

1984

## Letters of Credit in East-West Trade: Soviet Reception of Capitalist Custom

George M. Armstrong, Jr.

Follow this and additional works at: <https://scholarship.law.vanderbilt.edu/vjtl>



Part of the [Commercial Law Commons](#), and the [International Trade Law Commons](#)

---

### Recommended Citation

George M. Armstrong, Jr., Letters of Credit in East-West Trade: Soviet Reception of Capitalist Custom, 17 *Vanderbilt Law Review* 329 (2021)

Available at: <https://scholarship.law.vanderbilt.edu/vjtl/vol17/iss2/3>

This Article is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Journal of Transnational Law by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact [mark.j.williams@vanderbilt.edu](mailto:mark.j.williams@vanderbilt.edu).

# LETTERS OF CREDIT IN EAST-WEST TRADE: SOVIET RECEPTION OF CAPITALIST CUSTOM

*George M. Armstrong, Jr.\**

## Table of Contents

I. INTRODUCTION AND OVERVIEW OF SOVIET DOMESTIC COMMERCIAL TRANSACTIONS . . . . .	330
II. LAWS AND CUSTOMS GOVERNING SOVIET INTERNATIONAL FINANCE . . . . .	335
III. LETTERS OF CREDIT IN SOVIET INTERNATIONAL COMMERCIAL TRANSACTIONS . . . . .	337
A. General Characteristics . . . . .	337
B. The U.S.S.R. Bank for Foreign Trade's Security . . . . .	339
C. Protection of the Buyer . . . . .	341
D. Documents of Delivery in a Letter of Credit Transaction . . . . .	343
1. <i>General Inspection</i> . . . . .	344
2. <i>The Commercial Invoice</i> . . . . .	346
3. <i>The Bill of Lading</i> . . . . .	348
E. Relations Between the U.S.S.R. Bank for Foreign Trade and the FTO After the Documents Arrive . . . . .	354
1. <i>Seller's Breach of the Contract of Sale</i> . . . . .	354
2. <i>The U.S.S.R. Bank for Foreign Trade's Security for Reimbursement</i> . . . . .	355
IV. DOCUMENTARY DRAFTS AND BANK GUARANTEES . . . . .	357
A. Documentary Drafts . . . . .	357
B. Bank Guarantees and "Standby" Letters of Credit . . . . .	360

---

\* Associate Professor of Law, Louisiana State University Law School. Ph.D. 1982, Princeton University; J.D. 1981, University of Pennsylvania Law School; M.A. 1977 Princeton University; B.A. 1974, Vanderbilt University. Professors James Brook and Michel Rosenfeld of New York Law School have offered many useful comments on this article. Mr. Henry Saurborn, a member of the class of 1986 at New York Law School, assisted in the preparation of the text and notes.

V. CONCLUSION ..... 362

I. INTRODUCTION AND OVERVIEW OF SOVIET DOMESTIC  
COMMERCIAL TRANSACTIONS

A United States merchant contemplating a commercial sale to a Soviet buyer<sup>1</sup> initially may imagine that negotiating a contract of sale and arranging for payment with an enterprise in a centrally-planned economy present insurmountable, or at least incomprehensible, obstacles to those accustomed to working in free markets. Soviet industrial production<sup>2</sup> and internal commercial banking<sup>3</sup> are governed by the National Economic Plan and administered by governmental ministries supervising various sections of the economy. The governmental ministry in charge of the production of steel,<sup>4</sup> for example, composes an annual plan for each steel factory and determines the types of steel that each enterprise is to manufacture. This ministry also allocates the output of steel factories in coordination with the ministries that supervise the consumers of steel products, such as tractor<sup>5</sup> and automobile<sup>6</sup> manufacturers.

The contractual document that formalizes commercial relations between producers and purchasers of steel in the Soviet Union resembles an agreement negotiated and executed in capitalist economies in form only.<sup>7</sup> The general, substantive terms of all contracts of sale between Soviet state-owned firms are governed by the Statute on Deliveries of Goods of an Industrial-Technical Nature, enacted by the U.S.S.R. Council of Ministers.<sup>8</sup> The governmental ministries that directly administer socialist firms that produce and consume industrial products jointly draft "special

1. In 1978, Soviet trade with "developed capitalist countries" amounted to 19.7 billion rubles, which represents 28.3% of all Soviet foreign trade. A. ROMLEIDRA, *DENEZHNOE OBRASHCHENIE I KREDIT SSR* 314 (1979).

2. See A. NOVE, *THE SOVIET ECONOMY: AN INTRODUCTION* 87-110 (2d ed. 1968).

3. See *USTAV GOSUDARSTVENNOGO BANKA SSSR*, SP SSSR, 1960, No. 18, st. 160 [hereinafter cited as *USTAV GOSBANKA*].

4. Ministry of the Iron and Steel Industry.

5. Ministry of the Tractor and Agricultural Machinery Industry.

6. Ministry of Automobile and Truck Industry.

7. See generally Loeber, *Plan and Contract Performance in Soviet Law*, 1964 U. ILL. L.F. 128.

8. SP SSSR, 1969, No. 11, st. 64 [hereinafter cited as *Statute on Deliveries*].

terms of delivery" applicable to those transactions.<sup>9</sup>

The financing of a sale of goods between socialist enterprises is also directed by the central government.<sup>10</sup> The Soviet economy has retained certain *forms* of commercial finance familiar to Western merchants, such as letters of credit<sup>11</sup> and documentary drafts.<sup>12</sup> The U.S.S.R. State Bank (State Bank), however, assumes a much greater role in supervising Soviet internal commercial financing than a United States bank would undertake for similar transactions.<sup>13</sup> The Statute on Deliveries and relevant "special terms of delivery" ordinarily dictate the method of payment for sales between Soviet firms.<sup>14</sup>

Arrangements for the purchase and sale of goods and for payment among the countries constituting the Council for Mutual Economic Assistance (COMECON) generally follow the Soviet internal model.<sup>15</sup> The ministries of Foreign Trade of COMECON member countries execute annual protocols which specify the products that these countries will purchase from one another.<sup>16</sup> The Ministry of Foreign Trade then instructs the governmental ministry that directly supervises the relevant manufacturing firm

9. *E.g.*, *Osobyie usloviia sdachii postavki loma i otkhodov tsvetnykh metallov* (Special Terms of Delivery of Scrap and Broken Light Metal), 1 BIULETEN' NORMATIVNYKH AKTOV 35 (1977) (governing the purchase and sale of scrap metal).

10. The Charter of the U.S.S.R. State Bank declares in pertinent part: "The U.S.S.R. State Bank organizes and executes payment between enterprises, organizations and establishments for goods and services in addition to other payments. In undertaking payment operations, the U.S.S.R. State Bank supervises performance by enterprises, organizations and establishments of monetary and contractual discipline." USTAV GOSBANKA, *supra* note 3, art. 1.

11. *O beznalichnykh raschetakh i kreditovanii po operatsiam, sviazannym s raschetami* (On Moneyless Payment and Credit in Operations Connected with Payments), INSTRUKTSIIA GOSUDARSTVENNOGO BANKA SSSR, July 10, 1970, with amendments through February 6, 1978, §§ 181-193 [hereinafter cited as INSTRUKTSIIA GOSBANKA].

12. *Id.* §§ 6-43.

13. Armstrong, *Financing a Sale of Goods in a "Planned Market": Buyer, Seller and Bank in the U.S.S.R.*, 21 COLUM. J. TRANSNAT'L L. 243, 247-49 (1983).

14. In addition to letters of credit and documentary drafts, socialist firms may render payment through "special accounts," INSTRUKTSIIA GOSBANKA, *supra* note 11, §§ 220-225, through bank guarantees, *id.* §§ 237-292, by check, *id.* §§ 300-373, or by "planned payment," *id.* §§ 384-388.

15. Iu. S. SHIRIAEV, *MEZHDUNARODYNE PROIZVODSTVENNYE SISTEMY* 194-201 (1981).

16. *Id.*

to incorporate the items contained in the protocol into the firm's annual production plan. Upon shipment of the goods, the manufacturing firm transmits a draft, bill of lading, invoice, and any other necessary documents to its branch of the State Bank.<sup>17</sup> The State Bank transmits those documents to the State Bank in the buyer's country.<sup>18</sup> The buyer's bank automatically honors the draft<sup>19</sup> without consultation with the purchaser. The State Banks of the two countries then settle their accounts through the International Bank of Economic Cooperation,<sup>20</sup> the financial institution of COMECON.

Fortunately, from the standpoint of Western merchants, most of the intricacies of the Soviet and COMECON systems of economic planning are irrelevant in regard to international transactions. Realizing the importance of trade with developed capitalist countries, Soviet leaders have modified their economic system by creating discrete institutions and legal norms for the conduct of business with merchants from free market economies.<sup>21</sup> The U.S.S.R. Foreign Trade Arbitration Commission (FTAC), for example, resolves disputes arising from international commercial relations.<sup>22</sup> The FTAC applies rules of decision familiar to Western

---

17. Litinskaia, *O detsentralizovanykh raschetakh vo vneshnei torgovle* (On Decentralized Payments in International Trade), 1976 DEN'GI I KREDIT, 82, 83.

18. *Id.*

19. A. ZWASS, MONEY, BANKING & CREDIT IN THE SOVIET UNION AND EASTERN EUROPE 190 (1979).

20. Ustav Mezhdunarodnogo Banka Ekonomicheskogo Sotrudnichestva (Charter of the International Bank of Economic Cooperation), Ved. Verkh. Sov. SSSR, (1964, No. 7, st. 83, § 13).

21. In 1921 Lenin's Bolshevik government first gave trading concessions to firms from capitalist countries. The practice of allowing these concessions was discontinued under Stalin.

22. The Russian Socialist Federal Soviet Republic (RSFSR) Civil Code provides in pertinent part:

In the cases laid down by law or international treaty, a dispute arising from a civil law relationship may, on the agreement of the parties, be transferred for a decision to a chosen arbitration court (third party court), the Maritime Arbitration Commission, or the Foreign Trade Arbitration Commission of the U.S.S.R. Chamber of Commerce and Industry.

RSFSR CIV. CODE art. 27 (1964 as amended).

