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THE AUTONOMY PRINCIPLE OF LETTERS OF CREDIT

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ABSTRACT. *This article explores the erosion that the autonomy principle has suffered in documentary credit transactions. When a seller and a buyer encounter too many hurdles to reach an understanding, the parties decide to ask banks to accept the liability and thus solve the difficulties. The appeal of letters of credit as instruments of payment in international transactions lies in substituting an often unreliable promise of payment from an unknown buyer with the very certain promise from one or more banks. The complexity of a letter of credit arises from the fact that it protects not only the issuing bank and the applicant under a doctrine of strict compliance, but also the beneficiary under the autonomy principle. Through a discussion of recent cases where courts have argued in favour of overcoming the autonomy principle, this article suggests that fraud is not the only exception to this principle of the letter of credit, rather there are other exceptions that could question its autonomy. This article argues that if courts around the world keep interfering with letters of credit turning them into ancillary obligations, soon beneficiaries will be forced to accept exclusively letters of credit issued or confirmed by banks within those jurisdictions whose courts are prone to respect the autonomy of an independent undertaking.*

KEY WORDS: *Letter of credit, autonomy, exception, fraud, injunction.*

RESUMEN. *Cuando un vendedor y un comprador encuentran demasiados obstáculos para cerrar una negociación, dichas partes deciden solicitar la ayuda de instituciones bancarias que asuman los riesgos de la transacción, y así sobrepasar dicho problema. Lo atractivo de las cartas de crédito como instrumentos de pago en transacciones internacionales recae en sustituir la frecuente poco fiable promesa de pago de un comprador desconocido por la certera promesa de pago de un banco o grupo de bancos. La complejidad de una carta de*

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crédito surge del hecho de que no sólo protege al banco emisor y al ordenante bajo la doctrina de cumplimiento estricto, sino también al beneficiario conforme al principio de autonomía. Al hacer un breve señalamiento de los casos más recientes donde los tribunales han pronunciado otros posibles escenarios donde el principio de autonomía de la carta de crédito podría ser superado, este artículo sugiere que el fraude no es la única excepción al principio de autonomía de la carta de crédito, sino que existen otras excepciones que pueden poner en peligro su autonomía. Este artículo argumenta que si los tribunales alrededor del mundo siguen interfiriendo con las cartas de crédito, volviéndolas obligaciones subordinadas, los beneficiarios estarán obligados a únicamente aceptar cartas de crédito emitidas o confirmadas por bancos en aquellas jurisdicciones donde sus tribunales sí respeten la autonomía de obligaciones independientes.

PALABRAS CLAVE: *Cartas de crédito, autonomía, excepción, fraude, medida cautelar.*

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I. INTRODUCTION

This article explores the erosion the autonomy principle has suffered in documentary credit transactions. The first part explains the cornerstone role independent undertakings play in documentary credit transactions, including Letters of Credit (L/Cs), performance bonds and standby credits.[1]

[1] The law governing L/Cs has come a long way and is quite uniform around the world. Tremendous effort has been made by the International Chamber of Commerce ("ICC") with regard to documentary credits, establishing the Uniform Customs and Practice for Documentary Credits (*"UCP"*). As of July 1, 2007, the 6th revision of the UCP (the "*UCP600*"), the most revised version in the history of UCP, has been in effect. Robert Par-

Subsequently, this article focuses on the autonomy principle of L/Cs, as well as their payment, commercial and financing functions. The third and core part of this article discusses the most common exceptions to the autonomy principle as argued by courts and statutes, including fraud, nullity, illegality, attachment of proceeds, unconscionability, avoidance of the underlying contract and freezing orders by underwriting authorities. This section will also comment on British, U.S., Canadian, South African and Singaporean case law, as well as outline the challenges these courts have faced to maintain the role of L/Cs as a method of payment untouched by protecting beneficiaries under the autonomy principle, while calming the pleas of banks, buyers and governments under strict compliance doctrine,[2] public policies, statutes, public interest and third party rights. Finally, some comments will be presented in the conclusion.

Sellers want to minimize the risk of delivering goods and not being paid while buyers do not want to pay unless they are certain of receiving the goods they are buying.[3] The possibility of either party's defaulting on the business transaction, the physical distance between parties,[4] the different

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son, *UCP 600 - A New Lease of Life for Documentary Credits? Part 1*, FINANCE AND CREDIT LAW, 2007, 1, 6; Robert P. Imbriani, *The Holy Grail in Negotiating Terms in International Payment*, BUSINESS INTELLIGENCE AT WORK, 2007, 7, 1, 13. The purpose of the UCP600 is to reflect the customs traders apply when dealing with L/C transactions. For the UCP600 to apply, reference must be made in the L/C. In this respect, in its verdict of 16 November 16, 1978, the Commercial Court of Brussels ruled that the UCP600 applies to the legal relationship between parties that use the L/C device as form of payment in normal business activities, unless otherwise specified. Accordingly, the French Supreme Court ("*Cour de Cassation*") concluded that the UCP600 has the same effect as the French Civil Code. Moreover, in 1976, the Commercial Court of Paris reversed the assertion that the UCP600 was only a recommendation. Conversely, in the United Kingdom and in the United States, the UCP600 has no legal binding effect although its provisions are incorporated into almost every L/C by express provision, thus having the effect of contractual terms. In *Attock Cement Co. Ltd. v. Romanian Bank for Foreign Trade* [1989] 1 Lloyd's Rep. 572, Staughton L. J. explains the above by stating that unless otherwise agreed by the parties, the UCP restates the common law applicable to all letters of credit and performance bonds. Michael J. Smith, *Transmitting the Benefit of a Letter of Credit*, JOURNAL OF BUSINESS LAW 449 (1991). Dorothea W. Regal, *Letter of Credit Litigation*, INTERNATIONAL COMMERCIAL LITIGATION 52 (1996-1997), Likewise, U.S. Article 5 of the Uniform Commercial Code ("UCC") embraces the developments achieved in the UCP. Charl F. Hugo, *Documentary Credits: The Basis of the Bank's Obligation*, 117 SOUTH AFRICAN LAW JOURNAL 241 (2000).

[2] Yeliz Demir-Araz, *International Trade, Maritime Fraud and Documentary Credits*, 8 (4) INTERNATIONAL TRADE LAW & REGULATION 128 (2002).

[3] INDIRA CARR, INTERNATIONAL TRADE LAW (3rd ed., 2005).

[4] Generally, letters of credit (L/Cs) as a device for payment are not commonly used for domestic transactions because of the high cost, the lengthy processing time and the relative security a seller usually finds within a domestic legal framework. Stephen J. Leacock, *Fraud in the International Transaction: Enjoining Payments of Letters of Credit in International Transactions*, 17 VAND. J. TRANSNATL. L. 898 (1984). See also *Hamzeh Malas v. British Imex Indus-*

time zones and currencies, the need for additional intermediaries,[5] the nature of multi-jurisdictional transactions[6] and the fact that the parties do not usually know each other are reasons that explain the dominant role letters of credit ("L/Cs") play in the international trade law of our time.[7]

Generally speaking, an L/C is a written instrument[8] used when a person (the applicant) has a payment obligation towards another (the beneficiary) under a given transaction (usually the sale of goods).[9] The former asks a banking institution (the issuing bank) to assume primary[10] and absolute[11] liability by promising to pay the beneficiary under terms and conditions previously negotiated between the applicant and the beneficiary. Usually, these terms and conditions require that the beneficiary comply with specific provisions regarding the documents to be presented to the issuing bank.[12] Another common procedure may include the participation of a fourth party, a bank from the same country as the beneficiary[13] that may act as a "correspondent bank" of the issuing bank to advise the beneficiary on the terms of credit, or as a "confirming bank" that acquires the same liability towards the beneficiary as the issuing bank.[14] This confirming credit allows the beneficiary to deal with a local bank and avoid a certain degree of political risk that may prevent him from receiving payment.[15]

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tries Ltd. [1958] 2 Q.B. 127 cited by Razeen Sappideen, *International Commercial Letters of Credit: Balancing the Rights of Buyers and Sellers in Insolvency*, J. BUS. L. 146 (2006, MAR).

5 Rhys Bollen, *An Overview of the Operation of International Payment Systems with Special Reference to Australian Practice: Part 1*, 22 (7) JOURNAL OF INTERNATIONAL BANKING LAW AND REGULATION 381 (2007).

6 *Id.* at 379.

7 Paolo S. Grassi, *Letter of Credit Transactions: The Banks' Position in Determining Documentary Compliance. A Comparative Evaluation under U.S., Swiss and German Law*, 7 (81) PACE INTERNATIONAL LAW REVIEW 122 (2006).

8 Jacqueline D. Lipton, *Documentary Credit Law and Practice in the Global Information Age*, 22 FORDHAM INTERNATIONAL LAW JOURNAL 1998-1999 (1989).

9 Maurice Megrah, *Risks Aspects of the Irrevocable Letter of Credit*, 24 ARIZ. L. REV. 260 (1982).

10 Roy Goode, *Surety and On-Demand Performance Bonds*, J. BUS. L. 88 (1988).

11 Anthony Walker, *American Accord – Third Party Fraud and Letters of Credit*, 1 INTERNATIONAL FINANCIAL LAW REVIEW 5 (1982).

12 David Richard Taggart, *Letters of Credit: Current Usages and Theories*, 39 LA. L. REV. 602 (1978-1979).

13 JACK RAYMOND ET AL., DOCUMENTARY CREDITS: THE LAW AND PRACTICE OF DOCUMENTARY CREDITS INCLUDING STANDBY CREDITS AND DEMAND GUARANTEES (3rd ed., Butterworths, 2001).

14 Lijuan Zhou, *Legal Position between Advising Bank and Confirming Bank: Contrast and Comparison*, 17 (7) JOURNAL OF INTERNATIONAL BANKING LAW 226 (2002); Alphonse M. Squillante, *Letters of Credit: A Discourse, Part IV*, 85 COMMERCIAL LAW JOURNAL 51 (1980).

15 Gerard McCormack *et al.*, *Subrogation and Bankers' Autonomous Undertakings*, 116 LAW QUARTERLY REVIEW 141 (2000).

When a seller and a buyer encounter too many hurdles to reach an understanding, the parties usually ask banks to assume the liability.[16] The appeal of L/Cs as instruments of payment in international transactions lies in substituting an often unreliable promise of payment from an unknown buyer with the very certain promise from one or more banks.[17]

L/Cs entail a unilateral payment undertaking of "considerable complexity"[18] of a documentary nature that protects not only the issuing bank and the applicant under a doctrine of strict compliance,[19] but also the beneficiary under the autonomy principle. Basically, autonomy is the key principle governing L/Cs in that the issuing bank takes on the liability of the beneficiary without involving itself in the underlying transaction that brought about the need for the credit or any dispute thereunder.[20] The issuing bank is obligated to pay the beneficiary regardless of any valid defenses its customer may have against its liability to pay under the original contract, and is bound to pay the full amount of the credit even though the customer may have valid counterclaims or rights of compensation towards the beneficiary in the underlying contract.[21] These specific claims should be sought separately.[22] This means that the beneficiary need not evince his due performance in the underlying contract to be paid, but only produce the right documentation.[23]

II. The Independent Obligation of the Letters of Credit

As mechanisms for financing trade,[24] L/Cs have been used since the time of the Phoenicians, Babylonians, Assyrians and Greeks.[25] These in-

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[16] Jean Pierre Mattout, *Letters of Indemnity in Shipping Transactions: Legal Aspects*, 6 JOURNAL OF INTERNATIONAL BANKING LAW 322 (1991).

