

- 1 [1922] 1 KB 318 at 321, 322.
2 (1923) 14 Ll L Rep 586.
3 (1923) 14 Ll L Rep 586 at 588.
4 See para 5.8 et seq below.

2.11 Where a contract of sale calls for an irrevocable credit to be opened in London, a credit which is advised through a London bank which does not confirm it does not satisfy the contract, since the London bank gives no undertaking: *Enrico Furst & Co v WE Fischer Ltd*.¹ However, the objection must be taken in time by the seller; in *Enrico* a request by the seller for an extension of the credit was held to be a waiver. See paras 3.4 to 3.7 below.

- 1 [1960] 2 Lloyd's Rep 340.

B CONFIRMED AND UNCONFIRMED CREDITS

2.12 The use of these terms assumes the existence of an advising bank (also called the correspondent bank), and the distinction depends upon the position taken by that bank. In short, with a confirmed credit the advising bank adds its own undertaking to that of the issuing bank that the credit will be honoured. If the credit is unconfirmed, it does not: the sole undertaking is that of the issuing bank.

Unconfirmed credits

2.13 Where the credit is unconfirmed, the advising bank acts solely as the agent of the issuing bank. It will be instructed by the issuing bank to notify the credit to the seller. The credit is likely to provide for the documents to be presented to the advising or correspondent bank, and it will receive them as agent for the issuing bank. If it is to pay, it will pay simply as the agent of the issuing bank and not because of any obligation existing between it and the seller. The position of the advising bank as agent is considered in greater detail subsequently.¹ The important feature where the credit is unconfirmed is that, if the documents are wrongfully refused by the bank to whom they are presented, the seller has normally a remedy only against the issuing bank, which is usually abroad, and so proceedings may be more difficult than if he had an undertaking from a bank in his own country.

- 1 See para 6.6.

Confirmed credits

2.14 Where a credit is confirmed, the advising or correspondent bank adds its own undertaking to that of the issuing bank to honour or negotiate the credit as the case may be. This then gives the beneficiary the advantage

of having a paymaster in his own country. The credit will also be an irrevocable credit (see above),¹ and so the beneficiary will have the full benefits that the developed form of documentary credits provides. Article 8 of the UCP sets out the undertaking of a confirming bank (in similar terms as Article 7 sets out the undertaking of the issuing bank) to honour or negotiate the credit, with appropriate changes. Thus, for example, the confirming bank undertakes as appropriate to pay at sight or on a deferred date, to accept bills drawn on itself, and to be responsible for the acceptance of bills drawn on other drawees, and to negotiate without recourse bills drawn by the beneficiary on any drawee apart from itself. Where an advising bank purports to confirm a credit but reserves for itself a right of recourse against the seller, the two are inconsistent and the advising bank is not giving an absolute undertaking. The credit in these circumstances is not to be treated as a confirmed credit: see *Wahbe Tamari & Sons Ltd v Colprogeca*.² The position of the confirming banker is further discussed in Chapters 5 and 6.³ *Silent confirmations* and *confirmations on request* are considered in paras 6.25 and 6.26 below.

- 1 See para 2.8.
2 [1969] 2 Lloyd's Rep 18.
3 See Chapter 5 generally and para 6.22 et seq below.

C CATEGORISATION OF CREDITS BY PAYMENT OBLIGATION

2.15 UCP Article 6 provides:

'Article 6:

- a. A credit must state the bank with which it is available or whether it is available with any bank. A credit available with a nominated bank is also available with the issuing bank.
- b. A credit must state whether it is available by sight payment, deferred payment, acceptance or negotiation.'

This provides an important and convenient means of categorising credits in accordance with the type of payment obligation undertaken by the obligated banks. The bank with which the credit is made available, that is, at which the documents may be presented, is known as the 'nominated bank'; see Article 2, which also provides that any bank is a nominated bank if the credit is said to be available at any bank.

Sight credits and deferred payment credits

2.16 A credit may provide for payment on presentation of documents – after allowing time, of course, for them to be examined for compliance with the credit. Then it can be called a *sight payment* or *sight credit*.

2.17 Alternatively, the credit may provide for payment to be made at the conclusion of a period measured from the presentation of documents or, for example, from the date of the transport document. Then the credit is called a *deferred payment credit*. Such a credit has the advantage, for the buyer/applicant, that he need not reimburse the issuing bank until payment has been made and to that extent has the benefit of time to pay. In the UCP, the requirement that a bank should 'honour' the credit includes the obligation 'to incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment' (Article 2). Where payment is deferred, the beneficiary must wait for his money but has the security of the bank's undertaking; however, if the applicant is in the meantime to receive and to be able to deal with the goods, the bank will have to release the documents to him. The loss of security for the bank which would otherwise occur can be avoided by the use of a trust receipt as described in Chapter 11.¹ The risks for a bank which discounts its own deferred payment obligation by early payment, now considerably ameliorated by the UCP 600, are discussed at para 9.43 to 9.47 below.

¹ See para 11.11.

Acceptance credits

2.18 As a further alternative, the credit may provide that it will be honoured not by payment of money by the bank with which it is available but by the acceptance of a bill of exchange drawn by the beneficiary. This is known as an *acceptance credit*. If the bill is what may be called a time draft or a usance draft and provides for payment after a period from acceptance of the bill, then, unless the credit otherwise provides, payment will only be forthcoming when that time comes. Again, the UCP definition of 'honour' includes the obligation 'to accept a bill of exchange ("draft") drawn by the beneficiary and pay at maturity if the credit is available by acceptance'. The bill must be presented to the party on whom it is drawn for payment to be triggered. This will normally be the bank to which documents are to be presented under the credit and which is to make payment. But if the bill is drawn on the issuing bank or another bank, then, unless the credit otherwise provides, the strict position is that payment is only due on presentation of the bill to the party on whom it is drawn. The issuing bank and any confirming bank are of course obliged to ensure payment, whether or not payment is forthcoming from the party on whom the bill is drawn. The use of a time or usance draft provides another means of deferring payment under the credit, but with the advantage for the beneficiary that he obtains a negotiable instrument and can obtain payment before maturity by discounting the bill with another bank or finance house. Sometimes credits provide for the acceptance of a sight bill, that is, one payable at sight; those credits are equivalent to sight credits and the bill in that case has no real purpose.

Credits available by negotiation

2.19 Finally, the credit may be *available by negotiation* with a bank nominated in the credit (or with any bank if the credit so provides). UCP Article 2 defines negotiation as follows:

'Article 2:

Negotiation means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.'

The purpose of making a credit available by negotiation is that it enables the beneficiary to get money immediately by negotiating—in effect selling—the documents to the nominated bank. The nominated bank, having negotiated, is then entitled to be reimbursed by the issuing bank in due course. The sum payable to the beneficiary on negotiation will be discounted to reflect the interest accruing between the date of receipt of payment by him and the date on which payment is due from the issuing bank. It is apparent that there will only be need for negotiation where the credit does not provide for immediate payment: if it does, the beneficiary may just as well present the documents to the issuing bank himself either directly or using his own bank as his agent for collection.¹ The term 'negotiation' is sometimes used to refer the acceptance and payment against documents of the full amount of the credit. This is a misuse. Negotiation is better used only when the paying bank pays less than the full amount by reason of a time element, as Article 2 indicates.

Although the UCP envisages that negotiation will take place through the nomination mechanism just described, the cases show that the term is sometimes used in a somewhat different sense to refer to a situation where the undertaking in a credit is extended to third parties as well as the beneficiary, so that any third party covered by the undertaking may purchase the documents and present them to the issuing bank in his own name and his own right. In this book, credits of that type are referred to as 'negotiation credits' (as opposed to credits 'available by negotiation' with a nominated bank) and are discussed in the next section. However, the practice of using negotiation credits in that sense is now very limited and, particularly with the advent of UCP 600, offers little advantage. If, under a credit subject to the UCP, it is intended that the beneficiary should be able to obtain payment by selling the documents to any bank, then the credit should be made freely available by negotiation.

¹ Although it is not unusual for credits providing for immediate payment also to be made available by negotiation; this practice is prevalent in relation to credits issued by Chinese banks.

2.20 Types or Categorisations of Documentary Credits

D STRAIGHT AND NEGOTIATION CREDITS

2.20 A straight credit is one under which the undertaking of the issuing bank, or, if it is a confirmed credit, the undertakings of the issuing and confirming banks, are directed to the named beneficiary alone, and only he may rely on them. With a negotiation credit, by contrast, the undertakings are directed to any bank, or to any bank of a description stated in the credit, which becomes a bona fide holder of any bill of exchange and the other documents which are stipulated by the credit.

2.21 Negotiation by a bank under a negotiation credit may be distinguished from negotiation by a bank which does so as nominated bank under a credit providing for payment to be available from it by negotiation.¹

1 See para 2.19 above.

2.22 What is necessary to make a credit a negotiation credit, so that its promise may be accepted by any bank of appropriate description that negotiates documents complying with the credit? This is a matter of construing the words of the credit, and if the credit is carefully worded there will be no problem. If it does not appear that the undertaking embodied in the credit is to be construed more widely, the credit must be given effect to as a straight credit. The answer may be provided as a matter of necessary implication, as it was in the old case of *Re Agra and Masterman's Bank, ex p Asiatic Banking Corp'n*.¹ There was there an undertaking to honour drafts drawn on the bank, together with this statement 'This credit will remain in force for twelve months and parties negotiating bills under it are requested to indorse particulars on the back hereof.' It was held that this anticipated the negotiation of bills by other parties, and hence that there was an undertaking to them. The credit was not a documentary credit, but was simply a facility to obtain funds by drawing bills. But the logic of the construction was in no way dependent on that and would apply equally to a documentary credit. In *M A Sassoon & Sons Ltd v International Banking Corp'n*,² a similar argument was presented based on wording that was less clear. The Privy Council merely noted the argument, observing that 'it is a very summary way of converting the terms of a discount offer by one bank into an undertaking applicable to actual discounts by any other bank'. The ground of decision in the case, however, was that the seller had discounted the draft to the plaintiff not on terms that it was a negotiation pursuant to the credit, but on terms that the plaintiff should present the bill and documents to the buyer and so obtain payment. The buyer accepted the bill but later dishonoured it by non-payment, and the plaintiff was held to be entitled to recover from the seller as the drawer of a dishonoured bill.

1 (1867) 2 Ch App 391.

2 [1927] AC 711, PC.

2.23 Suppose that a credit simply states 'negotiation is permitted', and an undertaking is given in these terms: 'We undertake to honour all drafts drawn

under and in conformity with the terms of this credit'. Would such wording make the credit generally negotiable? There is no authority on such a wording in English law. A meaning has to be found for the words 'negotiation is permitted'. Their placing and context within the credit will be relevant. It may simply mean negotiation by a bank named in the credit. But if that does not appear possible, then probably the credit should be construed as permitting negotiation by any party.^{1,2} What is the position where the credit does not nominate any bank authorised to accept, pay or negotiate, nor allow negotiation by any bank? It is suggested in the ICC's *More Case Studies on Documentary Credits*³ that it is a normal practice in this event to deem the credit freely negotiable. It is then stated 'However this is not without risk.' It would indeed be a risky assumption to make. For such a credit contains nothing in its wording to suggest that it is freely negotiable and the sounder assumption must be that it is available only with the issuing bank. UCP Article 6.a begins 'A credit must state the bank with which it is available or whether it is available with any bank...'. It does not follow from this drafting that if the credit does not contain any such statement it is presumed to be freely negotiable with any bank.

1 A different position is taken in *Benjamin's Sale of Goods* (7th edn) para 23-063. Whilst it is accepted that without words sufficient to indicate that the credit should be generally negotiable or available it must be construed as a straight credit (see eg *Southern Ocean Shipbuilding Co Pte Ltd v Deutsche Bank AG* [1993] 3 SLR 686), it is suggested that, contrary to the view expressed in *Benjamin*, if the meaning is not obvious, it is a question of construing the words in accordance with international banking practice, and that nowadays there is and should be no tendency in the courts to favour straight credits in cases of uncertainty.

