REMEDIES TO FRAUD IN DOCUMENTARY LETTERS OF CREDIT: A COMPARATIVE PERSPECTIVE

OPRAVNÉ OPATRENIA PRI PODVODOCH S DOKUMENTÁRNymi AKREDITÍVAMI: KOMPARATÍVNA PERSPEKTÍVA

Hamed ALAVI*

I. Introduction

It is customary to face with disputes while practicing international trade. Diversified nature of such disputes range from arguments over on performance of parties in the sales contract to delays in delivery, quality of goods sold and etc. Among others, payment problems consist a major area of disagreements in international business disputes. Fraud is a common justification for importer (buyer) to refuse payment when documentary letter of credit is method of payment in international sales contract and courts of different jurisdictions have extensive experience in facing with LC fraud disputes(1). In principle to apply fraud exception to in

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II. International Legal Frameworks on LC Fraud Exception

II.1 UCP’s view

The Unified Customs and Practices for Documentary Letters of Credit (currently UCP 600) were published by ICC for the first time in 1933. UCP is considered as one of the most successful private initiatives in regulating international trade practice. Article 5 of the UCP has recognized the principle of autonomy in LC transaction by emphasizing that bank deals with documents not goods and liability of bank is limited to presentation of complying documents. However, it takes an absolute silent position towards fraud and leaves it open for national laws. To justify their approach, ICC authorities point at different ways to address the problem of abusive demand and fraud in different jurisdictions and consider protection of parties in good faith as responsibility of national courts. Many scholars confirm the sensitivity of fraud and different approaches of national jurisdictions to it by considering the silent approach of UCP to fraud exception as a ground-breaking success. They argue that current approach of UCP to fraud encourages national courts to deal with this problem with no negative effect on the market position of Documentary Letters of Credit as popular trade finance tool in international trade. In the same vein, Goode comments “the content and explanation of ICC Uniform Rules are influenced by the fact that these uniform rules are rules of best banking practice, not the rules of law... while fraud is ‘the province of the applicable law of the courts of the forum’”. This would convey the meaning that despite recognition of the problem of fraud by drafters of UCP, they have intentionally set it aside.

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(1) UCP 600, Article 5.
(4) Principle case of Szép vs Henry Schroder Banking Corporation was the first authority, which applied the fraud exception to independence principle of documentary letters of credit.
Leacock considers UCP approach to LC fraud as “unqualified liability” (13). He further explains that with reference to independent principle, paying bank does not have any liability to beneficiary’s fraud in case of paying against confirming documents even after receiving notice from applicants (14).

However, UCP’s silent approach to fraud has been criticized by other scholars on the basis that regulations should provide secure and predictable environment for trading partners, where different approaches of national laws to fraud is unsatisfactory as there is not provide certainty for businessmen who intend to enter international trade (15). Inclusion of fraud rule in UCP is one of the recommend solutions for non–harmonized approaches of national laws to this problem (16). Drafting a set of transnational trade law with special focus on non–harmonized aspects of international LC operation including fraud is another scholarly proposal (17) which does not seem realistic due to time consuming process of ratification of such draft by different nations (18). In brief, fraud exception is excluded from UCP and left under the discretion of national law. This approach of ICC has been denounced by some scholars who consider it as a reason for uncertainty in international trade while others call it as successful step towards increasing international marketability of Documentary Letters of Credit (19).

II.2 UNCITRAL Convention’s View

In late 1995 the United Nations Convention on Independent Guarantees and Standby Letters of Credit came into force with the goal of facilitating the function of Independent Guarantees and Standby Letters of Credit in international trade (20). The Convention is effective in contracting States (21) and despite the fact that its scope is limited to demand guarantees and standby letters of credit, it has application to Commercial Documentary Letters of Credit as well (22). This convention is the first international effort to address the problem of fraud in international LC transaction and three of its articles (article 13, 19 and 20) directly deal with abusive and fraudulent demand for payment under standby letters of credit and independent guarantees plus ways to prevent them. Therefore, Convention is considered a supportive regulatory framework to UCP (23). However; the word fraud has not been mentioned throughout the convention following the logic of preventing confusions, which may result from different interpretations of the term in different jurisdictions (24).

Article 13 is the guideline for beneficiary in making the demand under standby letters of credit and independent guarantees. It refers to condition under which beneficiary’s demand can be prevented: “[i]f the beneficiary, when demanding payment, is deemed to certify that the demand is not in bad faith (for example by providing confirmation letters from an authorized inspection firm regarding compliance of shipped consignment with terms of LC) and that none of the elements referred to in subparagraphs (a), (b), and (c) of paragraph 1 of article 19 are present.” (25).