[17] Alan Davidson, *Commercial Laws in Conflict – An Application of the Autonomy Principle in Letters of Credit*, 6 INT'L TRADE & BUS. L. ANN. 65 (2001).

[18] Gerard McCormack *et al.*, *Assignment of Documentary Credits*, 16 JOURNAL OF INTERNATIONAL BANKING LAW 138 (2001).

[19] Steven C. Rattner, *Letters of Credit: A Return to the Historical Documentary Compliance Standard*, 46 U. PITT. L. REV. 481 (1984-1985).

[20] E. Peter Ellinger, *The Autonomy of Letters of Credit after the American Accord*, 11, 2 AUSTRALIAN BUSINESS LAW REVIEW 118 (1983).

[21] Gerard McCormack *et al.*, *supra* note 15, at 142.

[22] Dora S. S. Neo, *A Nullity Exception in Letters of Credit Transactions?*, SINGAPORE JOURNAL OF LEGAL STUDIES 49 (2004).

[23] Ross P. Buckley *et al.*, *Development of the Fraud Rule*, 23 U. PA. J. INT'L ECON. L. 698 (2002).

[24] The present form of the L/C has only existed about 100 years. *See* in general Charles B. Harris II, *Commercial Letters of Credit: Development and Expanded Use in Modern Commercial Transactions*, 4 CUMB. SAMFORD LAW REVIEW 134 (1973-1974), cited in David J. Kalson, *The International Monetary Fund Agreement and Letters of Credit: A Balancing of Purposes*, 44 U. PITT. L. REV. 1061 (1982-1983).

[25] Richard A. Wiley, *How to Use Letters of Credit in Financing Sales of Goods*, 20 THE

struments were created by merchants as a way to help their own credit.[26] The term L/C comes from the French word *accreditif* ("the power of doing something"), which in turn derives from the Latin word *accreditivus* ("trust").[27] Stemming from the bill of exchange, the L/C was a useful device for travelers who did not want to carry hard cash on their journeys and would instead give this money in trust to their bankers in exchange for a "letter of credit," which could later be cashed at another bank at their destinations. Lord Denning has compared it to the bill of exchange because both share the same principle: autonomy.[28]

The L/C is a "complex of contractual obligations."[29] The basic structure of an L/C provides for 3 different independent commitments;[30] (1) a contract between the beneficiary and the applicant (the "*underlying transaction*"), (2) a contract between the applicant and the issuing bank for opening a credit for an amount to be reimbursed by the applicant (the "*application*"),[31] and (3) the issuing bank's undertaking towards the beneficiary that will honor the L/C if requirements are complied with.[32]

Academics argue that the difficulty of understanding L/Cs lies in the relationship between an L/C operation and the underlying contract.[33] This is indeed more intricate than appears at face value. On the one hand, there is the argument that opening an L/C cannot be construed as the execution of the buyer's obligation of the underlying contract. But on the other, if the L/C is not opened in favor of the seller, the buyer would be breaching the underlying contract by putting the seller in the position of having to look for other ways to enforce the contract, given that the applicant's liability towards the beneficiary is central, but its action is suspended during the time

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BUSINESS LAWYER 495 (1964-1965), cited in Stephen P. McLaughlin, *Letters of Credit: Exploring the Boundaries of Injunctions against Honour*, 4 FORDHAM INTERNATIONAL LAW JOURNAL 161, 170 (1980-1981).

26 Norman I. Miller, *Problems and Patterns of the Letter of Credit*. 1959 U. III. L. F. 162 (1959).

27 Robert Bulger, *Letters of Credit: A Question of Honor*, 16 N.Y.U. J. INTL L. & POL. 799 (1983-1984). *See also* Charles B. Harris II, *supra* note 24, at 157.

28 Clive M. Schmitthoff, *The Transferable Credit*, JOURNAL OF BUSINESS LAW 51 (1988).

29 Serguei A. Koudriachov, *The Application of the Letter of Credit Form of Payment in International Business Transactions*, 10 INTERNATIONAL TRADE LAW JOURNAL 41 (2001).

30 Herman N. Finkelstein, *Performance of Conditions under a Letter of Credit*, COLUM. L. REV. 747 (1925).

31 Professor McCormack argues that with documentary credit, the issuer usually takes security directly in the underlying transaction, through a pledge of the goods or documents representing the goods. Gerard McCormack *et al.*, *supra* note 15, at 45.

32 Robert D. Aicher, *Credit Enhancements: Letters of Credit, Guaranties, Insurance and Swaps (The Clash of Cultures)*, 59 THE BUSINESS LAWYER 933 (2004). *See also* Alphonse M. Squillante, *Letters of Credit: A Discourse, Part III*, 84 COMMERCIAL LAW JOURNAL 471 (1979).

33 Serguei A. Koudriachov, *supra* note 29, at 48.

the issuing bank is bound to pay under the L/C.[34] This explains why practitioners believe L/Cs try to compensate for the buyer's weaker position in the underlying transaction.[35]

The above supports the argument that even when the autonomy principle aims at isolating the payment undertaking by making it independent[36] of the underlying transaction, this transaction inevitably plays a significant role in determining the equities competing[37] within the L/C and in deciding the battle between the seller's certainty of payment against his factual right to be paid. Therefore, it is not possible to conceive the underlying transaction as separated from the L/C commitment. Basically, if there were no underlying transaction, there would be no L/C in the first place.[38] Empirical studies have proved that a lack of concern about the underlying transaction has brought about false calls, abuse and fraud.[39] Still, British courts have traditionally been very reluctant to instruct banks from honoring undertakings under L/Cs.[40]

Along this line, a recent study[41] says that in certain civil law countries,[42] and mostly in Latin American countries, jurisprudence does not consider the underlying transaction completely isolated from documentary commitment. In these countries, jurists have found difficulties in understanding the concept of the autonomy of independent undertakings because the principle of "cause" is deeply rooted in civil law tradition. Schwank[43] argues that

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34 Markus Heidinger, *Bank Guarantees, Letters of Credit and Similar Instruments under Austrian Law*, 12 (11) JOURNAL OF INTERNATIONAL BANKING LAW 452 (1997).

35 Ronald J. Mann, *The Role of Letters of Credit in Payment Transactions*, 98.8 MICH. L. REV. (2000).

36 Generally, U.S. academics and courts refer to the autonomy principle as "independency principle." *See generally*, Edward L. Symons, *Letters of Credit: Fraud, Good Faith and the Basis for Injunctive Relief*, 54 TULANE LAW REVIEW 357 (1979-1980); Michael Stern, *The Independence Rule in Standby Letters of Credit*, 52 U. CHI. L. REV. 236 (1985); Timothy J. Henderson, *The Independence Principle, The Presentment Warranty and the Status of the Texas Letter of Credit*, 22 TEX. TECH L. REV. 830 (1991).

37 Laura K. Austin, *Letters of Credit: Gold Bullion?*, 45 LA. L. REV. 930 (1984-1985).

38 Alphonse M. Squillante, *Letters of Credit: A Discourse, Part II*, 84 COMMERCIAL LAW JOURNAL 430 (1979).

39 Henry Stewart, *It is Insufficient to Rely on Documents*, 5.3 JOURNAL OF MONEY LAUNDERING CONTROL 225 (2002).

40 Antony Pugh-Thomas, *Letters of Credit - Injunctions - The Purist and the Pragmatist: Can a Buyer Bypass the Guarantor and Stop the Seller from Demanding Payment from the Guarantor*, 11 JOURNAL OF INTERNATIONAL BANKING LAW 211 (1996).

41 Friedrich Schwank, *New Trends in International Bank Guarantees*, 6 INTERNATIONAL BANKING LAW 37 (1987).

42 Belgian law acknowledges the abstraction between the underlying transaction and the documentary undertaking. *See generally* Philippe De Smedt, *First Demand Guarantees in Belgian Law*, 2 INTERNATIONAL FINANCIAL LAW REVIEW 20 (1983).

43 *Id.* at 38.

this principle is similar to the "consideration" concept in British law. However, in my opinion, this concept is not completely accurate since the concept of "cause" in civil law jurisdictions is sometimes not taken into account in the transaction. Moreover, the term "cause" is often used as an exception to the autonomy principle of documentary obligations, thus allowing the parties to benefit from it if included in the instrument.

In the words of Ackner in *Esal (Commodities) Limited v. Oriental Credit Limited*,[44] the nature of independent obligations relies on the issuer not concerned in "the least with the relations between the supplier and the customer nor with the question whether the supplier has performed his contractual obligation or not, nor with the question whether the supplier is in default or not." The whole idea behind independent law obligations is to have a certain guarantee that the bank's undertaking will not be affected by any abnormality regarding its underlying obligation and that the seller should not be conditioned to obtain payment solely by suing the buyer.[45] Therefore, generally speaking, courts are prevented from granting injunctions to order payment under a L/C.[46] However, it seems reasonable to uphold an unjust payment when there is evidence that the beneficiary is not entitled to receiving it. Nonetheless, academics[47] argue that making the issuer's performance subject to the underlying transaction will make L/Cs lose their commercial usefulness, making it better for merchants and courts striving for equity to seek three-party transactions like guarantees to assure the primary obligor in an underlying transaction.

III. AUTONOMY

An L/C is a "one-way abstract transaction, in which the emitting bank cannot reject the execution of its obligation by referring to the non-execution of obligations by other parties to the transaction."[48] The issuer's independent commitment is a *sui generis*[49] primary obligation and the "cornerstone of the commercial vitality" of this instrument of payment.[50] Understood as a merchant practice by British courts, a third beneficiary party theory device by

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[44] 2 Lloyd's Rep. 546, at 245 [1985] .

[45] Henry Stewart, *supra* note 39, at 225.

[46] John F. Dolan, *Tethering the Fraud Inquiry in Letter of Credit Law*, 21 BANKING AND FINANCE LAW REVIEW 480 (2006).

[47] Peter A. Alces, *An Essay in Independence, Interdependence and the Surety Principle*, 3 UNIVERSITY OF ILLINOIS LAW REVIEW 449 (2003).

[48] Serguei A. Koudriachov, *supra* note 29, at 47.

[49] Leacock argued that its binding nature is derived from statute even though it lacks consideration. Stephen J. Leacock, *supra* note 4, at 886.

