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Abstract

Documentary letters of credit have historically been an important and popular method of payment in international trading transactions. In fact, they have been described as the "lifeblood of international commerce." A number of uniform international practices have developed for their use, many of which are codified in international rules such as Uniform Customs and Practice for Documentary Credits. In the global information age, as the nature of international commerce changes, so too must the operation of such payment mechanisms. With the increase in electronic trading, the "documentary" nature of these credits may require some revision. This Essay examines ways in which the law and practice relating to documentary credits may need to be modified to accommodate electronic transactions.

DOCUMENTARY CREDIT LAW AND PRACTICE IN THE GLOBAL INFORMATION AGE

*Jacqueline D. Lipton**

INTRODUCTION

Documentary letters of credit have historically been an important and popular method of payment in international trading transactions. In fact, they have been described as the "lifeblood of international commerce."[1] A number of uniform international practices have developed for their use, many of which are codified in international rules such as Uniform Customs and Practice for Documentary Credits ("UCP 500").[2] In the global information age, as the nature of international commerce changes, so too must the operation of such payment mechanisms. With the increase in electronic trading, the "documentary" nature of these credits may require some revision. This Essay examines ways in which the law and practice relating to documentary credits may need to be modified to accommodate electronic transactions.

I. *BACKGROUND*

A. *The Conventional Documentary Credit*

A documentary letter of credit is a written instrument addressed by one party (the "account party") to another requesting that the latter, usually a bank or other financial institution, give credit to the person in whose favor it is drawn (the "beneficiary").[3] Historically, such instruments have been used as payment

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1. R.D. Harbottle v. National Westminster Bank, 2 All E.R. 862, 870 (1977) (Kerr, J.).

2. INTERNATIONAL CHAMBER OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (1993) [hereinafter UCP 500].

3. In practice, there are often one or more "paying banks" or "confirming banks" interposed between the issuing bank and the beneficiary. This can overcome jurisdic-

mechanisms in international commerce, substituting the creditworthiness of a known bank or financial institution for that of an often unknown buyer in another jurisdiction. More recently, they have come to be used as a security device that functions like a bank guarantee or performance bond. In this capacity, they are usually referred to as "standby letters of credit" as opposed to "commercial credits."[4]

All letters of credit involve at least three, and sometimes four or more, separate contracts that function independently of one another. In an international payments context, they are (a) the underlying contract for the sale of goods to which only the buyer and seller are parties; (b) the contract between the buyer and the issuing bank under which the bank agrees to issue the credit and to notify the seller of the credit as well as to make payments on presentation of stipulated documents by the seller; (c) a contract between the issuing bank and a "confirming" bank authorizing the latter to make payments on presentation of documents by the seller and to remit the documents to the issuing bank on reimbursement for amounts paid out by the confirming bank; and (d) the contract between the issuing bank (or the confirming bank) and the seller, under which the relevant bank undertakes to pay the seller on presentation of the stipulated documents.[5] It is not always necessary to involve a confirming bank, so the contractual relationship described in (c) may be absent in a given situation. In such a scenario, the contract described in (d) will involve the issuing bank rather than a confirming bank. A confirming bank will often be used in situations in which there is no accessible branch of the issuing bank available to deal in credits in the jurisdiction in which the seller is physically situated. In some documentary credit transactions, there may be more than one confirming bank depending on the existing interbank arrangements.[6]

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tional issues by allowing presentation of documents and payment to occur in the jurisdiction in which the seller is situated.

4. G.A. Fellinger, *Letters of Credit: The Autonomy Principle and the Fraud Exception*, 1 J. BANKING & FIN. L. & PRAC. 4 (1990).

5. *Id.* at 5.

6. A detailed discussion of the various types of contractual relationships that might arise between banks in documentary credit transactions is beyond the scope of this Essay. Interested readers should, however, be aware of the *Uniform Rules for Bank-to-Bank Reimbursements Under Documentary Credits*, drafted by the International Chamber of Commerce ("ICC"), which entered into force on July 1, 1996. They are discussed in

It should also be noted that sometimes, where a bank other than the issuing bank is involved in the transaction, such other bank does not take on the role of a "confirming" bank. It is possible for a second bank to act purely as an "advising" bank, that is to advise the seller of the existence of the credit without becoming engaged in a contractual relationship with the seller. Provision for this advisory role has been made in Article 7 of the UCP 500, which allows for a credit to be advised to a seller through a bank other than the issuing bank without "engagement" on the part of the advising bank. In such circumstances, however, the advising bank is obliged to take reasonable care to check the apparent authenticity of the credit.