If a Soviet firm loses its case before the FTAC, but does not voluntarily execute the FTAC's judgment, the plaintiff may present the judgment to a Soviet People's Court for enforcement. *O Vneshnetorgovoi Arbitrazhnoi Komissii pri Vsesoiuzno Torgovoi Plate* (On the International Trade Arbitration Commission of the All-Union Chamber of Commerce), SZ SSSR, 1932, No. 48, st. 281, § 12.

merchants and, in keeping with the Soviet policy of fostering international trade, generally renders judgments in accord with international mercantile practice.<sup>23</sup> Moreover, the rules of decision applied to foreign trade contracts subject to Soviet law are governed by the Russian Socialist Federal Soviet Republic (RSFSR) Civil Code and not the Statute on Deliveries between socialist firms.<sup>24</sup> The RSFSR Civil Code was drafted using the civil codes of Western European nations as models.<sup>25</sup> Although its provisions are less sophisticated and detailed than the civil codes of free market nations,<sup>26</sup> the RSFSR Civil Code unmistakably reflects the free market orientation of its drafters.<sup>27</sup> In addition, the Soviet Union has adopted the methods of financing international sales prevailing among free market countries and generally employs letters of credit in which the role of Soviet banks and their handling of drafts and other documents are modeled on Western practices.<sup>28</sup>

Because Soviet industrial enterprises are not legally competent to execute international contracts, Western merchants negotiate transactions with state-owned firms in the Soviet Union through Soviet Foreign Trade Organizations (FTOs).<sup>29</sup> Representatives of the FTO, individuals from the Soviet enterprise interested in the deal, and often officials of the U.S.S.R. Ministry of Foreign

---

23. See Armstrong, *The Problem of Autonomy in Soviet International Contract Law*, 31 AM. J. COMP. L. 63, 63-67 (1983).

24. See *supra* notes 8-9 and accompanying text.

25. I ENTSIKLOPEDIJA GOSUDARSTVA I PRAVA 509. The first RSFSR Civil Code was enacted in 1922. The present Civil Code was enacted in 1964. *Id.*

26. For example, a pledge is the only mechanism for securing repayment of a loan with property of the debtor. RSFSR CIV. CODE, arts. 192-202 (1964, as amended).

27. A.G. Goikhbarg, chairman of the drafting commission of the first RSFSR Civil Code, was trained under the tsarist legal system. Lenin, who was in poor health at the time, criticized the initial draft of the Civil Code, writing, "Do not play up to 'Europe,' instead push forward further in intensifying intervention of the state in 'private law relations,' in civil cases." 44 POLNOE SOBRANIE SOCHINENII 411-12. Lenin's failing health, however, did not permit him to influence the drafting process and enabled Goikhbarg to ignore his admonition.

28. See A. ZWASS, *supra* note 20, at 190.

29. The Government of the U.S.S.R. exercises a monopoly on all foreign trade. O Vneshnei Torgovle, Dekret VTsIK (On Foreign Trade, Decree of All-Russian Central Executive Committee), Mar. 13, 1922 (SU RSFSR, 1922, No. 24, st. 266). The Ministry of Foreign Trade implements this monopoly through All-Union Foreign Trade Organizations (FTOs). Soviet industrial enterprises may not directly enter foreign trade contracts. *Id.*

Trade, all participate in negotiations with Western merchants. Ordinarily, the representatives of the Soviet industrial firm negotiate the specifications of the goods, while the FTO officials, who are specialists in foreign trade, negotiate the terms of payment. If the negotiations produce a contract of sale, the FTO is named as the purchaser and its offices execute the document.<sup>30</sup> The FTO and the Western seller may agree upon any one of several forms of payment, including payment under a letter of credit issued by a bank in the seller's country,<sup>31</sup> acceptance and payment of the seller's drafts by the U.S.S.R. Bank for Foreign Trade,<sup>32</sup> or a guarantee by the Bank for Foreign Trade that it will honor the seller's drafts in the event of the buyer's default.<sup>33</sup> If a Soviet enterprise seeks to purchase goods from a Western merchant, a Soviet FTO will arrange with the Bank for Foreign Trade for the establishment of a letter of credit that names the merchant or its bank as beneficiary.<sup>34</sup>

This Article examines the Soviet system for financing the purchase and sale of goods by a Soviet enterprise from a Western merchant.<sup>35</sup> This Article is organized chronologically, commencing with the initial contact between a Western merchant and an FTO, the merchant's liaison with Soviet industrial enterprises.

---

30. The Soviet journal *Vneshnaia Torgovlia* (Foreign Trade), publishes monthly a compilation of the names of FTO officials authorized to sign contracts.

31. Discussion of this method of payment is omitted from this Article because letters of credit issued by banks outside the U.S.S.R. are not governed by Soviet law or commercial practice.

32. See *infra* notes 53-144 and accompanying text. For a description of the U.S.S.R. Bank for Foreign Trade, see *infra* notes 34, 61.

33. See *infra* notes 166-85 and accompanying text.

34. The U.S.S.R. Bank for Foreign Trade accepts documents of the title, checks, and other instruments for negotiation and payment; transfers funds to or from foreign countries at the request of its customers; opens, confirms, and advises documentary letters of credit; performs obligations under these credits; and negotiates notes and drafts drawn in Soviet or foreign currency. *Ustav Banka Dlia Vneshnei Torgovli Soiuzu Sovetskikh Sotsialisticheskikh Respublik* (SP SSSR, 1962, No. 16, st. 129, § 15) (Charter of the U.S.S.R. Bank for Foreign Trade) [hereinafter cited as *USTAV VNESHTORGBANKA*].

35. For recent analyses of other aspects of Soviet foreign commerce, see Elicker, *Western Joint Ventures to Carry Out Industrial Cooperation Agreements in the Soviet Union: Selected Problems for United States Parties*, 13 *INT'L LAW* 485 (1979); Hober, *Protection of Foreign Trademarks in the Soviet Union*, 14 *TEX. INT'L L.J.* 367 (1979); Shillinglaw & Stein, *Doing Business in the Soviet Union*, 13 *L. & POL. INT'L BUS.* 1 (1981).

The Article examines the role of the FTO in mediating relations between Soviet enterprises and their Western contracting partners. It then examines the procedures employed by the Bank for Foreign Trade to establish the credit, to handle the documentary transaction, and to determine whether to honor the seller's demand for payment. The Article finally considers two financing devices less frequently used in international trade, documentary drafts and bank guarantees.

## II. LAWS AND CUSTOMS GOVERNING SOVIET INTERNATIONAL FINANCE

Certain aspects of international finance have been governed by treaties and uniform national legislation for decades. The Geneva Convention on Notes and Drafts of 1930<sup>36</sup> provides uniform rules on the form of negotiable instruments, the procedure for their negotiation, and conflicts of law rules.<sup>37</sup> The Soviet Union adopted the Geneva Convention and incorporated it into its domestic law in 1937.<sup>38</sup> The United Nations Commission on International Trade Law (UNCITRAL) is currently drafting a new Convention on International Bills of Exchange and Promissory Notes.<sup>39</sup>

In contrast to the uniform rules on negotiable instruments, letters of credit and documentary drafts are generally regulated by customary banking practices. A respected Soviet authority has noted: "The rules of payment in the form of documentary letters of credit have been developed in international practice—in customs and conventions of international banking exchange."<sup>40</sup> The

---

36. Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes, June 7, 1930, 143 L.N.T.S. 259.

37. The United States and Great Britain have not adhered to the Geneva Convention on Notes and Drafts of 1930.

38. Polozhenie o Vekselakh, (Statute on Negotiable Instruments) (SZ SSSR, 1937, No. 52, st. 221). Enterprises in the U.S.S.R. may not issue promissory notes to one another. Drafts of socialist firms must be drawn on the State bank, and commercial acceptances are prohibited. The U.S.S.R. employs promissory notes only in foreign trade. V. MASLOV & A. PUSHKIN, SOVETSKOE GRAZHDANSKOE PRAVO: CHAST'VTORAIA 303 (1978).

39. UN Doc. A/CN.9/441 Annex (Aug. 10, 1977). UNCITRAL has attempted to create an optional negotiable instrument for use in international transactions. I. MEZNERICS, THE LAW OF BANKING IN EAST-WEST TRADE 243 (1973).

40. L. LUNTS, KURS MEZHDUNARODNOGO CHASTNOGO PRAVA (Course of Private International Law) 340 (1975); see also A. AL'TSHULER, VALIUTNYE OTNOSHENIYA VO VNESHNEI TORGOVLE SSSR 79 (Currency Operations in U.S.S.R. Foreign Trade) (1968).

International Chamber of Commerce (ICC), an organization composed of representatives from national chambers of commerce of most major noncommunist countries,<sup>41</sup> was established in the early part of this century to formulate the Uniform Customs and Practices for Commercial Documentary Credits (UCP).<sup>42</sup> The principal drafters of the UCP were bankers operating under the auspices of the ICC.<sup>43</sup>

Because the U.S.S.R. Chamber of Commerce is not a member of the ICC, the Bank for Foreign Trade did not initially adhere to the UCP. The Bank for Foreign Trade instead made special arrangements with its correspondent banks "containing a variety of rules by which these banks should be guided in performance of letter of credit obligations with Soviet banks."<sup>44</sup> On May 1, 1964, however, the Bank for Foreign Trade officially adhered to the UCP.<sup>45</sup> According to one Soviet author, the foreign trade banks of socialist countries have directly participated in the UCP revisions subsequent to 1964, and the Bank for Foreign Trade adhered to

---

41. The United States is at variance with most nations of the commercial world because letters of credit in this country are governed by mandatory legislation: Article 5 of the Uniform Commercial Code (UCC). The New York Clearing House Association recommended to that state's Law Revision Commission that it not enact Article 5, but, instead, leave the obligations of parties to letter of credit transactions under the regulation of the revised editions of the UCP. 1 New York Law Revision Commission, Report: Hearings on the Uniform Commercial Code 588-628 (1954).

The New York edition of the UCC provides in pertinent part: "Article 5 does not apply to a letter of credit or a credit if by its terms or by agreement, course of dealing or usage of trade such letter of credit or credit is subject in whole or in part to the [UCP] . . ."

NY UCC § 5-102(4) (McKinney 1964).

42. The ICC issued the first Uniform Customs and Practices in 1933. The ICC adopted the current edition in 1974. ICC, GUIDE TO DOCUMENTARY CREDIT OPERATIONS 39 (Brochure No. 305 1978) [hereinafter cited as ICC Brochure No. 305].

43. E. FARNSWORTH & J. HONNOLD, CASES AND MATERIALS ON COMMERCIAL LAW 444-45 (3d ed. 1976).

44. Al'tshuler and Volkov, *V mezhdunarodnykh raschetakh*, (On International Payments) 1964 Vneshnaia Torgovlia, No. 6, at 47.

