

DOCUMENTARY FRAUD – BUYERS, SELLERS AND BANKS AT RISK

INTRODUCTION

All fraudsters rely on some form of documentation to persuade their victims that a particular transaction is genuine. Very few deals are concluded without anything in writing and if they are, it is usually because the parties have complete trust in each other.

In documentary credit transactions fraud has reached epidemic proportions because false documentation can be generated relatively easily, often by one party, and presented to the negotiating bank who will often have great difficulty in establishing its authenticity.

Undoubtedly, the new electronic data interchange system will improve the situation, but care will have to be taken to combat new threats and to introduce security measures that are effective and can be regularly monitored world-wide.

In the world of documentary fraud there are many possible scenarios. Fraudsters will often select commodities in great demand and offer them for sale at reasonable prices using convincing documentation. Brokers are sometimes used to sell the goods, and they either know that the transaction is fraudulent or do not care whether it is or not. When the transaction crashes, the broker protests innocence and reminds all the parties that he too is an innocent victim. Seldom, if ever, will they agree to pay back the commission they received.

Over the last few decades documentary fraudsters have accumulated vast sums of money by manipulating documentary letters of credit and it is appropriate to look in detail at these instruments to examine their flaws.

LETTERS OF CREDIT

Documentary letters of credit developed in order to facilitate international trade and bridge the gap of distrust between buyers and sellers separated, as they so often are, by geographical, political, legal and cultural barriers. Sellers are naturally reluctant to part with their goods until they have been paid whilst buyers equally do not wish to part with their money until they are in receipt of the goods or at least know that they have been despatched to them.

A letter of credit is essentially an instruction from a banker in one country to a banker in another country authorising the payment of a certain sum of money to the person named therein (usually the seller). Payment is only made within a prescribed time against production of certain specified documents.

A buyer instructs his bank, "the issuing bank", to open a letter of credit in favour of a seller. The issuing bank instructs "the advising" or paying bank, in the seller's country to hand over the purchase price when the seller hands over documents confirming shipment of the goods. In a Collection Arrangement (documents against payment or documents against acceptance) the payment takes place in the buyer's country. Under such an arrangement the seller instructs a bank to hand over the documents of title to the goods to the buyer upon receipt of payment.

The attractiveness of a letter of credit from the point of view of the beneficiary is that if the documents he submits appear on face value to comply with the terms of letter of credit, the bank is required to pay regardless as to whether or not there is a dispute on the underlying commercial contract. This is the so called "independence" principle which is fundamental to the rules under which letters of credit are operated to ensure the smooth flow of international commerce. Banks deal with documents and not goods and do not concern themselves with underlying commercial transactions.

The documentary credit system works well if the buyer and seller are basically honest. But if they are not the system is easily abused. The real problem is that the documents stipulated for presentation by the buyer under the letter of credit, and which trigger payment to the seller, are notoriously easy to forge. Typically these documents will number anywhere from two to twenty or more and will nearly always include:

1. A bill of lading - often regarded as a key document in the transaction since it serves three functions, being: a receipt from the carrier evidencing shipment of the goods in question; a document of title representing the goods which can be negotiated or passed to another owner and finally, evidence of contract of carriage between the shipper and the carrier.
2. A commercial invoice made out by the seller specifying the quantity and quality of the goods.
3. Other documents that may also be specified by someone opening a letter of credit include certificates of origin, an insurance certificate if the sale is on a cif basis, survey certificate, packing lists, etc.

MODUS OPERANDI OF THE FRAUDSTER

Various modus operandi are open to the documentary letter of credit fraudster, who is usually, but not always, the seller. After locating a suitable target in the form of a gullible buyer, the fraudulent seller will contract to sell a quantity of goods to them and request that a letter of credit be opened in his favour. Once this has been done the fraudulent seller may:

1. Ship complete rubbish to the buyer - Typically containers are loaded with sand, rocks or rubble and bills of lading made out on a "said to contain" basis will specify the goods that the unfortunate seller expects to receive. Although the fraudulent seller will in most instances pay for the cost of transporting the containers to destination there will still generally be a substantial margin of profit in the deal.
2. Ship goods of lesser quantity or quality - Again, the fraudulent seller generally pays for transportation costs. If apprehended, the seller may be able to avoid criminal liability and only be held liable for the losses of the buyer in civil proceedings.
3. Ship absolutely nothing at all - Instead, forge or obtain an entire set of documents as specified in the letter of credit including the bill of lading. This is by far the most common technique adopted by the fraudulent seller.