Article 19 titled “Exceptions to payment obligation” provides list of situations, which provides issues with choice of refusal, demanded payment by beneficiary. Paragraph (1) provides that: ‘Any document is not genuine or has been falsified; no payment is due on the basis asserted in the demand and the supporting documents; or judging by the type and purpose of the undertaking, the demand has no conceivable basis.’ (26). Paragraph 2 explains the meaning of “no conceivable basis” (a) The contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialised; (b) The underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking; (c) The underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary; (d) Fulfilment of the underlying obligation has clearly been prevented by willful misconduct of the beneficiary; (e) Or in the case of a demand under a counter–guarantee, the beneficiary of the counter–guarantee has made payment in bad faith as guarantor/issuer of the undertaking to which the counter–guarantee relates” (27).

Further, paragraph (3) of the same article provides that: “in the circumstances set out in subparagraphs (a), (b) and (c) of paragraph 1 of this article, the principal/applicant is entitled to provisional court measures in accordance with article 20 (28). Scholars consider article 19 of convention successful in achieving it political and technical objectives (29).
Article 20 continues with providing possibilities for court action under the title of “Provisional court measures”.

1. Where, on an application by the principal/applicant or the instructing party, it is shown that there is a high probability that, with regard to a demand made, or expected to be made, by the beneficiary, one of the circumstances referred to in subparagraphs (a), (b) and (c) of paragraph I of article 19 is present, the court, on the basis of immediately available strong evidence, may: a. issue a provisional order to the effect that the beneficiary does not receive payment, including an order that the guarantor/issuer hold the amount of the undertaking, or b. issue a provisional court order to the effect that the proceeds of the undertaking paid to the beneficiary are blocked, taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm.

2. The court, when issuing a provisional order referred to in paragraph I of this article, may require the person applying therefor to furnish such form of security as the court deems appropriate.

3. The court may not issue a provisional order of the kind referred to in paragraph I of this article based on any objection to payment other than those referred to in subparagraphs (a), (b) and (c) of paragraph I of article 19, or use of the undertaking for a criminal purpose.(30)

From technical point of view, the Convention is successful in addressing major aspects of fraud rule developed by national courts in addition to offering a precise and useful guidelines. Article 19 (1) lists types of misconduct by beneficiary, which result in application of fraud rule both under LC contract and underlying sales contract. Also Convention provides guidance for actions which victim of fraud can take in paragraph 1 of article, may require the person applying therefor to furnish such form of security as the court deems appropriate.

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III. National Laws Approach to LC Fraud Exception

III.1 The American View

In this section, American approach to LC fraud will be reviewed. In doing so, principle case of Sztejn v. J. Henry Schroder will be studied. Sztejn case is known for laying the foundation of LC fraud exception in the United States of America and also in England. Further, Article 5–109 of Unified Commercial Code as statutory body of law, which regulates Fraud in LC operation in the United States and grant of injunction as a judiciary remedy to fraud will be analysed.

**Sztejn v. J. Henry Schroder banking Corporation**

This is the leading case on fraud rule in the United States of America that seriously affected the development of fraud exception in documentary letters of credit.(36) Another importance of Sztejn case is being a reference in the process of codification of 1962 version of UCC as well as being the principle authority for latter cases on fraud in LC operations.(37) Gao refers to Sztejn case as “it shaped the fraud rule in virtually all jurisdictions”.

In this case, based on the international contract of sale between Sztejn (the buyer) and Transea Traders Ltd (the Seller), documentary letter of credit issued by Schroder (the issuing bank) as the method of payment with the draft drawn by issuing bank on the Chartered bank (presenting bank). Before presentation of documents to the bank, applicant (Sztejn) demanded court for granting injunction against beneficiary based on receiving “cow hair, other worthless material and rubbish with intent to simulate genuine merchandise and defraud the plaintiff”. Sztejn also named Chartered bank as collecting bank not the holder in due course of the draft issued by issuing bank. Justice Shieftag of the New York Court of Appeal considered all allegations in case as true and rejected to motion of Chartered Bank to dismiss the compliant of Sztejn on the basis of two arguments: allegation and established fact of fraud being committed within the framework of underlying contract. His statement started as following:

“It is well established that a letter of credit is independent of...”

dependent Undertakings and Standby Letters of Credit’, 33 Int’l Law 831 (Fall), p. 843.
(37) In 1964 version of ULC fraud rule was under Article 5 section 5–114 but after revision of 1995 it is under Article 5, section 5–109.
(38) In 1996 version of ULC fraud rule was under Article 5 section 5–114 but after revision of 1995 it is under Article 5, section 5–109.
(39) 31 NYS 2d 631 (1941).
the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade (40).

