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RELEVANCE OF AUTONOMY, LETTER OF CREDITS AND FRAUD EXCEPTION IN DEVELOPED AND DEVELOPING COUNTRIES

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ABSTRACT
The assurance to the seller that it is able to deliver goods without exposure to the risk of not being paid, while also protecting the buyer from the risk of paying for goods which they may otherwise not receive, has maintained the role and use of LCs as a fundamental method of payment in international sale and purchase transactions throughout the years. The basic structure of LCs has remained the same despite the continuous intervention of judicial authorities around the world to impose exceptions to their use. This article seeks to highlight that the principle of autonomy as envisaged in the UCP 600 in connection with LCs is being upheld by the courts.
Key Words: Autonomy, LOC, Exceptions, International Trade.

INTRODUCTION
Documentary credits are vital tools for financing international trade. They allow transactions of goods and services in an international arena that may not have otherwise taken place. The utility of letters of credit is reliant upon their inherent autonomy from the underlying transaction; a bank that has issued a letter of credit cannot deny payment when conforming documents are presented to it, even if the underlying transaction has not been performed. Thus the seller has the security of guaranteed payment and the buyer can protect its interests by requiring specific documents to be provided such as the transport documents, quality certificate and insurance documents, which to some extent ensure performance. The autonomy principle is consequently vitally important to the use of letters of credit.

Documentary credit is the most common mode of payment for goods in the export trade and a primary instrument for financing international commerce. The operation of documentary credit has been highly harmonized by the Uniform Customs and Practice for Documentary Credits ("UCP"). Such "set of rules" (as defined in Article 1 of the latest version of the UCP, the "UCP600"), to a certain extent, coincides with the common law regime.

Under both the UCP600 and the common law, documentary credits are based on two fundamental principles: the doctrine of strict compliance and the autonomy of letters of credit. The latter is naturally at variance with so-called fraud exception.

In the present work we will consider two issues: (i) how do the UCP600 deal with the doctrine of strict compliance and the autonomy principle and (ii) what are the effects of the UCP600's attitude towards the autonomy principle on fraud exception. It is suggested that these two issues are strongly intertwined with each other.

Introducing letters of credit and the UCP600 Letters of credit (also known as documentary credits or commercial credits) are an extremely popular method of payment in international trade. They address most of the concerns of sellers and buyers by involving banks in the negotiation of commercial documents between the exporter and the importer.

Stated in its plainest terms, a letter of credit is a contract between the buyer and his bank (the so-called issuing bank) which allows documents and money to move in opposite directions, giving the buyer a

thorough documentary screening before payment is made and giving (at least in the case of confirmed letter of credit) the seller an additional debtor within his own jurisdiction (the so-called confirming bank).

However, considering a letter of credit as a unique contract is somehow limiting. In fact, setting up a letter of credit gives rise to several relationships between the various parties involved, governed by as many contracts.

The Uniform Customs and Practice of Documentary Credits 2007 version, publication No 600 (hereinafter, the "UCP600") are the sixth and latest revision of a successful instrument of harmonisation devised by the International Chamber of Commerce. They govern many aspects of the operation of letters of credit, upon express incorporation (they do not have force of law), by providing a detailed – although not comprehensive – set of rules for documentary credits.

The two basic principles of letters of credit
Letter of credits are based upon two key underpinning principles:
(i) The doctrine of strict compliance: the documents presented by the seller-beneficiary to the bank in order to obtain the payment must conform strictly on their face to the terms of the credit;

(ii) The autonomy of the letter of credit: the documentary credit is separate from and independent of the terms of the underlying (sale) transaction.

Both principles are already found in the common law regime for documentary credit. As to the doctrine of strict compliance, common law requires every single document tendered to tally precisely with the instructions in the letter of credit. The leading case is Equitable Trust Co of New York v. Dawson Partners Ltd[1], where Lord Sumner set the rule, engraved in his oft-quoted sentence: "there is no room for documents which are almost the same, or which will do just as well".

