amount paid for the purchase of export bills, allowing the negotiating bank to participate in the negotiation business offered by the beneficiary with confidence. Therefore, the negotiating bank should actively use export credit guarantees (after shipment) as a risk management measure, apart from assessing the beneficiary's credit rating.

4.3. The Countermeasure for Negotiation by Non-nominated Bank

In a usance L/C transaction, the beneficiary arbitrarily chooses a negotiating bank for various reasons even though the issuing bank nominated a bank to purchase the documents and/or draft. First, an issuing bank can designate a negotiating bank through SWIFT 47 although it is not obligated to do so. Therefore, unless a specific bank is designated, the beneficiaries are forced to sell the bill of exchange through their transaction bank.

Second, the beneficiary may choose to discount the draft and/or documents before the expiry date and recover the export price even if it is a usance bill free for selling unless explicitly prohibited on the credit. Also, even if the issuing bank designates a specific bank, it does not have to be purchased by the nominated bank only. In the event that the beneficiary is reluctant to sell the draft and/or documents to the nominated bank because it is not its transaction bank, or because direct transactions are practically difficult due to the physical distance, the beneficiary is free to choose any bank that offers the greatest benefits, including favorable bank charges. The

ICC also recognizes the beneficiary's right to sell to its own transaction bank, bypassing the nominated banks.

Third, even if it is designated by the issuing bank, the bank does not necessarily have to act accordingly. The nominated banks are free to decide whether to purchase or reject, taking into account the credit rating of the issuing bank. If a negotiating bank nominated by the issuing bank refuses to purchase the documents, the beneficiary has no choice but to choose its own transaction bank.

Fourth, the negotiating bank, even if not designated by the issuing bank, can purchase the draft and/or documents at its own risk and expense for the interest income up to the maturity. The issuing bank has no reason to prohibit this purchase because it is an independent operation of the bank, at its own risk. However, since the bank is participating in the credit transaction without being designated by the issuing bank, it cannot be legally recognized as a negotiating bank.

If a non-nominated bank wants to purchase the documents presented by the beneficiary, the best solution is to ask the issuing bank through the beneficiary to change the nominated bank. If a purchase is committed without designation by the issuing bank, it cannot be protected as a "bona fide holder" in a fraudulent transaction. Therefore, risk management measures are considered necessary, such as requesting the issuing bank through the beneficiary to designate itself as the negotiating bank or make payment after obtaining a guarantee from the issuing bank, if payment needs to be made before reimbursement. In particular, in the case of deferred L/Cs, the draft is not drawn and therefore cannot be protected by the bill of exchange law. Therefore, the negotiating banks should enter into an agreement with the beneficiary to assure reimbursement, request collateral for the purchase, and examine the documents applying strict criteria in order to manage risks on their own. Moreover, to be recognized as a legitimate negotiating bank, it must comply with the stipulated UCP provisions. In particular, it must be aware that only if all the four requirements of Article 2 ("Negotiation") of the UCP 600, are met, it can be recognized and protected as a legitimate negotiating bank.

5. Conclusion

The main purpose of this research was to examine the negotiation clause and general process related to negotiation under the UCP 600, explore the drawbacks of negotiation clause, and provide the solutions to the problems presented for smooth negotiation operation in practice. The findings of this research can be summarized as follows.

First, due to the negotiation provision in the UCP 600, both the beneficiary and negotiating bank may not be satisfied with the negotiation. That is, the beneficiary would want to receive payment immediately for cash flow whereas the negotiating bank would want to delay the payment to the maximum extent. The reason why both parties want this is because of the timing of the payment explicitly provided in Article 2 ("Negotiation") of the UCP 600. According to this article, the negotiating bank can make payment by "advancing or agreeing to advance funds to the beneficiary on or before the banking day on which the issuing bank reimburses the nominated bank". However, the phrase "on or before the banking day" can leave substantial problems in practice. If the beneficiary expects that the payment will be made immediately and asks for the purchase to take place, but the negotiating bank does not pay immediately on the ground of the UCP provision, the beneficiary will have no choice but wait until the expiry date, which may lead to bankruptcy or cause other forms of serious trouble. In order to prevent this problem from happening, it is necessary to remove the "on" in the "on or before" referred to in Article 2 ("Negotiation") of the UCP 600, and revise it to "before

maturity” or “on the day of negotiation.” Deleting such unnecessary interpretative confusion will allow the beneficiary to participate more actively in international trade transactions by recovering payment.

Second, as the L/C is a documentary transaction, payment proceeds only when the documents presented are in line with the terms and conditions of the L/C. However, as seen in many court cases, a malicious beneficiary presents forged or falsified documents and request the negotiating bank to purchase them. When a fraud transaction occurs, the negotiating bank which purchased the draft and/or documents without recognizing it can neither request reimbursement from the issuing bank nor can it exercise its recourse right to the beneficiary. Thus, the negotiating bank must, before purchasing the documents, do the best to meet all the four requirements of negotiation based on the UCP 600 and consider export insurance as a risk management measure.

Lastly, the beneficiary arbitrarily sells to its transaction bank the documents for various reasons in a usance L/C transaction even though the issuing bank nominated a bank to purchase. In Korea, many banks participate in negotiation transaction as a profit-making source. By joining this transaction the banks can earn interest until maturity. But, if a purchase is made without designation by the issuing bank, reimbursement entirely depends on the issuing bank’s decision. Thus, if the negotiating bank without being nominated by the issuing bank wants to increase profit by negotiation transaction, the best solution is to requests the issuing bank through the beneficiary to change the nominated bank. Moreover, as a risk management measure, the negotiating bank should enter into an agreement with the beneficiary to assure reimbursement, request collateral for the purchase, and strictly examine the documents.

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