Some fraudulent buyers have been able to defraud innocent sellers. Instances of fraud by the buyer most often occur when payment is on a Documents against Payment (or "D/P") basis and the buyers have been able to make up a convincing set of documents, together with bank stamps evidencing that payment has been made. In turn these documents are used to induce the carriers to part with the goods.

Some documentary letter of credit frauds are carefully syndicated. Instead of a solitary fraudster working on his own, a group of fraudsters acting as buyers and sellers will band together to defraud one or more banks using forged documents. These schemes require a degree of sophistication since, to be successful, the syndicate will need to obtain information about the bank or banks they wish to manipulate and in particular, the format of their letters of credit and issuing systems.

Forged letters of credit (usually in batches to increase the sum obtainable) are then made out purporting to have been issued by a bank in one country. These are then sent in the normal manner to an advising bank in another country who notifies the beneficiaries. The beneficiaries, being part of the syndicate, have in the meantime registered companies and opened false bank accounts using false names.

To obtain the necessary documents specified under the letters of credit the syndicate will either forge documents or ship containers of rubbish and present these documents to the advising bank. They will then disappear. Only when the advising bank tries to obtain reimbursement from the bank that has purportedly issued these letters of credit will the fraud become apparent.

There are no accurate statistics as to how many documentary letter of credit frauds take place in any given year but there can be little doubt that each year they net their

perpetrators hundreds of millions of dollars. Victims of these types of fraud are often understandably reluctant to let others know that they have been duped.

It is not difficult to appreciate why documentary letter of credit frauds have for some time been viewed as near perfect crimes. They are simple to engineer and operate. All that the aspiring fraudster needs to have is a basic knowledge of international trade, a front company incorporated in a jurisdiction where the beneficial ownership can remain shrouded in secrecy (some fraudsters are content to use a trading name or merely a false identity), a small office (or accommodation address) a telephone, fax machine (or telex) and a bank account.

The sums that can be netted from these types of fraud can be astronomical, frequently running into many millions of dollars. But the real beauty of this type of fraud is that it will generally not be discovered for weeks or months after it has been perpetrated. It is only when the hapless buyer goes to collect his cargo from the nominated vessel or the vessel does not arrive because it either does not exist or is not bound for the buyers port, that the fraud will be discovered. This time delay gives the fraudster ample time to spirit away his illicit gains. Very often the fruits of these frauds are transferred through a maze of offshore company accounts in jurisdictions where strong banking secrecy laws prevail. Sometimes these funds are paid into the account of a fictitious individual. Soon afterwards an individual using this name arranges to draw out all the funds deposited in cash before melting into the shadows. In this way the "money trail" is broken and the task of the investigator is made more difficult.

Because these frauds span a number of jurisdictions, the fraudsters know that there is only a very small risk of being apprehended and brought to trial. The legal problems surrounding jurisdiction, extradition, and conspiracy to defraud, quite apart from the "invisible" nature of the crime, its complexity, and the low priority it is often afforded by under-resourced law enforcement bodies in different parts of the world, leads all too often to a situation where these frauds go uninvestigated.

Complex international frauds can be very costly to investigate and if the prosecuting authorities in one jurisdiction can perceive a greater connection between the fraud and another jurisdiction they will all too often try and pass the buck by encouraging the unfortunate victim to go elsewhere.

Even when a victim is successful in persuading law enforcement to mount an investigation, the wheels of justice in many jurisdictions grind at an inordinately slow pace. Requests for judicial assistance, or "Commissions Rogatoires", from the authorities in one country to those in another may take many months to be answered and it may be years before any trial takes place.

