TOPE ADEBAYO LP

WHEN LETTERS OF CREDIT FAIL:

FIVE RECURRING DISPUTE PATTERNS IN TRADE FINANCE

www.topeadebayolp.com

INTRODUCTION

The letter of credit is one of the most successful instruments ever devised for managing payment risk in cross-border trade. It provides a simple but powerful assurance: if the seller ships the goods and presents conforming documents to the bank, the bank will pay,[1] regardless of whether the buyer is willing, solvent, or satisfied. For the buyer, the corollary assurance is that the bank will not release funds until the stipulated documents have been presented. This double security has made the documentary credit indispensable to global commerce and, for many commodity and capital goods transactions in Nigeria, effectively mandatory.

Yet disputes continue to arise with regularity, and often involve substantial sums. Letters of credit are highly standardised in practice, and parties involved are generally familiar with their structure, terms, and operational mechanics. However, disputes persist because the foundational principles governing letters of credit are frequently misunderstood.

Three principles are central. First, the autonomy principle: the credit is a transaction entirely independent of the underlying sale, and the bank's obligation to pay is not affected by the buyer's complaints about the goods, the performance of the seller, or any term of the sale contract.[2] Second, strict documentary compliance: banks deal in documents, not goods,[3] and compliance with the credit's terms is binary rather than approximate.[4] Third, the limited role of the bank: the bank is neither a quality inspector nor a commercial arbiter; it is a payment intermediary bound by the rules of UCP 600 and the terms of the credit it has issued.

This article examines the five dispute scenarios that arise most frequently in practice: documentary discrepancies, defective goods, fraud, inter-bank reimbursement failures, and regulatory interruption. Each represents a structural point of tension within the documentary credit system.

1. REJECTION FOR DOCUMENTARY DISCREPANCIES

Disputes arising from documentary discrepancies are the most common in letter of credit practice. They occur when the issuing or confirming bank examines the documents presented by the beneficiary and identifies inconsistencies with the terms of the credit. Under UCP 600, the bank has a maximum of five banking days following the day of presentation to determine whether the documents constitute a complying presentation.[5] This is a hard deadline, not a flexible guideline.

1 ICC, Uniform Customs and Practice for Documentary Credits (UCP 600) (ICC Publication No 600, 2007 Revision) arts 7(a), 15(a)-(b).

2 UCP 600, art 4(a).

3 UCP 600, art 5.

4 UCP 600, art 14(a).

5 UCP 600, art 14(b).

At Tope Adebayo LP, our mission is to be an innovative firm rendering the highest quality legal services and building enduring strategic relationships with our clients. Find out more about us and tell us how we can be of service to you by visiting www.topeadebayolp.com.

The standard of examination is strict compliance. A misspelt port name, a weight figure that deviates from the credit terms, or a Bill of Lading that describes the goods in language not precisely mirroring the credit may each constitute a valid discrepancy. The UCP does not recognise the concept of an "immaterial" discrepancy; compliance is binary: the document either conforms or it does not. A bank 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.[6] If the bank meets this standard and pays, it is entitled to reimbursement from the applicant; if it pays against non-complying documents without the applicant's waiver, the applicant may refuse to reimburse.

The riskiest dimension of the discrepancy dispute is procedural rather than substantive. Under UCP 600 Article 16, a bank that refuses must issue a single notice listing every discrepancy it relies upon and must state whether it is holding or returning the documents.[7] If the bank fails to comply with these requirements, whether by omitting a discrepancy, delaying the notice, or stating it will return the documents but then holds onto them, it is "precluded" from claiming that the presentation was non-compliant.[8] A procedural defect in refusal can be as serious as a substantive mistake in examination. The English Court of Appeal decision in Fortis Bank SA/NV v Indian Overseas Bank provides a clear illustration: the issuing bank identified discrepancies and rejected the presentation, but failed to return the documents for approximately three months.[9] The court held that the bank's failure to act in accordance with its own rejection notice triggered preclusion, and the bank was required to honour the credit in full.