The only established exception to the autonomy principle is the fraud exception.' When the seller fraudulently presents the documents for payment, the bank is entitled to refuse payment. Alternatively, the applicant may be entitled to an injunction to prevent such payment. The law on documentary credits is highly controversial as it attempts to balance two competing principles: upholding the autonomy of documentary credits, and preventing fraud. There is no internationally agreed construction of the fraud exception; instead domestic legal systems have construed the exception differently. It is unclear how the New Zealand courts will treat this contentious issue as it has not yet arisen at an authoritative level.

Financial transactions in international trade are inherently risky because the seller and the buyer are geographically separated. It is thus more difficult for the seller to gauge the buyer's ability and willingness to pay for goods and their trustworthiness.'" There are also other risks, such as disputes as to the quality of the goods holding up payment, conversion of currency, and political risks." In international trade transactions, the seller's principal concern is to receive the purchase price, and the buyer's principal concern is to receive the goods in conformity with the contract. Documentary credits provide a solution to the conundrum that the buyer will not wish to pay for the goods until they are en route and out of the seller's hands while the seller will not wish to part with them until he is assured of payment.

A documentary credit is a means of making a domestic or international payment **by** substituting a bank for the buyer as the party who guarantees and makes the payment.2 **A** buyer (applicant) will request their bank (issuing bank), usually in their country, to open a letter of credit in the seller's (beneficiary's) favour. The issuing bank then guarantees to the seller payment, upon presentation of certain agreed upon documents,

usually including the bill of lading, insurance documents and the commercial invoice. There is usually another bank (advising bank) involved, normally located in the seller's country, which advises the seller of the credit in their favour. The advising bank can only be involved if the credit nominates the bank or it is a freely negotiable credit.

The seller approaches the advising bank with the required documents, and if they conform to the letter of credit the advising bank makes payment to the seller. The advising bank then presents the documents to the issuing bank for reimbursement.
If the issuing bank considers that the documents conform to the credit stipulations, they are bound to reimburse the advising bank. The issuing bank can then debit the buyer's account and pass on the documents to the buyer. **A** properly functioning letter of credit thus ensures that neither the buyer nor the seller has both goods and cash at the same time."

The overwhelming majority of documentary credits incorporate and, thus, are regulated **by** the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits **(UCP).**

The documents represent the goods while they are in transit and their transfer is a symbolic delivery of the goods, provided that a bill of lading is included. The use of credits is useful for the buyer who can stipulate all the documentary requirements in the credit, thus getting the security that the goods have been shipped (bill of lading) and that they conform to the contract (quality certificate). The seller gets a high degree of security as payment does not depend on the solvency of the buyer; payment is guaranteed by the bank as long as there are complying documents. The bank has an irrevocable obligation to pay on presentation of documents that comply on their face.'

It is widely recognised that LCs are by and of themselves independent instruments, and are autonomous from the underlying contracts on which they are otherwise based. Under this principle, the issuer of an LC is not concerned with the underlying transactions. The characteristic of independence is embodied in Articles 3 and 4 of the Uniform Customs & Practice for Documentary Credits ('UCP') which was issued by the International Chamber of Commerce and adopted by countries.

In a typical transaction the applicant asks the issuing bank to assume absolute liability to pay the beneficiary under terms and conditions previously negotiated with the beneficiary. Banks, for the purpose of initiating this payment, will deal exclusively with documents and not with goods or services to which the documents may relate. Therefore, the payment by the issuer is based solely on a determination of the conformity of the documents presented by the claiming beneficiary, against the terms and conditions of the LC without reference to the performance of the underlying contractual obligations by the applicant or the beneficiary.

THE FRAUD EXCEPTION

In practice, banks will assume absolute liability to pay the beneficiary based on a valid claim under an LC and such an obligation has encouraged beneficiaries to accept the LC as a method of payment throughout the years. In addition, when courts are asked to award injunctions against a bank to stop payment under an LC, the courts are reluctant to grant such an order restricting payment.

It is a widely adopted principle that the bank shall pay the beneficiary unless the applicant pursues an official claim to stop payment of the proceeds under the LC. Such an injunction is only issued by the courts in very limited scenarios. While the Bahrain Law of Commerce No. 7 of 1987 does not include any specific exceptions pertaining to LCs, there have been recent examples of Bahraini courts accepting arguments based on fraudulent claims. In a recent judgment of Bahrain Chamber for Dispute Resolution, the judges emphasised clearly that without fraud being present and perpetrated by the beneficiary, there is no legal ground to block the payment under an LC.