Presumably, therefore, even in the absence of a contractual relationship with the seller, the advising bank might be liable in tort for negligent misrepresentations made to the seller about the authenticity of the credit. Where the relationship between the advising bank and the seller is governed by the laws of a jurisdiction such as Australia, there might also be other avenues of liability such as under Section 52 of the Trade Practices Act of 1974.[7]

B. *The "Standby" Credit*

Standby credits are similar to commercial credits in terms of the types of contractual relationships to which they give rise. Because the credits do not operate as a payment mechanism, but instead serve a guarantee function, the content of such contracts is somewhat different. In the case of a standby credit, the "underlying contract" (contract (a) in the above scenario) will not necessarily be between a buyer and seller. It may be between a party inviting tenders and a tenderer for a particular contract, or between a builder and a contractor.[8] Although these are the most obvious examples in practice, the nature of the underlying contract is not really important. What is important is that, again,

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detail in Howard Bennett, *Bank-to-bank Reimbursements Under Documentary Credits: The Uniform Rules*, LLOYD'S MAR. & COM. L.Q. 114 (1998).

7. This section provides that "[a] corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive." Trade Practices Act, 1974, ch. 2, § 52 (Austl.). Under the Trade Practices Act, a "corporation" includes a bank or financial institution. Trade Practices Act § 4.

8. *See* ROELAND BERTRAMS, BANK GUARANTEES IN INTERNATIONAL TRADE ch. 3, at 29-37(2d ed. 1996).

a series of contracts are attached to the underlying contract, but are operating independently of it. These contracts are generally serving to guarantee performance of the underlying contract. For example, consider a standby credit arising in the context of a construction contract where the purpose of the credit is to guarantee performance of the contractor's obligations to the construction site owner. The contractual matrix might be as follows: (a) an underlying contract between the site owner and the contractor for construction of a particular part of the project by the contractor; (b) the contract between the contractor and the issuing bank under which the bank agrees to issue the credit and to notify the site owner of the credit as well as to make payments on demand and/or on presentation of other stipulated documents by the site owner; (c) possibly a contract between the issuing bank and a "confirming" bank authorizing the latter to make payments on demand and/or on presentation of other documents by the site owner, and to remit any relevant documents to the issuing bank on reimbursement for amounts paid out by the confirming bank; and (d) the contract between the issuing bank (or the confirming bank) and the site owner, under which the relevant bank undertakes to pay the site owner on demand and/or on presentation of the other stipulated documents.

Again, the third contract (c) is optional, depending on the relationships between the parties and where they are physically located. The main difference between a standby credit and a commercial credit is obviously that while a commercial credit requires payment by the relevant bank on presentation of conforming documents, the standby credit is a little more variable. The standby credit may be paid against a written demand *as* the stipulated document or against a demand with some other documents specified, such as a certificate from a third party that there has been non-performance under the underlying contract. This practice has now been recognized in Article 20 of the Uniform Rules for Demand Guarantees[9] ("URDG"), which provides that any demand for payment under a demand guarantee (including a standby credit) shall be in writing and shall be supported by a written statement to the effect that the other party to the underlying contract is in breach of contract obligations and

9. INTERNATIONAL CHAMBER OF COMMERCE, UNIFORM RULES FOR DEMAND GUARANTEES (1992) [hereinafter ICC URDG].

the nature of the breach. Article 20 also contemplates that other written documents may be specified as stipulated documents to be presented to the bank in support of a payment request.[10]

At this stage, the main point to be made about the difference between standby credits and commercial credits is that standby credits tend, by their nature, to rely more heavily on the good faith of the parties than commercial credits. This reliance on good faith exists because under a commercial credit it is more difficult for the beneficiary (or the "seller") to make a fraudulent call on the credit as it has to present documents generally prepared by third parties, such as shipping companies and freight forwarders, in support of a call under the credit.

With respect to standby credits, on the other hand, the beneficiary can often make a call on presentation of a certificate of default under the underlying contract that it has drafted itself. There is not necessarily any automatic third party verification of the basis for the call, as is the case with a commercial credit. The absence of automatic verification provides greater scope for fraudulent calls and is a significant risk in such transactions, as there is no obligation on the paying bank to look to the underlying contract before making a payment. The point of the credit is to circumvent such delays and allow the bank to pay on presentation of conforming documents alone, while leaving the parties to litigate in relation to the underlying contract in due course.[11]

While this Essay is predominantly concerned with commercial rather than standby credits, it is worth acknowledging the good faith issue as it relates to standby credits, as it becomes relevant in a discussion of issues likely to arise under commercial credit practice in the global information age. The good faith

10. It should, however, be noted that many standby credits are governed by the ICC's Uniform Customs and Practice for Documentary Credits ("UCP 500") rather than its Uniform Rules for Demand Guarantees ("URDG"), as parties tend to be more familiar with the terms of the UCP 500, which do not require any form of "demand," but merely require presentation of conforming documents. When a sufficient number of parties ratify and implement the UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit ("UNCITRAL Convention"), New York, Dec. 11, 1995, reliance on the URDG, and indeed the UCP 500, in the context of standby credits might become a thing of the past in many international transactions, with parties complying instead with the provisions of the UNCITRAL Convention.