And continued on necessity to overrule the principle of independence in case of committing fraud by beneficiary:

“Of course, the application of this doctrine [the principle of independence] presupposes that the documents accompanying the draft are genuine and conform in terms to the requirements of the letter of credit.

However, I believe that a different situation is presented in the instant actions. This is not a controversy between the buyer and seller concerning a mere breach of warranty regarding the quality of the merchandise; on the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, where the seller’s fraud had been called to the bank’s attention before the drafts and documents have been presented for payment, the principle of the independence of the bank’s obligation under the letter of credit should not be extended to protect the unscrupulous seller. Although our courts have used broad language in the effect that a letter of credit is independent of the primary contract between the buyer and seller, that language was used in cases concerning alleged breaches of warranty, no case has been brought to my attention on this point involving intentional fraud on the part of the seller which was brought to the bank’s notice with the request what it withhold payment of the draft on this account” (42).

Court dismissed the motion of Chartered Bank against complaint of plaintiff and granted injunction to Szejn:

“Transeas was engaged in a scheme to defraud the plaintiff..., that the merchandise shipped by Transeas is worthless rubbish and that Chartered Bank is not an innocent holder of the draft for value but is merely attempting to procure payment of the draft for Transeas’s account” (43).

The case of Szejn is also important for recognizing the immunity of the holder in due course as well as bank security as a supporting reason in application of fraud exception:

“While the primary factor in the issuance of the letter of credit is the credit standing of the buyer, the security afforded by the merchandise is also taken into account. In fact, the letter of credit requires a bill of lading made out to the order of the bank and not the buyer. Although the bank is not interested in the exact detailed performance of the sales contract, it is vitally interested in assuring itself that there are some goods represented by the documents” (43).

“On this motion only the complaint is before me and I am bound by its allegation that the Chartered Bank is not a holder in due course but is a mere agent for collection for the account of the seller charged with fraud. Therefore, the Chartered Bank’s motion to dismiss the complaint must be denied, if it had appeared from the face of the complaint that the bank presenting the draft for payment was a holder in due course, its claim against the bank issuing the letter of credit would not be defeated even though the primary transaction was tainted with fraud”.

Injunction
Injunction in the United States of America is court order which obliges enjoined party refrain or perform an action (45). Federal Rules of Civil Procedure 65 (FRCP) defines two types of temporary injunctive relief as preliminary injunction and temporary restraining order. Preliminary injunction is granted in a hearing and after notice to enjoined party where applicant has sufficient proof for preserving status quo till final hearing. Temporary Restraining Order preserve the status quo for defined number of days and it might be granted without notice of enjoined party. Both type of injunction can be named interlocutory injunction (46). Permanent injunction is another judicial remedy to be granted on the basis of merit after trial (47).

Article 5 of the Unified Commercial Code
Article 5 of the Unified Commercial Code is governing the operation editorial board which published commentaries which are often cited by judges as an authority for explanation of different provisions (48). Article 5 of the current version of UCC is fully allocated to Documentary Letters of Credit (49). Drafting committee was following the goal of finding a way for further harmonization of US law with international regulations besides flexibility in practice to meet technological changes and keep the competitive position of LC in international trade. Article 5 of the UCC also contains relevant provisions in LC fraud exception (49).

Current Article 5–109 is titled “Fraud and Forgery” covers circumstances necessary for granting interlocutory injunction the text of article such circumstances as following:

“(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honour of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant: (i) the issuer shall honour the presentation, if honour is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honoured its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer’s or nominated person’s deferred obligation that was taken for value and without notice of forgery or material fraud after the obliga-

(44) UCC, Article 5 - 109.
tion was incurred by the issuer or nominated person, and (2) the issuer, acting in good faith, may honour or dishonour the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honour of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honouring a presentation or grant similar relief against the issuer or other persons only if the court finds that: (1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer; (2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted, (3) all of the conditions to entitle a person to the relief under the law of this State have been met; and (4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honour does not qualify for protection under subsection (a) (1).