[50] See *Ward Petroleum Corp. v. FIDC*, 903 F.2d 1297, 1299 (10th Cir. 1990), cited by Robert D. Aicher, *supra* note 32, at 898.

civil law academics, or an offer made by the issuer to the beneficiary, the certainty of payment provided by an L/C makes it traders' favorite payment device[51] since the underlying transaction is usually not entered *inter praesentes*,[52] thus binding the beneficiary to claim payment in a foreign jurisdiction.[53]

The autonomy of L/Cs and other financial devices is reflected in several judicial decisions[54] and upheld by the most important domestic and international legal frameworks.[55] This paper has identified three major functions of the principle of autonomy, which has been described as the "engine room behind of the letter of credit."[56] First, it has a payment function which consists of delimiting the risks[57] in the underlying transaction by allocating each party's liabilities,[58] so that the seller is paid and the issuer is either reimbursed or given recourse against the applicant regardless of any

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[51] Jonathan D. Their, *Letters of Credit: A Solution to the Problem of Documentary Compliance*, 50 FORDHAM L. REV. 848 (1981-1982).

[52] Nicholas L. Deak, *Letters of Credit (Documentary Credits)*, 2 N.Y.J. INTERNATIONAL & COMPARATIVE LAW 239 (1980-1981).

[53] According to its content, traders have created different kinds of L/Cs which are generally used pursuant to the form of payment intended by the seller and the buyer, either by presenting documents and installments, accepting bills of exchange issued by the issuing bank or accepting bills of exchange by negotiation. U.S.-British cases prefer the inclusion of the acceptance of bills of exchange in L/Cs while European cases usually tend to favor the presentation of documents practice. *See generally* Meir Yafrich, *Third Party's Attachment on Letter of Credit Proceeds*, JOURNAL OF BUSINESS LAW 158 (2001).

[54] In 1941, the New York Supreme Court in *Sztejn v. J Henry Schroder Banking Corp*, 31 NYS 2, 631 at 633-34 [hereinafter *Sztejn*] set forth the independency of an L/C in its underlying transaction. Almost 50 years later, a dictum by Lord Diplock in the well-known British case of *United City Merchants (Investments) Ltd. and Another v. Royal Bank of Canada and Others* ("*United City Merchants*") 1 A.C. 168 (1983), *The American Accord* asserted that notwithstanding whether the issuing bank has knowledge of a breach in an underlying transaction, if the documents appear to be correct, the issuer is bound to pay the credit. In Canada, the Supreme Court in *Angelica-Whitewear Ltd. v. Bank of Nova Scotia* ("*Angelica-Whitewear*") 36 D.L.R. (4th) 161, EYB 1987-67726, 1987 CarswellQue 24, 1987 CarswellQue 91, S.C.J. No. 5, 73 N.R. 158.6Q.A.C. 1.36B.L.R. 140, [1987] I S.C.R.59 (S.C.C.) stressed that the independence from the transaction is what gives L/Cs their advantage. Cited in Case Comment, *Phillips v. Standard Bank of South Africa Ltd. (Unreported - South Africa)*, 4 INTERNATIONAL BANKING LAW (1986).

[55] Articles 3 and 4 of UCP 600; Article 2 (b) of Uniform Rules for Demand Guarantees; Articles 2 and 3 of UNCITRAL Convention on Independent Guarantees and Stand-By Letters of Credit; and Sections 5-109 (1)(a), 5-114 (1) and 5 5-103(d) & cmt of UCC.

[56] Jonathan Arkins, *Snow White v. Frost White: The New Cold War in Banking Law*, 15 JOURNAL OF INTERNATIONAL BANKING LAW 31 (2000).

[57] Lisa G. Weiberg, *Letter of Credit Litigation – Bank Liability for Punitive Damages*, 54 FORDHAM L. REV. 923 (1985-1986).

[58] Gerard McCormack *et al.*, *supra* note 15, at 45.

dispute between the parties.[59] None of the banks participating in the L/C transaction are bound to act on the strength of the underlying transaction, not even if the L/C contains a direct reference to such a transaction.[60] Likewise, no set-off[61] or counterclaim is allowed.[62] The parties to an L/C can only counterclaim the party towards whom they are liable.[63] Under this principle, an applicant cannot sue the issuer on the strength of its dealings with the issues or with the beneficiary, citing the undertaking of the L/C.[64] Similarly, the undertaking of the issuer of the L/C does not concern nor binds the advising bank towards the beneficiary of this transaction in any way.

However, the autonomy principle of the L/C does not absolve the issuer of any liability triggered from its inexperience and resulting in failing its payment under the L/C towards the beneficiary.[65] Ward explains that the severance of the different undertakings that conforms the L/C device simply aims at avoiding any obstruction to issuing bank's payment obligation under the L/C, which means that the applicant still holds an action towards the issuing bank for any possible breach in the application contract.[66]

Secondly, Professor McCormarck explains its commercial function[67] in conjunction with the strict compliance doctrine as limiting the issuer's exposure by giving it the ministerial function of document checking[68] and fund transferring[69] so as to eliminate any doubt as to whether it is bound to pay or not,[70] as well as to ensure that the issuer will be reimbursed by the applicant,[71] solely based on the documents.[72] Illustrating the above, the British

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59 Ross P. Buckley *et al.*, *supra* note 23 at 656.

60 Serguei A. Koudriachov, *supra* note 29, at 47.

61 It is worth mentioning that a limitation to the autonomy principle was put in *Hong Kong & Shanghai Banking Corp. v. Kloeckner & Co. Ltd.* 2QB514 (1989) whereby it was held that the rights of set-off on an issuer against the beneficiary under a L/C are not affected by the autonomy principle, cited by Howard Bennett, *The Formal Validity of Demands under Performance Bond*, 6 JOURNAL OF INTERNATIONAL BANKING LAW 207-211 (1991).

62 Clive M. Schmitthoff, *supra* note 28, at 51.

63 Razeen Sappideen, *supra* note 4, at 146.

64 Serguei A. Koudriachov, *supra* note 29, at 48.

65 Alan Ward, *The Liability of Banks in Documentary Credit Transactions under English Law*, 13 JOURNAL OF INTERNATIONAL BANKING LAW 389 (1998).

66 *Id*.

67 *American Bell Int'l, Inc. v. Islamic Republic of Iran*, 474 F. Supp. 420, 426 (1979) cited by Peter A. Alces, *supra* note 47, at 550.

68 Christopher Hare, *Not so Black and White: The Limits of the Autonomy Principle*, 63 THE CAMBRIDGE LAW JOURNAL 288 (2004).

69 Gerard McCormack *et al.*, *supra* note 15, at 41.

70 Christopher Hare, *supra* note 68, at 289.

71 Serguei A. Koudriachov, *supra* note 29.

72 Lord Diplock in *The American Accord*, note 79, cited in Yeliz Demir-Araz, *supra* note 2, at 129.

case of *Gian Singh & Co. Ltd. v. Banque de l'Indochine*,[73] demonstrates that the autonomy principle binds an issuer to pay to the beneficiary even when the documents provided for under the terms of an L/C are forged. Likewise, the Australian decision on *Pacific Composites Pty Ltd. & Anor v. Transpac Container System Ltd. & Ors*[74] ruled that even when the documents required under an L/C are incorrect, the issuer is bound to pay. Moreover, *IE Contractors Limited v. Lloyds Bank Plc*[75] stated that the payment of independent obligations like L/Cs is subject to the condition of the proper presentation of documents and is not concerned at all with whether the facts represented in these documents are true or actually happened.

Finally, its financing function consists of protecting the parties (other than the issuing bank) to an L/C from any interference from being reimbursed by the issuer after paying the beneficiary[76] while also supporting sellers to leverage other transactions on the strength of the credit opened in their favor under the L/C.

IV. Exceptions

Assurance of payment plays a quintessential role when the seller asks the buyer to open an L/C, but does the seller have an absolute right to payment?[77] Donaldson remarked that thrombosis would occur were courts to disturb the mercantile practice of treating the rights under an L/C as being equivalent to cash in hand.[78] When courts are asked to award injunctions to enjoin payment under an L/C, a public interest test is carried out to decide whether the injunction would, on the one hand, prevent an innocent party from fraud or unconscionability, declaring a nullity[79] or an illegal transaction, or enforcing an act of state, or, on the other hand, if the injunction would strengthen the autonomy of the issuer's undertaking under the letter of credit.[80]

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73 2 All E.R. 754 (1974), cited by Jonathan Arkins, *supra* note 56, at 32.

74 Unreported decision of Tamberlin J., Federal Court of Australia, NSW District Registry in Admiralty, May 11, 1998, NG377 of 1996, cited in *Id.*

75 2 Lloyd's Rep. 496, Staughton L.J., 499 (1990).

76 Meir Yafrich, *supra* note 53, at 159; Robert S. Rendell, *Fraud and Injunctive Relief*, 56 Brooklyn Law Review 113 (1990-1991).

77 Ronald J. Mann, *supra* note 35, at 29.

78 *See Intraco Limited v. Notis Shipping Corp*, *The Bhoja Trader* ("*The Bhoja Trader*") 2 Lloyd's Rep. 256, 250 (1981).

79 Generally, nullity as exception is accepted in civil law jurisdictions. *See* Alberto Giampieri *et al.*, *Enforceability of International Documentary Letters of Credits: The Italian Perspective*, 27 The International Lawyer 1025 (1993).

80 *See Intraco Limited v. Notis Shipping Corp*, *supra* note 78.

In practice, it is often said[81] that issuers tell their beneficiaries the issuing bank will pay the credit unless an injunction is presented.[82] An injunction is used to block the execution of an L/C by preventing the beneficiary from claiming payment, the issuer from paying out the credit or, in some cases, both of these actions.[83]

As opposed to several studies[84] that recognize fraud as the only exception to the autonomy principle, this paper presents outline cases in which courts have asserted other possible scenarios where the autonomy principle is superseded. For instance, according to the rulings on *Rafsanjan Pistachio Producers Co-operative v. Bank Leumi (U.K.) Plc*[85] and *KBC Bank v. Industrial Steels (UK) Ltd.*,[86] fraudulent misrepresentation by the beneficiary on opening the credit is also a possible scenario for awarding an injunction to prevent the beneficiary from claiming payment.

Likewise, pursuant to Canadian case law,[87] the parties are allowed to contract out of the principle of autonomy by expressly stipulating in the terms of the credit that the issuer's undertaking will be conditioned to proof of the applicant's liability, thus having to inquire into the underlying transaction. Moreover, a recent study[88] suggests that the compliance test set forth in the UCP[89] indirectly boycotts the principle of autonomy as it centers on the fact that the seller can always present a claim through the underlying transaction. This is understood since the document requirements for the credit have been reduced to a point that the seller can easily produce these documents by relying heavily on the provisions in the original contract.

Professor McCormack[90] also points out that in some jurisdictions, the autonomy principle cannot prevent issuing banks' common practice of choos-

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81 Reade H. Ryan Jr., *Who should be Immune to the Fraud in the Transaction Defense in a Letter of Credit Transaction?*, 56 BROOK. L. REV. 128 (1990-1991).

82 Since injunctions are equitable remedies, they have been always subject to limitations by courts. *See* generally Francis Bacon, *Developments in the Law: INJUNCTIONS*, 78 HARV. L. REV. 995 (1964-1965).

83 Renee Martin-Nagle, *Injunctions of Letters of Credit: Judicial Insurance Against Fraud*, 3 JOURNAL OF LAW AND COMMERCE 305 (1983).

84 *See*, *e.g.*, Glower W. Jones, *Letters of Credit in The United States Construction Industry*, INTERNATIONAL BUSINESS LAWYER 16 (1986).