EXAMPLES OF DOCUMENTARY LETTER OF CREDIT FRAUD

Architects of documentary letter of credit frauds have sometimes been quite colourful characters who have later gone on to achieve notoriety as a result of even larger and more dramatic frauds, albeit of a different type.

In the early part of the 1960's the late Dr Emil Savundra's Fire Auto and Marine Insurance Company crashed spectacularly in London leaving a large number of disgruntled policy holders with unsettled claims. The company's demise had much to do with the flamboyant lifestyle of Dr Savundra and his practice of siphoning premiums paid to the company into offshore accounts in Liechtenstein. What was not generally known at that time was that Dr Savundra had a long history of fraudulent conduct which stemmed from his first large deal in 1951. In this instance he acted as a broker in the supply of 45,000 drums of lubricants to the Chinese Government at a price of \$1.23 million. The shipment was allegedly made in January 1951 on a Swedish vessel. The documents showed the shippers to be based in Marseilles. Subsequently payment was made in Switzerland against the production of a complete set of documents including the bills of lading and Lloyd's survey certificates. It later transpired that neither the vessel, the French shipper or indeed the cargo actually existed. All the documents presented to the bank were entirely false. In addition there was at that time an embargo on the export of oil to China giving the Chinese Government little recourse due to the illegality of the transaction.

Another flamboyant character was the aspiring Pakistani film mogul shipping magnate Mahmud Sipra, whose activities and unpaid loans of \$70 million were alleged to have contributed to the demise of the ill fated Johnson Matthey bank in London in 1984. In July 1980 he was involved in a deal to ship 6,000 tons of pulp to an Iraqi state organisation. According to the bill of lading this had been loaded on board the vessel Ocean Defender. The bill of lading and other false documents were presented to obtain payment of almost \$7 million under the terms of a letter of credit. The pulp never existed and the Iraqi buyers were saddled with a huge loss. Sipra also had the dubious distinction of being accused by a US District Judge of "old fashioned piracy on the high seas and overwhelming greed" in a case involving the wrongful diversion of a steel cargo.

Some documentary frauds are set up in a very elaborate way with the fraudster going to great lengths to mask his true identity and cover his tracks. In addition, the fraudster will very often try and use another individual or company to unwittingly carrying out the fraud. Lawyers who act as fiduciaries are particularly vulnerable in this regard. One such case which has these ingredients involved a vessel called the Aghios Nikolaos.

In 1980 an Italian who will be referred to as "Luigi Machetti" instructed a prominent and highly respectable firm of Swiss Lawyers in Lugano to set up a Liechtenstein company for him called Overseas Chemicals Supplies Establishment (OCSE). As anyone who has ever tried to investigate the beneficial ownership of a Liechtenstein establishment will know, it is

virtually impossible to obtain this information. Indeed it is fair to say that secrecy as to ownership, along with the tax advantages that are enjoyed by such companies, are their very *raison d'être*.

Having formed OCSE, Mr Machetti asked his lawyers whether they would act in a fiduciary capacity on his behalf. This they agreed to do. As fiduciaries they would carry out the instructions of Mr Machetti without disclosing his identity. This is a service commonly provided by lawyers in Switzerland.

Mr Machetti had previously worked for an Italian company who dealt extensively with the export of chemicals to various middle eastern oil companies. As a chemicals trader, Mr Machetti knew that a tender for the supply of 6,500 tons of caustic soda would soon be coming on to the market from a subsidiary of a large oil company in the Middle East. When the tender was put out Mr Machetti instructed his Swiss lawyers to place a bid on behalf of OCSE to supply the caustic soda for \$2.5 million. Knowing the market as he did Mr Machetti pitched his bid at an amount which he believed would not be viewed as being suspiciously low. In due course the middle eastern buyers agreed to accept OCSE's bid and a letter of credit was opened in OCSE's favour.

At this point Mr Machetti took two steps to divert attention away from OCSE when the fraud was discovered, as he had no intention of supplying the caustic soda which had been contracted. The first step was to obtain blank bill of lading forms from a shipping company which was perilously close to bankruptcy. The Greek shipping company chosen owned only one small vessel the Helen Pappas. The second step was to falsify documentation, which he then deposited with his Swiss lawyers indicating that the caustic soda was being supplied to OCSE by a company in Beirut called Dile International.

