

Fraud in the seafood trade

The pitfalls of using letters of credit

Letters of Credit are a popular method of payment in the international fish trade. When opening a Letter of Credit the buyer can be sure that he will receive the goods in the agreed time frame and that the documents will be issued according to his instruction. Otherwise the seller will not be paid. When receiving a Letter of Credit the seller is confident of the buyer's financial ability to pay for the goods.

Nevertheless the usage of Letters of Credit is not as simple as it may seem. Unscrupulous businessmen have learned how to use this instrument in such a way that their counterparty will either lose the goods and never be paid or will lose the money and receive no product. This article describes the most popular schemes used by dishonest seafood traders and explains how not to become their victims.

One of the methods used by dishonest traders to avoid payment for the received product is to issue a Letter of Credit (L/C) with an in-built discrepancy. If an unaware exporter accepts such an L/Cs he has every chance of shipping the product and not being paid.

Read the small print carefully

Here is an example of one of our recent cases (all companies' names have been changed). A seafood importer, Shark Bite Ltd, and the seller, Naïve Fish Export Ltd, made an agreement for delivery of several containers of frozen fish. The companies were located in different parts of the world and had no previous business experience with each other. The buyer wanted to pay for the goods only after the delivery and quality check. He committed himself to transfer the money to the seller after the goods have been received. As a payment guarantee he offered a simple L/C, where it was

stated that if the buyer would not pay in time the seller could demand the payment from the issuing bank and the bank would pay the seller immediately. The seller saw nothing wrong with this and accepted the agreement.

The shipment was made and duly received by the buyer. When the due day came, Naïve Fish Export Ltd saw no money in his account. He contacted the importer but received no firm answer of when the product would be paid. In this situation the seller decided to utilise the L/C and submitted to the bank the statement that the buyer did not pay. To his great surprise the issuing bank refused to pay because not all conditions of the L/C were met. "Applicant's [the buyer's] confirmation of default" was missing and without it the payment could not be made. See *Picture 1*. The fraudulent buyer

did his best to win time and neither paid the seller nor issued the confirmation before the L/Cs expiry date. Once the L/C expired the issuing bank was clear of his payment obligations and the only thing the seller could do was to start legal action against Shark Bite Ltd.

In this case we can see that the seller made a fatal mistake and accepted a L/C with an in-built discrepancy, namely that one of the documents needed to receive the payment should have been issued by the buyer. The fraudulent importer had no intention to pay for the fish and never issued the confirmation of default. The problem was that Naïve Fish Export Ltd. had little experience in working with bank instruments and lost his money because of it. In our next example we can see how a knowledgeable and

experienced exporter avoided substantial losses when working with an L/C.

Amending a Letter of Credit is not always possible

An exporter, Clever Fish Ltd, made a contract for the supply of frozen milt to an overseas buyer, Milt Import and Trade Ltd. The lot consisted of several containers that should be shipped one after another during the fishing season that lasts for a few months. The parties agreed on the quality and the price and the buyer opened an irrevocable L/C for the whole lot.

With the contract in their possession, Clever Fish Ltd. made an agreement with the fishermen for the delivery of the raw material. When the season started he began to purchase the milt and freeze it

ACK	*	WE HEREBY AUTHORIZE BENEFICIARY TO DRAW ON.....
ACK	*	FOR ACCOUNT OF UP TO AN AGREGATE AMOUNT OF US DOLLARS ONE
ACK	*	MILLION ONLY (USD1.000.000.00) AVAILABLE BY DRAFTS AT SIGHT
ACK	*	INDICATING THIS SLC NO. AND DATE ACCOMPANIED BY BENEFICIARY'S
ACK	*	SIGNED STATEMENT CERTIFYING THAT THE AMOUNT DRAWN UNDER THIS
ACK	*	CREDIT IS DUE AND PAYABLE TO THEM BY..... AND
ACK	*	THAT THEY HAVE NOT REQUESTED THE SAID AMOUNT FROM.....
ACK	*	AND HAVE NOT RECEIVED PAYMENT. ACCOMPANIED BY APPLICANT'S
ACK	*	CONFIRMATION ON DEFAULT THROUGHBANK BY TESTED
ACK	*	TELEX/SWIFT TO THE ADVISING BANK.

Picture 1: In the case of the seafood importer, Shark Bite Ltd, and the seller, Naïve Fish Export Ltd, the terms of the Letter of Credit included the submission to the bank of a document from the buyer (the confirmation on default) before payment could be made.