11. *See* Jacqueline Lipton, *Uniform Regulation of Standby Letters of Credit and Other First Demand Security Instruments*, 10 J. INT'L BANKING L. 402, 402 (1993).

issue is likely to arise because, with the speed of electronic transactions and decreased reliance on paper documents, parties in commercial credit transactions will now have to start relying more on notions of good faith and fair dealing than on third party pieces of paper. This reliance will be a global phenomenon and not limited to any particular jurisdiction.[12] Hence, it is worth players in all major international trading jurisdictions carefully watching these developments.

C. *The Commercial Credit in Modern Commerce*

Historically, commercial credits have been one of the most, if not the most, popular method of payment in international trading transactions involving the shipment of goods between jurisdictions. The main reasons for their popularity in this context have been that they allow the seller (beneficiary of the credit) to substitute the unknown credit rating of the buyer (account party) for the established and reliable credit rating of the issuing bank; upon the seller's tender of the requisite documents to the issuer of the credit, they assure prompt payment of the purchase price for shipment of the goods, the subject of the underlying sale contract; and they provide the buyer with symbolic delivery of conforming goods in the form of the documents presented by the seller to the bank.[13] In summary, the documentary commercial credit can inject a degree of certainty and security into international sales transactions between geographically distant parties who might otherwise be hindered in their dealings by risks inherent in the international nature of the transactions.[14]

The documents required under a commercial credit typi-

12. For a detailed discussion of ways in which standards of good faith are becoming further incorporated into commercial law in jurisdictions, such as Australia, Canada, and the United Kingdom, that have not previously accepted them as legal principles *per se* to any great extent, see, for example, Jacqueline Lipton, *Good Faith and Letters of Comfort*, 28(1) U. W. AUSTL. L. REV. 138 (1999); GOOD FAITH AND FAULT IN CONTRACT LAW (Jack Beatson & Daniel Friedman eds., 1995); H. Lucke, *Good Faith and Contractual Performance*, *in* ESSAYS ON CONTRACT ch.5 (P. Finn ed., 1987); John Carter & M. Furmston, *Good Faith and Fairness in the Negotiation of Contracts*, 8 J. CONT. L. 1 (1994); Roger Bronsword, *Two Concepts of Good Faith*, 7 J. CONT. L. 197 (1994); and Michael Bridge, *Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?*, 9 CANADIAN BUS. L.J. 385 (1984).

13. Fellinger, *supra* note 4, at 4.

14. *Id.* at 4-5. Naturally, such credits can be, and are, used in domestic transactions as well. They developed, however, largely in the international trade context for these reasons.

cally include an invoice for the goods shipped, an insurance certificate in respect of the goods, and a bill of lading or other evidence of transport of the goods by the seller.[15] These are all documents that the seller can obtain on shipment of the goods. This documentation allows the seller to present the goods for payment well before the buyer actually receives the goods—that is, the seller is effectively able to trade in the documents that "represent" the goods. This documentation also circumvents problems inherent in making the seller wait for the buyer to actually receive goods shipped before obtaining payment for them.

Thus, use of documentary credits keeps commercial activity flowing smoothly without the need for lengthy pauses between shipment of goods and payment, and the possible consequential need for interim finance for the seller. Problems arising in relation to the quality or quantity of goods shipped may be litigated between the parties to the underlying sales transaction on eventual receipt of the goods by the buyer. Prior to the litigation, the seller can use the payment moneys in furtherance of its business activities and the buyer can deal with the goods through the documents. The theory behind the use of documentary credits is often referred to as "pay now, litigate later," meaning that commerce continues to flow and payments continue to be made while disputes about conformity of goods to underlying contract stipulations are relegated to the background.

This Essay examines the impacts of the recent exponential increase in electronic trading in the international arena on commercial documentary credit practice. It considers ways in which the lack of paper documents and increased speed of underlying sale transactions affect previously accepted practices in this area. It first considers the main legal concepts underlying commercial credit transactions and then considers ways in which these concepts do not necessarily suit a "global information" society. It makes some suggestions for future documentary credit practice that will be relevant to banks and financial institutions worldwide, as parties to international transactions continue to resort to commercial credits as a payment mechanism in increasingly electronic dealings. These suggestions relate predominantly to the drafting of suitable payment conditions for transactions that

15. For a detailed description of these documents, see NATIONAL AUSTRALIA BANK LTD., FINANCE OF INTERNATIONAL TRADE ch. 3, at 29-37 (8th ed. 1996).

do not involve physical shipment of tangible goods, but rather electronic transfer of intangible "information products" such as computer software.