In fact as later enquiries showed, Dile International did not exist, its offices being a ruined building in a street in Beirut which formed a "no mans land" between rival Christian and Moslem factions.

On the 24th January 1981, a bill of lading indicating that the entire cargo had been loaded on board the vessel Aghios Nikolaos at Trieste, along with other documents required under the letter of credit, were presented to the advising bank in Switzerland who paid \$2.5 million to OCSE.

It was the old familiar story, the documents were all false, and the cargo never existed. There were in fact six vessels at that time by the name of Aghios Nikolaos but none had visited the port of Trieste in January 1981. Four months elapsed before the buyers realised that they had been defrauded, allowing Mr Machetti ample time to salt away his ill-gotten gains before disappearing and leaving his erstwhile Swiss lawyers in an embarrassing position.

Even in a sophisticated and well planned fraud of this nature mistakes can still be made. Close examination of the bill of lading revealed that the type written name of the vessel Aghios Nikolaos at the top of the form was misspelled on the vessels seal that was impressed on the bottom right hand corner of the form. Here the word "Aghios" appears as "Agihos".

It is questionable as to whether or not an alert bank clerk should have noticed this discrepancy when the documents were presented for negotiation.

Although warrants were issued for the arrest of Mr Machetti, to date he still remains a free and very wealthy man.

Some fraudsters deliberately try to ensnare their victims into some form of illegal activity so that when the fraud becomes apparent the victim is reluctant to try and recover his loss through fear of drawing attention to some questionable behaviour on his behalf.

A good example of this occurred a number of years ago in West Africa when a Nigerian importer reached an agreement with a Danish exporter under which he agreed to buy \$25,000 worth of electronic goods. Payment was to be on a documents against payment basis. The Nigerian importer was also keen to export hard currency out of the country in breach of his countries stringent exchange control regulations and he reached a secret agreement with his Danish business associate under which he would be over invoiced for the goods he received.

Under the secret agreement the Danish exporter would ship goods to the value of \$25,000 but invoice the Nigerian importer for \$250,000. The difference of \$225,000 would be credited to the Nigerian importers secret Swiss bank account. The arrangement naturally depended on a good deal of trust between the parties.

Temptation proved too much for the Danish exporter and he decided to produce totally false documents, including the bills of lading, to the collecting bank in Nigeria knowing that he could remind the Nigerian importer of the penalties of breaching exchange control regulations should the importer choose to complain. Unfortunately for the Dane he never received the proceeds of his fraud because a fraudulent bank clerk in the Nigerian collecting bank cleverly determined that the Nigerian importer was breaching exchange control regulations and the Danish exporter was perpetrating a documentary letter of credit fraud. The clerk took the money for himself knowing that neither party would come after him and run the risk of having their misdemeanours exposed.

Another not dissimilar fraud took place at the end of 1989 when a Taiwanese company entered into a contract to buy 5,000 tons of heavy melting steel from a company in Hong Kong, Durbingale Ltd. In order to avoid import duty the Taiwanese importers agreed with Durbingale that there would be two letters of credit opened to cover the purchase of the steel. The first covering sixty per cent of the value of the cargo would become payable on

shipment when the bills of lading and other stipulated documents were presented. The balance of 40 per cent of the value, ostensibly for freight, would become payable on delivery in Taiwan.

Durbingale duly arranged to ship the steel from Hodeidah in the Yemen and chartered the vessel Al Fayrouz to carry the cargo to Taiwan. The vessel commenced loading and the Taiwanese buyers, anxious to ensure that all was going well, sent their representative to Hodeidah who duly observed the cargo being loaded. He was unable to stay for the full six weeks which it took to load the vessel. In the event only about 3,000 tons of steel were loaded. However bills of lading were produced by Durbingale to show that the full 5,000 tons had been loaded and the first letter of credit was encashed. The Taiwanese waited in vain for their cargo and when they asked Durbingale what was causing the delay they were told that due to a cash flow crisis Durbingale were unable to pay the shipowners who in turn were reluctant to proceed to the discharge port. Durbingale asked for immediate payment of the second letter of credit to solve their cash flow crisis and the Taiwanese importers by now desperate for their steel reluctantly agreed.