THE PRINCIPLE OF AUTONOMY

As the bank's obligation to pay arises on the presentation of conforming documents, not on delivery of the goods, the financial transaction is essentially independent from the underlying sales transaction.

This characteristic of documentary credits is known as the autonomy principle. That the credit transaction is separate from the sales contract is expressly set out in Articles 4 and 5 of UCP 600.

Article 4 provides: A credit, by its nature, is separate from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract ...Consequently, the undertaking of a bank to honor, to negotiate or to fulfill any other obligation under the credit, is not subject to claims or defences by the applicant resulting from his relationships with the issuing bank or the beneficiary.
Article 5 further illustrates this point by adding "Banks deal with documents and not with goods, services or performance to which the documents may relate."

The consequence of this principle is that the performance of the underlying transaction is irrelevant to the payment of the credit, thus payment may be made on the documents even if the goods never arrive and the buyer has to seek damages from the carrier.

The autonomy of letters of credit is what gives them their appeal; they guarantee payment of the purchase price irrespective of the performance of the underlying transaction to which they relate. If the seller was not guaranteed payment their utility would be undermined. The efficacy of documentary credits has been described as "the life blood of international commerce".' It is exactly the independence from the performance of the underlying contract that gives documentary credits their international commercial utility and efficacy. The courts have traditionally been very reluctant to deviate from the strict autonomy principle. They are extremely unwilling to allow an applicant to prevent a bank from making payment to a beneficiary who presents seemingly conforming documents. There is, however, an exception to this principle, which can be invoked in cases of fraud.

THE FRAUD EXCEPTION EXPLAINED

Despite the bank's unconditional obligation to pay the seller upon presentation of the required documents, the issuing bank is not bound to pay under the letter of credit when there has been fraud by the seller. Fraud is a significant risk to the banks and buyers involved in credit transactions, and has been described as "a cancer in international trade". Thus a bank may refuse payment if they have clear evidence of fraud.

While most common law jurisdictions recognise the fraud exception to the autonomy principle, **UCP 600** contains no definition of it or direct reference to it. In determining the scope of the fraud exception, articles **7, 8,** 14 and 34 are relevant; these govern both the liability of the issuing or confirming bank and the duty of strict compliance owed **by** the bank in determining whether or not to accept the documents.

The ambit of the fraud exception is a very controversial area of commercial law. However, as previously stated, rather than attempting to address all of the controversies, this article will focus upon the conceptual basis of the fraud exception. This consideration will lead to conclusions on the ambit of the exception, as well as the standard of fraud required to invoke the exception.

FRAUD IN THE UNDERLYING TRANSACTION

The plaintiff in this case had contracted to purchase a quantity of bristles from Transea Traders Ltd. The purchase price was to be paid **by** letter of credit upon presentation of an invoice and bill of lading covering shipment of the goods. The documents presented described the bristles called for **by** the letter of credit;

however, the plaintiff alleged that Transea had filled the crates with worthless material with intent to simulate genuine merchandise and defraud him as purchaser. The plaintiff thus applied for an injunction to prevent the bank from making payment on the letter of credit on the basis of the seller's fraud.

The court came to the conclusion that where a seller is fraudulent, the independence of the bank's obligation under the letter of credit should not be extended to protect that unscrupulous seller. Thus the fraudulent beneficiary was not to benefit from his own fraud and the injunction was granted. The difficulty arising from *Sztejn* is that it is unclear whether it is a case of false documents or a case of fraud in the underlying transaction. Although it is generally recognised as introducing the "fraud on the documents" exception, Sheintag **J** looked to the performance of the underlying transaction in making his determination of documentary fraud. This created the controversy between the two concepts of the fraud exception, which are often difficult to distinguish. Since this case, there has

been much academic argument about the breadth of the fraud exception; some take a narrow view that fraud is restricted to the credit transaction and others take a broad view that fraud in the underlying transaction is also included.

The leading case in England is *United City Merchants v Royal Bank of Canada.*° In this case Lord Diplock stated that the exception referred to documents that contain, expressly or by implication, material representations of fact that to the beneficiary's knowledge are untrue.