85 1 Lloyd's Rep. 513 (1992), cited by E. Peter Ellinger, *New Cases on Documentary Credits*, JAN JOURNAL OF BUSINESS LAW 33 (1994).

86 Commercial Court, 27 Nov. 2000, cited in Case Comment, *Deceit and Letters of Credit*, 23 THE BUYER (2001) 7.

87 *Fuji Bank Canada v. 1440 Ste Catherine Street Developments Inc* 1997 CarswellOnt 1579, 6.

88 Jonathan Arkins, *supra* note 56, at 31.

89 *Id.*, articles 13.a and 37.c of UCP 600.

90 Gerard McCormack *et al.*, *supra* note 15.

ing whether or not to fulfill their payment obligations under an L/C based on the chance of entering into litigation with the beneficiary. This proved so in *Dairy Queen, Inc. v. Bank of Wadley*,[91] in which the issuer's defense against payment was on the grounds that the L/C had exceeded its lending limit.

1. *Fraud*

When traders are asked to identify an exception to the autonomy principle,[92] the most common response is imprecision. However, when it comes to fraud, defining parameters are very different from jurisdiction to jurisdiction,[93] even though the disparities are sometimes explained as being necessary.[94] Professor Goode[95] argues that fraud should be understood as a false statement knowingly and intentionally included in a document to be used against the deceived party. A breach of warranty would not suffice to prove fraud, but only the unscrupulous intention to deceive.[96]

Is it an option to decide whether an issuer should pay out or not under an L/C? It is generally assumed that issuers have the right to decide whether to refuse payment on grounds of fraud. Generally speaking, the autonomy principle allows banks to pay out the credit, acting in good faith,[97] in the face of documents that appear *prima facie* to comply with the terms prescribed in the credit.[98] Strict compliance doctrine obligates banks

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91 407 F. Supp. 1270 (M.D. Ala. 1976), cited in G. Hamp Uzelle III, *Letters of Credi*t, 10 THE MARITIME LAWYER 52 (1985).

92 John F. Dolan, *supra* note 46, at 491.

93 As an example of exceptions to the autonomy principle, according to the 1981 ruling of the *Cour de Cassation*, in the case of indisputable fraud by the beneficiary, the buyer can address the courts to seize the L/C account to prevent the beneficiary from receiving payment. In South Africa, the position is akin to that of France, whereby falsification of the documents required under the L/C clearly interdicts payment under the transaction. Anglo-American cases share the same limitations. However, the practice of applying this exception has been developed more in these countries. For example, while Britain has developed common criteria for applying the fraud exception, the U.S. law has a specific law to use when ruling on the position of issuing banks facing these types of practices. Gavalda Stufle, BANKING LAW (1989), cited by Serguei A. Koudriachov, *supra* note 29.

94 John F. Dolan, *supra* note 46, at 250.

95 Roy Goode, *supra* note 10, at 991. Davidson points out that the common law fraud in statements comes from *Derry v. Peek* 14 App Cas 337, 374 (1889). Alan Davidson, *supra* note 17, at 66.

96 *See* Case Comment, *supra* note 86.

97 Roy Goode, *Rule, Practice, and Pragmatism in Transnational Commercial Law*, 54 INTERNATIONAL & COMPARATIVE LAW QUARTERLY 539 (2005).

98 Dora S. S. Neo, *supra* note 22, at 51; Alphonse M. Squillante, *Letters of Credit: A Discourse, Part V*, 85 COMMERCIAL LAW JOURNAL 91 (1980).

to pay in the face of documents that strictly comply with the credit terms,[99] without any reference to facts not contained therein[100] or any examination of the factual background of the documents.[101] Nonetheless, case law has also proved that (1) where the issuer is aware of the fraud, in either the underlying transaction or the tender of the documents,[102] the issuing bank is not only entitled to refuse payment towards the beneficiary, but also has a limited duty to refuse this payment,[103] as seen in *Signal Capital Corp. v. First National Bank of Gatlinburg*[104] and *Ross Bicycles, Inc. v. Citibank*[105] (it can be argued, however, that the issuer may also have a limited duty to investigate)[106] and (2) the applicant has a right to apply for an injunction to prevent payment if fraud on the beneficiary's behalf can be proven.[107]

Well established in the United States in cases like *Sztejn*[108] and referred to in Britain in the *Edward Owen* case,[109] the fraud exception is an example of applying the principle *ex turpi causa non oritur action*.[110] Case law has evinced that the standards for applying fraud as exception dramatically lack uniformity, even between common law jurisdictions.

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99 *See generally Corporacion de Mercadeo Agricola v. Mellon Bank Int'l* 608 F. 2d 43, 47 (2nd Cir. 1979), cited by Gerald T. McLaughlin, *Letters of Credit: Basic Principles and Current Controversies*, 17 AUSTRALIAN BUSINESS LAW REVIEW 307 (1989).

100 J. P. Geraghty, *Many a Slip... Acceptance by a Bank of Documents under an International Documentary Credit*, 11 SOUTH AFRICAN MERCANTILE LAW JOURNAL 331 (1999).

101 Roy Goode, *Reflection on Letters of Credit – I*, J. BUS. L. 291 (1980).

102 This is the position of Canadian case law in *Angelica-Whitewear*, see *supra* note 54.

103 *See generally Sztejn*. *Id*.

104 No. 89-5760 (6th Cir. Apr. 24, 1990) (unpublished; text in WESTLAW), cited in Albert J. Givray, *Letters of Credit*, 44 BUS. LAW. 1567 (1988-1989).

105 555 N.Y.S.2d 740-741 (N.Y. App. Div. 1990).

106 *See*, *e.g.*, *Sztejn*, *supra* note 54 and *Royal Bank of Canada v. Darlington* (unreported), [1995] O.J. No.15, 1995 Carswell, Ont 2661 at [196] (Ont. Gen. Div).

107 See, among others, *Stztejn supra* note 54; *Discount Records Ltd. v. Barclays Bank Ltd.*, 1 Lloyd's Rep. 166 (1975). Recently, Rix J. in *Czarnikow-Rionda Sugar Trading Inc v. Standard Bank London Ltd. supra* note 112; *Banco Santander S.A. v. Banque Paribas*, 1 All E.R. 776 (2000), cited by Paterson, S. *et al*., *Fraud and Documentary Credits*, 16 JOURNAL OF INTERNATIONAL BANKING LAW 38 (2001). *Hamzeh Malas and Sons v. British Imex Industries Ltd.*, *supra* note 4; *R D Harbottle (Mercantile) Ltd. v. Barclays Bank International Ltd.* 1978 QB 159 (CA); *Edward Owen v. Barclays Bank*, *supra* note 79; *Bolivinter Oil S.A. v. Chase Manhattan Bank*, 1 Lloyd's Rep. 251 (1984) and *United Trading Corporation S.A. and Murray Clayton Ltd. v. Allied Arab Bank Ltd.*, 2 Lloyd's Rep. 554 (1985), cited by Antony Pugh-Thomas, *supra* note 40, at 212.

108 *See Sztejn*, *supra* note 54.

109 *Id*.

110 "Fraud unravels all", cited by Case Comment, *Documentary Credit – Derogation of the Principle of Autonomy on the basis that the Terms of draw-down have not been met*, 5.10 FINANCE & CREDIT LAW 4 (2003).

For instance, academics argue that in Britain, fraud is almost a theoretical concept since courts are quite reluctant[111] to grant injunctions.[112] Although British case law's position regarding fraud is based on *Sztejn*,[113] its conception is almost unattainable[114] unless the beneficiary has expressly confessed to committing the deceit; otherwise, the applicant would be required to (1) establish a cause of action and provide clear and obvious evidence of the fraud[115] to the issuer;[116] (2) prove that the beneficiary is accountable for the wrongdoing; (3) have the balance of convenience on the applicant's side;[117] (4) prove issuer's knowledge of the situation at the time of tendering the documents; and[118] (5) demonstrate that the injunction is the appropriate remedy.[119]

By way of contrast, other common law jurisdictions have treated this exception slightly different and less stringently.[120] U.S. courts have adopted flexible standards in the design of the fraud exception.[121] Even when fraud is suspected,[122] these courts do not hesitate in granting temporary injunc-

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111 Yeliz Demir-Araz, *supra* note 2, at 133.

112 *Id*.

113 *See Sztejn*, *supra* note 54.

114 *See* generally *Power Curber International Ltd. v. National Bank of Kuwait S.A.K.*, 2 Lloyd's Rep. 394 (1981), cited by F. R. Malan, *Letters of Credit and Attachment Ad Fundandam Jurisdictionem*, JOURNAL OF SOUTH AFRICAN LAW 151 (1994).

115 *The Society of Lloyd's v. Canadian Imperial Bank of Commerce* 1 A.C. 168 (1983); QB 208 (1982); 1 Lloyd's Rep. 267 (1979) and 2 Lloyd's Rep. 498 (1979), cited by Yeliz Demir-Araz, *supra* note 2, at 133.

116 *United Commercial Bank v. Hanuman Synthetics Ltd.*, 61 Company Cases 245 (1987), Brown L.J. in Edward Owen, *supra* note 55, cited in Shri N. K. Randeria, *Letter of Credit - Documents Drawn Thereunder Accepted - Discrepancies Pointed Out Later on of Trivial Nature*, 5 INTERNATIONAL BANKING LAW 150 (1987); *See also* Roy Goode, *supra* note 10, at 992.

117 This determines whether the balance of convenience is just and equitable for a court to grant the injunction. *See generally American Cynamid Co. v. Ethicon Ltd.* 1975 AC 396 *cited by* Alexander Loke, Case Comments, *Injunctions and Performance Bonds – A return to English Orthodoxy*, SINGAPORE JOURNAL OF LEGAL STUDIES 693 (1995). *See also Czarnikow-Rion- da Sugar Trading Inc. v. Standered Chartered Bank London Ltd.*, 1 All E.R. 890 (1990), *cited in* Simon Pullen, *Recent Developments in Letters of Credit*, 4(1) FINANCE & CREDIT LAW 2 (2001).

118 Sir John Donaldson MR in *Bolivinter Oil S.A. v. Chase Manhattan Bank supra* note 107, cited by Jason Chuah, *Briefing*, 4.1 FINANCE & CREDIT LAW 85 (2002).

119 Howard Bennett, *supra* note 61, at 210.

120 John F. Dolan, *supra* note 46, at 260.

121 *United Bank Limited v. Cambridge Sporting Goods Corp* 41 N.Y.2d. 254, 392, N.Y.S.2d 265, 360 N.E.2d 943 (1976).