In practice, discrepancy disputes are often driven by market conditions rather than genuine documentary defects. Where the price of the imported commodity has fallen since the credit was opened, the importer has an incentive to instruct the bank to scrutinise the documents for any possible ground of rejection, a practice sometimes described as the "typo-hunt." The exporter, on the other hand, will argue that the discrepancy is trivial or that the bank's conduct amounts to bad faith. The bank occupies a position of strict neutrality: its obligation is to the terms of the credit, and it must neither assist the importer's commercial strategy nor indulge the exporter's plea for flexibility.

Practical lessons

Exporters should treat document preparation as a technical discipline, not a clerical afterthought; the ICC's International Standard Banking Practice provides detailed guidance on how banks assess documentary compliance.[10] Banks must ensure that their rejection notices are comprehensive, timely, and internally consistent. A flawed notice can convert a justified rejection into an obligation to pay. Importers should not rely on the bank to identify discrepancies that serve their commercial interests; if the documents comply, the bank will pay, regardless of the applicant's instructions to the contrary.

[6] UCP 600, art 14(a). Under the predecessor regime, the standard was expressed as one of 'reasonable care': see UCP 500, art 13(a)

[7] UCP 600, art 16(c).

[8] UCP 600, art 16(f).

[9] Fortis Bank SA/NV v Indian Overseas Bank [2011] EWCA Civ 58.

[10] ICC, International Standard Banking Practice for the Examination of Documents under UCP 600 (ISBP) (ICC Publication No 821, 2023).

At Tope Adebayo LP, our mission is to be an innovative firm rendering the highest quality legal services and building enduring strategic relationships with our clients. Find out more about us and tell us how we can be of service to you by visiting www.topeadebayolp.com.

2. COMPLYING DOCUMENTS BUT DEFECTIVE OR NON-CONFORMING GOODS

This scenario tests the autonomy principle. The exporter presents documents that comply perfectly with the terms of the credit, the bank pays, and the importer then discovers that the goods delivered bear no resemblance to what was ordered (e.g., industrial chemicals turn out to be seawater, machinery consists of rusted scrap, or containers arrive empty). The importer's instinct is to demand that the bank reverse or withhold payment. The law provides no basis for such a demand.

UCP 600 Articles 4 and 5 establish the legal structure.[11] The credit is a separate transaction from the sale or other contract on which it may be based, and banks are in no way concerned with or bound by such contracts. In documentary credit operations, all parties deal with documents, and not with goods, services, or performance to which the documents may relate. The Supreme Court of Nigeria in ***Owigs and Obigs Nig Ltd v Zenith Bank Plc*** restated this position: *no defence to a claim on a letter of credit can be based on a breach of the underlying contract.*[12] *Even if the sale contract has been terminated or declared unenforceable, the bank must pay the exporter if the documents conform.*

The importer's remedy lies not in the credit but in the sale contract. The importer must reimburse the bank and then pursue the exporter through separate litigation or arbitration under the sale of goods contract, the applicable Incoterms 2020[13] rule, or the relevant product quality standards. This "pay first, sue later" model is the price of the letter of credit's liquidity and international acceptance.[14]

The importer is not, however, without protection at the documentary stage. The most effective tool is to require a pre-shipment inspection certificate, issued by a reputable independent inspection agency (that is, an independent third party engaged to inspect goods and certify matters such as quantity, quality, and conformity with contractual specifications), as a mandatory document under the credit. By making payment contingent on a third-party certificate attesting to the quality and quantity of the goods, the importer brings the physical reality of the cargo into the bank's documentary scope without breaching the autonomy principle. The credit should specify the inspection standard, the parameters to be verified (weight, composition, packaging), and the form in which the certificate must be presented, so that the bank can examine the certificate on its face in the same way it examines any other required document.

[11] UCP 600, arts 4(a), 5.

[12] Owigs and Obigs Nig Ltd v Zenith Bank Plc (Supreme Court of Nigeria, Suit No SC/CV/709/2020 – 2024 12 CLRN)

[13] International Chamber of Commerce, Incoterms® 2020: ICC Rules for the Use of Domestic and International Trade Terms (ICC Publication No 723E, ICC Publishing 2019).

[14] United City Merchants (Investments) Ltd v Royal Bank of Canada [1983] 1 AC 168 (HL).