This seems to suggest that the fraud exception is limited to fraud in the documents themselves; however, whether the exception also applies to wider fraud in the underlying transaction is an important but somewhat open question.
The way in which the courts conceptually base the fraud exception has made a major impact on how the courts have defined and limited it. In *United City Merchants, Lord* Diplock set out the maxim *ex turpi causanon oritur actio,* or fraud unravels all as the basis of the fraud exception.

The case essentially addressed the issue of whether fraud **by** a third party of which the beneficiary was unaware could be included in the exception. In holding that the only fraud sufficient to invoke the exception was that of the beneficiary himself or that to which he was a party, thus excluding the fraud of a third party, Lord Diplock supported a narrow formulation of the exception. The rationale for the exception was held to be the prevention of the proliferation of fraud. Thus framed, the exception focuses on the conduct of the beneficiary. Viewed in this way, it is easy to see why the exception is limited to fraud to the knowledge of the beneficiary or person claiming payment only and not to third party fraud.

The Working Group for the Revision of the UCP 400 agreed that Article 34 did not attempt to regulate the relationship between the banks and the applicant when a proved fraud has been committed. The fraud exception thus comes in over the top of Article 34. A bank is generally not liable for the accuracy of the documents but when the documents are clearly fraudulent, the bank has no mandate to pay in the face of fraud.

The fraud exception thus becomes part of the bank's consideration of the documents for strict compliance. This shows that the implied term approach is consistent with the UCP and its intended meaning. It also provides much more certainty for all parties involved, the bank knows that it has an irrevocable obligation to pay in all circumstances except where the documents do not comply or are clearly fraudulent, the applicant and beneficiary are also sure that payment is guaranteed except for this narrow exception and can protect their respective interests accordingly. The strict wording of Article 34 actually bolsters the narrow approach

to the fraud exception based on an implied term as this approach causes the least interference with the rule in that article.

Court of Appeal clearly set out that "the fraud exception to the autonomy principle recognised in English law **...** should remain based upon, the fraud or knowledge of fraud on the part of the beneficiary or other party seeking payment". This rejects the implied term conceptualization and brings the jurisprudence back to the position taken in *United City Merchants. Montrod* itself, however, has been expressly rejected in Singapore so far as it relates to the nullity exception, 4' and so may only be of limited importance.

The jurisdictional basis of the fraud exception is relevant when the applicant is applying for an injunction to prevent a bank from making payment as it determines what the cause of action will be. Under the *United City Merchants* approach, the cause of action will be deceit or breach of contract by the beneficiary, whereas under the *Czarnikow* approach, the cause of action will be breach of contract by the bank. This basis will also be relevant in determining where the balance of convenience lies.It is noted in *Czarnikow* that the balance of convenience will always be against the granting of an injunction as the bank's obligation is so important that it will always, in the absence of exceptional circumstances, outweigh the applicant's need for protection." As between the beneficiary and the bank, the cause of action for the beneficiary in a summary judgment application may also be based on a breach of contract by the bank by not honouring its obligation to pay out on presentation of conforming documents. Thus the bank has an obligation to the beneficiary to pay on conforming documents that is a mirror image of its mandate from the applicant, in that it also has an inbuilt exception that they will not be obliged to pay if the presented documents are clearly fraudulent.

This article will now critically examine approaches to the fraud exception from several common law jurisdictions, analyse the justifications for each approach and make recommendations for the New Zealand jurisprudence which tie into the duty of care owed by a bank under domestic banking law. When approaching the fraud exception from the implied term basis it is relevant to consider both what material the bank may refer to in establishing fraud and the standard of fraud required.

FOREIGN JURISPRUDENCE- THE UNITED KINGDOM

The first time the English courts considered the nature and extent of the fraud exception was in the case of *Malas and Another v British Imex Industries Ltd.* In this judgment, Jenkins **LJ** took the opportunity to highlight that the obligation of a bank to pay in credit transactions is irrevocable irrespective of any dispute between the buyer and seller and that the courts ought not to interfere with commercial practice." Thus a dispute over the quality of the goods was not sufficient to invoke the exception.