45. A. AL'TSHULER, *supra* note 40, at 139. The UCP "have the character of authoritative international codification." *Id.* at 138. "Thus the Uniform Customs are not only obligatory for the U.S.S.R. Bank for Foreign Trade . . . [t]hey also direct Soviet courts and arbitration in resolving disputes over international documentary credits." *Id.*; see also I. MEZNERICS, *supra* note 39, at 41-42.

the latest revised edition on October 1, 1975.<sup>46</sup>

The ICC has developed Uniform Rules for the Collections of Documentary Drafts.<sup>47</sup> A Western observer of the Soviet foreign trade system noted in 1973 that the ICC Uniform Rules for Collections were being applied by foreign trade banks of socialist countries on the basis of a "tacit understanding."<sup>48</sup> A leading Soviet authority subsequently referred to the Uniform Rules for Collections as "a very significant statement in the creation of a legal basis for regulation of payment in the negotiation [of instruments]."<sup>49</sup> The U.S.S.R. Bank for Foreign Trade has adhered to these rules since 1967.<sup>50</sup> Al'tshuler, a Soviet authority on international finance, has stated, however, that the Bank for Foreign Trade is also guided by "its own general instructions and agreements with correspondent banks" in the handling of documentary drafts.<sup>51</sup>

### III. LETTERS OF CREDIT IN SOVIET INTERNATIONAL COMMERCIAL TRANSACTIONS

#### A. General Characteristics

Through letter of credit arrangements, banks "acting at the request and in accordance with the instructions of a customer . . . make payment to or to the order of a third party."<sup>52</sup> The salient feature of letter of credit financing is that the issuing bank assumes the obligation to pay the indebtedness of its customer—the importer—upon presentation of the appropriate documents by the exporter. The establishment of a letter of credit in favor of

---

46. Kazakova, *Novye "unifitsirovanye pravila i obychai dlia dokumentativnykh akkreditivov"* (redaktsiia 1974g.) (New "Uniform Rules and Customs for Documentary Credits" (1974 Edition)), 1976 VNESHNAIA TORGOVLIA, No. 1, at 46.

47. See ICC Brochure No. 305, *supra* note 42. In the United States, Articles 3 and 4 of the UCC govern banking procedures for the collection of documentary drafts.

48. I. MEZNERICS, *supra* note 39, at 179.

49. L. LUNTS, *supra* note 40, at 344.

50. *Id.*

51. A. AL'TSHULER, *supra* note 40, at 140.

52. UCP General Provisions sec. b(i) (1974). The UCC defines a letter of credit as "an engagement by a bank or other person made at the request of a customer . . . that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit." UCC § 5-103(1)(a) (1978).

the Western seller therefore removes all risks associated with the solvency or good faith of the Soviet purchaser. Under the UCP, the obligation of the bank issuing the letter of credit to pay the beneficiary is entirely independent of the obligations of the buyer under the contract of sale.<sup>53</sup>

From the seller's standpoint, the great advantage of a letter of credit is that the obligation of the bank to honor the beneficiary's demand for payment is independent from the willingness or ability of the buyer to pay for the goods. That independence also represents the greatest threat to the buyer. There is a possibility that the documents the seller presents to the bank may conform in all respects to the requisites of the letter of credit, while the goods actually shipped under the contract of sale are nonconforming or, indeed, nonexistent.

Legally, letter of credit obligations are analyzed as abstract, as existing independently of the foreign trade contract. Thus, there is no right to deny the exporter's demand for payment on the basis of circumstances connected with performance of the foreign trade contract, e.g. related to actual nonperformance of the contract or even in connection with its rescission or annulment.<sup>54</sup>

The bank issuing the letter of credit is unconcerned with the seller's actual performance of the contract of sale. Under the UCP, "all parties concerned deal in documents and not in

---

53. UCP General Provisions sec. c. As Al'tshuler says, "the importer is responsible for paying under the contract [of sale], at the same time the party responsible for paying under the letter of credit is the bank." A. AL'TSHULER, *supra* note 40, at 161. "After the letter of credit is opened, it acts as a completely separate obligation, legally unrelated to the payment obligation under the foreign trade contract. The bearer of this obligation is not the importer but the bank." Al'tshuler and Volkov, *supra* note 44, at 48.

The UCC is in accord: "An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary." UCC § 5-114(1); see *Sztejn v. J. Henry Schroder Banking Corp.*, 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941).

54. A. AL'TSHULER, *supra* note 40, at 162. In the absence of a provision in a letter of credit that the issuing bank, before honoring the documents, should look beyond the documents and enter into controversies between buyer and seller regarding the quality of the merchandise shipped, the court will not permit the bank to delay paying drafts that are proper in form, genuine, and whose terms conform to the requirements of the letter of credit. *Sztejn*, 177 Misc. at 721-23, 31 N.Y.S.2d at 633-34.

goods."<sup>55</sup>

The bank issuing the letter of credit assumes the risk of its customer's insolvency, bad faith, or unwillingness to reimburse the bank.<sup>56</sup> The buyer assumes the risk that the goods will not conform to the contract. The bank and buyer protect themselves against these risks in the provisions of the application for establishment of the letter of credit. These provisions ordinarily require the buyer to pledge assets to cover funds that the bank is obligated to pay the seller and stipulate which documents the bank is to examine before honoring the demand for payment and the terms to be contained therein.<sup>57</sup>

### B. The U.S.S.R. Bank for Foreign Trade's Security

The U.S.S.R. Bank for Foreign Trade is a general service bank for all Soviet FTOs. The Bank maintains several accounts for each FTO including a "general account" from which the FTO pays current expenses, an account for the payment of customs duties, and escrow accounts containing money due the FTO from foreign buyers.<sup>58</sup> In addition, the Bank for Foreign Trade opens "special accounts" containing funds loaned to an FTO for a particular purpose.<sup>59</sup> An FTO may obtain a loan and a special account for any of several purposes including the establishment of letters of credit by foreign banks or the Bank for Foreign Trade.<sup>60</sup>

---

55. UCP art. 8(a) (1975).

56. As one Soviet authority on finance notes, "the bank is obligated to perform its obligations under the letter of credit to the exporter even if it is unable to obtain compensation from the importer." F. BYSTROV, *VALIUTNYE I KREDITNYE OTNOSHENIA V MEZHDUNARODNOI TORGOVLE* (Currency and Credit Operations in International Trade) 82 (1972).

57. See *infra* notes 68-79 and accompanying text.

58. L. FREI, *MEZHDUNARODNYE RASCHETY I FINANSIROVANIE VNESHNEI TORGOVLI KAPITALISTICHESKIKH STRAN* (International Payments and Finance of Foreign Trade of Capitalist Countries) 98 (1965).

59. *Id.* at 100.

60. Frei states:

The Bank For Foreign Trade extends credit to FTOs on the following bases: For opening letters of credit abroad for payment to foreign firms for goods and services; for imported goods en route from abroad to the U.S.S.R. and also for goods bailed abroad; for imported goods located at ports and warehouses in the U.S.S.R. under documents of title consigned to Soviet buyers and also for expenses and advances contemplated in these transactions.

*Id.* at 104.

The application that the FTO submits to the Bank for Foreign Trade to establish a letter of credit in favor of a foreign seller contains a request to open a special loan account.<sup>61</sup> The FTO is entitled to the special loan account only if the Ministry for Foreign Trade has approved the transaction.<sup>62</sup> The terms of these special loan accounts ordinarily require the FTO to repay the indebtedness within three to twelve months.<sup>63</sup> As security for the special loan account, the FTO grants the Bank a right of set-off against all unrestricted accounts at the Bank and "pledges" its legal interest in the goods.<sup>64</sup> Thus, "the liquid assets of the borrowing organization are not impaired."<sup>65</sup> The Bank for Foreign Trade may also require that all documents of title covering the goods be endorsed "to the order of the Bank for Foreign Trade."<sup>66</sup>

If the letter of credit is opened on a loan provided by the bank, then customarily a term is included [in the credit] that the bill of lading is consigned, not to the importer, but to the bank. In the event of the insolvency of the importer the bank may independently sell the pledged goods and set off the funds against the sum paid to the exporter under the letter of credit.<sup>67</sup>

---

61. Nosko & Poliakov, *Valiutnaia monopoliia; mezhdunarodnye raschety SSSR* (Currency Monopoly: USSR International Payments), 1967 DEN'GI I KREDIT, No. 10 at 49-53.

62. *Id.*

63. *Id.* All foreign trade contracts are subject to the annual economic plan of the Ministry for Foreign Trade. See *supra* notes 15-19 and accompanying text.

64. L. FREI, *supra* 58, at 104-05; see Nosko & Poliakov, *supra* note 61, at 53. The FTO's "pledge" of the documents of title, or the goods they cover, occurs when the FTO is applying for the letter of credit, at a time when the FTO cannot convey either the documents or the goods to the Bank. Under United States law, a pledge may only occur upon the creditor's taking possession of the property. See UCC § 9-305 (1978). Soviet law provides: "Pledged property other than buildings must be handed over to the pledgee unless statute or the contract otherwise provides." RSFSR CIV. CODE art. 196 (emphasis added). Soviet law provides for public recording of security interests only in personal dwellings. *Id.* art. 197.

65. Nosko & Poliakov, *supra* note 61, at 53.

66. A. AL'TSHULER, *supra* note 40, at 80. United States banks issuing letters of credit generally retain the documents of title to the goods and all rights to the proceeds of their sale until the obligation of the buyer to the bank is extinguished. See, e.g., Application and Agreement for Commercial Letter of Credit of Citibank, N.A., R. RYAN, LETTERS OF CREDIT 333, 336 para. 8 (1981).

67. F. BYSTROV, *supra*, note 56, at 82.

The restrictive endorsement of the documents of title permits the bank to secure reimbursement from the FTO before it releases the goods to the purchaser.

### C. Protection of the Buyer

The only obligation of the bank issuing the letter of credit is to honor the credit, according to its terms, upon presentation by the beneficiary of documents,<sup>68</sup> which appear on their face to be in accordance with the terms and conditions of the credit.<sup>69</sup> A buyer's interest in ensuring that goods have been shipped in the manner and under the conditions to which the buyer and seller contractually agreed is protected by stipulating in the application for the letter of credit the documents that the bank is to accept.<sup>70</sup>

Upon purchasing goods abroad, the FTO gives the Bank for Foreign Trade an application for opening a letter of credit in which all the terms contained in the sales contract relating to the credit, such as the requisite documents of title, invoices, purchase price and the schedule of payment are included.<sup>71</sup>

A buyer ordinarily provides in the application that the seller must present documents evidencing shipment, insurance policies, and a commercial invoice.<sup>72</sup>

The buyer, as the applicant for the letter of credit, ordinarily requires the seller, as the beneficiary, to present documents containing certain notations. For example, to verify that goods have

---

68. "All instructions to issue, confirm or advise a credit must state precisely the documents against which payment, acceptance or negotiation is to be made." UCP art. 14(a) (1974).