The shipowner had in fact issued the genuine bills of lading to Durbingale for the 3,000 tons of steel on board and was owed a substantial amount of money by this company in respect of outstanding freight. The vessel was waiting off Singapore and the owner was by now desperate to get rid of the cargo. Durbingale advised the shipowner that they had sold the cargo to a company in Singapore and agreed to settle all the outstanding freight providing the vessel discharged the cargo in Singapore. This was duly done and the Singapore buyers, now holding the genuine bills of lading and being unaware that this cargo had already been sold to the Taiwanese buyers, were able to acquire a good title to it. Durbingale closed its offices in Hong Kong and its owner left for early retirement in the sun.

Documentary letters of credit are sometimes used to secure payment of advance fees in what are known as "advance fee frauds". Good examples of these can be found in the recent spate of Nigerian oil frauds. Typically a buyer will be approached with an offer for sale of about one million barrels of Nigerian Bonny Light crude at below market rates, on board a vessel that has just left Nigeria. The buyers are told that the cargo is part of a special allocation outside the Nigerian National Petroleum Company's usual marketing channels. It is variously described as "Task Force Allocation", "Presidential Lifting" or the like. Would be buyers are advised that they must keep the transaction secret as important figures in the Government or Armed Forces are involved.

The purchasers are then lulled into a false sense of security by a succession of convincing faxes, telexes and other documents. Even if the purchasers were to check that the vessel carrying the crude existed and had called at a particular Nigerian port on a stated day, they would generally find nothing wrong. The fraudsters invariably use the names of vessels that have recently lifted oil from Nigeria. However the oil on board the vessel will belong to another company who is unaware that the cargo is being offered for sale.

Soon after a would be purchaser has entered negotiations for a cargo of Nigerian crude worth millions of dollars, he will be asked to make an advance cash payment of \$250,000 to cover "port expenses" or "administration costs". Frequently payment is by letter of credit and the seller's bank will inform the buyer's bank that they are holding an invoice for the purchase of a quantity of Nigerian crude.

The seller's bank will require that, within 48 hours of their confirmation that they have received documents from Nigeria confirming the stated cargo has been lifted, the buyer's bank undertakes to open an acceptable irrevocable confirmed divisible and transferable letter of credit issued by a prime bank in favour of a designated account with the seller's bank for the value of the cargo, payable upon authenticated delivery except for immediate payment of \$250,000 to the seller's account to cover port costs.

The main intention of the fraudsters is to obtain an "advance fee" of \$250,000 from one or more victims who are approached in this way. The bank being used by the fraudulent seller will be unaware of the fraudulent nature of the transaction and will unwittingly lend its often prestigious name to the transaction. Generally the fraudulent seller will agree to present 14 or more documents before the letter of credit is honoured and this contributes to the sense of security that the buyer feels, particularly as payment for the cargo is not due until it has been delivered. The documents presented are often a mixture of forgeries and genuine items.

There have been all too many instances where buyers have paid the advance fee of \$250,000 and travelled to the port of discharge to claim "their cargo" only to find a number of other individuals at the port laying claim to the same cargo and brandishing similar documents. It is usually the person or company who does not have any documents at that time because they are still working their way through the banking system who is the true owner of the cargo. Because the full value of the cargo only becomes payable on authenticated discharge of the cargo it has only rarely happened that fraudulent sellers have been able to obtain the full value of the cargo, their main objective being the "advance fee".

Some fraudsters lull their victims into a false sense of security over a period of time by promptly supplying small consignments without any problems. The trusting buyer increases his orders over a period of years and when a particularly large order has been placed the seller's execute a documentary letter of credit fraud. Most fraudsters though do not go to this trouble, preferring "the big hit" which will net them sufficient money to retire for life.