In *Harbottle,* Kerr **J** reiterated the importance of the independence of credit transactions and set out that the courts would only interfere in exceptional cases of established fraud. He also drew attention to the use of bank's irrevocable obligations as assignments of risk; the applicant takes the risk of the unconditional wording of a credit and the court should not be concerned with the difficulties of these applicants to enforce their claims against a fraudulent beneficiary with whom they have elected to trade.

The fraud issue has arisen in the courts since the new UCC s5-109 came into force. In 2002, the Supreme Court of Ohio considered *Mid-America Tire In v PTZ Trading Ltd.76* The court examined the history of the exception and noted the need to extend the meaning of "fraud in the transaction" beyond fraudulent documentation. The rationale for this is the need to deny rewarding fraudulent behaviour by beneficiaries. Another justification being that ordinarily the customer/applicant must bear the risk of loss but should not be required to assume the risk of making payment to a beneficiary who has engaged in fraudulent conduct. It is not clear why the applicant should not bear the risk of a fraudulent beneficiary as they elected to trade with

them, whereas the bank has less choice. Further, they chose to use a letter of credit to finance the trade rather than some other form of finance and so contractually allocated the risk as between them in knowing the irrevocable nature of credits.

The courts in the United States have thus allowed the fraud exception to include fraud in the underlying transaction. This is mainly reliant on the focus of the courts being on the prevention of fraud rather than on the efficacy of documentary credits and the needs of trade. Although a certain standard of fraud ("material fraud") is required to satisfy the court to grant an injunction, this approach encourages applicants to take their cases to court to prevent or delay payment on the basis of the underlying contract.

On the facts the bank was held not to have been entitled to accept the documents and pay out due to discrepancies in the documents. The argument based on fraud failed, however, because it was not sufficiently obvious to the bank that there was a forgery or a fraud, and so faced with seemingly regular documents the bank had no duty to satisfy itself that there had not been fraud.

This case demonstrates the different standards of the fraud exception for applications for interim injunctions and those to establish improper payment after notice of alleged fraud by the beneficiary. The former being the prima facie case standard and the latter the more stringent test that the fraud must be clear and obvious to the bank.

This statement vastly widens the limits of the fraud exception as it is traditionally understood. In formulating the fraud exception, the Singaporean courts have also considered unconscionability as a ground for granting an injunction against payment of a commercial letter of credit. This is, however, a very recent development in the law. In *Brody, White & Co Inc v Chemet Handel Trading Pte Ltd the* court held that clear fraud in the documents alone would be sufficient to constitute an exception to the autonomy principle and that fraud in respect of the underlying transaction would not affect the credit contract between the seller and issuing bank. This case thus followed the strict approach expounded in *United City Merchants.*

The judgment gives no authority for this development of the law, nor any justification. As a ground enabling a bank to enjoin payment under a letter of credit, unconscionability requires the bank to look past the documents and into the underlying transaction to determine whether there has been some unconscionable conduct on the part of the beneficiary. This defeats the autonomy principle by allowing contractual issues to interfere with the credit transaction.

In the opinion of the author, the introduction of an unconscionability exception is a major threat to the efficacy of credits in international commerce. Not only does it create a new exception to the autonomy of credits which is short of fraud, it also fails to precisely define that exception.

THE WIDE APPROACH

The wide approach is that fraud in the underlying transaction as well as fraud in the documents is sufficient grounds for declining payment or granting an injunction under a commercial letter of credit. This approach is favoured by several academics °8 as well as the North American Courts.

The main justification for this conception seems to be the prevention of the proliferation of fraud, particularly fraud in the underlying transaction." It is argued that the proliferation of fraud threatens the utility of letters of credit as much as, if not more than, court injunctions. On the other hand, it is not the place of banks to act as international policemen.

Proponents of this view have also justified it by pointing out that the innocent applicant may have no other remedy against the fraudulent beneficiary; thus this cause of action ought to be wider to allow injunctions in more cases. This argument is not compelling, as when a merchant decides to trade with another merchant and to arrange finance by way of a letter of credit, they are taking on the risk that the other merchant may be fraudulent. They choose to use a credit transaction because they know that payment will be guaranteed as long as the documents are strictly compliant with the credit. As these transactions are to be treated like cash, the applicant's correct cause of action in matters concerning the beneficiary is against the beneficiary alone and should not concern the credit transaction. The parties have thus contractually allocated risk as between themselves, and the courts should not seek to interfere with this, nor be concerned with the difficulties of proper remedies."