2 See also *Udharam Rapchand (Sons) HK Ltd v Mercantile Bank Ltd* [1985] HKLY 52.

3 ICC No 489, Case 191.

2.24 *European Asian Bank AG v Punjab and Sind Bank (No 2)*¹ demonstrates the difficulties which may arise as well as the principles to be applied in resolving them, and is worth detailed consideration. The Singaporean sellers, Bentrex, sold cloves to the Indian buyers, Jain, c. & f. Bombay. At Jain's request, the Punjab Bank in New Delhi opened a letter of credit through their correspondents in Singapore, the Allgemene Bank, which was advised to Bentrex through the European Asian Bank. The credit was available by Bentrex's drafts at 180 days after bill of lading date. Clause 6 provided 'Letter of credit should be advised through European Asia Bank... and should be divisionable and unrestricted for negotiation'. Clause 9 provided 'We hereby engage with drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of this credit that such drafts will be honoured on presentation and delivery of documents as specified above. Negotiations under this credit are restricted [to Allgemene Bank, Singapore]'. Reimbursement was to be effected from the Irving Trust, New York. Bentrex presented to the European Asian Bank documents and a draft drawn on Jain made payable to the order of the European Asian Bank. The bank sent the documents directly to the Punjab Bank in India, where the draft was accepted by Jain. Jain were then informed that the vessel and cargo

had been lost, and claimed on their insurers who repudiated liability: there had been a fraud, and no goods had been shipped at all. Meanwhile Bentrex had been paid by the European Asian Bank who were therefore out of pocket. The Irving Trust were not put in funds. Both the Punjab Bank and the Allgemene Bank (who had confirmed the credit) refused to pay the European Asian Bank. The main points decided by the Court of Appeal were these. It was held first that the European Asian Bank had negotiated the documents² and draft and were seeking payment on their own behalf: they were not acting as agents of Bentrex and so were unaffected by the fraud of Bentrex. Secondly, the apparent contradiction between clause 6 and clause 9 was to be resolved as follows. In clause 6 'divisionable' was an error for 'divisible' and the clause meant that the credit was transferable in whole or in part (clause 7 permitted part shipments). 'Unrestricted for negotiation' meant that documents could be presented under the credit by any transferee of the credit. Clause 9 meant that whoever presented the documents (Bentrex or their transferee) could only do so through the Allgemene Bank who would then negotiate the documents as the only authorised negotiator. It was therefore not a negotiation credit, and under the terms of the credit the European Asian Bank had no rights against the Punjab Bank. By reason, however, of the communications between the two banks at the time of the delivery of the documents to the Punjab Bank and Jain's acceptance of the bill, the Punjab Bank was estopped from denying that they were responsible for ensuring payment to the European Asian Bank at maturity. Therefore they were obliged to pay.³

1 [1983] 1 WLR 642, [1983] 1 Lloyd's Rep 611.

2 That is, the bank had bought the documents.

3 This may be compared with the view expressed by the ICC Banking Commission, *Opinions* (1984-1986) ICCNo 434 Ref 95, that documents may be presented direct to an issuing bank which must accept them and pay even though it has specified another bank as the negotiating bank in the credit advised to the beneficiary.

2.25 As the *Sassoon* and *European Bank* cases¹ demonstrate, in order to claim under a negotiation credit, the holder of the documents must have acquired them by a negotiation pursuant to the credit and not by other means. The wording of the credit is in any event likely so to provide.

1 See paras 2.22 and 2.24 above.

2.26 Other aspects relating to the position of a negotiating bank are considered subsequently in Chapter 7, Part B, and the questions of recourse are referred to in paras 6.32, 7.7 and 7.9 according to context.

E TRANSFERABLE AND NON-TRANSFERABLE CREDITS

2.27 Where a credit is designated as transferable, the beneficiary has the right to request the appropriate bank to make the credit available in whole or in part to one or more other parties, and perhaps at some other place. It is important to emphasise at the outset that the right is only a right to request, and the bank is not obliged to accede to the request should it not wish to do so. The credit must be expressly designated as transferable. The object of transfer is to enable the beneficiary nominated in the credit to use the credit to provide a means of payment to a party, or to the parties, from whom he in his turn is buying the goods. He may indeed have contracted to provide them with a credit. He can then satisfy his obligation by the transfer of so much of the credit opened in his favour as is required to pay his seller. He must, however, ensure that the terms of the contract which he has made with the party from whom he is buying will be met by the transfer of the credit for which he has contracted with his buyer. He must also ensure that the documents to which he is entitled from his seller will meet the terms of the contract with his buyer. Where the credit which the beneficiary receives is not designated as transferable, or if the bank does not accede to the request for transfer, the seller has the alternative of arranging a back-to-back credit. UCP Article 38 governs transferable credits, a topic fully discussed in Chapter 10.

F BACK-TO-BACK CREDITS AND COUNTER CREDITS

2.28 A credit may be described as back-to-back when it is intended that the documents which are received through the operation of it may be presented, with substitution of invoices (and possibly other documents), to obtain payment under another credit. Thus a seller of goods, the beneficiary of a credit opened in his favour by his buyer, may approach the bank which has advised the credit to him and request it to open a second credit in favour of his own suppliers, on the security of the first credit. This is likely to be possible only if he is already a customer of that bank. Alternatively he may approach his own bank and request them to do so using the credit already opened in his favour as a 'counter'. In the latter case the second credit may be called a counter credit. In each case the credit that the buyer has secured in favour of his own suppliers is a separate credit for which he is in the position of applicant. When complying documents are presented, he will have to reimburse the bank and take up the documents, regardless of the position between him and his buyer and under the credit of which he is beneficiary. In contrast, if he is able to arrange for transfer of the credit, he will avoid such risk. Back-to-back credits also carry a risk for banks on similar grounds: the bank in the middle of the chain has an obligation to pay the beneficiary of the

then present documents separately in relation to each instalment. The effect of Article 32 has been already described.¹ It is common also for credits expressly to permit the seller to make partial shipments. He may then present separately documents in respect of each shipment. If the credit is silent, partial drawings and shipments are allowed by Article 31.a, which provides:

'Article 31: Partial Drawings or Shipments.
a. Partial drawings or shipments are allowed.²

¹ See para 5.38.

² Article 31.a is considered at para 8.130.

D EXAMINATION AND ACCEPTANCE OR REFUSAL OF DOCUMENTS

Outline

5.41 When documents are presented to a bank under a credit, the bank will, depending upon its role and responsibility in the credit operation, examine them to see whether they comply with the stipulations of the credit. The first bank to do so will commonly not be the issuing bank but a nominated bank, which may be the bank which advised the credit to the beneficiary and may also have confirmed it. If it is satisfied that they conform, it will honour or negotiate. The issuing bank in its turn will then examine the documents. If the documents are discrepant, the applicant may be approached for a waiver of the discrepancies so that the documents can be accepted.¹ Absent a waiver, it is the duty of the bank to refuse the documents and give an appropriate notice in respect of the disposal of the documents. General requirements as to the examination of documents and requirements as to specific documents are considered in Chapter 8 so that the whole subject matter of documents is taken together. This section considers the procedural steps which banks should follow towards the beneficiary, in particular the course to be followed in rejecting documents.

¹ As to this practice, see paras 5.53 et seq. Note that Article 16.b refers only to the issuing bank and to its right to approach the applicant.

5.42 The procedure for examination of documents is set out in Article 14 and the procedure for waiver and refusal in Article 16. The relevant parts of those Articles are set out below; as discussed, there are some important differences from their predecessors in UCP 500. Compliance with Article 16 is important because of Article 16.f, which provides:

'Article 16: Discrepant Documents, Waiver and Notice
f. If an issuing bank or a confirming bank fails to act in accordance with Article 16 then it is precluded from claiming that the documents do not constitute a complying presentation.'

5.43 A bank which fails to act in accordance with Article 16, for example by failing to give a notice of refusal within the prescribed time or in the prescribed form, will be obliged to honour. However, if the documents were in fact discrepant, it will not be entitled to reimbursement, either by the applicant if it is the issuing bank or by the issuing bank if it is a nominated bank which honours or negotiates. So consequences which are very serious for a bank can follow from even a minor non-compliance.

5.44 Article 16.f applies only to an issuing or confirming bank. But in considering the application of Articles 14 and 16 it must be remembered that, in English law at least, a nominated bank which is given the duty under the credit of checking and accepting the documents, and commonly also the function of paying, does so as the agent of the issuing bank.¹ Where the nominated bank also confirms the credit it will act in a dual capacity in performing those functions, namely, so far as the issuing bank is concerned it acts as that bank's agent; and with regard to its own obligations to the seller as the confirming banker it acts as principal. So when a nominated bank comes to examine the documents presented to it, as it is the agent of the issuing bank it must comply with Articles 14 and 16 to secure compliance by the issuing bank with those Articles, as well as its own compliance. If it fails to do so, the effect may be to bar the issuing bank from contending against the beneficiary that the documents do not comply.

This will not matter to the issuing bank if the beneficiary has been paid. For in that situation the outcome will be that the issuing bank will refuse to pay the nominated bank (or, if the nominated bank has been reimbursed prior to the issuing bank's receipt and checking of the documents, it will be obliged to repay the issuing bank). Where it will matter is if, under the terms of the credit, the beneficiary has not been paid following presentation of documents (either because payment has been refused or is deferred under the terms of the credit) and is looking to the issuing bank for payment. Then non-compliance with Articles 14 and 16 by the nominated bank would bar the issuing bank from alleging that the documents were not in order. Should the buyer refuse to waive the discrepancy, the issuing bank could recover its ultimate loss from the advising bank as damages for breach by the advising bank of its duty as the issuing bank's agent.²

¹ See para 6.6 below. Cited, *Bank of Baroda v Vysya Bank* [1994] 2 Lloyd's Rep 87 at 91.1.

² Reference should also be made to the argument arising from Article 37.a that all acts of the correspondent bank are at the risk of the applicant for the credit, which is considered at para 4.22 above. The matters considered here are a further reason for rejecting that argument.

Examination of documents

5.45 Article 14.a provides:

'Article 14: Standard for Examination of Documents
a. A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank must examine a presentation to determine on the

basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.'

The documents must appear 'on their face' to constitute a complying presentation. As is provided by Article 5, 'Banks deal with documents and not with goods, services or performance to which the documents may relate.' The bank is not required and not entitled to take account of any information apart from the documents themselves. In particular it may not take account of information relating to the quality of the goods not shown by the documents. This principle, sometimes referred to as the principle of autonomy, has been discussed in Chapter 1.¹ The bank's duty in respect of the examination of documents is discussed in more detail in Chapter 8.²

¹ See paras 1.34 et seq.

² See paras 8.2 et seq.

Time for examination: UCP 600

5.46 In respect of time for examination, Article 14.b provides:

'Article 14: Standard for Examination of Documents

- b. A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank shall each have a maximum of five banking days following the day of presentation to determine if a presentation is complying. This period is not curtailed or otherwise affected by the occurrence on or after the date of presentation of any expiry date or last day for presentation.'

5.47 In context, the 'day of presentation' must be taken as referring to the day of presentation to the bank carrying out the examination. Where documents are presented by the beneficiary to a nominated or confirming bank, the documents will be examined first by that bank and then, if not refused, by the issuing bank. Although not expressly stated in Article 14.b, it seems clear that a separate period of five banking days applies to the examination by each bank.

5.48 Time for examination is expressly not curtailed or affected by the occurrence on or after the date of presentation of any expiry date under the credit or the last day for presentation. A beneficiary who makes a presentation less than five banking days before expiry has therefore no right to require an expedited examination so as to give himself the opportunity to make a further presentation if his first attempt is refused.

Time for examination: UCP 500

5.49 The introduction of a fixed period of five banking days for examining the presentation and giving notice of refusal is one of the more important

changes in UCP 600. Under UCP 500, the bank was given a 'reasonable time not to exceed seven banking days' to examine the documents and decide whether to take them up or refuse them. UCP 500 Article 13 provided:

'[UCP500] Article 13 Standard for examination of documents

- b The Issuing Bank, the Confirming Bank, if any, or a Nominated Bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.'

It must be emphasised that Article 13.b did not allow seven banking days: it allowed a reasonable time up to seven banking days. Moreover, the duty to (a) examine the documents and (b) determine whether to take up or refuse them were regarded as separate obligations and if the bank reached its decision on (a) unusually rapidly it did not excuse a delay in notification.¹ The determination in individual cases of whether a bank had acted within a 'reasonable time' or 'without delay' gave rise to considerable uncertainty and much litigation. The introduction of a fixed period is therefore a welcome development. Since, however, there may continue to be disputes under existing credits subject to UCP 500, a summary of the position under UCP 500 is set out below.

¹ *Seaconsar Far East Ltd v Bank Markazi Jomhourī Islami Iran* [1999] 1 Lloyd's Rep 36 at 41, a decision on UCP 400 Article 16.c of the 1983 Revision, the predecessor of UCP 500 Article 13.b.

5.50 Where a contract provides that something is to be done within a reasonable time, in English law this means such time as is reasonable in the circumstances of the particular case. In *Hick v Raymond and Reid*¹ Lord Herschell stated² '... there is of course no such thing as a reasonable time in the abstract. It must always depend upon circumstances ... the only sound principle is that "reasonable time" should depend on the circumstances which actually exist'. Those which actually exist as to be contrasted with those that ordinarily exist. But those actually existing are to be excluded in so far as they have been caused or contributed to by the party having the duty to perform within the time. In the same case Lord Watson stated³ '... the condition of reasonable time has been frequently interpreted; and has invariably been held to mean that the party upon whom it is incumbent duly fulfils his obligation, notwithstanding protracted delay, so long as such delay is attributable to causes beyond his control, and he has neither acted negligently nor unreasonably'. Matters which are obviously to be taken into account will include the numbers of documents to be examined and their complexity, language, and the problems posed in considering any possible discrepancies. It may also be relevant to consider the amount involved and any urgency, for example, caused by the period of time between the tender of the documents to the bank and the arrival of the vessel carrying the goods. A large and experienced bank operating in one of the world's financial centres may be

expected to act more quickly than a small bank in an out of the way place.⁴ It would be relevant that a bank's checking staff had been severely reduced by an epidemic or that the bank had a sudden and unexpected flood of credit work.