Text of UCC article 5-109 follows two main directions of "fraud immunisation" and "fraud exception" (50). An important aspect of Article 5–109 (a) is clarification of the fact that fraud is applicable both to forgery in documents stipulated in the Credit and in underlying sales contract. Article also comments on necessity of fraud to be material in order to issue injunctive relief. However, it does not define what does it mean for fraud to be material? Whereby, official comment on the Article provides: "the beneficiary has no colourable (meaningful) right to expect honour and where there is no basis in fact to support such a right to honour" (51).

Neither text of article 5–109 nor its official commentary refers to intention of beneficiary to defraud. As a result, it has been argued that UCC article 5–109 has focus on seriousness of fraud in the course of transaction not beneficiary’s intention and state of mind (52). It is clear from the official commentary that standard of proof for fraud is set high and mere suspicion of fraud by beneficiary does not affect the court decision to interrupt the regular operation of LC by issuing stop order payment to bank (53). Unlike American law, there is no statute regulating LC fraud rules in England and this area of law has been consistently governed by case law from late 1970s till today (54). English law does not have any definition for fraud and court should conclude its establishment on the case to case basis. However, according to existing authorities, there are four main types of LC fraud disputes distinguished in English Law. First, beneficiary sues the bank on the basis of bank’s rejection to pay despite receiving compliant presentation. Second, Bank has payed beneficiary, however, sues beneficiary due to presentation of fraudulent documents and request for restitution of the payment. Third, paying bank sues the issuing bank in request for reimbursement after effectuating the payment, and refusal of issuing bank to reimburse on the basis of fraud. Finally, before effectuating the
payment by bank, applicant request interlocutory injunction from court to stop bank from payment on the basis of beneficiary’s fraud.(64)

In similar way to American Law, it seems that under English law injunction is the most popular legal relief sought by applicant against either bank or beneficiary in cases of LC fraud. However, restrictive approach of English courts to interfere in independence principle of Documentary Letters of Credit creates doubt in usefulness of such remedy. This section explores non–harmonious approach of English courts to different types of LC fraud disputes with special focus on procedural aspects of interlocutory injunction in England.

Bank’s rejection to pay

Upon presentation of confirming documents by beneficiary, issuing bank and conforming bank if any has the duty to honour the presentation.(65) In case of bank’s decision not to effect the payment to beneficiary, it should prove the establishment of fraud based on existing standard of proof introduced by English Courts(66) (discussed in injunction chapter of current paper). However, it is rare that the bank refuses to honour the credit on its own initiative.(67) Banks generally do not reveal fraud and the information and instructions about fraud come from account party. After receiving allegation of fraud from account party, bank has the option to pay or not. In case it decides to effect the payment, obtaining the injunction from court to stop bank from payment on the basis of beneficiary’s fraud,(68) beneficary or entitlement against the account party to effect the payment is subjected to the higher standard than what is required in CPR 24.2. Therefore, for court, it is not sufficient that bank can show a real prospect of successfully establishing fraud in its defence. In addition, bank is required to prove the real established fraud “which has the capability of being clearly established at the interlocutory stage”(70). In occasions that bank does not resist payment on the basis of fraud rule like refraining to pay based on invalidity of letter of credit, it would be sufficient to satisfy the normal standard(71) while trying to show the real prospect of success under CPR 24.2.

Bank’s Entitlement for Reimbursement

General rule is that the bank, which has paid against confirming presentation, is entitled for reimbursement. However, in case of fraud, bank has no obligation against beneficiary or entitlement against the account party to effect the payment. In case of payment in such circumstances, bank cannot claim for reimbursement.(69) However, the bank, which does not have information about the fraud of beneficiary, will not be prejudiced.

In the case of Angelica–Whitewear Ltd v Bank of Nova Scotia(72) which was referenced by English courts, Le Dien J. from the Supreme court of Canada argued that it case of improperly paid draft by issuing bank the standard of proof for fraud should be set in the question that “Whether fraud was so established to the knowledge of issuing bank before payment of the draft as to make the fraud clear or obvious to the bank”.(78) According to Le Dien J. standard of proof for such cases was different from standard of proof when applicant is trying to obtain interlocutory injunction against bank to restrain the payment to the beneficiary. He explained that in latter case the “strong prima facie test will apply”.(79)

As it was discussed before, it can be understood that the bank which is trying to resist summary judgement against the payment to beneficiary is subjected to the higher standard of proof. However, this does not apply in the occasion that applicant, issuing bank or confirming bank try to resist the summary judgement as a result of being sued for reimbursement by the bank which has paid the fraudulent beneficiary.(80) In such occasions, defendant is expected to provide a real prospect of existing fraud and satisfy the normal test of CPR Part 24.2 at trial.(81)