At Tope Adebayo LP, our mission is to be an innovative firm rendering the highest quality legal services and building enduring strategic relationships with our clients. Find out more about us and tell us how we can be of service to you by visiting www.topeadebayolp.com.

Nigerian practitioners may want to note that the CBN has periodically imposed additional regulatory controls over invoiced prices, including the Price Verification System introduced in August 2023 and discontinued in July 2024. While no equivalent mechanism is currently mandatory, importers should remain alert to further CBN directives in this area.

Practical lessons

The bank is not a quality inspector, and importers who treat it as one are building their transaction on a misunderstanding. Pre-shipment inspection certificates are documentary safeguards that can be used to mitigate risk. Exporters must recognise that complying documents do not insulate them from claims under the sale contract; the autonomy principle protects the right to payment, not the right to deliver defective goods.

3. FRAUD, FORGERY, AND THE FRAUD EXCEPTION

The fraud exception is the only widely recognised ground on which a court may restrain a bank from paying under a letter of credit despite the presentation of conforming documents. It exists because the autonomy principle, taken to its extreme, would protect an outright swindler: a seller who ships worthless goods, forges the shipping documents, and then demands payment from a bank that has no means of knowing the truth. The law intervenes, but only narrowly.

The seminal authority is ***Sztejn v J Henry Schroder Banking Corp***, in which a New York court held that the autonomy principle should not be extended to protect an "unscrupulous seller" who had intentionally shipped worthless goods and presented fraudulent documents.[15] The bank had been notified of the fraud before payment, and the court permitted the buyer to restrain the credit. This decision established the fraud exception, but the English House of Lords in ***United City Merchants (Investments) Ltd v Royal Bank of Canada (the American Accord case)*** defined its limits.[16] Lord Diplock held that the fraud exception applies only where the beneficiary is a party to the fraud. If a third party (a carrier, a broker, a loading agent) forges a document without the exporter's knowledge, the bank must still pay the innocent beneficiary. The fraud exception requires proof of the beneficiary's knowledge; an innocent seller is protected from the fraud of rogue third parties.

In Nigerian courts, the standard of proof required to obtain an injunction restraining payment under a letter of credit is high. A mere allegation of fraud is insufficient. The applicant must present clear evidence that the beneficiary committed or participated in fraud, and that the bank had knowledge of it before payment.[17] Nigerian courts are reluctant to interfere with letters of credit, recognising that the instrument is central to international commerce and that frequent judicial intervention would damage the Nigerian banking sector's international credibility.

An emerging area of jurisprudence is the scope of the fraud exception, where the beneficiary, while perhaps not the author of the fraud, was recklessly indifferent to the accuracy of the documents it presented. In ***Crédit Agricole Corporate and Investment***

[15] Sztejn v J Henry Schroder Banking Corp (1941) 31 NYS 2d 631 (NY Sup Ct).

[16] United City Merchants (n 13).

[17] For the English position on the standard of proof required for injunctions restraining LC payments, see United Trading Corporation SA v Allied Arab Bank Ltd [1985] 2 Lloyd's Rep 554 (CA). Nigerian courts are expected to apply a similarly stringent standard.

At Tope Adebayo LP, our mission is to be an innovative firm rendering the highest quality legal services and building enduring strategic relationships with our clients. Find out more about us and tell us how we can be of service to you by visiting www.topeadebayolp.com.

Bank, Singapore Branch v PPT Energy Trading Co Ltd, the Singapore International Commercial Court held that recklessness on the part of the beneficiary was insufficient to engage the fraud exception; the bank was liable to pay despite finding that the beneficiary had been indifferent to the circumstances of the underlying transaction.[18] However, in the subsequent decision of ***Winson Oil Trading Pte Ltd v Oversea-Chinese Banking Corporation Ltd,*** the Singapore High Court departed from this approach and held that reckless indifference as to the truth or falsity of representations in documents presented under a letter of credit does fall within the fraud exception.[19] The two decisions have not yet been reconciled by the Singapore Court of Appeal, and the point remains unsettled.[20] If the broader ***Winson Oil*** approach gains acceptance, it would have significant implications for banks: if documents are presented that are clearly suspicious or internally inconsistent, and the beneficiary cannot credibly claim to have believed in their accuracy, the fraud exception may bite even in the absence of proof that the beneficiary was the author of

Practical lessons

Mere suspicion of fraud is not a defence to payment. The fraud exception is narrow by design, because the commercial utility of the letter of credit depends on the certainty that conforming documents will be honoured. Importers who believe they are victims of fraud must move quickly to obtain injunctive relief and must present evidence that meets the applicable threshold. Banks should maintain robust procedures for escalating suspicious presentations, but should not treat internal discomfort as a legal basis for dishonour. Exporters should ensure the integrity of their documentary chain, including verification of signatures and the provenance of transport documents.