High value commodities, where values can fluctuate quite significantly on world markets, are particularly attractive to the documentary letter of credit fraudster. Traders frequently sell a cargo of a particular commodity to a buyer at a fixed price which at the time gives them a reasonable margin of profit. They then cast around for a supplier. However by that time the market price has gone up dramatically and it becomes increasingly difficult for

them to fulfill their commitment without making a loss. Enter the fraudster with a cargo of sugar at below market prices and the traders' predicament is about to worsen dramatically.

SUGAR FRAUD

Sugar is a cargo whose price can fluctuate quite significantly on world markets and is a favourite with fraudsters. A case in point which involved a vessel, the Trident Dusk, took place at the beginning of 1988.

A middle eastern merchant obtained a valuable contract to supply 20,000 tons of sugar to his government's Ministry of Supply for about \$4 million. He then sought a supplier through a chain of brokers in Cyprus and Portugal during a period in which the world price of sugar increased dramatically, eroding his profit margin.

Eventually a supplier, Molina and Filhos, was found in Brazil who could supply such a cargo at an attractive price. A letter of credit was duly opened by the buyers who specified production of ten documents, including the bill of lading and a survey report by a firm of surveyors in Brazil called Deckmann and Jorgensen. In due course the documents were presented to the confirming bank showing that the full cargo had been loaded on board the Trident Dusk at Santos, Brazil on 25th April 1988.

When the documents were examined by the bank against the letter of credit stipulations a number of discrepancies were found. Moreover the bank discovered that there had been a typographical error by one of the bank clerks employed by the opening bank who had in error typed into the letter of credit the surveyors name as Deckmann and Jorgensen instead of Beckmann and Jorgensen.

This hadn't worried the fraudsters who had merely sealed the survey report with the words "Deckmann and Jorgensen accepted", a company that did not exist. Further enquiries revealed that the suppliers in Brazil, Molina and Filhos, had gone into liquidation five years earlier. Moreover, telexes that had supposedly come from them were in fact being sent from a public telex booth in Santos. When the movements of the Trident Dusk were checked it was found that she was at sea proceeding towards Brazil from the Middle East on the day that the bill of lading was issued indicating that she was in port at Santos. The attempted fraud failed. However in another similar sugar fraud the buyers were not so lucky.

At the end of 1987 a buyer in East Africa contracted to buy 4,000 tons of sugar from a company in Greece, who in turn were supposedly purchasing this commodity from a company in the Netherlands, who in turn purported to purchase the sugar from a non-existent company in the UK. In fact a conspiracy existed between the Greek and Dutch companies to defraud the unfortunate buyer and everything was nicely arranged so that

when the sugar never materialised, the blame could be laid squarely at the door of the non-existent English company.

In due course the buyer opened a letter of credit in favour of his Greek seller and carefully forged documents were presented to the confirming bank to obtain payment indicating that the sugar had been loaded on board the vessel *Secil Angola* at Antwerp in November 1987. The documents were in fact rejected by the bank on the grounds that they didn't contain a particular endorsement. This did not deter the fraudulent sellers who sent their representative to see the buyer and managed to convince him that the cargo was indeed on board the *Secil Angola* which would be calling shortly at the nominated discharge port. The buyer was thereby induced to part with \$ 415,000.

Unfortunately for the fraudulent conspirators the Dutch police had targeted the Dutch company as being possibly involved in drug smuggling and had placed telephone taps on their lines. Instead of listening to conversations about narcotics they learned of the fraudulent conspiracy and promptly arrested the owner of the Dutch company. All this goes to show that as a fraudster you can never be too careful - there is always the possibility of the unexpected.

Perhaps the best way to manipulate letters of credit on a regular basis is to operate your own bank.

In 1987 a group of creative fraudsters from Haiti set up a bank in a small residential apartment in New York with the grandiose name of The Bank of Haiti (BH). BH also had a similar "office" in Port-au-Prince, the capital of Haiti.

Having set up their banking structure, the group of fraudsters behind BH set up a company in Port-au-Prince, Universal Enterprises, and another company in New York called Silver Grace Corporation. In late 1987 a "deal" was set up involving a supposed purchase by Universal Enterprises of goods worth \$5 million from Silver Grace.