122 During the Iranian revolution, U.S. contractors speculated that their Iranian guarantors might make fraudulent calls on the credits. Therefore, the contractors asked the U.S. courts for injunctions against potential fraud. These applications were dismissed in cases like *American Bell Int'l v. Islamic Republic of Iran*, *supra* note 67 and *Pan American Airways Inc. v. Bank Melli Iran* 484111 S.D. N.Y. (1979) looking up at *Nadler and Mei Loong Corp. of China, Ltd.* 177 Misc. 263, 30 N.Y.S.2d 323 (1941) in which it was ruled that unless the de-

tions to prevent payment and then later give time for the buyer to establish his allegation.[123] The distinction between a breach of warranty and fraud in U.S. case law has been described in *Sztejn*[124] and in *United Bank Ltd. v. Cambridge Sporting Goods Corp.*,[125] which ruled that a bank could only be issued an injunction for not paying an L/C when fraud is evident,[126] and the bank had been informed of this before the documents had been presented. However, a dissenting position was set forth in *Dynamics Corp. of America v. Citizens and Southern National Bank*[127] in which an equitable broad definition of fraud was given and the injunction was granted even when fraud had not been clearly established, since the beneficiary was not guilty of the fraud. This concept has moved academics to argue[128] that in the United States, courts often grant preliminary injunctions without concern to the beneficiary, being often that this party would only learn of the proceedings on receiving the issuer's letter stating that the credit will not be honored. It seems that U.S. courts are more prone to grant temporary restraining orders if the circumstances[129] encompass the suspicion of fraud,[130] unlike British courts whose standards for granting injunctions are stricter.[131] Another contrast is that unlike British case law, U.S. statutes[132] and case law, such as *Shaffer v.*

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mands of the beneficiaries are proven to be fraudulent, payment would not be enjoined. Cited by F. Friedrich Schwank, *Documentary Letters of Credit – Recent Cases*, 1 INTERNATIONAL FINANCIAL LAW REVIEW 9 (1982).

123 Yeliz Demir-Araz, *supra* note 2.

124 *See Sztejn*, *supra* note 54. Later, the UCC attempted to codify this by applying the concept of "material" fraud to L/Cs. S.5-109 states that an issuer must refuse payment when fraud is found in the documents and was committed by the beneficiary.

125 See *United Bank*, *supra* note 121.

126 In *Sztejn*, *supra* note 54, an injunction was awarded on the grounds of not being goods at all rather than just damaged goods as in *Maurice O'Meara*, 39 A.L.R. 747 (1925), cited by Norman I. Miller, *supra* note 26, at 192.

127 356 F. Supp. 991, 995 (1973).

128 Dorothea W. Regal, *supra* note 1, at 52.

129 *See* Friedrich Schwank, *supra* note 41.

130 *See generally* the decisions in *Walton Insurance Co. v. Chase Manhattan Bank*, WL 1211555 (S.D. N.Y.) (1990); *Phillip Brothers, Inc. v. Oil Country Specialists, Ltd.* 787 S.W.2d. 38, 10 U.C.C. Rep. Serv. 2d. 943 (1990) (rehearing decision on 1-17-90 withdrawing decision of 6-7-89, 9 U.C.C. Rep. Serv. 2d 201 (Tex. 1989); *Ground Air Transfer, Inc. v. Westated Airlines, Inc.* 899 F2d 1269, 11 U.C.C. Rep. Serv. 2d. 177 (1st Cir. 1990); *O'Neil v. Poitras*, 551 N.Y.S.2d 92, 93 (N.Y. App. Div. 1990); *Lamar Builders, Inc. v. Guardian Sav. V. Loan Ass'n*, 789, S.W.2d 373, 374-75 (Tex. Ct. App. 1990); *Unifirst Fed. Sav. Bank. v. American Ins. Co.*, 905 F.2d 208, 211, 11 U.C.C. Rep. Serv. 2d. 926, 929-30 (8th Cir. 1990); *Ross Bicycles, Inc. v. Citibank*, 555 N.Y.S.2d 740-741 (N.Y. App. Div. 1990).

131 *United Trading Corporation S.A. v. Allied Arab Bank*, cited by Antony Pugh-Thomas, *supra* note 40.

132 UCC SS. 5-109. UCC Article 5 applies to fraud in the documents and fraud in the transaction, but limits this exception to cases of serious beneficiary misconduct. It also provides protection for third parties that have taken the beneficiary's documents in good faith

Brooklyn Park Garden Apartments[133] and *NMC Enterprises Inc v. Columbia Broadcasting Systems*[134] have set forth the incorporation of the underlying transaction in tethering the fraud inquiry by not restricting it to the documents.[135]

Canadian courts had recognized the fraud exception primarily by relying on the cases of *Sztejn*[136] and *Edward Owen*,[137] thus requiring an established case of fraud[138] and the issuer's actual knowledge of this. However, in later cases, such as *CDN Research & Development Ltd. v. Bank of Nova Scotia*;[139] *Rosen v. Pullen*;[140] *Henderson v. Canadian Imperial Bank of Commerce*,[141] and the leading case in Canada *Angelica-Whitewear*,[142] Canadian courts have been more inclined to accept only a *prima facie*[143] argument. In contrast with Britain and the United States, Canadian courts might issue injunctions in cases in which fraud is carried out in either the transaction[144] or issuing the documents.[145] Similarly, the position of South African courts of underpin-

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without being privy to fraud. Moreover, in order to grant injunctive relief, the applicant is required not to have good chances at a hearing of the merits and a security deposit must be posted to protect the beneficiary from potential loss by virtue of the injunctive relief. In the United States, the UCP is applicable to all documentary credits unless expressed otherwise. Article 5 contemplates the broader scope of the UCP and provides that where UCP is adopted but conflicts with Article 5, except when distinction is forbidden, UCP provisions are permissible modifications. Dong-heon Chae, *Letters of Credit and the Uniform Customs and Practices for Documentary Credits: The Negotiating Bank and the Fraud Rule in Korea, Supreme Court Case 96 DA 43713*, 12 FLA. J. INTNL F. 50 (1998); Mark A. Wayne, *The Uniform Customs and Practice as a Source of Documentary Credit Law in the United States, Canada and Great Britain: A Comparison of Application and Interpretation*, 7.1 ARIZONA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 160 (1989-1990); Note: Letters of Credit: Injunction as a Remedy for Fraud in U.C.C. Section 5-114, 63 MINNESOTA LAW REVIEW 501 (1978-1979).

133 250 NW 2d 172 (SC Minn) (1977).

134 14 UCC Rep Serv 1427 (SC NY) (1974).

135 *Intraworld Industries Inc v. Girard Trust Bank* 336 A 2d 316 (1975). Dissenting criteria was put forth in *Shaffer v. Brooklyn Park Garden Apartments* Minn. *supra* note 196 cited in Case Comment, *Recent Minnesota Cases. Commercial Law – Injunctive Relief for the Letter-Of- Credit Customer*, 4 WILLIAM MITCHEL LAW REVIEW 450 (1978).

136 See *Sztejn*, *supra* note 54.

137 *Id*.

138 Alan Davidson, *Fraud; the Prime Exception to the Autonomy Principle in Letters of Credit*, 8 (23) INTERNATIONAL TRADE & BUSINESS LAW ANNUAL (2003).

139 *Id.* 18 CPC 62 (1980).

140 (1981) 126 DLR (3d) 62.

141 (1982) 40 BCLR (SC).

142 See *Angelica Whitewear*, *supra* note 54.

143 *See supra* note 54, cited in Daniel Zacks, *United City Merchants: The Canadian Viewpoint*, (1) INTERNATIONAL BANKING LAW 7 (1987).

144 *Angelica-Whitewear*, *supra* note 54.

145 *Intraworld Industries Inc. v. Girard Trust Bank*, *supra* note 198, cited by Jimmy L. Jr.

ning the autonomy of the L/C in cases of fraud is akin to that of U.S. courts as proved in *Phillips & another v. Standard Bank in South Africa & others*.[146]

Finally, in other jurisdictions, the drafters of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit[147] did remarkable work in providing that courts may issue a provisional order preventing the beneficiary from receiving payment or freezing the proceeds thereof in cases in which fraud is suspected on strong evidence.[148] The Convention cogently avoids any definition of fraud to avoid falling in the court practice of giving the issuer the right to withhold payment. In contrast, UCP600 does not even mention the word fraud and the International Standard Banking Practice solely mentions that using a defense of fraud is available pursuant to domestic law. Academics argue that this lack of regulation in such international instruments is by no means a mistake, but a possible solution in tethering the fraud exception.[149]

2. *Avoidance of the Underlying Contract*

A careful examination of the extent to which the underlying transaction should be disregarded was outlined in *Potton Homes Ltd. v. Coleman Contractors (Overseas) Ltd*.[150] Although this case deals with performance bonds, a parallel between these documentary obligations and L/Cs can be drawn. In this case, Eveleigh argued that were the underlying contract to be avoided or the consideration to fail thereunder, the beneficiary should be enjoined from claiming payment. In this context, Arora[151] comments that allowing this exception would destroy the commercial utility of the documentary obligation by consigning the performance of this device to the lawfulness of the underlying contract.

Verner, *Fraud in the Transaction: Intraworld comes of Age in Itek*, 14 MEMPHIS STATE UNIVERSITY LAW REVIEW 164 (1983-1984).

146 1985 SA 301 cited in A. J. Kerr, *The Autonomy Principle in Documentary Letters of Credit Transactions: The First South African Decision*, 102 SOUTH AFRICAN LAW JOURNAL 381 (1985).

147 The UN Convention on Independent Guarantees and Standby Letters of Credit was adopted by the General Assembly of the United Nations on December 11, 1995, entering into force on January 1, 2000, after it was ratified by a 5th State. *See generally* Flip De Ly, *The UN Convention on Independent Guarantees and Standby Letters of Credit*, 33 THE INTERNATIONAL LAWYER 833 (1999).

148 Article 20.1.

149 Jean Stoufflet, *Fraud in Documentary Credit, Letter of Credit and Demand Guaranty*, 26 DICKINSON LAW REVIEW 26 (2001-2002).

150 See *supra* note 54, cited by Howard Bennet, *supra* note 61, at 580.

151 *Id*.

3. *Attachment in Letters of Credit Proceeds*

Academics have also referred to the applicant's insolvency[152] as an exception of the autonomy of L/Cs based on the argument that a receiver may attempt to enjoin L/C payment when holding a security interest in the applicant's assets. *Baja Boats Inc v. Northern Life Insurance Co.*[153] and *Martin v. Westfall Township*[154] are cases in which authorities have held that any payment by the applicant can be taken back as a preference under a preference period. Along this line of thought, it has been argued that *In re Twist Cap, Inc*.[155] may represent the first chance a court had to ban payment under an L/C on the strength of a bankruptcy proceeding. However, later decisions in *In re Page*;[156] *In re M.J. Sales & Distributing Co., Inc.*;[157] and *In re Price Choper Supermarkets, Inc.*;[158] have held the that payment under an L/C is an independent transaction and cannot be refunded since the issuer is paying from its own funds and not from the debtor's. Moreover, in *Agemene Bank Nederland, N.V. v. Soysen Tarin Urunleri Dis Ticaret Ve Sanayi A.S.*,[159] a case involving a negotiation credit and its assignment, it was held that a creditor who purports to attach its debtor's payment rights under an L/C may never see a clear opportunity to do so. In such case, the Southern District of New York awarded payment to the negotiating bank and dismissed the attachment application. Givray[160] explains this window of opportunity hypothetically by stating that if an application of attachment: (1) comes before the beneficiary has complied with the L/C requirements, it would be dismissed since the issuer's liability towards the beneficiary has yet to exist; (2) if it comes after the discharge of the issuer's obligation, this application would again fail because there is nothing to bind the issuer with the beneficiary, (3) if it comes after the acceptance of a draft drawn on the issuer, the application would be dismissed pursuant to statute law,[161] and finally (4) if it comes after a negotiation, it would be also dismissed since the credit proceeds no longer belong to the beneficiary. Examples of this last hypothesis

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152 Alan Davidson, *supra* note 138, at 34.