69. The UCP provides:

Payment, acceptance or negotiation against documents which appear on their face to be in accordance with the terms and conditions of a credit by a bank authorized to do so, binds the party giving the authorization to take up the documents and reimburse the bank which has effected payment, acceptance or negotiation.

UCP art. 8(b) (1975).

The bank "takes upon itself the responsibility for paying the sum specified in the credit upon presentation of the requisite documents." A. AL'TSHULER, *supra* note 40, at 80.

70. UCP art. 14(a).

71. L. FREI, *supra* note 58, at 104.

72. The application may also require the seller to present consular invoices, certificates of origin, delivery orders, and other papers indicating that conforming goods have been properly and legally shipped. UCP art. 33.

actually been shipped, the buyer may require the seller to present a bill of lading with the notation that the goods are "on board" rather than merely "received for shipment."<sup>73</sup> A careful buyer specifies in the application for a letter of credit "the terms which the contract of sale contains in relation to the quantity, quality and schedule for delivery of the goods are transformed, through the application for the credit, into notations on the documents relating to the goods and the schedule for shipment and payment."<sup>74</sup>

Pursuant to Soviet contract law, a buyer may require the seller to present documents to the bank to indicate that the seller has complied with all terms of the contract of sale.<sup>75</sup> If, however, the buyer includes a term in the letter of credit application that is not in the contract of sale, the buyer is in breach of the sales contract.<sup>76</sup> In contrast, if the buyer fails to include a relevant term from the sales contract in the application for a letter of credit, the buyer loses the protection ordinarily afforded by the bank's inspection of that term in documents of delivery. The bank's inspection of the seller's documents of delivery is guided only by the buyer's application for the letter of credit.<sup>77</sup> "Thus if the letter of credit does not require the beneficiary to present a document which the contract of sale calls for the seller to present, the buyer has no claim against the bank for the bank's failure to require this document."<sup>78</sup> Moreover, the complete conformity of

---

73. The UCP permits the issuing bank to accept only an "on board" bill of lading unless its customer has specified that another notation is acceptable. *Id.* art. 20(a).

74. Al'tshuler & Volkov, *supra* note 44, at 48. In addition to providing that the bill of lading is to be issued once the goods are "on board," the application ordinarily specifies that the bill of lading must be "clean." See *infra* notes 121-24 and accompanying text. The buyer may require the bill of lading to signify that freight has been prepaid and that the bill has been issued not later than a specified date. The buyer also specifies whether the seller is to ship the goods F.O.B., F.A.S., or C.I.F. and whether transshipment of a partial shipment of the goods is permitted. See *infra* notes 125-27 and accompanying text.

75. A. AL'TSHULER, *supra* note 40, at 161.

76. For example, the sales contract provided "F.O.B. seller's place of business" as the delivery term, but the letter of credit required the seller to present a bill of lading marked "C.I.F." or the buyer would be considered in breach of the sales contract.

77. Al'tshuler & Volkov, *supra* note 44, at 48.

78. *Id.* "The bank-issuer has responsibility only for formal performance of the instructions of its customer." A. AL'TSHULER, *supra* note 40, at 165.

the documents of delivery to the requirements of the letter of credit and the contract of sale does not guarantee that the seller has actually shipped conforming goods.<sup>79</sup>

#### D. Documents of Delivery

A seller demands payment from a letter of credit by presenting to the bank all the documents of delivery required by the letter of credit. Article 7 of the UCP provides in part: "Banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit."<sup>80</sup> The Western merchant is interested in the practices and procedures of the U.S.S.R. Bank for Foreign Trade that have been established for the examination of delivery documents because these practices and procedures determine whether the Bank will accept those documents and honor the seller's demand for payment. There are, however, few sources of authority on the practices and procedures of the Bank for Foreign Trade. The Bank has not published its internal regulations on documentary inspection, and no litigation examining the Bank's procedures has been discovered. The writings of Soviet scholars explaining the procedures contained in the UCP to domestic readers are the most authoritative guide to Western merchants on the practices of the Bank for Foreign Trade.

---

79. See *infra* note 120 and accompanying text.

80. UCP art. 7. The UCC provides:

An issuer must examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit but unless otherwise agreed assumes no liability or responsibility for genuineness, falsification or effect of any document which appears on such examination to be regular on its face.

UCC § 5-109(2) (1978).

The ICC Commission on Banking Technique and Practice has published two collections of decisions, Banking Commission Decisions 1975-1979, ICC No. 371 (Decisions 1979), and Banking Commission Opinions 1980-1981, ICC No. 399 (Opinions 1981), interpreting the UCP. As an example of the bank's obligation to inspect the documents, the ICC has ruled that the issuer is not required to check individual calculations made by the seller in a commercial invoice, but the bank may be liable to the buyer if it failed to notice obvious errors on the face of a commercial invoice. Decisions 1979, *supra*, R.40.

### 1. General Inspection

Soviet scholars reiterate the basic standard of inspection contained in the UCP: the delivery documents should "appear on their face to be in accordance with the terms and conditions of the credit."<sup>81</sup> Soviet scholars also adhere to the generally accepted international standard that "the bank may not verify the accuracy of the documents and, moreover, bears absolutely no responsibility for the quality or quantity of the goods shipped."<sup>82</sup> The Bank for Foreign Trade also "assumes no responsibility for possible alteration of the documents in transit or for falsity of any telegraphic transmission."<sup>83</sup>

If the documents presented by the seller fail to conform in some insignificant respect to the specifications of the letter of credit, the issuing bank may contact the buyer to ascertain whether the buyer will waive the discrepancy.<sup>84</sup> This procedure is sound commercial practice because the buyer is in the best position to determine whether the nonconformity is immaterial. Moreover, the buyer's need for the goods may be so pressing that it will waive the discrepancy in order to obtain the merchandise. The UCP "does not deal with the question of whether the issuing bank had a right to inform its customer of the existence of a discrepancy in the documents or to consult with the buyer."<sup>85</sup> The Western seller should not, however, expect the Bank for Foreign Trade to contact the buyer to discuss a waiver of document discrepancies. Soviet scholars consider the acceptance or rejection of

---

81. Kazakova, *supra* note 46, at 47. Kazakova refers to this rule as the "principle of external conformity," noting that documents which conflict with one another are not in conformity. *Id.*

82. G. ELIN, *INOSTRANNYE VALIUTY; MEKHAZIM MEZHDUNARODNYKH RASCHETOV* (Foreign Currency: Mechanism of International Payments) 167 (1946). This rule accords with UCP art. 9, and the practice of United States courts in applying the UCC, *see, e.g.*, *Bossier Bank & Trust Co. v. Union Planters National Bank*, 550 F.2d 1077 (6th Cir. 1977); *Dovenmuehle, Inc. v. East Bank*, 563 P.2d 24 (Colo. App. 1977). The obligation of the bank issuing a letter of credit under the UCC, to pay on that letter of credit, depends upon whether the documents presented to it conform to the credit's requirements. *See, e.g.*, *Fair Pavillions, Inc. v. First Nat'l City Bank*, 19 N.Y.2d 512, 227 N.E.2d 839, 281 N.Y.S.2d 23 (1967).

83. G. ELIN, *supra* note 82, at 161; *see* UCP art. 10.

84. United States banks generally follow the same procedure. *See* *Anglo-South Am. Trust Co. v. Uhe*, 261 N.Y. 150, 184 N.E. 741 (1933).

85. Kazakova, *supra* note 46, at 50.

a seller's demand for payment to be the sole prerogative of the Bank. Kazakova states that "the conduct which the Bank is obligated to take is clearly defined . . . [t]he bank must within a reasonable time examine the documents and decide whether they coincide with the requirements for payment from the letter of credit."<sup>86</sup> Moreover, in view of the legal restraints imposed on the managers of Soviet firms, the director of any FTO who knowingly waives contractual specifications for imported goods risks his career.

The U.S.S.R. Bank for Foreign Trade can follow either of two alternative procedures to preserve the transaction of sale upon receipt of documents that do not conform to the letter of credit. In lieu of rejecting the seller's demand for payment, the Bank may accept a letter of indemnity from the seller or a guarantee from the seller's bank.<sup>87</sup> The seller covenants not to hold the Bank liable and to return the money received from the credit if the buyer refuses to accept the tendered documents.<sup>88</sup> If, however, there is a "serious discrepancy" between the documents presented and the terms of the letter of credit, "the Bank may accept the documents for negotiation, not rendering any kind of payment, not even a conditional payment" from the credit.<sup>89</sup> This procedure transforms the letter of credit into an "on arrival draft."<sup>90</sup> The Bank holds the documents until the goods arrive and the buyer inspects the merchandise.<sup>91</sup> If the buyer determines that the goods conform to the contract of sale, it honors the seller's draft by authorizing payment from the special account. If a discrepancy between the delivery documents and the letter of credit requires the Bank to resort to this procedure, "all the advantages of the letter of

---

86. *Id.*

87. BYSTROV, *supra* note 56, at 82.

88. *Id.* (citing UCP art. 8).

89. A. AL'TSHULER, *supra* note 40, at 184.

90. "On arrival drafts" are not an aspect of letter of credit operations and thus are outside the scope of the UCP. Under the UCC, "[w]hen a draft or the relevant instructions require presentment 'on arrival,' 'when goods arrive' or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired." UCC § 4-502 (1977).

91. Because the UCP requires the issuing bank to either honor the seller's demand or to notify the seller's bank that the documents are nonconforming, UCP art. 8(a)-(e), the U.S.S.R. Bank for Foreign Trade can only follow this procedure of converting a letter of credit into an "on arrival draft" after securing the seller's consent.

credit form of payment are for naught."<sup>92</sup>

## 2. *The Commercial Invoice*

The conformity of the goods described in the commercial invoice with the description contained in the contract of sale and that transposed onto the letter of credit is ordinarily the buyer's only assurance that the goods shipped by the seller comply with the terms of the contract. The UCP states: "The description of the goods in the commercial invoice must correspond with the description in the credit. In all other documents the goods may be described in general terms not inconsistent with the description of the goods in the credit."<sup>93</sup> Soviet scholars are even more emphatic in stating that the goods described in the invoice conform to the description in the letter of credit:

The regulations contained in the [UCP] have special significance on the requirement that the name of the goods in the invoice must *exactly* correspond with the name in the text of the letter of credit. Banks should not accept an invoice having even the most *insignificant* variation in the name of the goods in comparison with that required by the letter of credit.<sup>94</sup>

International practice amply supports this rigorous requirement of conformity of the invoice with the letter of credit. As stated in an oft-cited English case, "there is no room for documents which are almost the same, or which will do just as well."<sup>95</sup>

---

92. A. AL'TSHULER, *supra* note 40, at 184.

93. UCP art. 32(c).

94. Al'tshuler and Volkov, *supra* note 44, at 50 (emphasis added).

95. Equitable Trust Co. v. Dawson Partners, Ltd., 27 Lloyd's List L.R. 49, 52 (1926), *cited with approval in* Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 806 (4th Cir. 1975) (letter of credit required "100% acrylic yarn" and the invoice referred to the goods as "imported acrylic yarn"); *see also* H. HARFIELD, *BANK CREDITS AND ACCEPTANCES* 73 (1974).