Narrative	79	<p>• REQUIRED INSPECTION CERTIFICATE ISSUED BY S.G.S WHICH SHOW 1ST GRADE Q'LTY-NO BLOOD COLOR, NO OVERMATURED MILT GOOD FRESHNESS, NO MIXED PINK COLOR MILT.</p> <p>• REQUIRED BUYER'S SHIPPING ORDER ISSUED BY FAX WHICH SHOWS BUYER HAS RECEIVED THE COPY OF S.G.S INSPECTION CERTIFICATE AND AGREES TO SHIPT.</p>
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Picture 2: Milt Import and Trade Ltd unsuccessfully tried to change the terms of the Letter of Credit to impose some more conditions on the seller Clever Fish Ltd.

attention to the export documents. All of them were issued strictly in accordance with the L/C terms and in the end the exporter received his money. It is worth adding that the product was of very high quality and the importer was able to sell it without any trouble.

Poor documentation can lead to losses

A dishonest importer can use other tricks to avoid full payment for the goods. For example, if the documents presented to the issuing bank contain discrepancies the buyer may ask for a price reduction in exchange for acceptance of the documents. The main idea of working with the Letters of Credit is that if the documents submitted by the beneficiary - the seller - comply with the L/C's terms and conditions, the beneficiary will be paid by the applicant's bank. The bank is dealing with the documents but not the goods so it has nothing to do with the quality or quantity of the shipped product. Dishonest exporters use this condition for their own benefit.

The following example can be a good illustration of this. An importer orders a shipment of expensive seafood product from an overseas supplier. This is the first time the companies are working together and they have no previous experience with each other. The seller demands an L/C at sight and the buyer accepts it. We must say that a great number of L/Cs do not

require a pre-shipment inspection report and it makes the fraudster's life much easier. This is also the case in our example: no inspection report is required by the L/C. So the seller receives the L/C, loads the container with fish waste and ships it to the buyer. While the containers are in transit, the exporter issues a complete set of export documents, stating that the cargo is frozen fish and submits it to the issuing bank. As the documents have no discrepancies and all other L/C conditions are met, the seller receives full payment from the bank and vanishes with the money.

Another scenario is when the seller is a fake company that after receiving the L/C ships nothing, produces fake documents and sends them to the bank. If the bank does not reveal the forfeited documents (they may look convincingly similar to the legitimate ones) and pays the seller, the buyer will be in serious trouble. More sophisticated companies that plan to stay in this business for a longer time can load the containers with a lower

quality fish product or cheaper substitute and send it to the buyer. As no pre-shipment inspection is often required and the export documents are issued according to the L/C's conditions the seller will be paid in full and afterwards the importer will have to start endless negotiations with the supplier demanding compensation.

As we can see risks exist both for the exporters and the importers. Many problems with the L/Cs can be avoided if seafood companies follow our simple recommendations below.

- The L/C should be irrevocable. A revocable L/C can be cancelled by the buyer at any time without the seller's knowledge.
- Try to avoid L/C transactions where documents required for presentation are extremely simplistic. Remember that simple documents can be easily forged.
- Overly complicated documents should also be avoided. You should be absolutely sure

that you can have all of the documents issued before accepting the L/C.

- It is advisable to use independent surveyors to inspect the cargo before loading and to confirm the shipment. Certificates from the surveyors should be required for presentation by the issuing/advising bank.
- Avoid L/Cs with short presentation time. The shipper should have enough time to issue all the documents, send them to the bank and in case of any discrepancy change the papers within L/C validity.
- Be careful with L/Cs from minor and unknown banks. Always ask your bank to check the issuing bank. If in doubt, ask for the L/C to be confirmed either by your bank or a prime bank. An alarming signal is when your bank rejects confirming the L/C.
- If the beneficiary is not a well-known company and you have never had any business with this firm before extreme care should be taken to discount the bills. It is advisable to check the beneficiary thoroughly before doing any business with them.
- Be sure that you will be able to ship the cargo before the latest shipment date. If you ship later the L/C becomes void, unless the buyer accepts the discrepancy.
- L/Cs where any of the documents required for presentation should be issued by the beneficiary or parties under his control should be rejected.
- Never accept L/Cs with contradictory terms like difference in presentation and last shipment dates, documents required etc.

The abovementioned recommendations are by no means exhaustive. All seafood companies are welcome to contact us for advice or check other publications on our website.

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