4. WRONGFUL DISHONOUR, DELAYED HONOUR AND INTER-BANK REIMBURSEMENT DISPUTES

Behind every letter of credit transaction is a reimbursement chain. The bank that pays the beneficiary, whether it is the confirming bank, a nominated bank, or the issuing bank's correspondent, must recover the funds from the issuing bank, which in turn debits the applicant's account. When this chain breaks down, the dispute shifts from the trader-bank relationship to the bank-bank relationship, governed by UCP 600 Article 13[21] or, where incorporated, the ICC Uniform Rules for Bank-to-Bank Reimbursements (URR 725).[22]

A critical point of distinction was clarified by the ICC Banking Commission Opinion approved in 2014.[23] Where the credit does

[18] Crédit Agricole Corporate and Investment Bank, Singapore Branch v PPT Energy Trading Co Ltd [2022] SGHC(I) 1. On appeal, the Singapore Court of Appeal reversed the SICC's decision on the letter of indemnity but did not consider the fraud finding, as it was not appealed: [2023] SGCA(I) 7.

[19] Winson Oil Trading Pte Ltd v Oversea-Chinese Banking Corporation Ltd [2023] SGHC 220.

[20] For a comparative analysis of the two decisions, see Watson Farley & Williams, 'False Representations in Letters of Credit: Key Developments in Singapore' (13 September 2023).

[21] UCP 600, art 13(b).

[22] ICC, Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR 725) (ICC Publication No 725, 2008).

[23] ICC Banking Commission Opinion (approved November 2014), published in ICC, Banking Commission Collected Opinions 2012–2016 (ICC Publication). The Opinion confirmed that where a credit is silent on the applicability of URR 725, UCP 600 sub-article 13(b) applies by default and the issuing bank is liable for interest on delayed reimbursement under sub-article 13(b)(iii).

At Tope Adebayo LP, our mission is to be an innovative firm rendering the highest quality legal services and building enduring strategic relationships with our clients. Find out more about us and tell us how we can be of service to you by visiting www.topeadebayolp.com.

not expressly incorporate URR 725, Article 13 of UCP 600 applies by default. Under Article 13(b)(iii), the issuing bank is responsible for any loss of interest if reimbursement is not provided on first demand. In the case considered by the Banking Commission, an issuing bank attempted to rely on the three-day processing window available under URR 725 as a defence for delayed payment. Because the credit incorporated only UCP 600, the Banking Commission held that the three-day defence was unavailable and the issuing bank was liable for all accrued interest from the moment of first demand.[24]

The role of the confirming bank is particularly sensitive. Confirmation adds an independent, binding payment guarantee, but a confirming bank's liability is limited to its obligations under the credit. A confirming bank that delays or fails to act may be found negligent, but its exposure does not extend to the anticipated profits of the underlying export transaction; those losses are speculative and fall outside the bank's contractual relationship ***(Owigs and Obigs Nig Ltd v Zenith Bank Plc).***[25] A bank's exposure for breach of its letter of credit obligations is limited to the specific losses flowing from that breach, not the wider commercial fallout.

In the current Nigerian economic climate, delayed honour is frequently not a matter of choice but a consequence of foreign exchange scarcity. When a Nigerian issuing bank cannot source the dollars required to reimburse a foreign confirming bank, a dispute over wrongful dishonour will follow. The practitioner must distinguish between a bank's legal obligation to pay, which is absolute under the credit, and its practical ability to settle in foreign currency. Foreign exchange scarcity may explain a delay, but UCP 600 treats the issuing bank's undertaking as unconditional, and the bank will accrue interest for every day that reimbursement is outstanding.