1 [1893] AC 22.

2 [1893] AC 22 at 29.

3 [1893] AC 22 at 32.

4 See *Bankers Trust Co v State Bank of India* [1991] 2 Lloyd's Rep 443 at 455.1 per Farquharson LJ.

5.51 In *Bankers Trust Co v State Bank of India*¹ evidence was given of the practice of the United Kingdom clearing banks to set a three-day time limit, which in general permitted two days for checking and one for taking instructions on any discrepancies found. In that case the bank had checked some 900 pages of documents in three days, but it fell down over the time wrongly allowed to its applicant to check them again.² In *Hing Yip Hing Fat Co Ltd v Daiwa Bank*³ three banking days following receipt of documents was found reasonable to check 19 pages of documents against a four-page credit. Kaplan J referred to the smaller size of the Daiwa Bank, to the fact that checkers in Hong Kong did not have English as their mother tongue and to the business of the particular month. In *Ozalid Group (Export) Ltd v African Continental Bank Ltd*⁴ it was common ground that five days should be sufficient. In *Seaconsar Far East Ltd v Bank Markazi*⁵ it was conceded that the bank was entitled to five working days. A bank which goes about its task conscientiously should have nothing to fear provided, of course, that exceptional circumstances do not take it out of the seven-day limit,⁶ and it may properly be hoped that the courts would not give much weight to criticisms made with hindsight about delays of an hour or two here and there. The *Bankers Trust and Hing Yip* cases, and also the more recent decision of the Hong Court of Appeal in *NV Koninklijke Sphinx Gustavsberg v Cooperatieve Centrale-Raiffeisen-Boerenleenbank*⁷ suggest that indeed they will not. The court would have in mind that the success of such an argument will mean that a beneficiary is paid for documents which do not comply with the credit, and the bank may find itself carrying a loss which is quite out of proportion to the fault on its part.

1 [1991] 2 Lloyd's Rep 443.

2 See para 5.52 below.

3 [1991] 2 HKLR 35.

4 [1979] 2 Lloyd's Rep 231.

5 [1993] 1 Lloyd's Rep 236 at 241.2. Cf [1994] 1 AC 438 at 446.

6 In some exceptional circumstances a bank may be able to rely on Article 17, Force Majeure: see para 4.21 above.

7 [2005] 4 HKC 373.

5.52 Under UCP 500, where the issuing bank had to determine whether to refuse the documents within a reasonable time, it was very unwise for the bank to permit the applicant itself to examine the documents for discrepancies. The fact that *Bankers Trust* had permitted its client to double-

check its examination of the documents (which took another three days) was fatal to its claim.¹ In the Court of Appeal it was stated, 'In particular we are agreed that on no view should a bank be allowed time to enable the buyers to examine the documents for the purpose of discovering further discrepancies.'² In *Bayerische Vereinsbank Aktiengesellschaft v National Bank of Pakistan*,³ where the bank acted as a mere 'postbox' for communicating the applicant's decision, Mance J stated:⁴

'What is clear, however, is that an issuing bank which (i) hands over to its customer responsibility for determining whether documents are discrepant (as distinct from making up its own mind in the first instance and approaching the customer, if at all, simply to ask whether it is prepared to waive discrepancies identified by the bank), and then (ii) adopts and communicates whatever decision its customer reaches is likely to take in the process more than the "reasonable time" allowed by art. 13(b) and to have failed to act "without delay" as required by art. 14(d) ...'

Under UCP 600, where the issuing bank has a fixed period of five banking days, there is perhaps less risk in involving the applicant, but it cannot be regarded as good practice; it is the job of the bank alone to examine the documents.

¹ *Bankers Trust Co v State Bank of India* [1991] 2 Lloyd's Rep 443; applied in *Indian Bank v Union Bank of Switzerland* [1994] 2 SLR 121.

² [1991] 2 Lloyd's Rep 443 at 452.1 per Lloyd LJ. Farquharson LJ said, at 455.1, that it might on rare occasions be permissible for the bank to permit the applicant to examine the documents for the purpose of determining its correct course in the light of discrepancies already found, but only where the discrepancies were of such a nature to require this for the applicant to assess their significance.

³ [1997] 1 Lloyd's Rep 59.

⁴ [1997] 1 Lloyd's Rep 59 at 69.

⁵ *Bankers Trust Co v State Bank of India* [1991] 2 Lloyd's Rep 443 at 455.1 per Farquharson LJ.

Refusal or waiver

5.53 Article 16 provides:

'Article 16: Discrepant Documents, Waiver and Notice

- a. When a nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank determines that a presentation does not comply, it may refuse to honour or negotiate.
- b. When an issuing bank determines that a presentation does not comply, it may in its sole judgement approach the applicant for a waiver of the discrepancies. This does not, however, extend the period mentioned in sub-article 14 (b).'

5.54 When a bank determines that a presentation does not comply, it has the right to refuse to honour. The issuing bank may also, in its sole judgment,

approach the applicant, who is usually its customer, for a waiver of the discrepancies. In many cases the discrepancies are of no commercial significance (they may be trivial) and the applicant still wishes to take up the documents and thereby acquire the goods; in that case, he will be prepared to waive any discrepancies. This practice is very common and has the result that a large number of credit transactions go through which would otherwise fail.¹ The purpose of the approach must be limited to waiver and should not be used to enable a joint decision to be made as to possible discrepancies. Of course, the applicant may have commercial reasons for refusing a waiver, for example if he no longer requires the goods, if he could purchase them elsewhere at a better price, or if the goods have been lost after shipment when at his risk.

¹ It has been suggested that in England and America some 60–70% of the documents presented fail to comply on first presentation, and a witness in *Bankers Trust Co v State Bank of India* [1991] 2 Lloyd's Rep 443 stated that in 90% of the cases where the applicant's instructions were sought the instructions were to accept the documents.

5.55 In a documentary sale, the buyer may in practice be able to take possession of the goods shipped even though the documents are discrepant and are refused by the bank. If so, then he will be deemed to have waived any discrepancies in the documents for the purpose of the sale contract but (in another illustration of the autonomy principle) it does not follow that there is also waiver for the purpose of the bank's obligations under the credit. In *Uzinterimpex JSC v Standard Bank plc*,¹ the Court of Appeal rejected the beneficiary's argument that a bank was bound to pay under a demand guarantee because the buyer had persuaded the carrier, in breach of duty, to release the goods to it. Moore-Bick LJ said:²

'In the case of a documentary sale it is necessary, as that case shows, to distinguish between the seller's right to obtain payment from the bank under the letter of credit and his right to obtain payment from the buyer where for some reason the mechanism provided by the letter of credit fails. As the decision in *Saffron v Société Minière Cafrika* (1958) 100 CLR 231 demonstrates, acceptance of the goods by the buyer may render him liable for the price and may to that extent involve a waiver on his part of discrepancies in the documents that would otherwise have entitled him to reject them, but it is not sufficient to render the bank liable under the letter of credit to pay the seller against documents that do not conform to its requirements.'

¹ [2008] 2 Lloyd's Rep 456.

² At para 29.

5.56 It is to be noted that Article 16.b gives discretion to the issuing bank: 'it may in its sole judgement approach the Applicant'. It has no obligation to do so. No doubt a bank which has an ongoing business relationship with the applicant would ordinarily consult its customer before rejecting the documents, and hence the goods. However, if the applicant is in financial difficulties, the bank is unsecured and there is a risk that the bank will not be reimbursed if it pays the credit, then the bank will be glad of the opportunity

to refuse the presentation and will not wish to approach the applicant for a waiver.

5.57 The UCP deals only with the issuing bank's right to seek a waiver. Where documents are not initially presented to the issuing bank but to a nominated or confirming bank, it will be that bank which would have to decide whether to refuse the documents if discrepancies are found. There is no reason in principle why a nominated or confirming bank should not seek a waiver permitting it to pay against the discrepant documents. However, that presents practical difficulties. The nominated bank would need to seek a waiver from the issuing bank, which would in turn need to seek a waiver from the applicant, a process which would be time-consuming and might not be possible within the five banking days permitted for the nominated bank's examination of the documents. Moreover, since the applicant is usually the customer of the issuing bank rather than the nominated or confirming bank, the latter will not usually have any particular interest in whether the underlying transactions succeeds or fails. It is better practice for the nominated bank to promptly refuse the presentation, so that the beneficiary may have an opportunity to put them right within the period of the credit or else send them for collection (see section F below).

5.58 Article 16.b provides that an approach to the applicant for a waiver does not extend the period for examination of the documents, which remains five banking days. UCP 500 Article 14.c similarly provided that an approach did not extend the maximum time period of seven days

Notification of refusal

5.59 Article 16.c provides that when a nominated bank acting on its nomination, a confirming bank (if any) or an issuing bank decides to refuse to honour or negotiate, it must give a single notice to that effect to the presenter.

'Article 16: Discrepant Documents, Waiver and Notice

- c. When a nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank decides to refuse to honour or negotiate, it must give a single notice to that effect to the presenter.

The notice must state:

- i. that the bank is refusing to honour or negotiate; and
- ii. each discrepancy in respect of which the bank refuses to honour or negotiate; and
- iii.
 - a) that the bank is holding the documents pending further instructions from the presenter; or
 - b) that the issuing bank is holding the documents until it receives a waiver from the applicant and agrees to accept it, or receives further instructions from the presenter prior to agreeing to accept a waiver; or

- c) that the bank is returning the documents; or
 - d) that the bank is acting in accordance with instructions previously received from the presenter.
- d. The notice required in sub-article 16 (c) must be given by telecommunication or, if that is not possible, by other expeditious means no later than the close of the fifth banking day following the day of presentation.¹

Time for notice

5.60 Does Article 16.d mean that notice must be sent by the close of the fifth banking day, or that it must arrive with the other party before then? There should be no difference where telecommunication is used. The question may be material where telecommunication is not used and there is a delay between the sending and the receipt of the notice. It may well be said that A has not given notice to B until B has received the notice. Nonetheless it is suggested that in the context of Article 16 it is sufficient that the bank refusing the documents should complete the acts which it has itself to carry out to give notice not later than the close of the fifth banking day following the receipt of the documents.

5.61 Under UCP 500, Article 14.d required the bank to give notice of refusal 'without delay'¹ after its decision to refuse the documents.

'The words "without delay" mean what they say, and nothing is to be gained by paraphrasing them. Where a decision to reject documents is made at or about the close of business on a Friday, as may have happened in this case, we would expect the obligation to give notice without delay to require that it be given on the Monday, which was the next banking day ... It may well be in other cases the obligation requires notice to be given on the same day as the decision is taken.'²

But it is for the party alleging delay, normally the beneficiary, to prove it.³ The requirement to give notice of the decision without delay is separate from and additional to the obligation to examine the documents within a reasonable time. Thus, if the bank reaches a decision unusually rapidly, it does not excuse any delay in notifying the beneficiary.³

1 This was held to mean 'without unreasonable delay' in *Rafsanjan Pistachio Producers Co-operative v Bank Leumi (UK) plc* [1992] 1 Lloyd's Rep 513 at 531.2: *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran* [1999] 1 Lloyd's Rep 36 at 42 (a decision on UCP 400 Article 16.c).

2 *Seaconsar* at p42.

3 *Seaconsar* at p42.

Form of notice

5.62 Article 16.d requires the use of 'telecommunication or, if that is not possible, by other expeditious means'. 'Telecommunication' includes

telephone, telex, fax and email. The ICC Commentary on UCP 400 refers to 'the practice of sometimes advising refusal by a properly authenticated telephone call'. Where authentication is a problem it can be ensured by a follow-up communication. In *Rafsanjan Pistachio Producers Co-operative v Bank Leumi (UK) plc*¹ Hirst J stated 'Moreover in my judgment it would be most undesirable to construe Article 16(d) [now as amended, 14.d] in a manner which obliged a bank to use a particular form of telecommunication. A telephone call might sometimes be the best mode. But I think that a bank might justifiably consider that a rejection message, which is an extremely important step ... should normally be sent in writing by telex; this will also ensure that the message is timed and that the answer-back records receipt, and will thus avoid any subsequent dispute ...' In *Hing Yip Hing Fat Co Ltd v Daiwa Bank*² evidence was given that in Hong Kong fax and telex were not used to give notice of refusal because of problems with authentication and verification; advice was sent by mail, courier or messenger, which was found satisfactory given the size of Hong Kong and the propinquity of its banks. Kaplan J held that, if communication by phone, fax or telex was possible, it ought to be used so the beneficiary could know his position as soon as possible, in particular so he could, if he was able, correct the discrepancies before the credit's expiry or consider offering an indemnity. Had this been the only point in the case the bank would have lost by reason of its delay in giving notice. The case emphasises the need for banks to follow the requirements of Article 16 precisely. If a senior representative of the beneficiary is present at the branch of the issuing bank, then the decision can be communicated orally to him, viva voce, and there is no requirement for further notice.³ The rationale for this is not that an oral communication is a form of telecommunication, which it clearly is not, but because a term permitting such notification can be implied into the documentary credit contract.⁴

1 [1992] 1 Lloyd's Rep 513 at 531.