A letter of credit was opened by Universal Enterprises through BH in favour of Silver Grace. In order to confer legitimacy it was necessary to find another leading bank to unwittingly lend its prestige to the transaction by acting as advising bank to Silver Grace. BH were able to find a leading bank in New York ("LB") to perform this role and managed to convince them not only that BH was a member of the American Bankers association but also that BH had US dollar funds at another bank to reimburse LB. LB accepted these assurances without checking them independently. In July 1988 BH wrote to LB advising them that the amount of the letter of credit was being increased from \$5 million to \$11.9 million. The stage was now set for the fraud to be executed.

The beneficiary of the letter of credit, Silver Grace, then used it to fraudulently obtain goods from India and the United States. They did so by transferring more than \$11.1 million of the proceeds of the letter of credit to legitimate sellers who supplied the goods believing they would receive payment out of the proceeds of the letter of credit. LB's role as a leading international bank conferred the transaction with the aura of legitimacy and Silver Grace exploited this to the full by getting LB to advise several banks in India of the terms of the BH letter of credit.

The goods received by Silver Grace were quickly sold and the proceeds of sale spirited away before the company ceased trading. It was when the Indian banks sought reimbursement from LB and they in turn sought reimbursement from BH that the fraud became apparent.

THE BANKS' ROLE

In letter of credit transactions, banks deal in documents and not in goods. They rely almost exclusively on documents in their commitments and procedures for financing international trade. Enshrined in the ICC-Uniform Customs and Practice for Documentary Credits (the latest version being the UCP600), which governs the letter of credit transaction in most countries in the world, one finds a number of important articles which lay down the responsibilities and liabilities of the banks. In particular:

Article 5 – “Banks deal with documents and not with goods, services or performance to which the documents may relate.”

Article 14 a – “{Banks} must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation”

Article 34 – “A bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document..... “

Banks have no obligation to look at the underlying transaction as has been mentioned. Yet all too often, gullible victims place too much trust in the system and appear to have a misguided notion that the banks will carry out the necessary checks that they themselves should have already affected.

Over the years suggestions have been made that the banks' checking role should extend beyond merely ensuring that the documents presented comply with the credit opened and encompass basic checks into the underlying transaction. The argument has often been put that banks being in the "front line" of checking the documents are also best placed to detect fraud in the underlying transaction and could in a number of cases do so without too much trouble. The banks counter arguments are that these types of checks should be made by the parties involved in the transaction and that to take on the responsibility could lead them

to incur huge potential liabilities. In addition bankers maintain that many letter of credit departments process a considerable number of transactions in any given day for relatively small amounts of money and are not geared up to making the types of additional checks that are often suggested.

Whilst it is most unlikely that banks as a whole will at some time in the future take on the responsibility of making additional checks into the transactions underlying documentary letters of credit, some banks do discreetly carry out such checks and alert their customers when something appears amiss.

There are times too when banks will respond very promptly to avert fraud. A good case in point occurred in August 1989 when a number of Taiwanese buyers arranged to buy substantial quantities of scrap metal worth millions of dollars from sellers in the Lebanon. Payment was to be made by documentary letter of credit. Prior to presentation of the documents under the letter of credit, some of the buyers were provided with copies of inspection certificates allegedly issued by the Beirut office of the well known classification society Bureau Veritas. This confirmed that the scrap existed and was of good quality. When examined by the ICC-International Maritime Bureau these documents were found to be fakes and the vessels on which the scrap was to be loaded were in fact laid up and unlikely to put to sea. The Lebanese banking community was alerted and payment was averted in all but two cases.

THE FRAUD EXCEPTION

The basic principle that the documentary credit is a distinct legal instrument and quite separate from the commercial contract is well established and widely recognised. As Mr Justice Kerr remarked in *R D Harbottle (Mercantile) Ltd v National Westminster Bank (1978)*.

"It is only in exceptional circumstances that the courts will interfere with the machinery or irrevocable obligations assumed by banks. They are the lifeblood of international commerce".

Fraud is one such exception.

It appears to be well established that a bank should not refuse to pay, accept or negotiate the credit even if the applicant informs them there is grave suspicion that the shipment is fraudulent and consequently the tendered documents are false. But if the bank positively knows that the documents are forged or falsified the situation is quite different.