153 *Id.* 203 BR 71 (1996).

154 *Id.* 197 BR 31 (1996).

155 I. Bankr. 284 (Bankr. D. Fla. 1979), cited by James A. Rodenberg, *Letters of Credit in Bankruptcy: Can the Independence Doctrine Survive Preference Attacks?*, 96 (4) COMMERCIAL LAW JOURNAL 96 (1991); Stanley F. Farrar, *Letters of Credit*, 38 THE BUSINESS LAWYER 1171 (1982-1983).

156 18 Bankr. 713 (D.D.C. 1982).

157 25 Bankr. 608 (S.D. N.Y. 1982).

158 40 Bankr. 816 (Bankr. S.D. Ca. 1984).

159 748 F. Supp. 177, 13 U.C.C. Rep. Serv. 2d 834 (S.D. N.Y. 1990), cited by Albert J. Givray, *supra* note 104, at 1613.

160 *Id*.

161 *Id.* at 1615, U.C.C. Article 5 section 4-303.1.

can be found in *Diakan Love, S.A. v. Al Haddad Bros.*[162] and *Supreme Merchandise Co. v. Chemical Bank*.[163]

Similarly, the possibility of preventing payment to the beneficiary under an L/C by seizing a beneficiary's claim against the issuing bank was argued in a South African case decided by the full bench of the Witwatersrand Local Division.[164] In this case, the principle of autonomy was exalted to the point of concluding that when a buyer agrees to open a credit in favor of his seller through an L/C, he is unconditionally giving up any right (*a*) he might later be entitled to or (*b*) to obstruct the beneficiary's rights to be paid in any way.[165] The argument presented by the applicant of this attachment and based on a similar decision[166] was that the autonomy principle was not undermined because such an attachment would not prevent payment, but would only lead to the payment being made to the deputy sheriff who would receive it on behalf of the real beneficiary for security reasons.[167] In the final judgment, Streicher rejected this last argument, explaining that even if the deputy sheriff receives the money on behalf of the beneficiary, the beneficiary would not receive anything until a court has decided on the allegations. *The Bhoja Trader*[168] case would not apply since in this specific case, the beneficiary did receive payment but was enjoined from taking it out of that jurisdiction.

Similarly, a recent case in Israel proposes the position of trying to keep the L/C device intact as a form of payment to the extent of preventing any interference from a third party even if this party is a creditor of the beneficiary.[169] In this case, the Supreme Court of Israel ruled that a prejudgement attachment[170] on the proceeds of an L/C would be not allowed because it would definitely impair the documentary credit system. This decision was upheld to maintain the high value placed on the principle of autonomy of L/Cs as payment devices. This particular case involved the Israeli importer Niko, Ltd., who, on facing a breach of contract by his manufacturer Shan Dong,

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162 584 F. Supp 782 (1984), cited by Gerald T. McLaughlin, *supra* note 99, at 303.

163 70 N.Y.2d 344, 514 N.E.2d 1358, 520 N.Y.S.2d 734 (1987).

164 222G to 223 of the report of the judgment of the full bench in *Sapan Trading (Pty) Ltd., Re* 1995 (1) S.A. 218 (W), cited by A. Nico Oelofse, *South Africa: Trade Finance – Letters of Credit*, 10 (6) JOURNAL OF INTERNATIONAL BANKING LAW 130 (1995).

165 *Id*.

166 *The Bhoja Trader*, *supra* note 78.

167 This point is also argued by Gerald T. McLaughlin, *supra* note 99, at 308.

168 *The Bhoja Trader*, *supra* note 78.

169 *NikoBadim Ltd. v. The Israel Discount Bank*, 54 PD 773 (2000), cited by Meir Yafrich, *supra* note 53.

170 A prejudgment attachment has a similar nature to that of an interlocutory relief. Yafrich compares this "pre-judgment relief" with the Mareva injunction, explaining that this relief aims at seizing the defendant's assets to aid the plaintiff in collecting his debt from the defendant after the case has been ruled in favor of the plaintiff, *id.* at 159.

tried to attach the proceeds to which the latter was entitled under an L/C issued by the Israel Discount Bank. This credit was separate and unrelated to the underlying transaction between Niko Ltd. and Shan Dong. The court's argument was that the principle of autonomy not only should be invoked *inter partes*, but should also be effective against third parties. The court's rationale for ruling that proceeds under an L/C are not attachable by neither the applicant for the credit nor any third party creditor was basically to enshrine the principle of autonomy as the quintessential element of L/Cs and to follow an *obiter dictum* ruled by a New York district court in *Diakan Love SA v. Al-Haddad Bros. Enterprises*.[171]

The civil law perspective was shown in *Societé Bisch v. Societé Facon Deutschland*,[172] in which the *Cour de Cassation* dismissed an attachment arguing that this remedy is not available to the applicant. Supporting this position while not exactly dealing with the same circumstances, U.S. cases like *East Girard Savings Associations v. Citizens National Banks*[173] and *Temtex Products, Inc. v. Capital Bank & Trust Co.*[174] have concluded that the autonomy principle prevents the issuer from considering the beneficiary's "ledger" and that an L/C is independent of any right of set-off that might be available under contract law between the issuer and the beneficiary. Regardless the above criteria, other academics have recently suggested that even amendments in *quasi rem* law that limit the attachment of the proceeds, the autonomy principle should not be extended to endanger the rights of creditors that are not party to the L/C device. Cases like *Chase Manhattan Bank, N.A. v. Banque des Antilles Francaises*[175] and *China Nat'l National Technical Import-Export Corp. v. Industrial Resources Corp*[176] judged that if this attachment rule applies to payment obligations in general, those rules should apply to L/Cs as well.

4. *Nullity*

Left open[177] by the House of Lords in *United City Merchants*[178] and indirectly considered in *The American Accord* by Lord Diplock, the nullity excep-

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171 *Id.* 584 F. Supp 782 (1984).

172 *Id.* at 309, Cass. Civ. Com. No. 86-16.737 (1986). *Id.* at 309.

173 *Id.* 593 F.2d 598 (1979).

174 *Id.* 623 F. Supp 816 (1985), *aff'd*, 788 F.2d 1563 (1986).

175 *Id.* Cass. Civ. Com, No. 81-11.971 (1983) reported in John H. Riggs, *Recent Developments in France in Documentary Credits and Bank Guarantees*, 14 LETTER OF CREDIT SEMINAR, London (1987).

176 Hu Gao Jing Shang Zi No. 30 in Shanghai Municipal High People's Court, Oct. 11, 1988. *Id.*

177 Dora S. S. Neo, *supra* note 22, at 70.

178 *See generally* Charl F. Hugo, *Documentary Credits: Apparently Conforming Documents Equals Conforming Documents! The Bizarre Heritage of United City Merchants (Investments) Ltd. v. Royal Bank of Canada*, 13 SOUTH AFRICAN MERCANTILE LAW JOURNAL 595 (2001).

tion to the autonomy of the L/C is recently at the core of discussion in the United Kingdom and Singapore.[179] Basically, the nullity exception aims at embracing cases in which the beneficiary is not guilty of fraud, but the documents are null[180] because they have been forged by a third party or have been executed without authorization.[181]

In the ruling on the *Montrod Ltd. v. Grundkotter Fleischvertriebs GmbH & Standard Chartered Bank*[182] (*"Montrod"*) case, the "nullity exception" has no place in British law.[183] In this case, the applicant filed for an injunctive relief, which would enjoin other parties to be paid under the credit. The applicant's argument was based on the grounds that one of the documents required under the L/C was executed by a party who had been misled by the beneficiary. The Court of Appeals held that there was no right to affirm that since one of the documents was allegedly a nullity, all the liabilities of the parties to the L/C were therefore null and void. Moreover, this erroneously executed document was not essential, but merely accidental to the credit because it only referred to the quality of the goods.[184] It also held that a nullity exception would not be beneficial to the certainty of L/Cs, would put the issuer in a predicament as to whether to look beyond the documents to explore facts —a task for which it certainly lacks the skills to do, and would undermine the rights of good faith beneficiaries.[185]

In contrast, Hooley[186] argued that the *Montrod* decision might encourage the circulation of forged documents in international trade. Likewise, he asserted that the purpose of L/Cs is to pay against documents of value, and since a null document is worth only the paper it is written on, a paying bank might be risking its right to being reimbursed. Within this context, in *Beam Technology (Mfg.) Pte. Ltd. v. Standard Chartered Bank*[187] a Singaporean court held that nullity is an exception to the autonomy principle and that neither the *United City Merchants*[188] nor the *Montrod* cases can be considered precedents. In this particular case, one of the documents to be tendered under the credit was considered a nullity since the party in charge of its execu-

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179 *Id.* Lord Diplock recognized that nullity would result if the documents tendered to the issuer lacked legal value.

180 Dora S. S. Neo, *supra* note 22, at 71.

181 Richard Hooley, *Fraud and Letters of Credit: Is there a Nullity Exception*?, 61 CAMBRIDGE L. J. 279 (2002).

182 [2001] December 20th, *cited by* Jason Chuah, *supra* note 118, at 86.

183 *Id.* H.H.J. Raymond Jack Q.C. in *Montrod*.

184 Dora S. S. Neo, *supra* note 22, at 71.

185 Mark Williams, *Documentary Credits and Fraud: English and Chinese Law Compared*, JOURNAL OF BUSINESS LAW 155 (2004).

186 Richard Hooley, *supra* note 181.

187 1 S.L.R. 597 (2003), *cited by* Dora S. S. Neo, *supra* note 22, at 73.

188 *See supra* note 54. Michael Furmston, *An Introduction to Bankers' Commercial Credits*, 2 INTERNATIONAL COMPANY AND COMMERCIAL LAW REVIEW 93 (1991).

tion did not exist. The main difference between this case and the *Montrod* case was that the null document in question was in fact material to the credit. In view of this decision and pursuant to Singaporean case law, a bank that is privy to the nullity of the document and even then goes on to pay the credit would definitely not be reimbursed. Therefore, a bank privy to the nullity is neither entitled (against the applicant) nor bound (against the beneficiary) to pay the credit.[189]

5. *Unconscionable Conduct*

"Freedom of contract cannot be absolute."[190] While common law courts were occupied dealing with equity, the civil law legislators were the first to consider some contracts as going against the "public good" or "conscionable."[191] Unconscionable conduct has made courts void contracts that are oppressive or go against public policy, lack a meaningful choice,[192] involve fraud, include excessively high prices, are linked to a sales program or use fine print.[193]

A recent case in Australia has made academics debate whether a statutory unconscionability can undermine the autonomy principle of the L/C. Based on the decision of the Australian case of *Olex Focas Pty. Ltd. v. Skodaexport Co. Ltd.*,[194] Davidson[195] argues that the 1974 Australian Trade Practices Act has often been cited as an incursion in the autonomy principle by providing against unconscionability. In this case, *Olex Focas Pty. Ltd.* agreed to provide an L/C to *Skodaexport Co. Ltd.* to secure the former's obligations of mobilization advances/securement advances contained in a construction contract. A dispute over delayed work arose and *Skodaexport* threatened *Olex Focas* with calling in the L/C unless its claim for the work done under the contract was lowered. The court decided that *Skodaexport* was abusing its position and its behavior was "unreasonable" and "against conscious," in terms of the 1974 Trade Practices Act (Cth) (s 51AA), for demanding more

189 Dora S. S. Neo, *supra* note 22, at 71.

190 Alphonse M. Squillante, *Unconscionability: French, German, Anglo-American Application*, 34 ALBANY LAW REVIEW 301 (1969-1970).