The ICC has ruled that the requirements of the letter of credit were not met when the invoice described the goods as "second hand" and the letter of credit contained no such term. Opinions 1981, *supra* note 80, R.80. On the other hand, a seller was entitled to recover from the issuing bank when the letter of credit covered sugar of a certain description and the commercial invoice reproduced this description but with the addition of a brand name. The ICC noted that the addition of the brand name rendered the invoice more complete and did not derogate from the requirement that the invoice "correspond" to the credit. Opinions 1981, *supra* note 80, R.81. New York courts have held that a bank might accept an invoice describing the merchandise as "unground casein" even

The policy underlying this strict conformity rule is that "[a]n issuer's obligation to its customer . . . does not include liability or responsibility . . . based on knowledge or lack of knowledge of any usage of any particular trade."<sup>96</sup> Bankers cannot be expected to know, for example, whether "machine shelled ground nut kernels" are interchangeable with "coromandel groundnuts."<sup>97</sup> Bankers are responsible only for knowing and following the customs of the banking profession.<sup>98</sup> Nor can the seller or buyer reasonably expect the bank to consult industry experts or reference works to determine whether the term employed in the invoice to describe the goods is synonymous with the description in the letter of credit. By rigorously applying the requirement of conformity, the bank protects itself against a claim by the buyer that it wrongfully honored the letter of credit. The seller whose demand for payment from the credit is rejected can only blame his own careless drafting of the invoice.

In addition to a description of the goods shipped, the commercial invoice states the price of the goods and, thus, the amount of money to which the seller claims to be entitled from the letter of credit. Unless the letter of credit permits shipments by installment and partial payment,<sup>99</sup> the amount of the invoice should coincide precisely with the amount of the credit.<sup>100</sup> The UCP states: "Unless otherwise specified in the credit, banks may refuse commercial invoices issued for amounts in excess of the amount per-

---

though the credit referred to the goods as "casein." *Bank of N.Y. & Trust Co. v. Atterbury Bros.*, 226 A.D. 117, 234 N.Y.S. 442 (1929), *aff'd*, 253 N.Y. 569, 171 N.E. 786 (1930).

96. UCC § 5-109(1)(c).

97. *See J. H. Raynor & Co. v. Hambros Bank, Ltd.*, [1942] 2 All E.R. 694 (C.A.).

98. UCC § 5-109(1).

99. The UCP allows partial payments "unless the credit specifically states otherwise." UCP art. 35(a). Applications for letters of credit at United States banks commonly specify whether or not the buyer permits installment shipments.

100. "The amount referenced in the invoice must coincide with the amount of the letter of credit. It must be emphasized that the amount of the invoice not only should not be greater, it should also not be less than the credit." A. AL'TSHULER, *supra* note 40, at 181. The ICC has also ruled that banks should not accept an invoice stating a smaller sum than that referenced in the credit unless the credit contains words such as "up to" or language of similar sense. Decisions 1979, *supra* note 80, R.44.

mitted by the credit."<sup>101</sup> "The UCP provides the bank with discretion in relation to the possibility of accepting invoices exceeding the sum of the letter of credit. Thus, banks may accept such invoices without violation of the terms of the credit."<sup>102</sup> Although a bank may never pay the seller a sum greater than that specified in the letter of credit, a bank may honor the invoice to the extent of the funds specified in the letter of credit.<sup>103</sup>

Soviet scholars emphasize that the Bank for Foreign Trade would honor an invoice in excess of the amount of the credit only in extraordinary circumstances. The discretion that the UCP affords the issuer bank "does not mean that the bank decides the matter capriciously."<sup>104</sup> The Bank for Foreign Trade would not honor an invoice if the document disclosed that the seller had increased the price of the goods or had included in the invoice costs that the letter of credit had allocated to the seller.<sup>105</sup> "The basic criterion to which the bank is subject in such cases is the reason for which the invoice amount exceeds the amount of the credit."<sup>106</sup> The Soviet commentator, Al'tshuler, however, does not provide cases in which the invoice amount permissibly exceeded the amount of the credit.<sup>107</sup> Bystrov observes that an exporter who discovers that he will not be able to abide by the terms of the credit because of an increase in the cost of raw materials or carriage, "should communicate with the importer and negotiate alterations in the terms of the credit."<sup>108</sup>

### 3. *The Bill of Lading*

Bills of lading perform several functions in letter of credit transactions. They indicate whether the carrier received the goods in apparent good order<sup>109</sup> and whether the seller shipped the goods according to the terms of the contract.<sup>110</sup> Pursuant to So-

---

101. UCP art. 32(b).

102. A. AL'TSHULER, *supra* note 40, at 181; *see also* Kazakova, *supra* note 46, at 48.

103. A. AL'TSHULER, *supra* note 40, at 181.

104. *Id.*

105. *Id.*

106. *Id.*

107. War risk insurance in a CIF contract, however, might be an example. *See* UCC § 2-320.

108. F. BYSTROV, *supra* note 56, at 82.

109. *See infra* notes 120-24 and accompanying text.

110. *See infra* notes 125-27 and accompanying text.

viet law, bills of lading also provide a method of transferring ownership in the merchandise without delivering possession.<sup>111</sup>

The obligations of the shipper and carrier<sup>112</sup> and the negotiability of the bill of lading may depend upon the nationality of the law governing the contract of carriage.<sup>113</sup> The Brussels Convention on Unification of Certain Rules on Bills of Lading provides general international standards on the liabilities of parties to contracts of carriage.<sup>114</sup> Although the U.S.S.R. has not adhered to this Convention, the Merchant Shipping Code adopts many of its norms and "the reasonableness of the U.S.S.R.'s adherence to the treaty is mentioned in the works of Soviet authors."<sup>115</sup> The Merchant Shipping Code governs any bill of lading issued under a contract of carriage executed in the U.S.S.R. "unless otherwise established by agreement of the parties."<sup>116</sup>

International letter of credit transactions generally require the seller to present a "clean" bill of lading that conforms to the terms of the letter of credit, is dated not later than a time specified in the letter of credit, and issued by a carrier. The letter of credit may also require the bill of lading to be negotiable. Under a bill of lading governed by Soviet law, once the seller has had the opportunity to examine the document, he is estopped from making any claim against the carrier for inadequacy of the bill in any of these respects.<sup>117</sup>

111. See *infra* notes 135-43 and accompanying text.

112. The obligations of the carrier to the person entitled to the goods under the bill of lading are outside the scope of this Article.

113. The chartering of a vessel is governed exclusively by national law. O. SADIKOV, PRAVOVOE REGULIROVANIE MEZHDUNARODNYKH PEREVOZOV (Legal Regulation of International Shipments) 195 (1981). A contract to charter a Soviet vessel executed in the U.S.S.R. is also governed by Soviet law. MERCHANT SHIPPING CODE OF THE U.S.S.R. [hereinafter cited as MERCHANT SHIPPING CODE] art. 14(11) (1968).

114. Convention for the Unification of Certain Rules Relating to Bills of Lading, August 25, 1924, reprinted in KNAUTH, OCEAN BILLS OF LADING 37-72 (4th ed. 1953).

115. O. SADIKOV, *supra* note 113, at 218.

116. MERCHANT SHIPPING CODE § 14(11); see also N. POZDNIKOV, EKSPORTNO-IMPORTNYE OPERATSII 206 (1970). The U.S.S.R. Ministry of the Maritime Fleet drafts all Soviet bills of lading. *Id.* at 213. A bill of lading issued under a contract of carriage executed by a United States exporter in Moscow would be governed by Soviet law, even if the bill of lading itself was issued by the Soviet carrier in the port of New York. "[The] bill of lading is not the contract of carriage, but only evidence of it." O. SADIKOV, *supra* note 113, at 216.

117. Kokin, *Vneshnetorgovyi konasament kak tsennaia bumaga* (Interna-

The shipper [exporter] should inspect the bill of lading and establish that it is legally competent to transfer ownership of the goods. The period for presenting claims on the legal invalidity of the bill of lading begins from the moment when the shipper was able to examine the bill of lading. Insufficiencies of the bill of lading usually become visible upon presentation of the bill of lading to the shipper. If complaints about inadequacy of the bill of lading are not made before the ship leaves port then it is considered that the shipper has no claim against the carrier. The primary creditor before departure of the ship from port has the right to demand removal of deficiencies from the bill of lading or refuse the contract of shipment, for example if the date of the bill of lading does not correspond to the date of the letter of credit.<sup>118</sup>

The seller's failure to inspect the bill of lading precludes any claim against the carrier in the event the Bank for Foreign Trade determines that the document cannot convey ownership of the cargo or that the goods have been misdescribed.<sup>119</sup>

From the standpoint of the buyer, the description of the goods in the bill of lading is secondary to the description in the commercial invoice. Even though the cargo master of the carrier executes the bill of lading, he has no direct knowledge of the contents of the cargo being shipped.<sup>120</sup> On the other hand, the buyer and the bank issuing the letter of credit rely upon the bill of lading as evidence that the goods were shipped in apparent good order. Although Soviet law permits the carrier to include a clause in the bill of lading stating that "the weight, quantity, quality, content and value" of the cargo is unknown,<sup>121</sup> the carrier must note

---

tional Bill of Lading as Commercial Paper), 1974 Sov. Gos. I PRAVO, No. 7, at 124, 127.

118. *Id.*

119. *See id.*

120. Under Soviet law, the seller is responsible to the carrier for "all consequences of the incorrectness or inaccuracy of information specified" in the bill of lading. MERCHANT SHIPPING CODE § 123. The UCP provides that the description of the goods in the bill of lading may be "in general terms not inconsistent with the description of the goods in the credit." UCP art. 32(c).