2 [1991] 2 HKLR 35.

3 *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran* [1999] 1 Lloyd's Rep 36; discussed by Bennett [1999] LMCLQ 507 at 515-516. Given the importance of the contents of the notice, namely that the bank is prohibited from relying on discrepancies not contained in the notice, it is highly desirable for evidential purposes that there should be a written record. See para 5.65 below.

4 [1999] 1 Lloyd's Rep 36 at 39.

Single notice

5.63 A single notice of refusal must be given, which must cover each of the matters in Article 16.c. Once the bank has given notice that it is refusing to honour or negotiate, then subsequent notices can and should be ignored; this was also the position under UCP 500 even though there was there no express requirement for a 'single notice'.¹

1 More Queries and Responses on UCP 500, ICC No 596, Ref 27.

come to act as collecting bank for two rather different reasons. First, the beneficiary may find it convenient to use its services in this way. For example, the beneficiary may prefer to use its own bank to forward the documents where they have to be presented abroad rather than forwarding them itself. It may also want to have the documents checked by the bank for compliance with the credit. If there are discrepancies, a bank may be in a better position to request their waiver than the beneficiary itself. Secondly, the beneficiary may have been financed by the bank to obtain the goods which are the object of the transaction underlying the credit, either by way of a general overdraft arrangement or by a specific advance. In either case the bank may well require that the documents be presented through it, so that it has control of the documents in the event that the transaction goes wrong. Where a credit is a straight credit, that is to say, is not a negotiation credit, the only way in which the beneficiary's bank can involve itself with the documents to be presented under the credit is to act as agent for collection unless, of course, the credit has been advised through it.

The collecting bank as agent

7.3 A collecting bank acts as the agent of the beneficiary for the purposes of presentation and receiving payment.¹ This has the consequence that, if the documents are fraudulent to the beneficiary's knowledge, there will be no obligation to pay the collecting bank.² So if the collecting bank makes an advance to the beneficiary in anticipation of the collection, it will be at risk. In cases of fraud it will be important, therefore, to determine whether the bank is collecting in its own right having negotiated, ie purchased, the documents from the beneficiary, or whether it is collecting as the beneficiary's agent. This may involve a careful examination of the relations between the bank and the beneficiary and of the relevant documents, particularly as to at what stage, if it did, the bank credited the beneficiary with the sum in question.³

1 See, for example, the role performed by SCB in *Marconi Communications v PT Pan Indonesia Bank* [2007] 2 Lloyd's Rep 72 at 75.2.

2 See, among other cases, *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168 and *European Asian Bank AG v Punjab Bank (No 2)* [1983] 1 WLR 642 at 652A, [1983] 1 Lloyd's Rep 611 at 615.1.

3 See *European Asian Bank AG v Punjab Bank (No 2)* [1983] 1 WLR 642 at 657, [1983] 1 Lloyd's Rep 611 at 618, 619. For reference to the cases relating specifically to discount and collection of bills of exchange see *Benjamin's Sale of Goods* (7th edn) paras 22-067 et seq.

Recourse and fraud

7.4 If payment has been obtained fraudulently, then the paying bank has a restitutionary claim against the beneficiary¹. If the money is still in the hands

of the collecting bank, or has been handed over to the beneficiary by the collecting bank acting other than in good faith or acting with knowledge of the paying bank's claim, then a restitutionary claim may also lie against the collecting bank.²

1 See para 9.48 below.

2 See para 9.50 below and the discussion of the scope of the change of position defence to restitutionary claims in *Niru Battery Manufacturing Co v Milestone Trading Ltd* [2004] QB 985 at paras 143-172 and 191-192.

B NEGOTIATION BANKS

General

7.5 As mentioned in Chapter 6, the term 'negotiation bank' does not appear in the UCP. It is used here to refer to a bank which has negotiated (ie purchased) documents in its own right to be presented by it as a principal under a letter of credit which is a negotiation credit. Straight and negotiation credits have been considered in Chapter 2.¹ The difference between credits available by negotiation and negotiation credits has been described in para 2.19. In short, a negotiation credit in this sense is one where the undertaking given by the credit is addressed to all bona fide holders of the documents, or to banks generally or to banks of a particular description. It is open to such parties to negotiate, that is, to buy, the documents and to present them under the credit in their own right. In contrast, the undertaking contained in a straight credit is directed only to the beneficiary, and no other party can obtain rights under the credit save by transfer (if it is transferable) or by assignment. A bank which purchases the documents under a negotiation credit may be called a negotiation bank. The essential distinction between a negotiation bank and a collecting bank is that a negotiation bank holds the documents in its own right, whereas a collecting bank holds them as agent for the beneficiary.

1 See para 2.20.

The contract

7.6 A negotiation bank becomes a contracting party to the credit, and, if the undertaking contained in the credit is not honoured, it may sue the issuing bank and any confirming bank. The contract probably comes into being when the bank acquires the documents in reliance on the credit. The alternative is that it comes into being when the documents are presented by it. The former appears more consistent with the likely position between the issuing bank and the beneficiary, which is that the contract comes into being on the advice of the credit to the beneficiary.¹ A bank may acquire documents without reliance on, and without intending to utilise, the letter of credit.² If it does so, it may

be that it cannot then operate the credit. This appears to be the position in the United States.³ If it is the case that the contract between a negotiation bank and the issuing bank comes into being when the negotiation bank acquires the documents, it would follow that no contract would then come into being if the negotiation bank acquires the documents with a different intention. But this need not prevent a contract coming into being subsequently if the intention changes, at any rate by the time documents are actually presented. It is to be pointed out that the paying bank will not know in what circumstances and with what intention the negotiation bank acquired the documents and so, if that were relevant, it would not know whether or not it was bound to accept them. It is therefore suggested that the more practical view is that a bank which acquires documents without the intention of presenting them under the credit, may later change its intention and do so. There is, however, no authority in English law.

1 See para 5.3 above.

2 See the facts in *M A Sassoon & Sons v International Banking Corp'n* [1927] AC 711 set out at para 5.96.

3 See *Banco Nacional Ultramarino v First National Bank of Boston* 289 F 169 (1923).

Recourse against a negotiation bank

7.7 A negotiation bank is in the same position as the beneficiary of a credit so far as any question of recourse by an issuing or confirming bank is concerned. Subject to para 7.8 below, it is suggested that there is, therefore, no right of recourse for the reasons discussed in Chapter 5 and Chapter 6.¹

1 Paras 5.93 et seq and 6.45 et seq.

Fraud

7.8 The right of a negotiation bank to operate the credit is not defeated by the fact that the beneficiary or a third party has been fraudulent, provided that it takes the documents in good faith. The negotiation bank is not responsible for the genuineness of the documents.¹ There can, however, be recourse against a negotiation bank if there was fraud by the beneficiary and the negotiation bank did not take the documents in good faith or if there was independent fraud by the negotiation bank itself. Formerly, the position was different for a bank which was not a negotiation bank but a bank which had agreed to discount a deferred payment credit by taking an assignment of the beneficiary's rights. That distinction, however, is no longer the case.²

1 See *Guaranty Trust Co of New York v Hamay & Co* [1918] 2 KB 623, *European Asian Bank AG v Punjab Bank (No 2)* [1983] 1 WLR 642 at 652 and 658 and more generally *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168 and Chapter 9 below.

2 See para 6.19 above.

Recourse by negotiation bank

7.9 The bank will undertake to negotiate the documents upon terms which may be found in the bank's form completed by the beneficiary requesting the bank to negotiate the documents, or the terms may be found in other documents. It is essential to examine the relevant documents to see what the terms are. Generally the position may be stated as follows. Whereas an issuing bank can look only to the applicant for reimbursement and if the documents which it has accepted do not conform to the credit it is at risk, and a confirming bank can only look to the issuing bank and is similarly at risk, a negotiation bank is free to agree rights of recourse against the beneficiary. The negotiation bank's position is closely allied to that of the beneficiary and unlike an issuing and a confirming bank, will ordinarily have recourse against the beneficiary if the credit fails to provide payment, as is discussed in the next two paragraphs.

(a) Bills of exchange

7.10 Where, as is usually the case, a negotiation bank buys documents which include drafts, if these are dishonoured the bank has the right of recourse of a holder against the beneficiary as the drawer of the draft.¹ The negotiation bank will only lose this right of recourse on the bill if it is expressly agreed that it shall not have such a right, either as part of the terms on which the bill is discounted, or by the beneficiary marking the bill when he draws it 'without recourse' or with some other wording so as to exclude his liability under it to a holder.² Such a wording, however, would not exclude recourse where the beneficiary was fraudulent, although, as the negotiation bank if bona fide would take the documents free of the fraud and be able to present under the credit, recourse should not then be necessary (assuming the documents were otherwise compliant).³ Even where the bill is drawn without recourse, the negotiation bank may perhaps have a right of recourse arising not on the bill but separately from the negotiation transaction itself.⁴ But it is more likely that the drawing of the bill 'without recourse' negates any such right. In short, the negotiation bank will normally be entitled to recover from the beneficiary what it has paid with interest in the event that the bill is dishonoured because the documents are rejected as not complying with the credit, or for any other reason not the fault of the negotiation bank.

1 Bills of Exchange Act 1882, s 55(1).

2 See Bills of Exchange Act 1882, s 16(1).

3 See also Bills of Exchange Act 1882, s 29(1) and 38(2). In *KBC Bank v Industrial Steel (UK) Ltd* [2001] 1 Lloyds Rep 370 the negotiation bank's claim in deceit against the beneficiary succeeded despite having negotiated 'without recourse'. The documents negotiated were discrepant as well as fraudulent and it was, therefore, common ground that the issuing bank had been entitled to reject them.

4 See Case 11 in *Case Studies on Documentary Credits*, ICC No 459.

Time at which fraud must be apparent

9.53 At what time must the fraud be apparent to the bank? This question arises in two different situations: first, if the bank has already paid on the credit and the applicant (or other instructing party) is resisting reimbursement;¹ secondly, if the bank has not paid and is resisting proceedings by the beneficiary for payment under the credit.²

¹ See para 9.40.

² See para 9.32.

9.54 In the first situation, if the bank pays in accordance with the terms of the credit, then it is entitled to reimbursement unless there was clear evidence of fraud at the time of payment.¹ The bank has a strictly limited period to consider the documents and cannot and should not engage in prolonged inquiries of the sort which might be carried out at a full trial between beneficiary and applicant. It is not open to the applicant objecting to the bank's decision to rely on evidence not made available to the bank at the time of payment. See *United Trading Corp'n SA v Allied Arab Bank Ltd*:²

'The relevant date for establishing knowledge of fraud

It seems to us clear that, where payment has in fact been made, the bank's knowledge that the demand made by the beneficiary on the performance bond was fraudulent must exist prior to the actual payment to the beneficiary and that its knowledge at that date must be proved. Accordingly, if all a plaintiff can establish is such knowledge *after* payment, then he has failed to establish his cause of action. The bank would not have been in breach of any duty in making the payment without the requisite knowledge. We doubt that this is really open to contest.'

¹ *Crédit Agricole Indosuez v Generale Bank* [1999] 2 All ER (Comm) 1009 at 1015.

² [1985] 2 Lloyd's Rep 554n at 560.

9.55 In the second situation, if fraud is apparent at the time payment is due, then the bank must not pay and has a defence to a claim by the beneficiary. Suppose, however, that the bank rejects documents for alleged discrepancies or for alleged fraud but that decision is subsequently held (or conceded) to be wrong based on the material available at the time payment was due, can the bank defend proceedings relying on new evidence of fraud which came to light after the date for payment but before the trial? As discussed above, in *Balfour Beatty Civil Engineering v Technical & General Guarantee Co Ltd*¹ Waller LJ identified the 'absurdity' that would result if a court, having heard evidence on an application for summary judgment, felt bound to give judgment because it concluded that, although fraud was now sufficiently established, it had not been sufficiently established and known to the bank at the time when the demand was made under the relevant instrument. The key to avoiding this absurdity lay in his view in recognising that the bank would, in this situation, have a cause of action against the beneficiary for fraudulent misrepresentation, on which it could obtain summary judgment which it could then use to

extinguish its liability on the instrument. In a case where the fraudulent misrepresentation was so clear as itself to justify summary judgment, no difficulty arose. The parties' established rights to judgment would simply cancel out and preclude any judgment on the claim. In other cases, if the evidence of fraud was 'powerful' the bank could either seek a stay of execution in respect of its liability on the instrument or a deferral of any judgment on the instrument until after trial of its counterclaim. If the evidence was less than powerful, the bank would simply be left to pursue a counterclaim against the beneficiary for reimbursement or its remedy against its customer.²

¹ (1999) 68 Con LR 180, see para 9.35 above.