The wider approach is not compelling because it allows purely contractual issues to defeat the letter of credit and reassigns the contractual allocation of risk as between the parties." This attacks the basic premise upon which letters of credit rely - their autonomy - and defeats the intentions of the parties. A defrauded applicant has other causes of action for redress, whereas a bank would be left without such redress if upon unknowingly paying out to a fraudulent beneficiary it could neither recover from the applicant nor that beneficiary, assuming that the fraudulent beneficiary had disappeared after receiving the money. If the beneficiary was still in the picture, the bank would have a claim for unjust enrichment, for a fuller discussion on the allocation of risk as between the contracting parties.

THE NARROW APPROACH

The narrow approach favoured by the English courts is also supported by several academics." The overwhelming rationalization for the narrow approach lies in an explanation of the nature of credits. It has been repeated throughout this article that documentary credits rely on their independence from the underlying contracts for their very utility. To allow a party to block payment on the basis of a breach of the underlying contract undermines the parties' expectations and the contractual allocation of risk.

The position ought to be the same whether restraining the bank from making payment or the beneficiary from claiming payment as the effect on the credit contract is the same.' ' It is noted, however, that in *Sirius* underlying contractual matters were permitted to interrupt the credit contract.

The narrow formulation is justified practically as the bank deals exclusively with the documents alone. Therefore the only kind of fraud that a bank is entitled to consider as sufficient to justify a refusal to make payment is that which is clear on the face of the documents. The bank is capable of identifying clear fraud in the documents as part of the duty to ensure strict compliance. This is what an applicant would have intended when giving power to the bank to pay on presentation of conforming documents.

Another justification for the strict approach is that the wider application of the exception is damaging to the reputation of banks.

Article 34 is the most relevant provision for assessing the liability of a bank and it states: Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s) **...** nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by the document(s), or for the good faith or acts and/or omissions, solvency, performance or standing of the consignors, the carriers, the forwarders, the consignees, or the insurers of the goods, or any other person whomsoever.

This makes it very clear that banks play a purely mechanical role in credit transactions; they ensure the documents are strictly compliant and are in no way liable for the content of those documents. Banks are not

experts in trade transactions; they are not qualified to evaluate evidence of fraud and they do not have the resources to ensure that the contents of the documents are accurate and the parties reliable.
To assume such a role would make credit transactions slow and cumbersome; it ought to be the responsibility of the applicant to verify the details of the transaction. The bank merely ensures that all stipulations are met and can then be relied upon to pay out on the credit.

The fraud rule becomes an exception to the traditional role of the banks set out in the UCP only if it allows the banks to look outside of the documents and to scrutinise the underlying transaction as expounded by the wider understanding. However, if looked at as a rule that is part of the compliance of documents, it is not an exception at all. It is obvious that if a document is clearly forged or fraudulent, the bank is not mandated to accept it, as the bank is required to ensure compliance and a forged document is surely not what is required by the credit. Thus only fraud that is clear to the bank from the face of the documents that it is bound to inspect will justify a refusal of payment as gleaned from Article 15.

This leads us to the position that the bank should normally act in accordance with its customer's mandate, but not if reasonable skill and care indicate a different course."4 The bank's duty to pay on demand, therefore, is not an absolute unqualified duty to pay without enquiry. Thus a bank should question the mandate or make further inquiries when a reasonable banker would consider that there is serious possibility that the customer was being defrauded. The banker must therefore have reasonable grounds for believing that an order is an attempt to misappropriate funds.' Basing the ability of the customer to sue the bank on the excess of mandate that has occurred, rather than the fact that some third party has committed fraud by forging a cheque, ensures certainty in this area of the law. A bank will only be liable if it goes outside of its instructions; that is when it pays or refuses to pay in circumstances in which it is not authorized to do so. This certainty allows all parties to know where they stand in relation to payment and liability.

THE FRAUD EXCEPTION FOR NEW ZEALAND

The suggestions for New Zealand are that the fraud exception should be drawn by reference to the contractual relationship between the applicant and the issuing bank and conform as closely as possible to the intent of the **UCP.**

It is proposed therefore, that the implied term approach adopted in *Czarnikow* should be applied in New Zealand. The fraud exception would thus be narrowly defined so as to allow the autonomy of letters of credit to be disturbed in the least possible of instances. The court, similarly, would be interfering in commerce to a minimal degree.