Practical lessons

Confirming banks have an independent right to reimbursement from the issuing bank, and this right accrues from the moment of first demand unless URR 725 is expressly incorporated and provides otherwise. Banks that delay reimbursement bear the full cost of accrued interest. The distinction between legal entitlement to payment and practical inability to pay is critical: foreign exchange scarcity may explain a delay but does not excuse it. Parties structuring credits should consider whether to incorporate URR 725 explicitly, as the choice between UCP Article 13 and URR 725 determines the procedural framework for reimbursement disputes.

5. INJUNCTIONS, SANCTIONS, ILLEGALITY, AND REGULATORY INTERRUPTION

The final category of disputes arises not from any failure by the parties but from external intervention: court orders, international sanctions, or regulatory mandates that prevent or complicate payment. These disputes are distinct from the preceding four because they do not depend on the conduct of the importer, exporter, or bank in relation to the credit, but on the legal and regulatory environment in which the credit operates.

The intersection of trade finance and international sanctions is now a primary source of high-value litigation. Banks

[24] ICC Banking Commission Opinion TA.807rev, "Reimbursement under a credit not subject to URR 725" (approved November 2014), published in Gary Collyer (ed), ICC Banking Commission Collected Opinions 2012–2016: New Opinions on UCP 600, ISBP 681, ISBP 745, URC 522 and URDG 758 (ICC Publication No. 785E, 2016)

[25] Owigs and Obigs (n 12).

At Tope Adebayo LP, our mission is to be an innovative firm rendering the highest quality legal services and building enduring strategic relationships with our clients. Find out more about us and tell us how we can be of service to you by visiting www.topeadebayolp.com.

routinely include sanctions clauses in their confirmations and undertakings, reserving the right to withhold payment if the transaction involves a sanctioned entity, vessel, or jurisdiction. In Kuvera Resources Pte Ltd v JPMorgan Chase Bank NA, the Singapore Court of Appeal considered a bank's refusal to pay because the vessel used in the shipment was linked to a sanctioned Syrian entity.[26] The court upheld the bank's right to include a sanctions clause, even where the original credit did not contain one, on the basis that the confirmation was a separate undertaking. However, the court imposed an important limit: sanctions clauses cannot confer unbridled discretion on the bank. The bank must demonstrate a real risk of violating a specific sanctions law, not merely an internal compliance preference or a general sense of discomfort.

For Nigerian practitioners, localised regulatory intervention is often more disruptive than international sanctions. The Central Bank of Nigeria's "Ultimate Supplier of Products" rule requires that the Form M (the mandatory import application) be opened only in favour of the party that is the direct seller of the goods to the importer, and that payment under a letter of credit be made only to that party as beneficiary.[27] Where an importer routes payment through an undisclosed intermediary, and the bank, upon discovering this, cancels the credit or refuses to provide foreign exchange, a conflict arises between the bank's regulatory obligations and its contractual commitments. A bank cannot unilaterally cancel an irrevocable credit once it has been issued and communicated to the beneficiary.[28] If the bank cancels on the basis of a Form M violation, it may remain liable to the exporter for wrongful dishonour, even if it was acting in compliance with CBN directives. The CBN's November 2020 clarification introduced a conditional exception: where it is unavoidable that an importer uses a buying agent, the agent may qualify as the ultimate supplier provided specified documentation is submitted to and approved by the CBN before the Form M is opened.[29] However, the exception is narrow, and the tension between regulatory obligation and contractual commitment remains a genuinely difficult position for Nigerian banks.

Exchange rate volatility adds a further layer of complexity. CBN directives require the Nigeria Customs Service to apply the closing foreign exchange rate prevailing on the date the Form M was opened for the purpose of computing import duties.[30] If the Naira depreciates significantly between the opening of the Form M and the arrival of the goods, the importer's clearing costs may exceed the commercial value of the cargo, prompting an attempt to abandon the goods and stop payment. Nigerian banks must be clear: a change in the exchange rate is a commercial risk borne by the importer and is not a valid legal ground for the bank to refuse to honour a complying presentation.