121. O. SADIKOV, *supra* note 113, at 226. The UCC also permits the issuer of a bill of lading to include a similar disclaimer. UCC § 7-301(1). The UCP validates the use of these clauses. UCP art. 17. The ICC has ruled that a bill of lading may contain the legend: "weight, measure, marks, numbers, quality, contents and value, although declared by shipper in the Bill of Lading, are considered to be unknown unless the contrary has been expressly acknowledged and agreed to." Decisions 1979, *supra* note 80, R.24.

on the bill any apparent defect in the packaging or external condition of the cargo.<sup>122</sup> A bill of lading that bears a carrier's notation "which expressly declares a defective condition of the goods and/or packaging" is not "clean,"<sup>123</sup> and will not be accepted by the Bank for Foreign Trade for payment from a letter of credit.<sup>124</sup>

The bill of lading is also the means by which the bank issuing the letter of credit determines whether the goods have been properly shipped, in particular whether the cargo has travelled by one vessel or has been "transshipped." Buyers are ordinarily reluctant to permit transshipment because the use of two or more vessels or modes of transport in sequence increases the risk of loss or damage to the goods. Applications for letters of credit issued by United States banks often permit the buyer to specify whether transshipment is "permitted" or "prohibited."<sup>125</sup> Apparently, the practice of the U.S.S.R. Bank for Foreign Trade regarding transshipments differs from the procedures of United States banks. "[T]he absence of a prohibition on transshipment does not give the Bank the right to accept several bills of lading, i.e. the original bill of lading and the transshipment bill of lading."<sup>126</sup> Under Soviet practice, the buyer applying for the letter of credit must specify that transshipment is permitted or the Bank will reject sequential bills of lading.<sup>127</sup>

In international transport, the carrier often issues bills of lading in sets,<sup>128</sup> which is not to be confused with "copies" of bills.

122. MERCHANT SHIPPING CODE art. 124; *see also* O. SADIKOV, *supra* note 113, at 226.

123. UCP art. 18(a). The ICC was asked to rule on the effect of a carrier's notation: "The goods having been packaged in paper and/or plastic bags, the carrier's rights and immunities in the event of loss or damage of the goods as a result of the nature of that packaging are hereby expressly reserved." The Commission ruled that the bill was "clean" because it did not "expressly" declare a defective condition of the goods or packaging. Decisions 1979, *supra* note 80, R.25.

124. *See* UCP art. 18(b); *see also* O. SADIKOV, *supra* note 113, at 226.

125. Application and Agreement for Commercial Letter of Credit of Citibank, N.A., *supra* note 66.

126. A. AL'TSHULER, *supra* note 40, at 178.

127. *Id.* Soviet practice is, therefore, inconsistent with the UCP: "Unless transshipment is prohibited by the terms of the credit, Bills of Lading will be accepted which indicate that the goods will be transshipped en route, provided the entire voyage is covered by one and the same Bill of Lading." UCP art. 21(a).

128. Under the UCC, "[e]xcept where customary in overseas transportation,

The purpose of this practice<sup>129</sup> is to insure that at least one member of the set reaches its destination. Each bill of lading in a set is transmitted by different means to the bank opening the letter of credit. The captain of the carrier signs each bill in the set.<sup>130</sup> Any one of these bills can transfer ownership of the goods to a holder of the bill.<sup>131</sup>

Banks are understandably reluctant to pay funds from a letter of credit upon presentation of only one bill from a set of bills of lading.<sup>132</sup> An interloper possessing the other bill in the set, may obtain the cargo from the carrier and deprive the bank of its security. Accordingly, "foreign banks refuse in practice to accept bills of lading presented in less than a full set."<sup>133</sup> A Western seller, however, may be able to convince the Bank for Foreign Trade to accept a letter of guarantee from another bank, promising to hold the issuer of the credit harmless if the other members of the set are wrongly intercepted.<sup>134</sup>

The final significant feature of the bill of lading is its capacity to transfer ownership of the goods being shipped. Ordinarily, the seller must present the bill of lading to the Bank for Foreign Trade in a form such that ownership is transferred to the Bank because the Bank uses the cargo as security for reimbursement from the buyer.<sup>135</sup> Pursuant to Soviet law, a bill of lading must contain several "essential characteristics" to transfer owner-

---

a bill of lading must not be issued in a set of parts." UCC § 7-304(1). The U.S.S.R. Merchant Shipping Code provides, "In foreign carriage of goods, if the sender [exporter] so desires, a bill of lading may be issued to him in several copies of identical content . . ." MERCHANT SHIPPING CODE § 125.

129. The practice originated when international transit was more perilous.

130. M. MAKOVSKII, PRAVOVYE REGULIROVANIE MORSHKIKH PEREVOZOV GRUZOV (Legal Regulation of Maritime Freight Shipments) 155-56 (1961). The captain does not sign "copies" of the bill of lading.

131. UCC § 7-304(5). "After the goods have been delivered on the basis of one of the copies of the bill of lading, the others shall lose force." MERCHANT SHIPPING CODE art. 125. "[A]ll copies of the bill of lading have equal authority." Kokin, *supra* note 117, at 124.

132. See *Dixon, Irmaos & Cia, Ltd. v. Chase Nat'l Bank*, 144 F.2d 759 (2d Cir. 1944), *cert. denied*, 324 U.S. 850 (1945).

133. A. AL'TSHULER, *supra* note 40, at 179.

134. In the *Dixon* case, the seller proved that New York banks customarily accept the guarantee of another bank in lieu of a full set of bills of lading. 144 F.2d at 761; See Honnold, *Letters of Credit, Custom, Missing Documents and the Dixon Case: A Reply to Backus and Harfield*, 53 COLUM. L. REV. 504, 504-05 (1953).

135. See *supra* notes 64-67 and accompanying text.

ship.<sup>136</sup> The most significant characteristic is the language in the bill identifying the party entitled to the goods. The bill of lading must state:

the name of the recipient (a straight bill of lading), or an indication that the bill of lading was issued "to the order of sender," or the name of the recipient with an indication that the bill of lading was issued "to the order of recipient" (an order bill of lading), or an indication that the bill of lading was issued for the bearer (a bearer bill of lading) . . . .<sup>137</sup>

If the seller procures a negotiable bill of lading from the carrier, he may transfer rights in the goods to the Bank for Foreign Trade by a special endorsement or an endorsement in blank.<sup>138</sup> The holder of a bearer bill of lading transfers title by delivery.<sup>139</sup> A seller who obtains a straight bill of lading from the carrier in exchange for the goods may transfer title to the Bank for Foreign Trade by following the Soviet legal procedures for assigning rights under a simple contract.<sup>140</sup> An effective assignment of contract rights requires the seller to deliver the straight bill of lading to the Bank for Foreign Trade<sup>141</sup> and to notify the carrier that the Bank is entitled to the cargo.<sup>142</sup> Pursuant to Soviet law, the transferor of a straight bill of lading (seller) is not liable to the Bank for the carrier's failure to deliver the cargo unless the transferor executes a separate agreement of suretyship.<sup>143</sup>

---

136. M. MAKOVSKII, *supra* note 130, at 61; *see* Kokin, *supra* note 117, at 124; *see also* MERCHANT SHIPPING CODE art. 123. "Essential characteristics" include the names of the carrier and the sender, the destination of the goods, a description of the goods, the freight and other payments due the carrier, or an indication that the freight has been paid in full. *Id.* at 124(4)-(8). In contrast, the UCC does not contain a list of essential characteristics of bills of lading. Under the UCC, a bill of lading is negotiable "if by its terms the goods are to be delivered to bearer or to the order of a named person." UCC § 7-104(1)(a). "Any other document is nonnegotiable." *Id.* § 7-104(2).

137. MERCHANT SHIPPING CODE art. 124(6).

138. *Id.* art. 126(2). The UCC requires the holder's "endorsement and delivery" of the bill. UCC § 7-501(1).

139. MERCHANT SHIPPING CODE art. 126(3). The UCC permits negotiation of a bill of lading issued to the order of bearer by "delivery alone." UCC § 7-501(1).

140. *See* MERCHANT SHIPPING CODE art. 126(1).

141. RSFSR CIVIL CODE art. 212.

142. *Id.* art. 213. Under the UCC, the owner of goods bailed under a non-negotiable bill of lading may transfer title to the goods by giving written notification to the carrier. *See* UCC § 7-403(4).

143. *See* RSFSR CIVIL CODE art. 212. The UCC suggests that United States

## E. Relations Between the U.S.S.R. Bank for Foreign Trade and the FTO After the Arrival of Documents

### 1. *Seller's Breach of the Contract of Sale*

The essence of the letter of credit transaction is the obligation of the issuing bank to honor the seller's demand for payment upon presentation of documents conforming on their face to the letter of credit requirements.<sup>144</sup> In determining whether to honor the seller's demand, the Bank does not evaluate the seller's actual performance under the contract of sale. The practices of the Bank for Foreign Trade during the interval in which it determines whether to honor the seller's demand,<sup>145</sup> apparently limit communication between the Bank and the buyer to an even greater degree than the procedures of United States banks.

Occasionally, the buyer discovers before the documents arrive that the seller has breached the contract of sale by shipping non-conforming goods. If the inadequacy of the seller's tender of delivery is not apparent on the face of the documents, the Bank will honor the seller's demand for payment, notwithstanding the protests by the buyer. "Even receipt by the issuing bank of notice of actual nonconformity of the goods does not alter its responsibility for payment if the documents are presented in the form corresponding to the credit."<sup>146</sup> The UCP provides: "In documentary credit operations all parties concerned deal in documents and not in goods."<sup>147</sup> The rules do not specify whether an issuing bank may consider information from the buyer that the documents are fraudulent. The emphasis which the UCP places on the "face" of the documents,<sup>148</sup> however, implies that the bank should not consider any information supplied by buyer.

In contrast, the UCC permits the issuing bank to consider a notification by the buyer that there is "fraud, forgery or other defect not apparent on the face of the documents."<sup>149</sup> Although

---

law would yield a different result. A person who "transfers a document of title for value" warrants "that his negotiation or transfer is rightful and fully effective with respect to the title to the document and the goods it represents." UCC § 7-507.