(64) Malek A & Quest D (2009), 'Documentary Credits - The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees' 4th ed, Tottel, para 9.2, pp. 207–208.
(65) Malek A & Quest D (2009), 'Documentary Credits - The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees' 4th ed, Tottel 264.
(66) Ibid.
(68) Ibid 33.
(69) Ellinger P. Noe. D. (2010 ), 147
(72) Banque Saudi Fransi v Lear Siegler Services Inc[2007] 2 Lloyd’s Rep 47.
(73) Ibid. 31–32.
(74) Ibid 33.
(75) Ibid. 32.
(76) Ibid, 31–32.
(78) Ibid, 59, 84.
(79) Ibid.
(80) Ibid.
(81) Ibid.
In case of Banque Saudi Fransi v Lear Siegler Inc\(^{(82)}\), the issuer of a performance bond was seeking for summary judgement against the instructing party who provided a counter indemnity. After making the payment to the beneficiary defendant, issuing bank raised the defence of not being bound for payment under the country indemnity due to dishonest claim of the beneficiary. In trial, defendant managed to successfully resist against the summary judgement by showing the real prospect, which was clearly established\(^{(83)}\). In the above decision, it is implied that although, beneficiary might successfully obtain the summary judgement against bank as a result of bank’s failure to establish a clear evidence of fraud, there is no guarantee that bank can in return obtain summary judgement for receiving reimbursement against the instructing party. Because the instructing party should only meet requirements of the low test of real prospect of fraud in the trial.\(^{(84)}\)

Fraud in deferred payment obligations

Under the deferred payment credits, the nominated bank has the obligation to pay on the maturity date in accordance with the credit terms. As under deferred payment system there is no immediate payment available to seller till the date of maturity of credit, the seller is responsible to ship goods and expects payment on maturity. Such process will impose financial burden on seller. Therefore, market demand in similar conditions resulted in creation of forfaiting practice. In forfaiting practice, nominated bank may agree to discount the beneficiary’s documents and expect reimbursement from issuing bank on maturity date. In case of beneficiary’s fraud before the maturity date, applicant and issuing bank will definitely try not to reimburse the nominated bank, which has paid to fraudulent beneficiary. Despite the fact that establishment of beneficiary’s fraud will depend in facts of each individual case and in addition guideline for interbank reimbursements under deferred payment is provided by UCP 600, it worth to review the right and obligations of involved financial institutions under deferred payment before and after coming into force of the UCP 600.

**Banco Santander SA v Banque Paribas**

In Banco Santander SA v Banque Paribas, the fraud of beneficiary created serious problems for Santander, which was the confirming bank under the deferred payment arrangement\(^{(85)}\).

In 1980 Napa Petroleum Trade applied to open a deferred payment credit at Banque Paribas in favour of Bayfern Ltd. Based on the request of Paribas, Banco Santander advised the credit as nominated bank to beneficiary. Later, Banco Santander decided to add its confirmation to the credit. The deferred payment was due 180 days after issuing the bill of lading. Beneficiary presented confirming documents to Santander on 15 June 1998. According to the credit arrangement, Paribas as issuing bank and Santander as confirming bank had the duty to pay the beneficiary on 27 November 1998. However, Santander agreed to discount the credit before maturity. Therefore, Santander discounted the credit and sum of payment minus discounting fee was transferred to the Bayfern’s account. Bayfern irrevocably assigned Santander to its rights under the credit. However, before the date of maturity, Paribas informed Santander about presentation of forged documents by beneficiary and refused to reimburse Santander on maturity. Santander sued the Paribas and the trial judge ruled in favour of Paribas as Bayfern assigned its rights under the credit to Santander. The Court of Appeal confirmed the judgment of trial court as an assignee of Bayfern. Santander has no better position than assignor given that in case of non-discounting credit, Santander would not face any risk due to refusal of Paribas based on beneficiary’s fraud. Alternative argument of Santander as holder the position of confirming bank was rejected by court because under UCP500 issuing bank was only undertaking to reimburse nominated bank in case of honouring the deferred credit at maturity. Judgement of Banco Santander v. Banque Paribas was an unwelcomed decision in the international banking society as banks were regularly discounting deferred payment credits. However, after coming into force of the UCP 600, it addressed the issue of deferred discounted payments under article 7(c) and Article 12 (c). The article 7 (c) holds that assignment of rights from the beneficiary to the discounting bank is not necessary anymore and as a result, bank is entitled for reimbursement at the maturity date.

“Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity”\(^{(86)}\)

The new Article 12 (c) of the UCP 600 has been the subject of many discussions among commentators. The debate is on the impact of the authorization. There is an argument among commentators who consider this new rule as legal basis for mitigating the risk of fraud between the date of payment and maturity date while others consider it as a right given to the nominated bank, which might be used under its own discretion and definitely on its own risk.\(^{(87)}\)

by nominating a bank to accept a draft or incur a deferred payment undertaking, an issuing bank authorizes that nominated bank to pay or purchase a draft accepted or a deferred payment undertaking incurred by that nominated bank.\(^{(88)}\)

The most important objections are made by commentators who consider that UCP 600 is setting aside Banco Santander and similar cases. “Produced the undesirable result of effectively removing a useful option or risk apportionment”.\(^{(89)}\)

Injunction

According to the independence principle, courts should not...
interfere in the process of documentary credit and demand guarantees operation and grant injunction unless a recognized exception is established(90). Under English legal system, injunction is recognized as an equitable remedy in private law; therefore, court has discretion whether or not to grant it(91). Injunction has a prohibiting nature, which means to stop doing, repeating or continuing, an act or to undo an act with wrongful nature(92). There are two main types: interlocutory and perpetual injunctions in English law. The interlocutory ones also known as pre-trial or interim intend to preserve the status quo before going to trial. However, perpetual injunction will be granted after approval of the applicant’s case in trial(93). As it will be explained later, a Freezing order or Mareva Injunction is “an order of the court restraining a party to proceedings from removing assets from the jurisdiction of the court or otherwise dealing with assets located within the jurisdiction and, in more limited circumstances, from dealing with assets outside the jurisdiction(94)”. From the explanation, it is clear that Mareva Injunction is also a type of interlocutory injunction. It follows the objective of preventing actions against judgment by transferring assets out of jurisdiction or disappearing them within jurisdiction(95). Freezing order can be granted as ex parte and without notice of beneficiary(96).

Since it will be really difficult for account party to recover payment in cases of real LC fraud, interlocutory injunctions provide some remedy for affected party by prohibiting payment to beneficiary. When there is doubt about fraudulent conduct of beneficiary, applicant may apply to court for interlocutory injunction against beneficiary, paying bank or both of them. However, application for injunction against beneficiary should be done before presentation of stipulated documents in the credit to the bank. After presentation of documents by beneficiary, it is only possible to require granting injunction against bank. This section will review approach of English legal system to interlocutory injunction when there is allegation of fraud in international operation of Documentary Letters of Credit.

Legal basis for granting injunction under English Law

Under the section 37 of the Senior Court’s Act 1981, The High Court may order (whether interlocutory or final) to grant injunction in all cases in which it seems to the court to be just or convenient to do so(97). Power of the High Court to grant interim injunction in support of foreign proceedings under section 25(1) of the Civil Jurisdiction and Judgement’s Act 1982(98). Therefore, account party has the right and option to require court for issuing interim injunction in order to restrain beneficiary from demanding money under the demand guarantee or letter of credit which is payable in England in support of foreign proceedings. However, it is not easy to obtain injunction against the beneficiary or paying bank under English law. So far only three cases have managed to obtain injunction: Themehelp Ltd. v West(99), Kavaerner Jhon Brown Ltd v Midland Bank Plc(100), Lorne Stewart Plc v Hermes Kreditversicherungs AG(101). The general principles for granting injunction were set out in the case of American Cyanamid Co v Ethicon(102) based on the speech of the Lord Diplock: ‘applicant faces two main problems in application for interim injunction. First of all, he has to show an arguable claim against the party he is trying to enjoin. For this purpose, applicant should establish the fact that party owes him a duty either in contract or in tort against which that duty fraud is taking place and being enough evidences that beneficiary is knowledge about taking place of fraud(103). Besides it should be proved that granting the injunction by bank is correct practice and will pass the test of balance of convenience.