² In this context 'powerful evidence' is similar to 'real prospect of success'. See *Safa Ltd v Banque du Caire* [2000] 2 Lloyd's Rep. 600.

9.56 However, in the later case of *Safa Ltd v Banque du Caire*¹ Waller LJ accepted that a claim by a bank that is being sued on what it alleges is a fraudulent demand is something the bank can raise by way of defence or set-off and not simply by counterclaim. In *Solo Industries UK Ltd v Canara Bank*² Mance LJ (with whom the other members of the Court of Appeal agreed) considered Waller LJ's analysis in *Balfour* and held that:

'Another way of reaching the same conclusion in cases where there is, by although not before the time of the hearing, established fraud, (and probably also in case where there is, by the same time "powerful" evidence of fraud) may be by applying Lord Diplock's underlying principle that the court should not lend its process to assist fraud and that "fraud unravels all". No question arises in this context of the grant of injunctive relief or of any requirement for that purpose to have a cause of action. It would affront good sense, and probably general principles relating to illegality, if courts were obliged to give judgment in favour of a beneficiary now shown to be acting fraudulently.'

¹ [2000] 2 Lloyd's Rep 600.

² [2001] EWCA Civ 1059; [2001] 1 WLR 1800 at [21].

9.57 In *Mahonia Ltd v JP Morgan Chase Bank*,¹ Colman J expressed the view that it was unnecessary to confine the bank's position to one founded on a counterclaim for damages or circuitry or potential circuitry of action: 'as long as there is before the court evidence which establishes fraud by the beneficiary there is evidence sufficient to establish a straight defence based on *ex turpi causa*'. For this purpose Colman J agreed with Waller LJ's analysis in the *Balfour Beatty* case that the strength of the fraud case has to be tested on the evidence available at the hearing as distinct from the time of demand. He reasoned that just as the bank's entitlement to withhold payment was based, according to the *United City Merchants* case, on clear evidence of fraud and therefore of an *ex turpi causa* defence at the time when the demand is made and payment would otherwise be due, so also the bank should have a direct defence on the basis of *ex turpi causa* at whatever stage in the proceedings prior to the hearing it can adduce the evidence necessary to establish fraud. The availability of the defence could not depend on whether evidence of fraud becomes available before or after demand is made and payment is otherwise due.²

1 [2003] EWHC 1927 (Comm); [2003] 2 Lloyd's Rep 911 at paras 45–47.

2 At the subsequent trial Cooke J agreed with Colman J's conclusions on this issue. See *Mahonia Ltd v JP Morgan Chase Bank* [2004] EWHC 1938 (Comm) at para 209.

9.58 The same conclusion should be reached if, as considered in para 9.14 above, the basis of the exception is a limitation in the bank's mandate, for in common with the general rule in contractual disputes the bank should be entitled to justify retrospectively its refusal to perform its obligations using any reasons known at trial.¹ Article 16.f prevents the bank doing this in respect of discrepancies if they have not been notified to the beneficiary, but the fraud exception is governed by common law and not by the UCP and there is no equivalent provision which prevents the bank from relying on late evidence in support of a fraud defence. Therefore, although the bank's initial decision to reject should be based on clear evidence of fraud at that time, it is suggested that if that decision should be wrong the bank should be entitled to justify its rejection using all facts known at the time the matter is tried, whether on an application for summary judgment or at a full trial. It is conceivable that a bank might abuse such a rule by declining payment in a borderline fraud case, taking a chance that further material will come to light before trial. Of course it is then taking a risk with its reputation as well as its liability and it is doubtless for that reason that the reported cases mostly concern attempts by applicants to restrain payment rather than attempts by banks to avoid payment.

¹ This is the general rule in contractual disputes: *Chitty on Contracts* (30th edn) para 24-014.

Other materials on fraud

9.59 For comparison purposes, set out below are the relevant extracts relating to fraudulent or abusive drawings in International Standby Practices 1998 (ISP98) (a set of rules for standby credits), the United States Uniform Commercial Code and the United Nations Convention on Independent Guarantees and Standby Letters of Credit. None of these is directly applicable to the English law on the fraud exception.

(a) *Fraud and ISP98*¹

9.60 Like the Uniform Customs, ISP98 does not make provision for fraud, but contains an express reservation:

'Rule 1.05: Exclusion of Matters Related to Due Issuance and Fraudulent or Abusive Drawing

These Rules do not define or otherwise provide for: ...

- c. defenses to honour based on fraud, abuse, or similar matters. These matters are left to applicable law.'

¹ See para 12.34 below.

(b) *Fraud and the United States Uniform Commercial Code*

9.61 The United States Uniform Commercial Code (UCC) applies to credits governed by United States state law and not, of course, to those governed by English law. The UCC is also displaced, so far as it is inconsistent, by the provisions of the UCP where they are expressly incorporated into a credit. However, it is a useful illustration of how the exception can be codified.

'UCC §5-109 Fraud and Forgery:

- (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 honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:
- (1) the issuer shall honor the presentation, if honor 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 honored 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 obligation was incurred by the issuer or nominated person; and
 - (2) the issuer, acting in good faith, may honor or dishonor the presentation in any other case.'

(c) *Fraud and the United Nations Convention on Independent Guarantees and Standby Letters of Credit*

9.62 The Convention entitles but does not impose a duty on the guarantor/issuer, as against the beneficiary, to refuse payment when confronted with fraudulent or abusive demands for payment. The Convention has not been ratified by the United Kingdom, United States or any Commonwealth country or European Union member state.¹ However, it provides another codification of the exception. The Explanatory Note to the Convention² states that 'a main purpose of the Convention is to establish greater uniformity internationally in the manner in which guarantor/issuers and courts respond to allegations of fraud or abuse in demands for payment under independent guarantees and stand-by letters of credit ... That difficulty and the resulting uncertainty have been compounded further because of the divergent notions and ways with which such allegations have been treated both by guarantor/issuers and by courts approached for provisional measures to block payment. The Convention helps to ameliorate the problem by providing an internationally agreed general definition of the types of situation in which an exception to the obligation to pay against a facially compliant demand would be justified'.

'Article 19 Exception to payment obligation:

- (1) If it is manifest and clear that:
- (a) Any document is not genuine or has been falsified;
 - (b) No payment is due on the basis asserted in the demand and the supporting documents; or
 - (c) Judging by the type and purpose of the undertaking, the demand has no conceivable basis, the guarantor/issuer, acting in good faith, has a right, as against the beneficiary, to withhold payment.
- (2) For the purposes of subparagraph (c) of paragraph (1) of this article, the following are types of situations in which a demand has no conceivable basis:
- (a) The contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialized;
 - (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 wilful misconduct of the beneficiary;
 - (e) 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.¹

1 The Convention has been ratified or acceded to by Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama and Tunisia.

2 See paras 45 and 46 of the Explanatory Note by the UNICTRAL secretariat.

B INJUNCTIONS

Introduction

9.63 Where the applicant for a documentary credit or a performance bond considers that the beneficiary is going to make or has made a presentation under the credit or bond which he should not make and which should not be met with payment by the paying bank, he may seek to prevent the presentation or payment or both by applying for injunctions against relevant parties. Such an application will meet a number of difficulties. Injunctions have been upheld in three cases: *Themehelp Ltd v West*;¹ *Kvaerner John Brown Ltd v Midland Bank plc*² (both in reliance on the fraud exception and criticised in *Czarnikow-Rionda v Standard Bank*);³ and *Lorne Stewart plc v Hermes Kreditversicherungs AG*⁴ (where a performance bond was found not to be payable according to its terms). The general principles to be applied in applications for interlocutory injunctions were set out in the speech of Lord Diplock in *American Cyanamid Co v Ethicon Ltd*,⁵ but caution must be exercised in drawing too close parallels with those general principles because

of the special factors which apply to letters of credit, and the public policy in not obstructing the flow of the 'lifeblood of commerce'.⁶ A claimant faces two difficulties in particular. First, he must show that he has a good arguable claim against the party he is seeking to injunct. This will involve him establishing a case of fraud to the knowledge of the party to be injuncted (otherwise the court will not interfere with the operation of the credit), and he must establish a duty owed to him by that party, either in contract or in tort. Secondly, it must appear that the grant of an injunction is the correct exercise of the court's discretion after considering the balance of convenience. So, even if a case as to fraud is sufficiently established, the case is likely to fail where the party sought to be injuncted is a bank because damages will be a sufficient remedy for any breach of duty by the bank. These principles as developed in connection with documentary credit and performance bond or guarantee cases are considered below.

1 [1996] QB 84.

2 [1998] CLC 446. The balance of convenience was not explicitly considered by the court.

3 [1999] 2 Lloyd's Rep 187 at 190.2.

4 (Unreported, 22 October 2001) Garland J.

5 [1975] AC 396.

6 *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152 at 1161.

The basic rule – the autonomy of the credit¹

9.64 The basic rule is that the court will not interfere to prevent the operation of a credit on the ground of matters which are extraneous to the credit itself. This is but one aspect of the autonomy principle. In *Hamzeh Malas & Sons v British Imex Industries Ltd*² the plaintiff buyers considered that the goods supplied as the first instalment under a two instalment contract were seriously defective and sought to prevent the defendant sellers from presenting documents in respect of the second instalment under the confirmed credit which the buyers had arranged to be opened as the means of payment. The injunction was refused. In giving the leading judgment in the Court of Appeal, Jenkins LJ stated:³

'We have been referred to a number of authorities, and it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with that established practice.

There is this to be remembered, too. A vendor of goods selling against a confirmed letter of credit is selling under the assurance that nothing will prevent him from receiving the price. That is of no mean advantage when goods manufactured in one country are being sold in another. It is,

furthermore, to be observed that vendors are often reselling goods bought from third parties. When they are doing that, and when they are being paid by a confirmed letter of credit, their practice is – and I think it was followed by the defendants in this case – to finance the payments necessary to be made to their suppliers against the letter of credit. That system of financing these operations, as I see it, would break down completely if a dispute as between the vendor and the purchaser was to have the effect of “freezing”, if I may use that expression, the sum in respect of which the letter of credit was opened.’

1 Cited, *Themehelp Ltd v West* [1996] QB 84, CA.

2 [1958] 2 QB 127.

3 See [1958] 2 QB at 129.

9.65 In *Howe Richardson Scale Co Ltd v Polimex-Cekop*¹ the claimant sellers had arranged for a performance bond or guarantee to be given by the second defendant bank in respect of the deposit paid to them by the buyers (who were the first defendants), the deposit to be repaid by the bank on the buyer’s first demand if the goods were not delivered by a date. Problems arose in the performance of the contract, in particular as to the opening by the buyers of a letter of credit. The sellers contended that in any event the goods were delivered to warehouse by the date. The buyers made a demand on the bond and the bank informed the sellers that it felt bound to pay. The sellers initially sought injunctions against the buyers and the bank, but did not pursue the latter on appeal. The buyers did not take part in resisting the application, the case being argued by the bank. The Court of Appeal declined to follow *Elian and Rabbath v Matsas*² where an injunction restraining a party from calling a guarantee was granted, stating that that decision should be regarded as very special.³ Roskill LJ stated:⁴

‘The bank, in principle, is in a position not identical with but very similar to the position of a bank which has opened a confirmed irrevocable letter of credit. Whether the obligation arises under a letter of credit or under a guarantee, the obligation of the bank is to perform that which it is required to perform by that particular contract, and that obligation does not in the ordinary way depend on the correct resolution of a dispute as to the sufficiency of performance by the seller to the buyer or by the buyer to the seller as the case may be under the sale and purchase contract; the bank here is simply concerned to see whether the event has happened upon which its obligation to pay has arisen. The bank takes the view that that time has come and that it is compelled to pay; and in my view it would be quite wrong for the Court to interfere with Polimex’s apparent right under this guarantee to seek payment from the bank, because to do so would involve putting upon the bank an obligation to inquire whether or not there had been timeous performance of the sellers’ obligations under the sale contract.’

1 [1978] 1 Lloyd’s Rep 161.

2 [1966] 2 Lloyd’s Rep 495.

3 See [1978] 1 Lloyd’s Rep at 165.1.

4 [1978] 1 Lloyd’s Rep at 165.2.

9.66 Lastly, it is worth quoting an often-referred-to passage from the judgment of Kerr J in *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd*.¹ He stated:

‘It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration ... The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged.’

1 [1978] QB 146 at 155H–156A.