Practical lessons

Exporters must scrutinise the terms of any bank confirmation for sanctions clauses and assess the sanctions exposure of the vessels, counterparties, and jurisdictions involved in the transaction. Banks must ensure that their sanctions clauses are specific and lawful, not a device for escaping inconvenient obligations. Importers must ensure

[26] Kuvera Resources Pte Ltd v JPMorgan Chase Bank NA [2023] SGCA 28.

[27] Central Bank of Nigeria, Circular TED/FEM/FPC/GEN/01/005 (24 August 2020). The CBN defines "Ultimate Supplier of Products" as "the direct party selling the goods to the importer irrespective of whether the party involved is the manufacturer or internationally recognised buying company/supplier/agent": Central Bank of Nigeria, Circular TED/FEM/FPC/GEN/01/009 (18 November 2020).

[28] UCP 600, arts 7(a)–(b), 10(a).

[29] CBN Circular TED/FEM/FPC/GEN/01/009 (18 November 2020). The required documentation includes evidence of authorisation to act as agent or distributor for the original equipment manufacturer, transfer pricing documentation, and detailed KYC and profile information on the buying company.

[30] Aghogho Udi, 'Customs to use exchange rate on date of "Form M" for import duty assessment – CBN' (Nairametrics, 23 February 2024) https://nairametrics.com/2024/02/23/customs-to-use-exchange-rate-on-date-of-form-m-for-import-duty-assessment-cbn/ accessed 21 March 2026

At Tope Adebayo LP, our mission is to be an innovative firm rendering the highest quality legal services and building enduring strategic relationships with our clients. Find out more about us and tell us how we can be of service to you by visiting www.topeadebayolp.com.

that the Form M accurately reflects the identity of the ultimate supplier and that the credit's validity period accounts for potential regulatory delays. In all cases, the distinction between regulatory inability to pay and contractual dishonour must be clearly understood: the former may explain the bank's position, but it does not extinguish the bank's legal liability.

CONCLUSION

The five dispute patterns examined in this article are not exceptional. They are recurring features of letter of credit practice and arise primarily from misunderstanding the instrument. The letter of credit is not a guarantee of satisfactory performance. It is not an insurance policy against defective goods. It is not an invitation to the bank to exercise commercial judgment on behalf of the applicant. It is a payment mechanism that operates entirely within the world of documents, and its reliability depends on every participant (importer, exporter, and bank) understanding and respecting that boundary.

The autonomy principle protects the integrity of the credit by severing it from the underlying sale. The strict compliance standard protects banks by giving them a clear, objective basis for their payment decision. The preclusion rule protects beneficiaries by ensuring that banks bear the consequences of procedural failures in their examination and refusal process. The fraud exception protects the system from outright dishonesty, but deliberately sets the bar high, because the alternative would be to allow every disgruntled buyer to freeze payment on the basis of unproven allegations.

Most letter of credit disputes are preventable. They are prevented not by clever litigation strategy after the fact, but by precise drafting at the outset, disciplined document preparation during performance, and rigorous procedural accuracy in examination and refusal. For the importer, this means requiring inspection certificates. For the exporter, it means treating every field on every document as a potential ground for rejection. For the bank, it means recognising that a flawed rejection notice is as dangerous as a flawed examination. In trade finance, the details are not just details. They are the entire mechanism.

At Tope Adebayo LP, our mission is to be an innovative firm rendering the highest quality legal services and building enduring strategic relationships with our clients. Find out more about us and tell us how we can be of service to you by visiting www.topeadebayolp.com.

PLEASE NOTE THAT THIS ARTICLE IS FOR INFORMATION PURPOSES ONLY AND DOES NOT CONSTITUTE LEGAL ADVICE

AUTHOR

GBENGA OGUNDOYE
ASSOCIATE

For further enquiries, log onto www.topeadebayolp.com

Do you need to get in touch with us, to know more on how we can help you and your business? Kindly contact us by using any of the details provided below:

TOPE ADEBAYO LP

3rd Floor, The Phoenix, Beside Etiebet Place, Mobolaji Bank Anthony Way, Ikeja, Lagos, Nigeria.
p: +234 708 869 9174, +234 813 532 1156
e: info@topeadebayolp.com
w: www.topeadebayolp.com