There have been arguments on contradictory nature of intervening in the process of bank’s operation via granting of interim injunction with independent principle. As a result, it was suggested that independent principle will not be violated in case of granting injunction against beneficiary to prevent demand on documentary credit or demand guarantee. A similar view was taken by court in the court of appeal of the Themehelp Ltd. v West(104). In that case, the Court of Appeal ruled for granting injunction against the beneficiary of a demand guarantee in order to restrain him from demanding payment on the basis that the underlying contract was affected by fraudulent misrepresentation of him. However, the Themehelp Doctrine has been criticized heavily on the basis that enjoining beneficiary for demanding payment violates the assurance of payment provided by letter of credit. There will be no difference for beneficiary to be prevented from receiving payment by being enjoined from court or because of an injunction preventing the bank to pay him(105). In addition majority decision in Themehelp did not receive any judicial support from succeeding cases for example it was rejected in the cases of Group Josi Re v Wallbrook Insurance Co Ltd and Others(106), Czarnikow-Rionda Sugar Trading Inc v Standard Bank London(107), and Sirius International Insurance Corp

(97) Themehelp Ltd v West and Others [1996] QB 84.
(99) Themehelp Doctrine has been criticized heavily on the basis that enjoining beneficiary for demanding payment violates the assurance of payment provided by letter of credit. There will be no difference for beneficiary to be prevented from receiving payment by being enjoined from court or because of an injunction preventing the bank to pay him.
(102) Ibid.
(103) Themehelp Ltd v West and Others [1996] QB 84.
v FAI General Insurance Co. Ltd. Even May LJ in the case of Sirius International Insurance Corp v FAI General Insurance Co. Ltd, with whom the other members of the court of appeal agreed, considered the decision of Themehelp as questionable.

The standard of proof
When account party is looking for injunction to prevent beneficiary from demanding payment or bank from enforcing payment on the basis of fraud exception, the first necessary step to take is meeting the standard of proof. In the case of United City Merchants (Investment) Ltd v Royal Bank of Canada, the standard of proof for fraud was considered when Lord Diplock held the requirement as “Clear, obvious, or established fraud known to the issuer or confirmor of the letter of credit.” Also Ackner LJ, in the case of United Trading Corp. SA v Allied Arab Bank Ltd laid down the standard of “only realistic inference” in order to provide an alternative to the “clear evidence” provided by Lord Diplock in United City Merchants. Ackner LJ further emphasized that:

“The evidence of fraud must be clear, both as to the fact of the fraud and as to the [guarantor’s] knowledge. The mere assertion or allegation of fraud would not be sufficient…We would expect the court to require a strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer.”

Court also commented:

“for the evidence of fraud to be clear, it would be expected that the buyer was given the necessary opportunity to answer the allegation against him and he (buyer) fails to provide any, or any adequate answer in circumstances where one could properly be expected. If the court considers that on the material before it the only realistic inference is satisfying the balance of convenience.”

Other similar position was taken by Mance LJ in The Court of Appeal of Solo Industries UK Ltd v. Canara Bank. Mance LJ while responding to the contention of bank to prevent the beneficiary from demanding payment or bank from enforcing payment on the basis of fraud exception, the first necessary step to take is meeting the standard of proof. In the case of Solo Industries UK Ltd v Canara Bank, the standard of proof for fraud was considered when Lord Diplock held the requirement as “Clear, obvious, or established fraud known to the issuer or confirmor of the letter of credit.” Also Ackner LJ, in the case of United Trading Corp. SA v Allied Arab Bank Ltd laid down the standard of “only realistic inference” in order to provide an alternative to the “clear evidence” provided by Lord Diplock in United City Merchants. Ackner LJ further emphasized that:

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The main reasons against granting injunction can be named as resistance of adequate remedies for damages, imminent expiry date of credit, availability of freezing injunction and availability of final accounting between parties.

Mareva Injunction or Freezing Orders
It can be concluded from the discussion above that English courts are not willing to interfere in operation of Documentary Letters of Credit by issuing Interlocutory Injunction. However, there is possibility for plaintiff to apply for Freezing Order against belongings of the beneficiary. Since freezing orders are also of the interlocutory nature, English courts are prudent in granting them and numerous conditions should be satisfied by applicant for obtaining it.