191 *Id*.

192 *Williams v. Walker Thomas Furniture Co*., 350 F.2d 445, 449 (1965), cited by Clinton A. Stuntebeck, *The Doctrine of Unconscionability*, 19 MAINE LAW REVIEW 84 (1967).

193 *Morehead v. New York ex. rel.*, Tipaldo, 298 U.S. 587 (1936); *Central Budget Corp. v. Sanchez*, 53 Misc. 2d 620, 279 N.Y.S. 391 (Civ. Ct. of City of New York, New York County) (1967); *Frostifresh Corp. v. Reynoso*, 52 Misc. 2d 26, 274 N.Y.S.2d 757 (D.C. Nassau County N.Y.) (1966), cited by Alphonse M. Squillante, *supra* note 255, at 73.

194 3 VR 380-404 (1998), cited by Alan Davidson, *supra* note 138.

195 *Id*.

money than was reasonably needed to protect itself. Therefore, the court awarded the corresponding injunction.[196]

The distinction between fraud and unconscionability was put forward in the Singaporean case of *Dauphin Offshore Engineering & Trading Pte. Ltd. v. The Private Office of HRH Sheikh Sultan bin Khalifa bin Zayed Al Nahyan*.[197] Following various supporting cases,[198] it was ruled that unconscionability is a separate grounds for denying payment under an L/C. The court's argument was that unlike fraud, unconscionable conduct involves unfairness.[199] Nonetheless, a later case[200] set the extent to which this exception can be used, asserting that calling in the entire amount of the credit may be uncalled for since only the exceeding amount is found to be unconscionable.

6. *Illegal Underlying Transaction*

It is trite law that the autonomy principle should not enable the parties to circumvent statutes or contravene public policy.[201] Following a decision in *Old Colony Trust Co. v. Lawyers Titles' & Trust Co.*[202] it has been said[203] that Aston made the first reference to illegality as an exception to the autonomy of the L/C in *Pillans v. Van Mierop*.[204] The certainties of commercial law should not outrank public policy[205] and it is in the interest of society to prevent illegal conduct.[206] Infringing lending limits on credits,[207] violating ex-

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196 Jeffrey J. Browne, *The Fraud Exception to Standby Letters of Credit in Australia: Does it Embrace Statutory Unconscionability?*, 11 BOND LAW REVIEW (1999).

197 1 SLR 657 (2000), cited by Poh Chuh Chai, *Banking Law*, 26 SAL ANNUAL REVIEW (2000).

198 *See generally Raymond Construction Pte. Ltd. v. Low Yang Tong & Anor* (Suit 1715/1995, unreported judgment dated 11.7.1996); *Min Thai Holdings v. Sunlabel*, 2 SLR 368 (1999); *Sin Kian Contractor Pte. Ltd. v. Lian Kok Hong*, 3 SLR 732 (1999); and *GHL Pte. Ltd. v. Unitrack Building Construction Pte. Ltd. & Anor*, 4 SLR 604 (1999), cited *in* Adrian S. P. Wong, *Restraining a Call on a Performance Bond: Should "Fraud or Unconscionability" be the New Orthodoxy?*, 12 SINGAPORE ACADEMY OF LAW JOURNAL 153 (2000).

199 *Id.* Lai Kew Chai J. in *Raymond Construction Pte. Ltd. v. Low Yang Tong & Anor*.

200 *Id. Eltraco International Pte. Ltd. v. CGH Development Pte. Ltd.* [2004] 4 SLR 290.

201 Gordon B. Graham *et al.*, *Standby Credits in Canada*, 9 CANADA BUSINESS LAW JOURNAL 198 (1984).

202 See *supra* note 150, cited by Renee Martin-Nagle, *supra* note 83, at 324.

203 Alan Davidson, *supra* note 138, at 32.

204 *Id*.

205 Colman J. in *Balfour Beatty Civil Engineering Ltd. v. Technical & General Guarantee Company Ltd.*, 68 CON LR 180 (2000).

206 Gerald T. McLaughlin, *supra* note 99, at 310.

207 *Id. International Dairy Queen Inc. v. Bank of Wadley*, 407 F. Supp. 1270 (M.D. Ala) (1976). Dissenting the latter, see in general *City Nat'l Bank v. First National Bank & Trust Co.* and *First Am. Nat'l Bank v. Alcorn, Inc.*, 361 So. 2d 481 (1978).

change control laws[208] or disobeying government bans on payments to certain persons are common illegalities.[209] However, when the illegality in the transaction is solely trivial, the autonomy principle should not be superseded on the grounds of public policy.

In Mahonia Ltd. v. J. P. Morgan Chase Bank,[210] the court held that when an underlying transaction is illegal, the L/C resulting from this transaction would also be affected by any illegality. In this case, British courts refused to enforce the L/C supporting an alleged misdemeanor committed by the beneficiary, who was trying to obtain a loan of US$350 million by using the L/C in disguise without accounting for this debt in its books, thus violating the U.S. securities law. The reasons given were that since the L/C was part of the structure of the misdemeanor, the L/C is deemed to have an illegal purpose.

Likewise, in *Chuidian v. Phillipine Nat'l Bank*,[211] illegality and other reasons were argued as excuses for dishonoring an L/C. After the collapse of Philippine government in 1990, the Manila office of the Philippine National Bank refused to honor an L/C to be made available at the bank's branch in the United States on the strength of the government's ban order by applying principles of illegality, international comity and act of State. The L/C was securing a loan, the proceeds of which the applicant had invested in prohibited foreign securities. After the diversion was disclosed, the L/C was frozen by the new Philippine government. The California Central District Court concluded that the determination of illegality of the L/C depended on the jurisdiction under which the L/C was to be performed and since all the arrangements had taken place in the Philippines, dishonoring the commitment was allowed.

Another form of illegality that may imperil the autonomy principle is a preferential transfer in breach of a bankruptcy statute. Broadly speaking, the trustee or receiver in charge of the debtor's pool of assets can avoid the transfer of the debtor's assets within a certain period before the debtor enters into an insolvency procedure. This issue was the heart of the litigation in *In re Air Conditioning of Stuart, Inc.*[212] and later in *In re Compton Corp.*[213] In these cases, the applicant opened an L/C by giving security to the issuer

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208 Agasha Mugasha, *Enjoining The Beneficiary's Claim on a Letter of Credit or Bank Guarantee*, 5 JOURNAL OF BUSINESS LAW (2004).

209 McLaughlin argues that during Iranian crisis, President Carter ordered that all payments under L/Cs to Iranian beneficiaries should be made on blocked accounts. Gerald T. McLaughlin, *supra* note 99, at 310.

210 [2003] Commercial Court, cited by Jason Chuah, *Documentary Credits and Illegality in the Underlying Transactions*, 6 JOURNAL OF INTERNATIONAL MARITIME LAW 9 (2003).

211 734 F. Supp. 415 9 (1990), cited by Julia Anderson Reinhart, *Reallocating Letter of Credit Risks: Chuidian v. Philippine National Bank*, 18 N.C.J. INTERNATIONAL LAW & COMMERCIAL REGULATION 725 (1992-1993).

212 72 Bankr. 657 (1987), *aff'd in part and rev'd in part,* 845 F.2d 293 (1988).

213 831 F.2d 586 (1987), *reg'h granted*, 835 F.2d 584 (988).

and then later was subject to an involuntary bankruptcy proceeding. In these cases, the court decided to allow the issuer to pay the L/C and keep the collateral and allow the receiver to recover the amount of the credit from the beneficiary so that neither the autonomy principle nor the bankruptcy policy would be impaired.[214]

7. *The Mareva Injunction*

A general principle of law states that no debtor's assets can be foreclosed before delivering judgment.[215] Named after the *Mareva Compania Naviera v. International Bulk Carriers Ltd.* case,[216] the Mareva order is nothing more than an injunction that can be granted pre- or post-judgment[217] to freeze the defendant's assets until a final ruling has been made.[218] Courts have identified two basic requirements for awarding this relief: namely, an arguable or at least a *prima facie* case[219] and clear evidence of an eminent attempt on the debtor's behalf to dispose of the assets.[220] Not having assets within the jurisdiction of the awarding court is not an impediment for granting these orders since Canadian and British courts have asserted that courts can freeze the defendant's assets even if the assets are found outside their jurisdiction.[221]

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214 *Id.* This was also allowed in connection with Section 550 (a)(1) of the U.S. Bankruptcy Code pursuant to which a receiver is allowed to recapture "the value" of the property transferred in detriment of the debtor's assets.

215 A. Nico Oelofse, *supra* note 164, at 130.

216 2 Lloyd's Report 509 (1975). It originated in *Nipon Yusen Kaisha v. Karageorgis*, 1 W.L.R. 1093 (1975).

217 Simon Vaughan, *Moments to Savor in the Development of the Mareva*, 7 INTERNATIONAL BANKING LAW 101 (1988).

218 The origin of the order was equity. However, the 1981 Supreme Court Act encoded it in statutory form and was renamed as a freezing order even though British and U.S. courts still refer to it as a Mareva injunction. Jeffrey L. Wilson, *Three if by Equity: Mareva Orders and the New British Invasion*, 19 SAINT JOHN'S JOURNAL OF LEGAL COMMENTARY 673 (2004-2005).

219 A standard developed by Lord Denning in *Rasu Maritima S.A. v. Perusahaan Pertambangen* (1978) QB 644, cited by Simon Vaughan, *supra* note 217, at 102.

220 Michael Brandon, *Recent Developments in International Law Affecting International Transactions*, 15 INTERNATIONAL LAWYER (ABA) 630 (1981).