II. *KEY CONCEPTS: THE AUTONOMY PRINCIPLE, THE FRAUD EXCEPTION, AND THE DOCTRINE OF STRICT COMPLIANCE*

Before considering the impact of electronic commerce (or "e-commerce") on documentary credit practice, it is first necessary to examine some of the key legal concepts that have developed with regard to such credits over the years. A number of important legal principles have developed in relation to documentary credits of both the commercial and standby type, to ensure that they operate in an efficient manner in commercial practice and reinforce the underlying importance of their *documentary* nature. The most significant of these principles are the autonomy principle, the "fraud exception" to the autonomy principle, and the doctrine of strict compliance.

The autonomy principle embodies the notion that the contracts established under a letter of credit, as identified above, operate completely independently of one another. In particular, a paying bank should not look to actual performance under the underlying contract to determine whether or not to pay a call by a beneficiary under a credit. The fraud exception to the autonomy principle establishes circumstances in which a paying bank might be expected to take into account performance or otherwise under the underlying contract. This exception deals with circumstances in which it may be appropriate for payment under a credit to be enjoined.[16] The good faith exception can

16. A wealth of literature and case law has developed internationally in relation to the "fraud exception" both in the context of commercial credits and standby credits. A detailed comparative discussion of the operation of the fraud exception is beyond the scope of this Essay. Interested readers, however, might consult *United City Merchants v. Royal Bank of Canada*, 2 All E.R. 720 (1982); *Edward Owen Eng'g v. Barclays Bank Int'l*, 1 All E.R. 976 (1978); *Contronic Distributors v. Bank of New South Wales*, 3 W.L.R. 110 (1984); *Hortico v. Energy Equip. Co.*, 1 W.L.R. 545 (1985); Fellinger, *supra* note 4; Michael Grunson & Hartwin Bungert, *Letters of Credit: The Independence Principle Vindicated*, 113 BANKING L.J. 614; and Penelope Zohrab, *Standby Letters of Credit: Fortex*, N.Z.L.J. 392 (1996). For recent Australian developments in the area, particularly in relation to the potential role for a developing doctrine of "unconscionability" in relation to calls made under letters of credit, see *Olex Focas v. Skodaexport Co.* (Supreme Court of Victoria, Aug. 28, 1996, unreported) (Batt, J.); Alan Tyree, *Performance Bonds and Section 51AA of the Trade Practices Act*, 8 J. BANKING & FIN. L. & PRAC. 338 (1997); and

be particularly important in the case of standby credits where the transactions, by their very nature, are more reliant on the good faith of the parties than on the production of independent third party documents. It may be that courts have to be more prepared in these circumstances to allow the parties to look to the underlying contract before payment is made. The notion of allowing parties to do so is impliedly contemplated in Article 20 of the URDG, which requires the beneficiary to state the nature of the breach of the underlying contract when seeking payment. Naturally, the risk with courts supporting dramatic moves in this direction is that the whole point of the credits, the autonomy of the different contractual arrangements, may be destroyed. In the electronic age, this question may also become quite relevant in commercial, as opposed to standby, credit practice for reasons discussed below.

The strict compliance doctrine refers to the need for strict conformity of documents presented by the beneficiary of a credit to the documents stipulated in the credit. If there are any discrepancies, then the issuing bank should refuse payment on the credit.

The autonomy principle is codified in Article 3(a) of the UCP 500,[17] which provides that "[c]redits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the Credit . . . ."[18] Additionally, Article 4 of the UCP 500 emphasizes the overriding importance of the documentary requirements in commercial credits, stating that "[i]n Credit operations all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate."[19] Article 14 of the UCP 500 sets out the requirements for strict compliance and gives issuing banks some guidance as to the course of action to

B. Zillmann, *A Further Erosion into the Autonomy of Bank Guarantees?*, 13 BUILDING & CONSTRUCTION L. 354 (1997).

17. This has been recognized in Article 5 of the UNCITRAL Convention, which requires the observance of good faith in the international practice of standby credits as a guiding principle in interpretation of the convention.

18. UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit art. 3(a).

19. *Id.* art. 4.

follow if there is a discrepancy between presented documents and the requirements of the credit. It includes provision for a bank to refuse to accept non-complying documents[20] and gives an issuing bank the discretion to approach the account party for a waiver of any discrepancies in the documents.[21] It also requires a bank refusing to accept documents for non-compliance, to notify the beneficiary of the refusal within seven days of receipt, and to state all the discrepancies that form the basis of the refusal.[22] Failure to meet these requirements can preclude the bank from claiming that the documents do not comply with the terms of the credit.[23] This last point might be regarded as a contractual derogation from the strict compliance doctrine, but it does appear reasonable from a commercial perspective.

III. *HISTORICAL PRACTICE MEETS THE NEW MILLENNIUM: THE IMPACT OF E-COMMERCE ON DOCUMENTARY CREDIT PRACTICE*

The above principles and their codification in the UCP 500 have developed over more than a century of international trading and are now firmly established in practice. In fact, because banks are so familiar with these principles and with associated provisions of the UCP 500, they have tended to incorporate the UCP 500 into transactions involving standby credits and performance bonds, rather than to use alternate sets of rules drafted expressly for such transactions.[24] There are probably a number of reasons for reliance on the UCP 500, some of which involve criticisms of the alternate sets of rules.[25] There is nevertheless some evidence that a significant reason for this tendency is the familiarity of the banks, particularly departments that issue both standby and commercial credits, with the above principles relating to operation of commercial credits.[26]

The familiarity of banks and international trading parties

20. UCP 500, *supra* note 2, art. 14(b).
21. *Id.* art. 14(c).
22. *Id.* art. 14(d).
23. *Id.* art. 14(e).
24. *See supra* note 12 and the ICC URDG, *supra* note 9.
25. For criticisms of alternative sets of rules such as the UNCITRAL Convention, see BERTRAMS, *supra* note 8, at 23. See also discussion in Lipton, *supra* note 12, which compares the provisions of the UCP 500 and the URDG in relation to standby credits.
26. BERTRAMS, *supra* note 8, at 26.

with the current documentary credit system could well become a practical problem as new methods of trading develop as we move towards the twenty-first century. As noted above, the commercial credit system is premised on trading in *documents* in place of tangible goods in circumstances where delivery of the goods might take some time and the parties do not want payment delayed in the interim. As electronic commerce gains currency, however, both the use of paper documents and the need to ship goods at all are decreasing. These changes in focus will have a significant impact on the use of commercial credits in international trade.

With the onset of the global information age come trading possibilities that have never before existed. It is now possible to buy and sell a number of items electronically, either over the Internet or otherwise.[27] These transactions involve items that are themselves electronic and can be delivered to a buyer by electronic means rather than by physical shipment.

Even where there is a need for a physical shipment of tangible goods, much of the supporting contract negotiation and drafting can be conducted electronically rather than in traditional paper form. Contracts may be negotiated by e-mail, and there are now circumstances in which contracts can also effectively be completed in digital form. Rather than requiring a hard copy of a contract document containing a party's signature, digital encryption methods can be used to authenticate a transaction. In fact, Article 20(b) of the UCP 500 now makes explicit provision for such means of authentication, providing that "[a] document may be signed by handwriting, by facsimile signature, by perforated signature, by stamp, by symbol, or *by any other mechanical or electronic method of authentication*."[28] Clearly, where banks accept documents authenticated in the ways enumerated by Article 20(b), there is a need to accept documents created by electronic and other means as "originals." This need is also contemplated by Article 20(b), which states: "[u]nless otherwise stipulated in the Credit, banks will . . . accept as an original document(s), a document(s) produced or appearing to have been produced: (i) by reprographic, automated or computerised sys-

27. *See, e.g.*, Raymond T. Nimmer, *Intangibles Contracts: Thoughts of Hubs, Spokes, and Reinvigorating Article 2*, 35 WM. & MARY L. REV. 1337, 1380 (1994).

28. UCP 500, *supra* note 2, art. 20(b) (emphasis added).

tems; [or] (ii) as carbon copies . . . ."[29] Thus, there are at least two significant ways in which the advent of e-commerce impacts on previous practices relating to the use of commercial documentary credits. They are, first, the increasing reliance on electronically generated documents in place of physical circulation of original paper documents, and second, the possibility of electronic transmission of some goods under an underlying sale contract in place of physical transport of goods from one jurisdiction to another. As indicated above, the first issue raises questions relating to the types of documents issuing banks will accept under a credit to support payment. This issue is not so contentious in modern practice, however, as the UCP 500 has made some provision for electronic documents and authentication mechanisms.