The fraud exception and proof

9.67 The autonomous nature of letters of credit means that absent fraud by the seller presenting documents to the confirming bank seeking payment, the court will not restrain a bank from paying a letter of credit which is payable according to its terms, nor a beneficiary from seeking payment. Nor, again, absent fraud, will the court restrain a beneficiary from drawing on a letter of credit which is payable in accordance with its terms on the application of a buyer who is in dispute with the seller as to whether the underlying sale contract has been broken.¹ The exception has been considered specifically in relation to injunctions in a number of cases.² It has been emphasised in all of them that the fraud and the knowledge of the bank must be clearly established. Thus in the *Edward Owen* case³ Lord Denning MR stated⁴ ‘The only exception is where there is a clear fraud of which the bank had notice’ and Browne LJ stated:⁵ ‘But it is certainly not enough to allege fraud: it must be “established” and in such circumstances I should say very clearly established.’ Geoffrey Lane LJ referred⁶ to ‘if it had been clear and obvious to the bank that the buyers had been guilty of fraud’. With this in mind, at the termination of the judgment of the Court of Appeal in *Bolivinter Oil SA v Chase Manhattan Bank*⁷ the court gave general guidance as to the granting of *ex parte* injunctions in relation to credits and bonds. The court stated:⁸

‘Before leaving this appeal, we should like to add a word about the circumstances in which an *ex parte* injunction should be issued which prohibits a bank from paying under an irrevocable letter of credit or a purchase bond or guarantee. The unique value of such a letter, bond or guarantee is that the beneficiary can be completely satisfied that whatever disputes may thereafter arise between him and the bank’s customer in relation

to the performance or indeed existence of the underlying contract, the bank is personally undertaking to pay him provided that the specified conditions are met. In requesting his bank to issue such a letter, bond or guarantee, the customer is seeking to take advantage of this unique characteristic. If, save in the most exceptional cases, he is to be allowed to derogate from the bank's personal and irrevocable undertaking, given be it again noted at his request, by obtaining an injunction restraining the bank from honouring that undertaking, he will undermine what is the bank's greatest asset, however large and rich it may be, namely its reputation for financial and contractual probity. Furthermore, if this happens at all frequently, the value of the irrevocable letters of credit and performance bonds and guarantees will be undermined.

Judges who are asked, often at short notice and *ex parte*, to issue an injunction restraining payment by a bank under an irrevocable letter of credit or performance bond or guarantee should ask whether there is any challenge to the validity of the letter, bond or guarantee itself. If there is not or if the challenge is not substantial, *prima facie* no injunction should be granted and the bank should be left free to honour its contractual obligation, although restrictions may well be imposed upon the freedom of the beneficiary to deal with the money after he has received it. The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests upon the uncorroborated statement of the customer, for irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged. The appeal will be dismissed.¹

- 1 *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152, 1160-1162; *Sirius Insurance Co v FAI General Insurance Ltd* [2003] EWCA Civ 470; [2003] 1 WLR 2214.
- 2 *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 WLR 315; *R D Harbottle (Merchant) Ltd v National Westminster Bank Ltd* [1978] QB 146; *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159; *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251, also reported in part at [1984] 1 All ER 351n, [1984] 1 WLR 392; *United Trading Corp SA v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554n; *Tukan Timber Ltd v Barclays Bank plc* [1987] 1 Lloyd's Rep 171; *Themehelp Ltd v West* [1996] QB 84; *Czarnikow-Rionda v Standard Bank* [1999] 2 Lloyd's Rep 187. See also *Society of Lloyd's v Canadian Imperial Bank of Commerce* [1993] 2 Lloyd's Rep 573 and *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152.
- 3 *Edward Owen Engineering Ltd v Barclays Bank International Ltd*. [1978] QB 159.
- 4 [1978] QB 159 at 171C.
- 5 [1978] QB 159 at 173A.
- 6 [1978] QB 159 at 175.
- 7 [1984] 1 Lloyd's Rep 251.
- 8 [1984] 1 Lloyd's Rep at 251, [1984] 1 WLR at 393, [1984] 1 All ER at 352.

9.68 In *United Trading Corp SA v Allied Arab Bank*¹ the Court of Appeal had to consider an argument that every possibility of an innocent explanation had to be excluded by the applicant for the injunction. In rejecting this as an over-statement of the burden of proof the court entered upon a detailed examination of what must be shown and concluded that it was sufficient that it established as seriously arguable that, on the material available, the only

realistic inference was that the beneficiary was guilty of fraud. Ackner LJ stated:²

'The evidence of fraud must be clear, both as to the fact of fraud and as to the bank's knowledge. The mere assertion of allegation of fraud would not be sufficient (see *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251 per Sir John Donaldson MR at p 257). We would expect the Court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. In general, for the evidence of fraud to be clear, we would also expect the buyer to have been given an opportunity to answer the allegation and to have failed 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 to draw is that of fraud, then the seller would have made out a sufficient case of fraud.

While accepting that letters of credit and performance bonds are part of the essential machinery of international commerce (and to delay payment under such documents strikes not only at the proper working of international commerce but also at the reputation and standing of the international banking community), the strength of this proposition can be over-emphasised. As Mr Justice Neill observed in the judgment under appeal, it cannot be in the interests of international commerce or of the banking community as a whole that this important machinery that is provided for traders should be misused for the purposes of fraud. It is interesting to observe that in America, where concern to avoid irreparable damage to international commerce is hardly likely to be lacking, interlocutory relief appears to be more easily obtainable. A temporary restraining order is made essentially on the basis of suspicion of fraud, followed some months later by a further hearing, during which time the applicant has an opportunity of adding to the material which he first put before the Court. Moreover, their conception of fraud is far wider than ours and would appear to include ordinary breach of contract. (See *Dynamics Corp of America v Citizens and Southern National Bank* 356 F Supp 991 (1973); *Harris Corp v NIRT* 691 F 2d 1344 (1982); and *Itek Corp v F N Bank of Boston* 566 F Supp 1210 (1983)). These cases appear to indicate that, for the purpose of obtaining relief in such cases, it is not necessary for an American plaintiff to demonstrate a cause of action against a bank, whereas it is as previously stated, common ground that a plaintiff must in this country show a cause of action. There is no suggestion that this more liberal approach has resulted in the commercial dislocation which has, by implication at least, been suggested would result from rejecting the respondent's submissions as to the standard of proof required from the plaintiffs. Moreover, we would find it an unsatisfactory position if, having established an important exception to what had previously been thought an absolute rule, the Courts in practice were to adopt so restrictive an approach to the evidence required as to prevent themselves from intervening. Were this to be the case, impressive and high-sounding phrases such as 'fraud unravels all' would become meaningless.

The learned Judge concluded that the test to be applied by the Courts is the standard of the hypothetical reasonable banker in possession of all the relevant facts. Unless he can say "this is plainly fraudulent; there cannot be any other explanation", the Courts cannot intervene. We respectfully disagree. The corroborated evidence of a plaintiff and the unexplained failure

12.41 As under the UCP, non-documentary conditions in the standby can be disregarded. However, a condition is not non-documentary if its fulfilment can be 'determined by the issuer from the issuer's own records or within the issuer's normal operations', eg the date of presentation of the document to the issuer or a fact which can be taken from a published index (eg if a standby provides for determining amounts of interest accruing according to published interest rates).¹

¹ Rule 4.11.

(c) *Rejection*

12.42 If the issuer rejects the presentation it must give a notice of dishonour stating all discrepancies on which the dishonour is based and return the documents to the beneficiary or dispose of them on his instructions. Failure to give notice precludes the issuer from relying on a discrepancy subsequently.¹ However, unlike the UCP, a failure to state that the documents are being returned or held pending a waiver or pending further instructions from the beneficiary does not preclude a defence to payment by the issuer.² This reflects the fact that documents presented under standby credits normally have no intrinsic value. The ISP98 rules on giving notice of dishonour differ from those in both UCP500 and UCP600. Notice must be given within a reasonable time, but notice within three days after presentation is deemed reasonable and notice more than seven days is deemed not reasonable.³ A particular feature of ISP98 is that if the applicant refuses to take up documents from the issuer he is obliged to give a notice of dishonour to the issuer specifying the discrepancies, failing which he is precluded from raising them. No fixed time period is given, but notification must be given 'within a time after the applicant's receipt of the documents which is not unreasonable'.⁴

¹ Rules 5.01 to 5.03.

² Rule 5.07. Contrast UCP Article 16.c.iii.

³ Rule 5.01.

⁴ Rule 5.09.

(d) *Reimbursement*

12.43 Rule 8.01 provides for the issuer's right to reimbursement on payment against a complying presentation. The applicant must also indemnify the issuer against all claims arising out of 'the fraud, forgery or illegal action of others'.¹ *The Official Commentary* notes that the risk of fraudulent presentations is to be borne by the applicant. It is not clear whether it is intended that the applicant should still bear the risk if the fraud was apparent to the issuer at the time of presentation, presumably not.

¹ Rule 8.01b.ii.

Fraudulent and abusive calls

12.44 Where the document or documents against which the credit is payable lie within the power of the beneficiary alone, as is the position where the document is the beneficiary's written demand or his demand accompanied by his own certificate or statement in terms provided by the credit, the credit is open to considerable abuse by the beneficiary. If he is without scruple, he may make a demand under the credit whether or not he has a genuine belief that the account party is at fault in the manner intended by the credit. He will nonetheless be assured of payment unless the bank is prepared to refuse payment on the ground that it can establish lack of genuine belief so the fraud exception is established.¹ As is made clear by the outcome of the cases on fraud considered in **Chapter 9**, it will be an exceptional case in which a beneficiary fails to obtain payment on this ground. Even in cases where the situation is that the applicant is only arguably at fault and there may be considerable doubt about it, unless the beneficiary wishes to preserve his relationship with the account party, he is very likely to present documents under the credit to utilise his advantage. 'In short, the consequences of a call on a standby letter of credit... can be harsh, draconian and abrupt.'²

¹ See Chapter 9.

² *Royal Bank of Canada v Darlington* (1995) 54 ACWS (3d) 738, per Blair J.

12.45 An account party who wishes to avoid being wholly at the mercy of the beneficiary may have two lines of action open to him depending on whether he is in a position to negotiate the terms of the credit or not. His best course is to arrange for the inclusion among the documents to be presented of one which depends upon a third party of integrity. Thus his position might be improved if, where the underlying contract was an engineering or construction contract, the certificate of the architect engineer or quantity surveyor appointed under the contract was required. It has to be borne in mind that such persons are appointed by the employer under the contract, namely the beneficiary of the credit, and may tend to favour the employer. This may be particularly so in situations where the protection is most badly needed because the employer is seen as likely to behave in an unscrupulous manner. Where the underlying contract is one of sale of goods, the certificate of an independent inspection agency may be required. In other situations it may be possible to utilise the certificate of a company's auditors or that of an independent firm of accountants. Even if appointed by the employer, any third party giving a certificate in those circumstances owes a duty of care to the beneficiary, since it is given for his benefit: *Niru Battery Manufacturing Co v Milestone Trading Ltd.*¹

¹ [2004] 1 Lloyd's Rep 344. See further para 8.152.

12.46 Another means of providing some limited protection is to ensure that the credit does not become operable until an appropriate event has occurred. This will probably be the opening of the credit by which payment pursuant to

the underlying contract is to be made to the account party for the standby credit. Similarly the account party may try to arrange a cut-off point at the other end. Obviously the earlier the expiry date is, the more advantageous to him. It has to be remembered that it may well happen that, as the expiry date draws near, an unscrupulous beneficiary will ask for the credit to be extended, threatening that, if it is not, he will present documents under the credit. The applicant may try to include a cancellation clause, entitling him to require the cancellation of the credit by presenting a certificate that the underlying contract has been fully and satisfactorily performed on his part.

12.47 The circumstances in which the bank can refuse payment on the grounds of fraud by the beneficiary have been considered in **Chapter 9**. The same principles apply to a standby credit as apply to an ordinary credit.¹ It may be that in the case of standby credits and performance bonds the English courts will tend to the easing of the rule in order to check at least some of the apparently blatant abuses by beneficiaries which have gone unchecked so far.² It must be said, however, that if parties enter into transactions which may so easily be abused, there is only a very limited role which the courts can play in preventing that abuse if they are not to rewrite the bargains into which the parties have entered.

¹ *Society of Lloyd's v Canadian Imperial Bank of Commerce* [1993] 2 Lloyd's Rep 579; *Kvaerner John Brown Ltd v Midland Bank plc* [1998] CLC 446.

² See *United Trading Corp SA v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554n at 561. See also *TTI Team Telecom International Ltd v Hutchison 3G UK Ltd* [2003] 1 All ER (Comm) 914, where Judge Thornton QC held that 'lack of good faith' by the beneficiary might justify non-payment; see further para 9.29 above.