The first is that the plaintiff should show a substantive cause of action against the defendant. Judgement of Fourie v. Le Roux has approved this requirement, which was
raised for the first time in the case of Siskina (128). Second, a good arguable case must be established in order to grant freezing orders. This requirement was established in case of Ninemita Maritime Corp. v. Trave Schiffahrtsgesellschaft & Co (127). Third, plaintiff should provide court with evidence that in cases of not restraining defendant’s assets, there is a real risk for removing them out of jurisdiction before enforcement of judgement (128). Since assets should be located in England (129), plaintiff should prove that defendant’s assets are present within the jurisdiction (130). Fourth, in case of considering freezing order as unjustified, plaintiff must have access to sufficient financial resources to cover damages (131). Exceptionally, it is possible to obtain freezing order despite access to limited financial resources (132). Fifth, all relevant information, which can affect the process of granting enforcement of judgement (133). Since 1988, issuing international freezing orders by English courts have gained more importance (134). There are three elements involved in international freezing orders: a defendant subjected to doing business who is located either within the jurisdiction or abroad (135). One of the main problems on the way of obtaining international freezing order is convincing the court on “just and convenient nature” of the plaintiff’s claim due to oppressive effect of internationally enforcing court order on defendant who is located in a different jurisdiction (136). Granting freezing orders will become crucial when defendant is located in the foreign jurisdiction or his assets in domestic jurisdiction are not sufficient (137). Since 1988, issuing the globally effective freezing orders by English courts gain more importance (138). There are three elements involved in international freezing orders: a defendant subjected to domestic jurisdiction, assets located abroad, third party with control over assets who is located either within the jurisdiction or abroad (139). One of the main problems on the way of obtaining international freezing order is convincing the court on “just and convenient nature” of the plaintiff’s claim due to oppressive effect of internationally enforcing court order on defendant who is located in a different jurisdiction (139). Second issue is relevant to the third parties affected by global freezing orders. Generally, international banks are affected with such orders (140) and when such third parties are involved, enforceability of freezing order issued by English court in another jurisdiction is a valid question (141). In general manner, banks are not subjected to freezing orders (142) as such orders will create inconvenience for their normal business process and place the customer’s confidence to bank in danger (143). Other problem is enforcing third party in a other jurisdiction to obey a court order issued by a foreign court. It has been argued that inserting a term in the court order, which binds parties who can obey, and excuse orders can be a solution to this problem (144).

In conclusion, English courts have a restricted approach in interfering with autonomy principle of Documentary Letters of Credit. Despite existence of remedies like interlocutory injunction and freezing order, difficulties on the way of obtaining them in LC fraud cases create doubts about their effectiveness. Possibility to obtain global freezing order can be a relief in LC fraud cases for trades involved in international business. However, granting them is under the discretion of court and subjected to precondition of being “just and convenient”.

IV. Conclusion

Current paper discussed the possible access to remedies for affected party in case of fraud in Documentary Letters of Credit from a comparative perspective. For this purpose, paper has been divided into two main parts: part one studied problem of LC fraud from the lens of international regulations by scrutinizing approaches of Uniform Customs and Practices of Documentary Letters of Credit and UNCITRAL Convention on Standby Letters of Credit and Demand Guarantees. Part two reviewed English and American law perspectives on the subject matter. UCP is silent regarding fraud and leaves the ground open for national laws. UNCITRAL Convention does not use the term fraud. However, within the framework of article 15,19 and 20 defines condition under which payment can be prevented and provisional measures which can be taken by court.

Under American Law, LC fraud is regulated in Article 5–109 of the Unified Commercial Code which defines standard of proof for court and remedies for affected party. According to article 5–109 of UCC, injunction is the main remedy for LC fraud in the United States of America while scope of beneficiary’s fraud include forgery in presented documents as well as fraud in underlying sales contract. Injunction has been considered a remedy because in case of effectuating payment
by bank, account party will have very limited chance for re-
turning the money from fraudulent beneficiary. Although, 
granting injunction is not easy in the United States, but its 
seems to be more difficult to obtain such remedy under En-
lish Law. LC fraud is regulated under case law in England. 
Despite the fact that English law also considers injunction as 
the main remedy for affected party before granting the final 
court order, scope of fraud in England is limited to forgery 
in presented documents by beneficiary to bank. Such limited 
scope of fraud rule has roots in historical tendency of English 
courts neither to interfere in smooth operation of interna-
tional trade nor undermine the absolute application of in-
dependence principle in LC operation. Also high standards 
of proof for establishing fraud in court and limited access of 
applicant to interlocutory injunction in English legal system 
create doubts about usefulness of such remedies. Freezing 
orders (domestic and international) are alternative remedies 
for LC fraud in England, which affected parties, hence their 
advocates should keep that in mind. However, they should 
remember that English courts demand specific requirements 
for granting such remedies which are principally different 
from requirements for granting injunction. Therefore, it is 
recommended to plaintiff to define his defence strategy on 
the basis of either remedy from the beginning.

Therefore, it is recommended to parties in international 
trade to be aware of availability of remedies for fraud in ap-
licable law to their contract and requirements for granting 
them, which are not the same in different jurisdictions.

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