As Mr Justice Griffiths remarked in a Court of Appeal case in 1981 "The banks obligation is to pay upon the presentation of genuine documents in accordance with the requirements of the letter of credit. If the documents presented are fraudulently false they are not genuine conforming documents and the bank has no obligation to pay".

In a leading American case (*Sztejn v Henry Schroder Banking Corporation*) heard in New York in 1994, an exporter agreed to ship 50 cases of expensive bristles. The shipment was made, the documents were in order but the cases were filled with worthless cow hair. The court held that the doctrine of separation of the letter of credit from the underlying sales contract should not extend to protect the unscrupulous seller.

It seems that, for a bank to justify its refusal to pay, the fraud must be one to which the beneficiary is party or of which he has knowledge. The authority for this is the case of *United City Merchants (Investments) Ltd v Royal Bank Of Canada* (1983). In this case loading brokers had fraudulently written an incorrect loading date on a bill of lading to give the false impression that the goods had been shipped within the period required by the credit. The House of Lords decided that the confirming bank had no right to refuse payment because the seller was unaware of the fraud.

This case has led to some disquiet in banking circles and has no doubt made bankers particularly wary about refusing payment in the absence of clear cut fraud on the beneficiary's behalf.

PREVENTION

No paper on documentary letter of credit fraud would be complete without some examination of the steps that can be taken to avoid becoming a victim.

Whilst there are many different types of fraud to be found throughout the world, they all have one common characteristic - the fraudster preys on the gullibility and human greed of his victim. Documentary letter of credit frauds are no exception.

Usually there are tell tale signs or warning signals at the very outset of a fraudulent transaction to alert a potential victim that there is something not quite right with the deal. All too often these are disregarded by the victim, who is consumed instead by the prospect of making a fantastic profit. These warning signals include:

- The offer of a commodity at an unusually low price by a company with whom the victim has had no previous dealings and about which little is known.
- The offer of commodities which are in great demand but not readily available.
- A request for payment conditions which are out of line with those customary.
- A request for an advance fee for port expenses, administration costs etc.
- The use of names which resemble but are not those of well-known trading houses.

- The use of pressure for the fast acceptance of offers and for letters of credit to be opened.

It is important to keep in mind the fact that all victims are volunteers. Apart from watching out for the warning signals that fraudulent transactions so often display, would-be victims can take a number of steps to avoid falling into the fraudsters trap. Simple precautions that buyers (who are so often victims of these frauds) can take include:

- Making checks into the background of the sellers, through banks, embassies and other trade sources.
- Requesting a full set of documents of title to the goods for presentation under the credit.
- Requiring the provision of a performance bond from the supplier's bank.
- Calling for inspection, analysis, weight, and other certificates to be issued by independent third parties.
- Checking that the vessel nominated to perform the voyage has the capacity to carry the particular cargo, will be calling at the nominated loading port and is scheduled to go to the discharge port.
- Arranging for a cargo surveyor to go to the loading port to examine the cargo and supervise the loading operation. Additionally and if practicable, providing for a supercargo to remain on the vessel during transit.

Whilst it is fair to say that only a small percentage of letter of credit transactions that are affected by fraud, the impact on the victim company can be quite devastating and frequently leads to liquidation.

When confronted with such frauds victims quickly examine ways of recovering their losses. If, as is so often the case, the goods have never existed and the fraudster has vanished into thin air with his ill gotten gains, the victim will first consider a claim against the insurers of the goods. They soon learn that insurers will not indemnify their insured in circumstances where the goods never actually existed. Victims may then explore ways of "redistributing the loss" by formulating a claim against one or more parties who may have acted negligently during the transaction.

Banks frequently find themselves in the front line as targets for these claims, though proving negligence in most instances is far from easy.

Although would-be victims can go a long way towards minimising their exposure to the types of documentary letter of credit fraud described, there is no sign of any decrease in this variety of fraud. Indeed the growing sophistication of the documentary letter of credit

fraudster and the fact that they so often elude arrest calls for increased vigilance by all those involved in international trade.