C INDEPENDENT GUARANTEES

Functions of independent guarantees

(a) Performance bonds and guarantees

12.48 These are the most common, and can be used for straightforward contracts of sale as well as for construction and other complicated projects. Thus, in the case of sale, if a buyer is in a sufficiently strong commercial position to do so, he may require the seller to open a performance bond for a proportion, perhaps 5% or 10% of the purchase price, this to be payable on first demand in the event of the seller's failure correctly to perform the sale contract. For example, the underlying contracts in the *Harbottle* case¹ were for the sale of horse tic beans and for the sale of coal. If the seller is wise, he will, if he can, procure that his bond only becomes effective after the buyer has opened his letter of credit: this will avoid the risk that there will be disputes over the credit and the buyer will call the bond.² Sometimes a seller will simply add the amount of the bond, or a substantial proportion of it, to the contract

price because he knows that there is a strong likelihood of the bond being called whether or not he correctly performs his part of the contract.

¹ *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 146.

² *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159.

(b) Bid or tender bonds or guarantees

12.49 Where bids or tenders are called for on large contracts the buyer (or employer) may want an assurance that the tenderers are wholly serious and capable of undertaking the work and will be able to enter a contract to do so supported by the appropriate performance bond if they are selected. The tender instructions will then require that the tenderers supply a bond which will be released either if the tenderer is not selected or following the entering into of the contract and the provision of the contract performance bond within a specified period. The tender bond must almost of necessity be a demand bond.

(c) Advance payment bonds or guarantees

12.50 If an advance payment is to be made to a contractor or seller to provide him with some immediate finance, the employer or buyer can obtain security by means of a bond providing for repayment of the advance should the seller fail to perform the contract. An example is to be found in *Howe Richardson Scale Ltd v Polimex-Cekop*.¹ The guarantee covered an advance payment of £25,000 on the contract price of £500,000 for equipment to be manufactured by the plaintiffs. The guarantee was called by the making of a demand when the plaintiffs who had completed manufacture did not ship the equipment: the defendants had failed to open a letter of credit and to give shipping instructions. Another example is *Gulf Bank KSC v Mitsubishi Heavy Industries Ltd (No 2)*² where Mitsubishi arranged for an advance payment guarantee to the Kuwaiti Ministry which was later called as a result of the Iraqi invasion. A more recent example is *Uzinterimpex JSC v Standard Bank plc*,³ where the advance payment guarantee, provided in relation to consignments of cotton, was called even though the goods had been received by the buyer. The case is discussed in para 12.69 below.

¹ [1978] 1 Lloyd's Rep 161.

² [1994] 2 Lloyd's Rep 145.

³ [2008] 2 Lloyd's Rep 456.

(d) Retention money bonds or guarantees

12.51 It is common practice for construction and engineering contracts to provide for moneys otherwise certified as payable to be retained until

completion of the work, partly by way of security, and partly because although work may have been certified for payment it is possible that maintenance work will be required in respect of it under the maintenance provisions of the contract. The employer may be prepared to release all or part of the retention moneys against a bond provided by the contractor which will give the employer security of recovery should the contractor default.

(e) *Maintenance bonds or guarantees*

12.52 These secure the performance of a contractor during the maintenance period of a construction contract and are commonly linked to the release of retention moneys.

Legal nature

12.53 Independent guarantees are an autonomous obligation of the guarantor to pay against stipulated documents. In *Edward Owen Engineering Ltd v Barclays Bank International Ltd*¹ Lord Denning MR stated:²

'All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is where there is a clear case of fraud of which the bank has notice.'

The position of fraud as the 'only exception' has come under challenge in recent years from the doctrines of unconscionability (see para 9.26 et seq) and illegality (see para 13.106 et seq).

¹ [1978] QB 159.

² [1978] QB 159 at 171.

Construction: independent or conditional guarantee?

12.54 As mentioned at the start of this chapter, it is often unclear from its terms whether a particular instrument was intended to act as an independent guarantee or a conditional guarantee. This is a question of the greatest importance: under an independent guarantee, payment must be made against documents, under a conditional guarantee, proof of primary liability is required which means that there will have to be an extensive investigation of

the facts and possibly a lengthy trial before payment will be ordered. The analysis is often complicated by the confusing terminology but, as one might expect, the terminology used is not conclusive and the court must analyse the substance of the obligation undertaken. In *American Home Assurance Co v Hong Lam Marine Pte Ltd*,¹ the Singapore Court of Appeal stated:

'The term "performance bond" or "performance guarantee" is sometimes used to denote a genuine contract of guarantee or indemnity. To make matters even more confusing, a guarantee or indemnity may be given in circumstances in which one might expect to find a true performance bond. The nature of the particular contract, whether it happens to be a guarantee or an indemnity, or a performance bond, and whether the normal incidents of a contract of that class have been modified, is ultimately a question of construction in each case, and is often very difficult to resolve...'

¹ [1999] 3 SLR 682.

12.55 The principal authorities in which the question has arisen are discussed below. Each case turns on the wording of the relevant instrument, but it may be concluded from the cases that, where a guarantee or bond is stated to be payable by a bank or other financial institution on demand, in the absence of clear words indicating that liability under it is conditional upon the existence of liability on the part of the account party in connection with the underlying transaction, the guarantee is to be construed as an independent guarantee entitling its beneficiary to payment simply against an appropriately worded demand accompanied by such other documents as the guarantee may require.¹ In particular, such a guarantee will not be construed as payable only if a particular event has occurred simply because the guarantee sets out, without more, the event or events following the happening of which it is intended that a demand may be made. It is possible that where the guarantee is part of an international transaction the tendency of the court to hold that all that is required is an appropriate demand together with any other documents as may be specified by the guarantee, will be stronger than in a purely domestic context.

¹ The position may be somewhat different in a non-banking context, see *Marubeni Hong Kong and South China Ltd v Government of Mongolia* [2005] EWCA Civ 395; [2005] 1 WLR 2497, discussed at para 12.61 below.

12.56 *Esal Commodities Ltd v Oriental Credit Ltd*.¹ The applicant for the bond, Reltor Ltd, an associate company of Esal, went into liquidation. The bond provided 'We, hereby issue this performance bond for a sum not exceeding US\$487,300... being 10 per cent of the tender value... We undertake to pay the said amount of your written demand in the event that the supplier fails to ship the agreed quantity in accordance with the terms of their contract with you and subject to the receipt of irrevocable sight letter of credit confirmed and payable in London from you in their favour.' It was contended by Oriental Credit as the bank indemnifying Wells Fargo Bank who in their turn were indemnifying the Banque du Caire who had confirmed and paid on the bond, that there was no liability under the bond unless and

applied to Sonali to open a letter of credit in favour of the seller. The Bank of Credit and Commerce Hong Kong (BCCHK) agreed to add its confirmation. The seller presented the documents to BCCHK, which subsequently negotiated the documents and presented them to Sonali. Sonali failed to reimburse BCCHK despite its having either accepted the documents or failed to reject them in a timely fashion. As a result, BCCHK commenced proceedings seeking reimbursement from Sonali. In analysing the position at common law, Cresswell J cited with approval the approach adopted by Mance J's judgment in *Bank of Baroda* above, both with respect to the characteristic performance of the relationship between confirming bank and beneficiary and also with respect to the application of Article 4(5) to ensure that the same law applied to all the contracts that the beneficiary had with the banks.

¹ [1995] 1 Lloyd's Rep 227 subsequently referred to with approval by Staughton LJ in *Wahda Bank v Arab Bank plc* [1996] 1 Lloyd's Rep 470 at 473, CA.

13.53 It is suggested that there is an alternative route to this result based on an argument that the performance characteristic of the contract is that of the bank that examines the presented documents and determines whether to accept or reject them.

13.54 Where there is only one bank involved, namely example (1) in para 13.49 above, this interpretation of Article 4(2) of the Convention would result in the law of the issuing bank governing that contract.

13.55 Where the contract under examination is that between the confirming bank and the beneficiary, namely example (2) in para 13.49 above, this interpretation of Article 4(2) of the Convention would result in the law of the advising bank governing that contract.

13.56 Where there are two banks involved and the contract under examination is that between the issuing bank and the beneficiary, the presumption in Article 4(2) would only produce the suggested and desired result if the advising/confirming bank could be treated as 'a place of business other than the principal place of business'¹ of the issuing bank. Unless one is a branch of the other this will not be the case. As a result Article 4(5) would have to be applied to give the outcome desired.² In the Giuliano-Lagarde Report it is stated that it is 'quite natural' that, where they differ, the law of the bank's place of business shall prevail over the country of performance.³

¹ The relevant words from Article 4(2).

² See *Bank of Baroda v Vysya Bank* [1994] 2 Lloyd's Rep 87 at 93.1 and *Bank of Credit and Commerce Hong Kong Ltd v Sonali Bank* [1995] 1 Lloyd's Rep 227.

³ See the Giuliano-Lagarde Report page 21.

13.57 In *PT Pan Indonesia Bank Ltd TBK v Marconi Communications International Ltd* the Court of Appeal held that the factors of the most

obvious significance in determining which country that has the closest connection to the contract between seller/beneficiary and issuing/confirming bank under a letter of credit were (i) the place where the documents necessary to procure payment to the seller/beneficiary are to be presented and checked; and (ii) the place where payment to the seller/beneficiary is to be made against those documents.¹ Using this test, the Court of Appeal disregarded the presumption in Article 4(2), and applied Article 4(5) to determine which law would govern the contract before it.

¹ [2007] 2 Lloyd's Rep 72 at 84.

13.58 The Court of Appeal also confirmed that it was desirable that the same system of law should govern the co-existing contracts between:

- (a) the issuing bank and the beneficiary;
- (b) the confirming bank and the beneficiary; and
- (c) the issuing bank and the confirming bank.¹

¹ [2007] 2 Lloyd's Rep 72 at 83.

13.59 Marconi entered into a contract to supply telephone equipment and services to an Indonesian company. Payment for this underlying transaction was to be by a documentary credit. The credit had been issued through an Indonesian bank, Hastin Bank, on the application of the Indonesian buyer. PT Pan Indonesia Bank ('Panin') was another Indonesian bank that acted as the confirming bank in relation to the letter of credit, under which Marconi was the beneficiary. The letter of credit was to be advised through Standard Chartered Bank in London. Standard Chartered Bank was authorised (but not obliged) to give value for Marconi's drafts drawn on Panin against compliant documents and claim reimbursement from Panin by payment of the draft upon maturity.

13.60 Both Hastin, the Indonesian issuing bank, and Panin rejected the documents presented under the letter of credit. Panin therefore refused to pay Marconi. Standard Chartered Bank rejected the alleged discrepancies as unjustified but Panin refused to pay. Hastin became insolvent. Panin admitted that it had been intended that under the letter of credit drafts would have been drawn on Panin Bank; Marconi would have negotiated such drafts with Standard Chartered Bank London and would have received payment from Standard Chartered Bank in London.

13.61 Marconi issued proceedings in England claiming damages for Panin's failure to honour its obligations as confirmer of the letter of credit. The matter came before the Court of Appeal on the Bank's challenge to the jurisdiction of the English court. Argument focused mainly upon the question of what law governed the relevant contract. In accordance with the relevant test¹ Marconi had to establish that it had a good arguable case that English law applied.

¹ *Seaconsar Far East v Bank Markazi Jombouri Islami Iran* [1994] 1 AC 438.

13.62 Potter LJ, who delivered the judgment of the Court, first stated that at common law the place with which the contract between the issuing bank and the beneficiary embodied in the credit was most closely connected was the place 'at which the documents will be presented and at which and at which authority has been given to make payments of sums due or to accept drafts drawn under the credit.' The same result was reached under the Rome Convention in *Bank of Baroda v Vysya Bank*.

13.63 At first instance in *PT Pan Indonesia Bank Ltd TBK v Marconi Communications International Ltd* David Steel J had followed *Bank of Baroda v Vysya Bank* and held that there was a good arguable case that the Article 4(2) presumption should be disregarded because the contract as a whole was more closely connected with England than Indonesia. The Court of Appeal agreed with David Steel J's approach. Potter LJ observed that it is 'misleading' to speak of a law governing a letter of credit because as a matter of fact and law a letter of credit gives rise to a number of autonomous bilateral contracts between banks and the transacting parties, each of which contracts has a separate characteristic performance and potentially a different governing law.¹ Potter LJ further stated that:²

'62... it is in our view important for the court to bear in mind the essential nature and commercial purpose of a letter of credit transaction in the international sale of goods, namely to provide the seller/beneficiary with the right to receive payment against compliant documents in a particular country, usually that in which the seller carries on business ...