144. See *supra* notes 81-86 and accompanying text.

145. See *supra* notes 90-92 and accompanying text.

146. A. AL'TSHULER, *supra* note 40, at 167.

147. UCP art. 8(a).

148. See UCP art. 7.

149. UCC § 5-114(2)(b); see e.g., *United Bank Ltd. v. Cambridge Sporting*

the bank may choose to ignore the information, the UCC permits the buyer to enjoin the bank from honoring the letter of credit in a court of appropriate jurisdiction.<sup>150</sup> The New York Court of Appeals has held that a buyer may obtain an injunction preventing the bank from honoring the letter of credit on the basis of fraud in the underlying transaction, even though the UCP, rather than the UCC governs the letter of credit.<sup>151</sup> The court ruled that the right to enjoin payment on the basis of fraud was developed by pre-UCC case law and, because there is no direct conflict between the UCC and the UCP, the UCP did not abrogate this right.<sup>152</sup>

A Soviet FTO that learns of its Western seller's shipment of nonconforming goods is unlikely to obtain an injunction prohibiting the Bank for Foreign Trade from honoring the seller's demand for payment. Soviet commentators are knowledgeable of United States jurisprudence and expressly disapprove of the practice of enjoining payment on the basis of fraud.<sup>153</sup> The overriding policy of the Soviet Government in the international commercial area is to present their FTO as utterly reliable trading partners.<sup>154</sup> This policy would almost certainly preclude either an FTO from seeking an injunction or the FTAC from granting one.

## 2. *The Bank's Security for Reimbursement*

To induce the Bank for Foreign Trade to issue the letter of credit and to extend a loan in the amount of the purchase price, a Soviet FTO grants the Bank a set-off right to all funds in its accounts and conveys a security interest in the goods.<sup>155</sup> After the

---

Goods Corp., 41 N.Y.2d 254, 360 N.E.2d 943, 392 N.Y.S.2d 265 (1976) (contract to deliver new boxing gloves—seller's shipment of old, unpadded, ripped, and mildewed gloves held to constitute fraud in the transaction).

150. UCC § 5-114(2)(b).

151. *United Bank Ltd.*, 41 N.Y.2d 254, 360 N.E.2d 943, 392 N.Y.S.2d 265 (1976).

152. *Id.* at 258 n.2, 360 N.E.2d at 947-48 n.2, 392 N.Y.S.2d at 270 n.2; see also *W. Pat Crow Forgings, Inc. v. Moorings Aero Indus., Inc.*, 93 Misc.2d 65, 403 N.Y.S.2d 399, (Sup. Ct. 1978). For pre-UCC case law, see, e.g., *Sztejn v. J. Henry Schroder Banking Corp.*, 31 N.Y.S.2d 631, 177 Misc. 719 (Sup. Ct. 1941).

153. See A. AL'TSHULER, *supra* note 40, at 167. The ICC also disapproves of the UCC rule permitting an injunction in the event of the beneficiary's fraud. "[W]hen a bank has a personal and irrevocable undertaking it should not be prevented from honoring its word." Opinions 1981, *supra* note 80, R.86.

154. Armstrong, *supra* note 23, at 64-67.

155. See *supra* note 64 and accompanying text.

goods arrive at a Soviet port, the FTO may immediately reimburse the Bank and take possession of the bill of lading. Frequently, however, the FTO will not have funds available to reimburse the Bank until its customer, the Soviet industrial enterprise for whom the goods were initially ordered, has paid the FTO.<sup>156</sup> In order to expedite the delivery of the goods to the enterprise, the Bank may retain a nonpossessory security interest in the merchandise.<sup>157</sup>

The Bank generally retains a trust receipt, a type of security interest not specifically permitted by the RSFSR Civil Code.<sup>158</sup> The trust receipt (*sokhranaia raspiska*) "is issued by the customer to the bank in those cases where goods are pledged to the bank but placed in the custody of the debtor."<sup>159</sup> This security device obligates the FTO "to hold the relevant documents or the goods received in trust for the bank" and to remit the proceeds of the sale of the merchandise directly to the secured party.<sup>160</sup> After the FTO receives payment from the Soviet industrial firm, it remits the amount of the special loan account to the Bank for Foreign Trade. If, for any reason, the FTO fails to remit the proceeds of the merchandise, the Charter of the Bank permits it to "levy upon funds of the debtor located in the Bank."<sup>161</sup> "In the absence of such funds of the debtor, the Bank for Foreign Trade may levy upon goods or other items of value in the possession of the

---

156. The state enterprise ordinarily pays the FTO through the "acceptance form of payment." L. FREI, *supra* note 58, at 94. The FTO transmits documents demanding payment to the branch of the State Bank that serves the industrial enterprise. This branch usually honors the FTO's demand for payment without consulting its customer.

157. I. MEZNERICS, *supra* note 39, at 99.

158. The only security interest in property that the Civil Code specifically sanctions is the pledge. See RSFSR CIVIL CODE art. 192-202. Pledged property must be conveyed to the creditor "unless statute or the contract otherwise provides." *Id.* art. 196; see also I. MEZNERICS, *supra* note 39, at 99. A trust receipt is commonly used in the United States to serve the obligation of automobile dealers to repay banks financing their inventory. For a form of trust receipt used in automobile financing, see E. FARNSWORTH & J. HONNOLD, *supra* note 43, at 778-79.

159. G. ELIN, *supra* note 82, at 161.

160. See I. MEZNERICS, *supra* note 39, at 99. Prior to adoption of the UCC, nonuniform state law governed trust receipts in the United States. See 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 4.1 (1965). See generally *id.* ch. 4. Currently, trust receipts are subsumed under the general provisions of UCC Article 9. UCC § 9-102, official comment 1.

161. USTAV VNESHTORGBANKA, *supra* note 34, § 34.

debtor."<sup>162</sup>

#### IV. DOCUMENTARY DRAFTS AND BANK GUARANTEES

In place of a letter of credit issued by the U.S.S.R. Bank for Foreign Trade, the Western seller and Soviet buyer may agree to payment by means of a documentary draft drawn upon the FTO. In a documentary draft, the seller looks to the creditworthiness of the FTO as its source of payment. This type of transaction is not common in East-West trade, nor in international finance generally, because of the financial risk that the foreign seller assumes.<sup>163</sup> The parties may, however, agree that the buyer's obligation to pay the documentary draft will be guaranteed by the U.S.S.R. Bank for Foreign Trade.<sup>164</sup> This arrangement provides the seller with much the same security as a letter of credit.

##### A. Documentary Drafts

In a documentary draft transaction, the seller exchanges the merchandise with the carrier for a bill of lading. The bill may be drawn "to the order of" the seller. The seller then draws a draft, a document similar in form to a bank check,<sup>165</sup> ordering the buyer to pay the contract price "at sight" or a specified number of days after "sight" to the order of the seller. Unlike a bank check, there are only two parties to a draft. The seller is both "drawer" and "payee" and the buyer is the "drawee."<sup>166</sup> The seller then delivers the draft, the bill of lading, the commercial invoice, and other

---

162. *Id.*

163. In the worst case scenario, the seller's goods are in a foreign warehouse and the buyer refuses to honor the draft. The seller must then negotiate with the buyer from a position of weakness or bring suit against the buyer in a foreign court.

164. *See infra* notes 185-95 and accompanying text.

165. The UCC defines a "draft" as an "order to pay a sum certain in money" which is drawn upon a bank or other party. UCC § 3-104(1)(b). A draft is a check if it is "drawn on a bank and payable on demand." *Id.* § 3-104(2)(b).

166. Polozhenie O. Vekselakh (U.S.S.R. Statute on Negotiable Instruments) (SZ SSSR, 1937, No. 52, st. 221), divides all instruments into two classes. A note, which is a two party instrument, contains a promise by one person to pay to the other a sum certain at a specified time. A draft is a document containing the order of the drawer (*trassant*) to the drawee (*trassat*) to pay a specific sum to the payee (*remitent*), the drawer or a third party. V. MASLOV & A. PUSHKIN, *supra* note 38, at 304.

documents<sup>167</sup> to its bank for transmittal to the Bank for Foreign Trade.<sup>168</sup>

Pursuant to the U.S.S.R. Statute on Negotiable Instruments,<sup>169</sup> the laws of the jurisdiction in which the draft is drawn govern the form of the instrument, all questions relating to the issuance of the draft, and the rights of any holder.<sup>170</sup> A leading Soviet commentator has noted, however, that "insofar as payment of the instrument is to be made in the territory of another country, all questions relating to the obligations of the acceptor or payor are subordinate to the laws of the place of payment."<sup>171</sup> This conflict of laws rule greatly simplifies the task of the United States because Soviet law relating to the form of negotiable instruments is substantially more strict than the requirements of the UCC. Under Soviet law, a draft must bear a legend stating that it is a negotiable instrument.<sup>172</sup> It must contain an unconditional order to pay a specific sum of money to a named payee, the time and place of payment, the name of the party to whose order payment must be made, the date and place of execution, and the signature of the maker.<sup>173</sup> "Absence of even one of these requisites leads without more to invalidity of the document as a negotiable instrument."<sup>174</sup> In contrast, the UCC does not require that an instrument bear a legend, nor specify the place of payment or the date and place of execution.<sup>175</sup>

---

167. In addition to the basic delivery documents, a documentary draft transaction often requires the seller to transmit insurance policies, inspection certificates, and other documents to satisfy the buyer that goods conforming to the contract have been shipped.

168. Al'tshuler states that "[t]he essence of a documentary draft transaction is this, that the bank accepts for its client, the exporter, the documents relating to the merchandise and transmits them through its own channels to its correspondent bank for delivery to the importer upon payment of the requisite sum." A. AL'TSHULER, *supra* note 40. The UCC outlines the same procedures, albeit in the Pickwickian parlance of the Code drafters. UCC § 4-204.

169. *See supra* note 166.

170. A. AL'TSHULER, *supra* note 40, at 214.

171. *Id.*

172. Statute on Negotiable Instruments, *supra* note 166, § 7.

173. *Id.*

174. V. MASLOV & A. PUSHKIN, *supra* note 38, at 304. The formalism of Soviet law on negotiable instruments can be traced to the Geneva Convention on Notes of 1930, *supra* note 36 and accompanying text, which, in turn, was manifested in the rigidity of Continental legal systems. The United States and Great Britain did not adhere to the Convention.

175. *See* UCC § 3-104.