The second issue may, however, have a greater impact on commercial credit practice. Traditionally, goods might be shipped from a seller to a buyer over a period of weeks or even months. Now, some electronic goods, such as computer software, electronic databases, and Internet domain names,[30] can be transferred from a seller in one country to a buyer in

29. *Id.*

30. As an aside, it is worth noting that such electronic items are clearly regarded as tradable commodities by the market. There is, however, significant legal debate about the extent to which they satisfy legal conceptions of "property." Computer software and electronic databases have generally been protected as intellectual property by copyright law in most major trading jurisdictions. In some circumstances, however, they might be patentable, at least in the United States. Australia, the United Kingdom, and the European Union ("EU") countries have not been so ready to accept the potential patentability of such items. *See, e.g.*, Clive Gringas, *Patents: Patentability of Software*, 8 EUR. INTELL. PROP. REV. D-240 (1996); David W. Webber, Intellectual Property Protection for IT Developments – The Debate Continues (1996) (paper presented at World Computer Congress, IFIP); Sean E. Gordon, *The Very Idea!: Why Copyright Law Is an Inappropriate Way to Protect Computer Programs*, 20 EUR. INTELL. PROP. REV. 10 (1998). There is some suggestion that electronic databases should be protected under a new form of *sui generis* right and certain jurisdictions have moved in this direction. *See, e.g.*, Stanley Lai, *Database Protection in the United Kingdom: The New Deal and its Effects on Software Protection*, EUR. INTELL. PROP. REV. 32 (1998); Simon Chalton, *The Effect of the EC Database Directive on United Kingdom Copyright Law in Relation to Databases: A Comparison of Features*, 6 EUR. INTELL. PROP. REV. 278 (1997). Internet domain names are also contentious in this respect. They are clearly traded as a commodity, but have not been wholeheartedly accepted as property rather than a contractual license to use a name granted by a domain name registration authority. See, for example, the discussion in Jacqueline Lipton, *What's in a (Domain) Name? Web Addresses as Loan Collateral*, 1 J. INFO. L. & TECH. (visited June 29, 1999) <http://www.law.warwick.ac.uk/jilt/99-2/lipton.html> (on file with the *Fordham International Law Journal*).

another instantaneously at the touch of a button. There is no need for shipping documents, and there is no further need for a payment system that can cope with delays in shipping and counteract the effects of these delays on payment. This change will clearly have an impact on the use of the traditional documentary credit as a payment mechanism if, indeed, parties to such transactions still choose to employ such payment mechanisms. There is some anecdotal evidence to suggest that commercial credits are in fact currently being employed in this context, as will be discussed below.

IV. *"PURE" ELECTRONIC TRANSACTIONS AND COMMERCIAL CREDIT PRACTICE*

A. *The Changing Face of International Commerce*

Returning for a moment to the primary reasons for the popularity of commercial credits as a payment mechanism in international transactions, as mentioned a significant factor in their popularity was the ability to trade in documents rather than goods. This ability circumvented delays in payment while waiting on shipment of goods. The other significant reason for the popularity of commercial credits was the ability to substitute the established and reliable credit rating of one or more banks for the often unknown credit rating of the buyer.

In a purely electronic sales transaction where digital goods are transmitted via electronic means from a seller to a buyer, the first of these reasons falls away. If there is no delay in shipping, then there is no longer any need for a payment mechanism that circumvents potential delays. As a corollary, there is no need to substitute trading in transport documents for trading in the goods themselves. In fact, such a substitution is not possible in practice. The goods would arrive with the buyer at the same time as, or even before, associated documents could be delivered to the issuing bank, assuming the existence of such documents in the first place.

One reason for using a letter of credit as a payment mechanism remains—the ability to substitute the creditworthiness of a known bank for that of an unknown buyer. This factor, coupled with the general familiarity of banks with documentary credits, may support the continued use of such credits in this context, despite the fact that in many senses such a payment mechanism is no longer really necessary for such transactions. In fact, the need to substitute the creditworthiness of a known bank for that of an unknown buyer arguably increases dramatically in the world of electronic commerce. In this world, there is much greater scope than ever before for international trading between anonymous parties who have never met one another and may not be able to ascertain the jurisdiction in which the other is physically located.

If commercial credits are to be used in this context, then there will clearly be some need for the parties to revisit issues relating to their drafting and operation. This review is necessary because, in electronic trading, the parties will not likely be trading in shipping documents. The credit must be drafted to suit the needs of the individual transaction, bearing in mind that the focus will now be on security and certainty of payment in terms of the creditworthiness of the bank and not in terms of the ability to deal in documents rather than goods. In other words, banks will no longer be able to employ standard form credits that specify payment on presentation of shipping documents. New payment terms will have to be incorporated.