63. In the context of the overall purpose of a letter of credit transaction, when considering the contracts arising between the seller/beneficiary and the issuing or confirming bank, the geographical location of the factors which, absent the presumption contained in Article 4(2), are of most obvious significance when considering the closest connection with a particular country, are not the location of the central administration or place of business of either of those banks but the place where the documents necessary to procure payment to the seller/beneficiary are to be presented and checked, and the place where payment to the seller/beneficiary is to be made against those documents. I would also observe that, whereas the place where the contract is made may have jurisdictional significance, in these days of electronic communication it is of little significance so far as "close connection" is concerned. While frequently the confirming bank will be the corresponding/advising bank, it is not necessarily so, as this case demonstrates. Nor does it affect the essential nature, structure and effect of the transaction as governed by the UCP. In either case, the confirming bank, by adding its confirmation, simply assumes by separate engagement, obligations to the same effect as those of the issuing bank so far as the beneficiary is concerned: see UCP Article 9(a)(iv) and 9(b)(iv).'

The place in which documents are presented and payment is made will therefore be determinative of which system of law governs the contract between the seller/beneficiary and the issuing/confirming bank. This is a practical and commercially desirable outcome.

1 [2007] 2 Lloyd's Rep 72 at 84 para 61.

2 [2007] 2 Lloyd's Rep 72 at 84 paras 62 and 63.

13.64 In *PT Pan Indonesia Bank Ltd TBK v Marconi Communications International Ltd*, the only contract that might not have justified the application of English law under Article 4(5) was that between the issuing bank (Hastin) and the confirming bank (Panin); both banks were based in Indonesia. Potter LJ remarked that the contract between issuing and confirming bank merely established the confirming bank's right to reimbursement consequential upon payment to the seller/beneficiary for whose benefit the letter of credit had been established. The court's view appears to have been that this contract is of secondary importance and the law governing it would not be permitted to override or 'infect' the question of which law governs the contract between the seller/beneficiary and the issuing/confirming banks: those contracts being the main purpose for the existence of the documentary credit.¹

1 [2007] 2 Lloyd's Rep 72 at 85 para. 67 and see para 13.67 below.

(3) Contracts between applicant and issuing bank

13.65 The applicant and issuing bank will normally be in the same country. It is suggested that on any analysis the contract between them must ordinarily be governed by the law of the country in which the issuing bank is situated since that is the place in which banking services would be provided by the bank to its customer (here the applicant) and in which repayment of the credit would be made to the bank by the applicant. This was certainly the position adopted by the common law. In *Libyan Arab Foreign Bank v Bankers Trust* Staughton J stated that 'as a general rule the contract between a bank and its customer is governed by the law of the place where the account is kept, in the absence of agreement to the contrary'.¹ The applicant will usually have an account with the bank that it requests to open a letter of credit. As a result the same law will govern their relations both in respect of the account and such credits as the bank is requested to open.

1 *Libyan Arab Foreign Bank v Bankers Trust* [1988] 1 Lloyd's Rep 259 at 270.

13.66 It is submitted that the same result would follow from the application of the Rome Convention. It will be the issuing bank which effects 'the performance which is characteristic of the contract'.¹ The statement in the Giuliano-Lagarde Report that 'in a banking contract the law of the country of the banking establishment with which the transaction is made will normally govern the contract' is directly applicable.² It is also logical that, if the issuing of the credit is the performance characteristic of the contract between the issuing bank and the beneficiary, it should also be the performance characteristic of the contract between the issuing bank and the applicant. Any

other conclusion could result in the issuing bank having to apply different systems of law to its dealings with different parties to the letter of credit. This would hardly be a sensible situation. Even if Article 4(2) does not provide the desired result, Article 4(5) could be used to attain it.

¹ See Article 4(2) Rome Convention.

² Giuliano-Lagarde Report, p 21: see also the cases applying this principle to banking contracts generally at para 13.31 above.

(4) Relations between banks

13.67 If a correspondent bank is employed, it will almost certainly be in a different country to the issuing bank. The functions which it performs are carried out vis-à-vis the issuing bank as the agent of the issuing bank. Those functions, namely the advising of the credit, the examination of documents and payment functions, are all carried out by it in the country in which it is situated. It was held in *Bank of Baroda v Vysya Bank* that the 'performance which is characteristic of the contract' for the purpose of Article 4(2) of the Rome Convention is effected by the correspondent bank by adding its confirmation to the letter of credit.¹ The application of this law will result in the same law being applied as governs the relationship between the issuing/confirming bank and the beneficiary. The same conclusion would be reached under the common law rules.²

¹ *Bank of Baroda v Vysya Bank* [1994] 2 Lloyd's Rep 87 as applied in *Bank of Credit and Commerce Hong Kong Ltd v Sonali Bank* [1995] 1 Lloyd's Rep 227. See also *Wahda Bank v Arab Bank plc* [1996] 1 Lloyd's Rep 470, per Staughton LJ: 'When one bank issues a letter of credit and instructs another bank to confirm it, once again the confirming bank will wish to be sure that its right of reimbursement is, back-to-back, the same as its liability. It will wish to ensure that it takes no risk other than the solvency of the bank that is going to reimburse it.' The performance 'characteristic' of a contract between confirming and issuing banks is not the fulfilment of the confirming bank's right to reimbursement by the issuing bank, this is merely consequential on the character of the contract and does not characterise it for the purpose of Article 4(2) (*Bank of Baroda v Vysya Bank* [1994] 2 Lloyd's Rep 87 at 91, per Mance J).

² *Habib Bank v Central Bank of Sudan* [2006] 2 Lloyd's Rep 412.

13.68 Where the two banks are based in the same country the question of which law governs under the Rome Convention should be straightforward to answer, since all relevant events are likely to take place in that country and the law of that country will govern. This is supported by the reasoning (*obiter* as the point was not at issue) in *PT Pan Indonesia Bank Ltd TBK v Marconi Communications International Ltd* where the Court of Appeal considered this relationship between banks in the context of the Rome Convention. Potter LJ tentatively held that 'it could be said that' the contract between the issuing and confirming banks, both of whom were based in Indonesia, was governed by Indonesian law under the presumption in Article 4(2) and that overriding this by the application of Article 4(5) was unlikely to be justified.¹

¹ *PT Pan Indonesia Bank Ltd TBK v Marconi Communications International Ltd* [2007] 2 Lloyd's Rep 72 at para 67.

(5) Negotiation credits

13.69 The credit may enable any bank to negotiate documents and to present them under the credit to the advising bank, or as the credit provides negotiation may be restricted to a class of banks (probably defined by situation) or just one bank. In each of these situations two relationships have to be considered: first, that between the negotiating bank and the banks giving undertakings under the credit; secondly, that between the beneficiary and the negotiating bank.

13.70 (a) With regard to the negotiating bank and the banks giving undertakings in respect of the credit, it is suggested that a negotiating bank is in the same position as the beneficiary himself, whom it has effectively become. Thus the same governing law must apply between the negotiating bank and the issuing and any confirming bank, and it will be the law of the place where the bank is situated to which presentation of documents is to be made by the negotiating bank. It cannot make any difference that the negotiating bank is situated in another country. Among other reasons, if that could affect the choice of proper law, it would mean that the proper law of the credit varied according to whether negotiation occurred and where the negotiating bank was situated. If the negotiation takes place in the same country as the bank to which presentation of documents is to be made under the credit, the same law will apply between the beneficiary and the negotiating bank as governs the credit. Negotiation may, however, take place in another country. For example, an issuing bank might advise a negotiable credit direct to a beneficiary in another country in which negotiation then takes place. Where the credit is available by negotiation, in the sense that the credit provides for the advising bank to negotiate the documents, the governing law of the credit will be the law of the place where the advising bank is situated.¹

¹ This statement in the third edition was approved as supporting the conclusions reached by the Court of Appeal in *PT Pan Indonesia Bank Ltd TBK v Marconi Communications International Ltd* [2007] 2 Lloyd's Rep 72 at para 65. See also Brindle & Cox at 8-115 for criticism of this view.

13.71 It is suggested in para 13.67 above that the law governing relations between an issuing bank and an advising bank which has to handle the documents is likely to be the law of the place where the advising bank is situated. This should also be the case where the credit is available by negotiation by the advising bank. If that is right, it follows that in this respect an advising bank nominated by the credit to negotiate is in a different position to a bank which negotiates under a freely negotiable credit: (i) the former's relations with the issuing bank to which it must present the documents which it has negotiated are governed by the law of the place where it is situated; while (ii) the latter's relations with the bank to which it must present the documents are governed by the law of the place where that bank is situated. This follows as a matter of logic because of the special position of a bank nominated by the credit to handle the documents.

13.72 (b) The law governing relations between the beneficiary and the bank to which it negotiates the documents need not be, and is perhaps unlikely to be, the same law as that governing the credit itself. Although that law is one factor in determining the governing law between the negotiation bank and the beneficiary, each case has to be examined on its own facts to see with which system of law the contract between them relating to the negotiation has its closest and most real connection. The law of the country where the negotiation takes place is likely to be a strong contender.

(6) Transferable credits

13.73 Where a credit is transferred to a second beneficiary, new relationships come into being with the banks giving undertakings under the credit, in that those undertakings are extended to the new beneficiary as well as remaining extended to the old. Where the place of presentation of documents remains unchanged by the transfer, it is clear that the law governing the undertakings given to the second beneficiary should be the same as the law which governs the undertakings given to the first beneficiary.

13.74 However, the credit may be transferred to another place in another country pursuant to Article 38.j of the UCP, with the object that the second beneficiary can present documents in his own country. Does this then mean that the undertakings given to him by the issuing and any confirming bank will be governed by a different law, namely the law of the second beneficiary's country? It is suggested that it does not and that there should remain one law governing the whole operation of the credit as between the undertaking banks and both beneficiaries, which should be determined, as has been discussed, as the law of the place where the bank is situated to which documents are to be presented by the first beneficiary. Anything else means that transfer of the credit to another country has the effect of partially changing the governing law.¹ By the same token, if there is one consistent governing law, it may mean that the bank to which the credit is transferred and the second beneficiary will be obliged to operate the credit in accordance with a foreign law.² If the bank to which the credit is transferred confirms the credit to the second beneficiary, it is suggested in this instance that the law governing the contract between that bank and the second beneficiary should be the same law that governs the contract which is being confirmed, namely the contract between the issuing bank and the second beneficiary arising from the transferred credit.

¹ It may be suggested against this that, in accordance with the reasoning previously adopted, the governing law must be the law of the place where the bank to which the documents are to be presented is situated: that is, of the country of the bank at which the documents are to be presented under the transferred credit. There are here, however, other important elements to consider such as consistency and commercial certainty, which make the proposed solution preferable in relation to transferable credits.

² A possibility to be borne in mind is that provisions of the law of the country where presentation of documents is to take place, may require to be applied to questions specifically concerning presentation.

(7) Bills of exchange

13.75 Where there is a question of the law governing a particular issue arising in connection with the right of a claimant to be paid in reliance upon rights given by a bill of exchange, rather than by the undertakings arising in connection with the credit pursuant to which the bill has come into being, in England the applicable law is determined by s 72 of the Bills of Exchange Act 1882. Questions arising under bills of exchange and other negotiable instruments are excluded from the ambit of the Rome Convention by Article 1(2)(c). A claimant may be relying on the bill rather than on the credit when he is holder of an accepted bill either as the drawer or as a party to whom it has been negotiated, and he is claiming against the acceptor. Likewise where the claim is against the drawer of the bill (the beneficiary of the credit) and the claim is made by one to whom the bill has been negotiated with recourse. The Bills of Exchange Act 1882 does not apply to a contract that is commercially connected to a bill or note but that is not embodied within the negotiable instrument itself. Thus obligations arising from confirmed documentary credits come within the general conflicts of law rules applicable to contracts that have already been considered in this chapter.

13.76 Section 72 of the Bills of Exchange Act 1882 does not, however, provide a complete code in relation to the choice of law questions that could arise in connection with a bill of exchange.¹ Section 72 provides:

'72. Where a bill drawn in one country is negotiated, accepted, or payable in another, the rights, duties, and liabilities of the parties thereto are determined as follows:

- (1) The validity of a bill as regards requisites in form is determined by the law of the place of issue, and the validity as regards requisites in form of the supervening contracts, such as acceptance, or indorsement, or acceptance *supra protest*, is determined by the law of the place where such contract was made. Provided that –
 - (a) Where a bill is issued out of the United Kingdom it is not invalid by reason only that it is not stamped in accordance with the law of the place of issue.
 - (b) Where a bill, issued out of the United Kingdom, conforms, as regards requisites in form, to the law of the United Kingdom, it may, for the purpose of enforcing payment thereof, be treated as valid as between all persons who negotiate, hold, or become parties to it in the United Kingdom.
- (2) Subject to the provisions of this Act, the interpretation of the drawing, indorsement, acceptance, or acceptance *supra protest* of a bill, is determined by the law of the place where such contract is made. Provided that where an inland bill is indorsed in a foreign country the indorsement shall as regards the payer be interpreted according to the law of the United Kingdom.
- (3) The duties of the holder with respect to presentment for acceptance or payment and the necessity for or sufficiency of a protest or notice of dishonour, or otherwise, are determined by the law of the place where the act is done or the bill is dishonoured.