According to Articles 4 and 5 of the UCP, the credit transaction must be autonomous from the underlying sales transaction, so that the bank is dealing with documents alone and not goods. Under Article 34 the bank takes no responsibility for the accuracy or falsification of any document, and under Article 14 must ensure, on the basis of the documents alone, that the presentation comply with the requirements set out in the credit. When electing to open a letter of credit, an applicant is forming a contractual relationship with a bank based on the terms of the UCP.

This contractual relationship consists of the applicant giving the bank a mandate to pay out, on their behalf, the amount of the credit when the beneficiary presents conforming documents. The bank is not entitled to refuse to pay unless the documents do not conform, and they are not permitted to look to the underlying performance in deciding whether to pay. A term implied into this relationship would be that the bank is not mandated to pay on documents that are clearly fraudulent. Thus when a bank is considering the compliance of the presented documents and discovers that a document is clearly forged or has been fraudulently altered,

they are not permitted to pay. To do so would be beyond their mandate and they would be liable for a breach of contract.

The principle of autonomy has been clearly stated by Jenkins LJ in the case Hamerh Malas and Sons v British Imex Industries Ltd[3]: "it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not".

Later, Lord Diplok, in the case United City Merchant (Investments) Ltd v Royal Bank of Canada (The American Accord)[4], reaffirmed such a rule: "the whole commercial purpose for which the system of confirmed irrevocable documentary credit has been developed in international trade is to give to the seller an assured right to be paid before he parts with control of the goods that does not permit of any dispute with the buyer as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment of payment".

The doctrine of strict compliance and the UCP 600: a relaxation The provisions of the UCP600 largely reflect those of common law. However, they have adopted a different, more relaxed approach to the strict compliance rule.

In fact, they allow a certain amount of leeway in the description of the goods in most of the documents (Article 14.d: "data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit"; 14.e: "in documents other than the commercial invoice, the description of the goods, services or performance, if stated, may be in general terms not conflicting with their description in the credit"). They tolerate certain discrepancies in credit amount, weight and value of the goods (Article 30, particularly letter b: "a tolerance not to exceed 5% more or 5% less than the quantity of the goods is allowed […]").

They permit – provided that certain requirements are complied with - the use of documents which are not or appear not to be originals (Article 20.b), whereas under common law only originals are acceptable.
At the same time the strict compliance rule is fully preserved in relation to the commercial invoice: "the description of the goods, services or performance in a commercial invoice must correspond with that appearing in the credit" (Article 18).

This approach should not a surprise. The entire structure of the UCP600 tends to limit and circumscribe the responsibilities and the duties of banks; letters of credit are largely, though not only, banking instruments. This is particularly clear in Articles 34 ("Disclaimer on Effectiveness of Documents"), 35 ("Disclaimer on Transmission and Translation") and 36 ("Force Majeure").

It is certainly true that the UCP600 benefit every party involved in a documentary credit transaction (i.e., beneficiaries, applicants and banks), for they set forth an intelligible and extended code of rules. However, it can hardly be put into question that the primary beneficiary of the UCP600's provisions is the bank. After all, the role of banks can be considered the most crucial and problematic in the documentary credit transaction.

The autonomy principle and the UCP600 the aforementioned bank-oriented attitude of the UCP600 also explains the reason for their confirmation and reinforcement of the doctrine of independence. As long as

banks limit their task to the examination of the documents, regardless of the transaction underneath the letter of credit, their position is significantly simplified.

The sanctity of the separation of the documentary credit from the underlying transaction is carved in Articles 4 ("a credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit […]") and ("banks deal with documents and not with goods, services or performances to which the documents may relate") of the UCP600.

These provisions state in various ways, from different points of view, that a letter of credit – although it springs out of an underlying transaction – becomes insulated from it.
Article 4.b of UCP600 ("an issuing bank should discourage any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, proforma invoice and the like") goes even further, suggesting that banks dissuade the applicant/buyer from putting in the letter of credit any kind of link to the underlying transaction.