B. *A Cross-Border Sale of an Internet Domain Name*

One example of a cross-border sale of an internet domain name appeared recently on a domain name information website.[31] It involved a sale of a ".com" internet domain name from a company in the United States to an unknown French company, with payment for the transfer of the name to be made by documentary credit.[32] The credit for this transaction was issued by the Bank of New York.

To understand the implications of this transaction for documentary credit practice, it is necessary to appreciate the legal nature of domain names and administrative requirements for their

31. Jeremy Elson, *A Domain Name Success Story* (Nov. 20, 1998) (visited June 29, 1999) <http://www.igoldrush.com/feat8.htm> (on file with the *Fordham International Law Journal).*

32. An Internet domain name is the mnemonic form of a World Wide Web address that makes the site in question easier to recall, for instance, "microsoft.com." Under the rules of the relevant domain name registering authorities, these names can usually be transferred from one person to another by executing appropriate documentation and lodging it with the authority in question. Different authorities register names with different Top Level Domains (or "TLDs"). Network Solutions Inc. in the United States is responsible for the ".com" TLD.

transfer. Although common parlance in the international market would have one believe that a domain name is a species of intangible or intellectual property capable of being traded as any other "information product,"[33] this misconception is not a true representation of the legal position. In fact, domain names are really only creatures of contractual license granted by a registration authority, such as Network Solutions Inc., which uses the ".com" domain, to an applicant: "[n]o one "owns" a doman [sic] name any more than someone "owns" a telephone number."[34]

One of the "proprietary" attributes that is arguably missing in the case of domain names is the ability for registrants to directly transfer them to others in the marketplace. This restraint has not deterred parties from "trading" in domain names, but they have to do so in a certain way. A domain name cannot be transferred instantaneously in the way that, say, computer software may be transferred. There are only two ways to transfer a domain name: (1) to sell the company that holds the name so that the license to use the name is transferred along with the company and (2) to apply to the relevant registration authority for deletion of the registration in the "seller's" name and re-registration in the name of the purchaser.

Thus, the example of a sale of a domain name is not really analogous to a "pure" electronic transaction involving, say, sale of unpatented software to be delivered electronically over the internet.[35] Perhaps a better analogy could be made with the sale

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33. *See, e.g.*, Charlotte Waelde, *Is the Dam About to Burst? An Analysis of Domain Name Disputes in the UK*, J. INFO. L. & TECH. (Oct. 12, 1998) (visited June 29, 1999) <http://elj.warwick.ac.uk/jilt/cases/97_2pitm/> (on file with the *Fordham International Law Journal*); Kenton Yee, *location.location.location: A Snapshot of Internet Addresses as Evolving Property*, 6 S. CAL. INTERDISC. L.J. 201-43 (1998).

34. Network Solutions, *Frequently Asked Questions* (July 11, 1998) (visited June 29, 1999) <http://www.internic.net/faq/own.html> (on file with the *Fordham International Law Journal*); *see* Philip Hourigan, *Domain Names and Trade Marks: Disputes from an Australian Perspective*, *in* GOING DIGITAL: LEGAL ISSUES FOR ELECTRONIC COMMERCE, MULTIMEDIA AND THE INTERNET 77 (Anne Fitzgerald et al. eds., 1998).

35. It should not, however, be assumed that software cannot be patented. Although software patents in the United Kingdom and Europe have been the exception rather than the rule, there have been numerous instances, particularly in the United States, where patents have been granted for software products, often those that are to be used on the Internet. *See, e.g.*, J. Swinson, *Patents in Cyberspace: Electronic Commerce Patents*, *in* GOING DIGITAL: LEGAL ISSUES FOR ELECTRONIC COMMERCE, MULTIMEDIA AND THE INTERNET, *supra* note 34.

of a patent recorded on one or more national registers. The contents of a patent in the form of information describing a method or process can be transferred electronically via computer or facsimile transmission from one party to another. The patent itself, however, cannot be formally transferred without following statutory transfer and registration procedures relevant to the jurisdiction(s) in question. The same might be true of dealings in registered trademarks. Although graphic representations of such marks can be transferred electronically, transfer of the registration itself is a separate issue involving compliance with many applicable statutory formalities.

In tying this discussion in with drafting appropriate payment terms in a documentary credit, there is an obvious possibility in such cases of making documentary or other evidence of the registration in the purchaser's name of the domain name, or of particular intellectual property rights such as patents and registered trademarks, a payment condition under a commercial credit. There is clearly no possibility of using traditional transport documents as triggers for payment as no such documents will exist in these transactions. There may be concerns, however, that the relevant registry might not show a record of the purchaser holding the relevant domain name, patent, or trademark at the time of payment, if it had been on-sold to another party before payment. Thus, a payment condition relating solely to the state of a domain name, patent, or trademark register at the time of payment may not always be particularly reliable.