221 See generally *Silver Standard Resources Inc. v. Joint Stock Co. Geolog* (1988), 1998 CarswellBC 2725, [1988] B.C.J. No. 2887, 168 D.L.R. (4th) 309, 15 B.C.A.C. 262, 189 W.A.C. 262, 59, B.C.L.R. (3d) 196, [1999] 7 W.W.R. 289 (B.C.C.A.) at para. 23 [*Silver Standard*]; *Mooney v. Orr* (1994), 1994 CarswellBC 488, 98 B.C.L.R. (2d) 318, [1995] 1 W.W.R. 517, 33, C.P.C. (3d) 13 (B.C. S.C.[In Chambers]) additional reasons at (1994); *Hamza v. Hamza* 1997 Carswell Alta 723, [1997] A.J. No. 836, 29 R.F.L. (4th) 460, [1997] 9 W.W.R. 592, cited by David A. Crerar, *Mareva Freezing Orders and Non-Party Financial Institutions: A Practical Guide*, 21.2 BANKING AND FINANCE LAW REVIEW 173 (2006). However,

A Mareva injunction was first granted for a documentary obligation in the *Bhoja Trader* case.[222] In this case, Staughton lifted a previously granted injunction and replaced it with a freezing order that banned the defendants from disposing their assets and any other monies payable under the bond within the jurisdiction.[223] When this case reached the Court of Appeals, the injunction was dismissed to underpin the autonomy of the bond, which was to be paid in Greece. However, the arguments in this case urged the courts to consider the application of a Mareva injunction in *Z Ltd. v. A-Z and AA-LL*,[224] *Potton Homes Ltd. v. Coleman Contractors Ltd.*,[225] and *United Trading Corporation S.A. v. Allied Arab Bank Ltd.*,[226] though an injunction was not granted in their final resolution, or if it was, it was dismissed in the end. The precedent set by these rulings has led academics to assert that, although the nature of an injunction is based on court discretion,[227] there is no apparent reason why courts should refuse a Mareva injunction when it comes to documentary obligations provided that the jurisdictional requirements set forth in *Siskina (Cargo Owners) v. Distos Compania Naviera S.A.*,[228] and the guidelines put forward by the courts in *Third Chandris Shipping Corporation v. Unimarine S.A.*,[229] and *Z Ltd. v. A-Z and AA-LL*, are met. Therefore, the

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in *Ashtiani v. Kashi*, 3 WLR 647 (1986), Lord Justice Dillon argued that pre-judgment injunctions should be limited to assets within the jurisdiction since (*a*) it could very well be oppressive to the defendant for all his assets to be frozen regardless of their location as a result of an order of the British court; (*b*) a Mareva injunction over foreign assets would be difficult for British courts to police; (*c*) pre-judgment Mareva injunctions would involve an invasion of the absolute right to privacy; and (*d*) the object of the Mareva is not to give the plaintiff security for the amount of his claim, cited by Simon Vaughan, *supra* note 217, at 102.

222 See Albert J. Givray, *supra* note 104.

223 Peter S. O'Driscoll, *Performance Bonds, Banker's Guarantees and the Mareva Injunction*, 7 NORTHWESTERN JOURNAL OF INTERNATIONAL LAW & BUSINESS 398 (1985-1986).

224 *Id.* 1 Q.B. 558 (1982).

225 28 B.L.R. 19 (1984), cited by Howard Bennett, *Performance Bonds and the Principle of Autonomy*, JOURNAL OF BUSINESS LAW (1994).

226 2 Lloyd's Rep. 554 (1985), cited by Antony Pugh-Thomas, *supra* note 40.

227 Wilna Faul *et al.*, *The Mareva Injunction*, 2 SOUTH AFRICAN MERCANTILE LAW JOURNAL 305 (1990).

228 (1979) A.C. 210, in which the House of Lords ruled that for an applicant to succeed in obtaining a Mareva Injunction he may prove a pre-existing cause of action under English law different and separated from the action seeking the Mareva injunction. Cited by Peter S. O' Driscoll, *supra* note 223.

229 *Id.* at 395. I Q.B. 645 (1979). Such case described the guidelines that a plaintiff must follow in applying for a Mareva Injunction, namely, (1) give knowledge to the court of all material information related thereto; (2) provide the court with details about the claim specifically grounds, amount of the issue and points made by the defendant; (3) reasons implying that the defendant owns assets within the jurisdiction; (4) provide with reasons for believing that the defendant may dispose of his assets prior to receive a final judgment;

Mareva injunction can be used independently of any action directed at preventing the issuer from paying the credit as long as the requirements for this an injunction are met. Professor Goode argues that this injunction does not harm the autonomy principle because it only has a bearing on the proceeds of the credit that have been drawn down.[230]

V. Final Comments

When a seller agrees to open an L/C, he assumes that the last step he would have to take to obtain his money would be tendering the documents to the issuer.[231] Reality is much different. Being the favorite payment device for merchants does not make it perfect.[232] Every rule has it exception and the autonomy principle of the L/C is not exempt from this.[233] This paper has provided a brief outline of the major exceptions courts in major common law jurisdictions usually take into account when granting injunctions to prevent payment of an L/C. Broadly speaking, courts all over the world seem to only issue injunctions when the case is as serious as to "make it obviously pointless and unjust to permit the beneficiary to obtain the money."[234]

On the one hand, there are the position of *Sztejn*[235] and UCC that go beyond ensuring payment of an L/C and, on the other, we have British case law, which is so strict about exceptions (specifically fraud) that it has reached the point of not allocating the risks of the transaction among the parties, but solely allocating them on the applicant. All in all, the UCP[236] seems to have a more successful approach in regulating L/C transactions. Traders have not challenged its application since it establishes the required framework for enforceability, is sensitive to bankers' and businesses' needs, and complements international business practices.[237] Davidson argues that the UCP and the International Standard Banking Practice have intention-

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and (5) take liability to cover any damages resulting from the discharge of the relief or the lack of grounds for awarding the injunction.

230 *See generally* Roy Goode, *Reflection on Letters of Credit – II*, Journal of Business Law 378 (1980).

231 E. Peter Ellinger, *Tender of Fraudulent Documents*, 7 Malaya Law Review 27 (1965).

232 Yeliz Demir-Araz, *supra* note 2, at 134.

233 Charles Chatterjee *et al.*, *The Principle of Autonomy of Letters of Credit is Sacrosanct in Nature*, 5.1 Journal of International Banking Regulation 72 (2003).

234 See Official Comment to UCC 5-109 and *Ground Air Transfer v. Westate's Airlines*, 899 F 2d 1269 at 1272-1273 (1st Cir.) (1990), *cited by* Agasha Mugasha, *supra* note 208, at 535.

235 See *Sztejn*, *supra* note 54.

236 UCP 600, *supra* note 1.

237 Jose MA. Emmanuel A. Caral, *Lessons From ICANN: Is Self-Regulation of the Internet Fundamentally Flawed?*, 12 International Journal of Law and IT 4 (2004).

ally left the matter of fraud to the courts. "Jurisdiction and fraud are two matters which the UCP cannot deal with."[238]

The fraud exception has given courts a very difficult time. Nullity seems to have become the new fraud. It has been argued recently[239] that the fraud exception should disappear since the concept was misunderstood from the beginning. This argument relies on the fact that fraud has never been separate grounds for denying payment. Since fraud invariably involves documents, an inconformity with the credit often ensues, causing the issuer to deny payment in the first place under the strict compliance doctrine. Other academics argue that the fraud rule should be based on the premise of total failure of consideration.[240] If this argument is correct, it would be very difficult to distinguish the line between the fraud exception and a breach of the underlying contract. Another viewpoint argues that, in recent years, the fraud exception has been fashioned in such a way as to not erode the autonomy principle.[241] This paper suggests that the recent propositions are based on the wrong assumption that fraud came after the letter of credit as method of payment. Therefore, these efforts are unlikely to be completely successful. Fraud is a practice that began long before the letter of credit device was created. Moreover, there are other exceptions that could endanger the autonomy of the letter of credit. These exceptions are neither new nor have surfaced recently. The question is why they seem to pervade the letter of credit device. The answer is logical. The letter of credit device is flawed from its outset and like every tool or piece of machinery, maintenance and modernization is required; otherwise it will continue to be worn down until it is completely useless.

Academics argue that courts are rapidly developing exceptions to the L/C. The concern is that if this continues, the commercial function of the L/C as certain and prompt payment device[242] would no longer apply. This argument has led academics to contend that unless the courts are given guidance as to tethering the exceptions, the L/C as a payment device is doomed to disappear.[243] This conclusion would also coincide with the overarching

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238 Declaration of Dan Taylor, Vice President of the ICC Banking Commission, at the 2000 Annual Survey of Letter of Credits Law and Practice, New York, 9 March 2000, cited by Alan Davidson, *supra* note 138, at 33.

239 Andrew Borrowdale, *The Autonomy Rule and Fraud Exception in Documentary Credits*, 99 THE SOUTH AFRICAN LAW JOURNAL 139 (1982).

240 Menachem Mautner, *Letter-Of-Credit Fraud: Total Failure of Consideration, Substantial Performance and the Negotiable Instrument Analogy*, 18 LAW AND POLICY IN INTERNATIONAL BUSINESS 611 (1986).

241 Alan Davidson, *supra* note 138.

242 Richard F. Dole Jr., *Warranties by Beneficiaries of Letters of Credit under Revised Article 5 the UCC: The Truth and Nothing but the Truth*, 39 HOUSTON LAW REVIEW 375 (2002-2003).

243 Nadeem Faruqi, *Letters of Credit: Doubts as to their Continued Usefulness*, 8 N.Y.L. SCH. J. INT'L & COMP. L. 327 (1986-1987).

fact that an allegation of an exception generally delays the payment of a credit and carrying out an investigation on every credit would increase costs and place burdens on the issuers that they are not prepared to bear.[244]

Against the academics are the practitioners who contend that even when the documents imply a default in the underlying contract, buyers almost always waive the discrepancies and permit full payment to the beneficiaries of the L/C.[245] This line of reasoning would render the certainty of payment of an L/C a complete fallacy since empiric studies have proven the seller's right to be paid at all times at the buyer's discretion in waiving the discrepancies in the documents submitted by the seller.[246] Within this context, another optimistic viewpoint is that there are not many cases in which courts have awarded injunctions because the courts are not eager to interfere with the banks' business, making almost every exception practically useless. This position holds that even when a bank knows a payment demand is fraudulent, it would be obligated to pay the credit on the lack of evidence to support the issuer's wrongdoing. Banks seem to be prepared to pay beneficiaries that are able to produce documents that appear to conform to the credit[247] because they apparently have no other option. If issuers refuse to pay and the courts dismiss the argued exception, the courts would be liable towards the beneficiary for breach of contract. On the other hand, if the bank pays the credit, thus underpinning the independence principle, and the courts later determine that there was evidence of an exception, then the issuer may face liability towards the applicant. In this case, the credit would probably not be reimbursed and, were illegality present, liability may be claimed for criminal conduct.[248] Similarly, practitioners argue that the disputes arising from L/Cs are very sporadic since the good faith and reliability of the parties play a distinctive role.[249] The reality is that if the courts continue to interfere with credits, turning them into ancillary obligations, beneficiaries will be bound to look for other solutions, such as requiring only L/Cs issued or confirmed by banks within jurisdictions whose courts tend to respect the autonomy of an independent undertaking.[250]

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244 Stephen J. Leacock, *supra* note 4, at 912.

245 Ronald J. Mann, *supra* note 35.

246 *Id*.

247 Jason Chuah, *supra* note 210.

248 Gerald T. McLaughlin, *supra* note 99, at 310.

249 Stuart Cotton, *LOCs: Not Foolproof but Still Safe*, 88 BEST'S REVIEW 57 (1987).

250 John F. Dolan, *supra* note 46, at 270.

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