The autonomy principles and the fraud exception: a trade-off the doctrine of autonomy meets an essential need of the documentary credit transactions, often expressed by English courts and clear on the face of the UCP600's provisions. In short, letters of credit can perform their role smoothly only as long as they can operate without interference from "outside".

Documentary credits are "the life blood of international commerce", as scenically declared by Ackner LJ in the case United City Merchant (Investments) Ltd v Royal Bank of Canada (The American Accord). The necessity of proper operation outweighs the undisputable importance of the sale relationship between buyer and seller.

However, there is another aspect to be mentioned, perhaps the most delicate issue in the field of documentary credit, strictly entwined with the principle of autonomy: the matter of fraud, which can concern either the documents or the transaction. The UCP600 do not address the effect of fraud on the documentary credit arrangement and the matter is, therefore, left to the domestic applicable law.

Letters of credit are the lifeblood of commerce, it has been declared. On the other hand, fraud may be considered the "cancer" of international trade. There are powerful policy reasons for counteracting fraud. The primary legal instrument against fraud is the so-called fraud exception. Based on such an exception the buyer may request an injunction to stop the bank from paying the seller on the credit.

The problem here is that fraud usually concerns the documents or the underlying transaction; therefore, invoking the fraud exception inevitably conflicts with the preservation of the autonomy principle. In other terms, allowing banks or applicants to put forward the fraud ground in order to avoid or recoup payment amounts leads to creating a link between the letter of credit and the contract, breaching the golden rule of autonomy.

Moreover, if the case of fraud is clearly established (that is, if the claimant can prove clear and obvious fraud and the bank's knowledge), it may even be possible to obtain an injunction against beneficiaries and banks preventing them, respectively, from requesting the payment and from paying.

It represents the only, limited exception to the autonomy of letters of credit.

So far, we have considered how the UCP600 deal with the autonomy principle. It is now possible to answer the question of the effects of the UCP600's attitude towards the autonomy principle on fraud exception.
It is submitted that if the UCP600 have, as they do, reinforced the doctrine of independence, it must follow that they have somehow weakened the other side of the coin.

Therefore, it is argued that incorporating the UCP600 in a letter of credit would shift the balance on the relevance of the principle of autonomy and, as a consequence, it could make it even harder for a buyer to try to avoid the obligations of a letter of credit by invoking fraud exception.

CONCLUSION

In the light of the aforementioned considerations, it is contended that the policy of the UCP600 is to accept the existence of some "cancers" to prevent the overall lifeblood of international commerce. The fraud exception to the autonomy principle has created vast confusion throughout the common law world both as to its conceptual basis and its limits. New Zealand is in the advantageous position of having no binding authorities on the fraud exception and so is free to conceptualize and limit the exception in the best way possible. This article has aimed to show that the best way to conceptualize the exception is in terms of the contractual relationship between the applicant and issuing bank, rather than on a general condemnation of fraud."

This contractual basis not only accords with domestic banking law, but also preserves the autonomy of letters of credit. Giving the exception this conceptual basis restricts the application of the exception to clear fraud in the documents and prevents it from becoming too expensive or nebulous.

The fraud exception, thus understood, is easy and quick for issuing or confirming banks to apply and therefore conserves the speed and efficacy that is essential to international credit transactions. This conceptualization makes the fraud exception part and parcel of the bank's duty to ensure the strict compliance of documents. Thus only clear evidence of fraud that does not require the bank to investigate outside of those documents is 145 This is supported by the bank's right of reimbursement of moneys paid by it from the applicant as demonstrated in sufficient to invoke the exception. This is consistent with the UCP and the expectations of the parties.

To include mere unconscionable conduct which does not itself amount to fraud is to severely threaten the autonomy principle on which the letter of credit system rests. It encourages parties to a contract that underlies a letter of credit to bring contractual or tortuous causes of action based upon purely contractual matters to court as grounds for an injunction against payment of a credit. This is clearly inconsistent with Articles 3 and 4 of the UCP. Before any meaningful recommendations can be made for New Zealand, it is necessary to analyse the justifications for the different constructions of the fraud exception. This analysis will be confined to the wider exception of the North American jurisdictions that includes underlying fraud, and the narrow conception as favoured by the English courts.

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