In the case of the sale of the domain name referred to above, the parties ultimately incorporated a number of alternate payment conditions in the credit as follows:

(1) Evidence of an authentic e-mail from Network Solutions stating that the domain is currently owned by the purchaser company or its designate.

(2) An Internet search of Network Solutions' registry, conducted by either party, and showing that the name is currently owned by the purchaser or its designate.

(3) Confirmation by the director of the purchaser company to the bank that the company or its designate has obtained the name.

The credit further noted that if the purchaser had transferred the name to another party, it would be a sufficient payment condition for the seller to show, through any of the above methods, that the name had been transferred to the purchaser at some point in the past.

This credit clearly served the purpose of substituting the creditworthiness of the Bank of New York for that of the unfamiliar French company. It could not rely on non-existent shipping documents as evidence of performance under the underlying contract, although it could rely on third party evidence concerning registration of the domain name.

Alternatively, payment could be made on express confirmation from the purchaser to the bank that it had obtained registration of the name (condition 3 above). This last type of condition, while clearly not possible under a conventional credit due to delays between shipment and receipt of goods, is ideally suited to electronic trading transactions. One can see the usefulness of this condition, particularly where it is used in conjunction with other payment conditions that rely on "third party" assurances such as evidence of registration.

C. *Payment Conditions in the Electronic Age: General Principles*

It must be noted that pure reliance on assurances by the purchaser that it has received the goods or rather "information products" identified in the underlying contract can be dangerous for reasons similar to those that make general standby credit practice risky. In each case, the bank is effectively relying on the good faith of at least one of the parties to the underlying contract in terms of deciding whether or not to pay out under the credit. In the case of standby credit, as noted above, the bank and the account party are relying on the beneficiary not to make an unjust call under the credit that does not have to be substantiated by any third party assurances. In the "pure" electronic transaction context, the bank and the beneficiary are effectively relying on the account party not to unjustifiably withhold its acknowledgment that it has received the relevant "information products."

An unscrupulous purchaser may refuse to provide such an acknowledgment just as easily as it might refuse to pay a seller by check or under other more direct payment mechanisms. Thus, in circumstances where independent third party verification of performance of the seller's obligations under the underlying contract is not available due to the nature of the transaction, a documentary credit may well prove more costly and time consuming, but no more reliable, than alternative payment mechanisms.

In general, therefore, "third party" payment conditions are always to be preferred where possible. In the case of conventional credits, third party documents are traditionally provided by shipping companies in the form of various shipping documents. In the case of electronically generated sales of registrable items, the third party assurance can often be provided by a relevant registration authority, or at least by searching its records.

In the context of some electronic transactions, third party payment conditions may not be viable—for example, the electronic transfer of computer software products and the right to use them where such products are not subject to a patent. A documentary credit is unlikely to prove particularly useful as a payment mechanism here because in many significant trading jurisdictions, such as the United Kingdom and Australia, there are no registers of copyright material. Thus, there is no possibility of obtaining an official third party acknowledgment of transfer of ownership of copyright as the basis for a "third party" payment condition. It must be acknowledged, however, that in practice such outright sales of computer software copyright would be rare. A license to use or market the software would be more usual and would not require a documentary credit as a payment mechanism, as the commercial credit is more obviously geared towards international sales than licenses or marketing arrangements.

CONCLUSION

In the modern world of e-commerce, there is an ongoing role for conventional payment mechanisms such as documentary credits. In fact, the commercial credit's characteristic of substituting the creditworthiness of a known bank for that of an unknown purchaser makes it very attractive in this context. As e-commerce makes it possible to deal with almost infinite numbers of new trading partners, many of whom will remain relatively anonymous due to the nature of electronic trading, a payment mechanism that creates certainty and security of payment in this way is desirable.

Current commercial credit practices will, however, have to be modified to accommodate this new form of trading. Where trading involves physical shipment of goods but contracts are made electronically, payment conditions will have to be drafted, or relevant provisions of the UCP 500 incorporated, to deal with electronic contracting and authentication mechanisms.

Where trading is conducted in a pure electronic form involving electronic transfer of digital goods and associated intellectual property rights, payment conditions will have to be drafted to suit the case at hand. If the sale involves material in electronic form that is subject to registration as, say, a domain name, patent, or registered trademark, then evidence of transfer of registration to the buyer may be included as a payment condition. In other cases, it may be that the credit needs to rely on actual confirmation by the buyer of receipt of the goods. This reliance may carry with it the unacceptable risk that an unknown and unscrupulous buyer refuses to acknowledge receipt of goods to stall payment. Ultimately, documentary credits may prove to be of little or no use in such situations.