Upon receipt of the draft and other documents, the Bank for Foreign Trade contacts its client, the FTO, and "transmits the documents to the payor for its inspection and . . . decision on the question of payment."<sup>176</sup> The FTO's transmittal of the delivery documents does not grant to the payor either the rights in the goods or the "right to make use of the documents to take delivery of the goods until it makes payment."<sup>177</sup> Unless the instructions sent by the United States bank to its Soviet correspondent indicate that the buyer's bank may wait until the goods arrive before presenting the documents to the buyer,<sup>178</sup> the buyer is not entitled to inspect the goods before deciding whether to honor the draft and pay for the merchandise.<sup>179</sup> If the buyer is satisfied with the documents, it must honor the draft according to its terms by paying the instrument if it is a sight draft<sup>180</sup> or "accepting" the draft and thereby agreeing to pay it after the expiration of a specified period.<sup>181</sup>

Ordinarily, the bank collecting payment on a documentary draft from the buyer undertakes no financial responsibility to the seller.<sup>182</sup> If the collecting bank, however, violates its instructions by transmitting the bill of lading to the buyer in such a form that the buyer can take delivery of the goods without honoring the draft, the bank bears liability to the seller for the contract price.<sup>183</sup> Although Soviet scholars report no such occurrences in

---

176. A. AL'TSCHULER, *supra* note 40, at 146. UCC sections 4-210 and 4-211 establish the duties of a buyer's bank.

177. A. AL'TSHULER, *supra* note 40, at 146. The ICC Uniform Rules for Collections (URC) state that banks must verify that the documents received appear to be as listed in the collection order and must immediately advise the party for whom the collection order was received, the buyer, of any documents missing. Banks have no further obligation to examine the documents. URC art. 2.

178. Drafts, when used in this manner, are called "on arrival" drafts. See UCC § 4-502.

179. Under the UCC, the buyer is not entitled to inspect the goods when the contract provides "for payment against documents of title." UCC § 2-513(3)(b).

180. A United States bank, presenting a documentary draft payable at sight, may take only a cashier's check, certified check, or other bank obligation as payment. UCC § 4-211(1)(d).

181. The UCC defines "acceptance" as "the drawee's signed engagement to honor the draft as presented." UCC § 3-410(1).

182. The bank that undertakes the obligation to collect a draft "does not require the freezing of any of its financial assets" in contrast to the duties of a bank issuing a letter of credit. A. AL'TSHULER, *supra* note 40, at 80.

183. *Id.* at 145. Under the Uniform Rules for Collections, "unless otherwise instructed, the presenting bank will only release the documents to the drawee

the practice of the Bank for Foreign Trade, Al'tshuler notes with approval the decisions of courts in other jurisdictions imposing liability on a collecting bank for misdelivery of documents of title.<sup>184</sup>

## B. Bank Guarantees and Standby Letters of Credit

From the viewpoint of Western sellers, the primary disadvantage of documentary draft transactions is the possibility that the buyer will inspect the documents in bad faith. The Bank for Foreign Trade may present documents that conform in all respects to the contract for sale, but the buyer may refuse to honor the draft, alleging that the documents are nonconforming. At that point the merchandise is either en route or already bailed at a Soviet warehouse. The seller has several unattractive and expensive options. The seller may divert the goods to another foreign customer, direct that the goods be shipped back to the United States, or negotiate with the buyer to accept the goods at a reduced price.<sup>185</sup>

---

after full payment has been received." URC § 13.

184. When the buyer:

uses the documents to obtain release of the goods, this should be analyzed as acceptance of an offer, creating an obligation to pay for the goods. . . . In many cases the bank, presenting the documents for inspection, demands security from the payor. However, the liability of the buyer for payment for the documents does not diminish the liability of the bank to the exporter on whose behalf the bank is acting, in a case where the receipt of the documents by the buyer in [what is meant to be] a preliminary fashion is not followed by payment as a result, for example, of the insolvency of the buyer.

A. AL'TSHULER, *supra* note 40, at 145. The UCC states that a collecting bank is the "agent" of the seller, UCC § 4-201(1), and "must use ordinary care in . . . presenting an item." UCC § 4-202(1)(a).

The Virginia Supreme Court held a collecting bank liable to the owner of a documentary draft for failure either to require the drawee to honor the draft or to notify the owner of the drawee's dishonor. *Suttle Motor Corp. v. Citizens Bank*, 216 Va. 568, 221 S.E.2d 784 (1976).

185. Under a documentary draft governed by the UCC, the presenting bank bears some responsibility for the goods during this period. In the event of the buyer's dishonor, the bank looks to the owner of the draft, here the United States seller, for instructions. UCC § 4-503(b). These instructions may include a request by the seller that the bank arrange for reshipment of the merchandise, but "it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for such expenses." *Id.* The Uniform Rules for Collections provide that the bank "will not accept any instructions" unless the owner of the draft has nominated a representative to act "in

The seller can avoid the risk of the buyer's bad faith by negotiating as a part of the contract of sale, a requirement that the buyer supply either a standby letter of credit or a guarantee from the Bank for Foreign Trade. Under a standby letter of credit, the Bank assumes the obligation to pay the foreign seller's drafts if the Soviet buyer refuses to honor them.<sup>186</sup> Guarantees issued by the Bank for Foreign Trade may be either "conditional" or "unconditional."<sup>187</sup> An unconditional guarantee actually provides the seller with greater protection than a letter of credit, because "it gives the beneficiary the opportunity to decide unilaterally whether to make a demand upon the guarantee and the actual right to receive payment from the guarantee, irrespective of any actual damages."<sup>188</sup> To make a demand on the guarantee, the seller need only present a statement to the Bank declaring that the FTO is in breach of its obligation to honor the draft. Because the Bank may not look beyond the seller's statement to determine whether the buyer's failure to pay is rightful, "payment by the bank under an unconditional guarantee is no evidence of the beneficiary's actual right to payment under the right guaranteed [the contract of sale] or of the existence of liability of the buyer."<sup>189</sup>

If the Bank for Foreign Trade issues a "conditional guarantee" to the foreign seller, its obligations are identical to those of a

---

case of need." URC § 18. Moreover, "[b]anks have no obligation to take any action in respect of the goods to which a documentary collection relates." URC § 19.

186. Volkov and Ivanov, *Novyi vid akkreditiva v mezhdunarodnykh raschetakh* (A New Type of Letter of Credit in International Payments), 1963 DEN'GI I KREDIT, No. 6, at 78, 80. "In [an ordinary letter of credit transaction] there is a direct responsibility of the bank, having established the credit, in the [standby credit transaction] there is a supplementary, i.e. indirect responsibility which is also characteristic of a bank guarantee." *Id.*

187. The Charter of the Bank for Foreign Trade allows the Bank to "take upon itself a commission for the monetary obligations of Soviet juridical persons, arising out of international trade, navigation and from other sources and satisfactory performance of these obligations abroad. . . . This commission is often called, in practice a guarantee." L. LUNTS, *supra* note 40, at 344; see USTAV VNESHTORGBANKA, *supra* note 34, § 17.

188. A. AL'TSHULER, *supra* note 40, at 320.

189. *Id.* The seller may demand payment from the guarantor without ever having made a claim against the buyer unless the terms of the guarantee provide otherwise. *Id.* at 322.

surety under Soviet law.<sup>190</sup> The RSFSR Civil Code provides that a surety or a bank issuing a conditional guarantee "is entitled to set up against the creditor any defense which the principal debtor might have had."<sup>191</sup> This right permits the bank issuing a conditional guarantee to look beyond the seller's demand for payment to determine whether the buyer is liable for the purchase price. Despite the guarantor's right to reimbursement from its customer,<sup>192</sup> the Bank is likely to be vigilant in asserting defenses that the buyer has against the seller. If the Bank pays the unconditional guarantee without bringing suit against the seller, the FTO may assert any defenses in opposition to the Bank's claim for reimbursement that it could have brought against the seller.<sup>193</sup> Moreover, Soviet authors note that the seller's claim upon an unconditional guarantee places the Bank in a conflict of interest.<sup>194</sup> Although it is not inclined to involve itself in a dispute between the parties, the Bank does have an interest in the financial position of its customer, the buyer.<sup>195</sup>

## V. CONCLUSION

To attract the commerce of capitalist nations, the Soviets have adopted the customs of international finance prevailing in market economies. Soviet reception of Western customs concerning letters of credit, documentary drafts, and bank guarantees follows the pattern of Soviet adoption of capitalist norms and institutions in other areas of international trade. The Soviet's acceptance of international financial customs is explained, in part, by the absence of options. The Soviet Union cannot insist that merchants from Western mercantile economies subordinate their interests to an institution such as the COMECON International Bank of Economic Cooperation, because Western merchants rely upon the in-

---

190. Sections 203, 205, 207, and 208 of the RSFSR Civil Code apply to a contract of guarantee. RSFSR CIV. CODE § 210. Soviet authors agree that the laws of the U.S.S.R. govern guarantees issued by the Bank for Foreign Trade "irrespective of the nationality of the law which governs the obligation guaranteed." L. LUNTS, *supra* note 40, at 345; see A. AL'TSHULER, *supra* note 40, at 304, 314.

191. RSFSR CIV. CODE § 205.

192. USTAV VNESHTORGBANKA, *supra* note 34, §§ 33, 34; see A. AL'TSHULER, *supra* note 40, at 301-02.

193. RSFSR CIV. CODE § 205.

194. A. AL'TSHULER, *supra* note 40, at 320.

195. *Id.*

dependence of their banks and their own vigilant inspection of documents as a protection against breach by their contracting partners. In addition, the Soviet Union must, to a great extent, accept the international economic system as it stands. Despite the contemporary military influence of the Soviet Union, it is not a leader in international finance. That position is held by the banks of the United States and London. The role of the U.S.S.R. Bank for Foreign Trade in international finance with market economies is too small for it to influence greatly the rules by which international finance is conducted.

The inability of the U.S.S.R. to impose upon the international market payment mechanisms developed for the East European-planned economy cannot, however, fully explain the Soviet reception of capitalist customs. The U.S.S.R. has not merely acquiesced in practices existing in the free market. It has, especially in the last decade, embraced these customs. Soviet treatise writers frequently advocate the application of international banking customs in a manner more rigid than United States banks. For example, the Soviets criticize the right of a bank's customer to obtain an injunction to prevent the bank from honoring a letter of credit, a right the UCC permits.<sup>196</sup> Soviet writers also argue that the issuing bank should not contact its customer to determine whether the documents that the seller presented are acceptable or whether the buyer will waive any discrepancies in the documents.<sup>197</sup>

The principle underlying the position of Soviet commentators on the practices of banks in international finance is the abhorrence of any flexibility in the application of international banking customs that might cause the U.S.S.R. Bank for Foreign Trade to appear to be an unreliable financial institution. The Soviets believe that they must prove their reliability in international trade to encourage commerce with capitalist nations. Therefore, their international trading institutions not only adopt the rules and customs of their capitalist counterparts, but also apply many of these rules more rigorously than Western financial and legal institutions to enhance the image of the U.S.S.R. as a reliable partner in international trade.

---

196. *See supra* notes 149-52 and accompanying text.

197. *See supra* notes 87-89 and accompanying text.

