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Letter of Credit: A Legal Perspective

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ABSTRACT

The purpose of documentary credit is to provide a mechanism to facilitate the settlement of an international or domestic trade transaction by using a bank's undertaking. Letters of Credit (LoC) have been in prevalence since the twelfth century as a financial instrument used to promise payment against the delivery of goods. Letters of credit expedite mercantile transactions by providing an independent assurance of payment to parties and therefore are equipped with the feature of reliability and certainty of payment. There exist several types of letters of credit with their differential features, regulating legal framework, use, and obligations of parties involved therein. The UCP 600 regulates international Letter of Credit transactions and controls rights and obligations of parties subject to well established Principle of Autonomy and Doctrine of Strict Compliance. Simultaneously, the Fraud exception also restricts dishonest beneficiaries from obtaining payment without actually performing their duties towards the issuing bank and buyer (applicant). This research paper examines in detail the concept of letter of credit and its regulatory mechanism in relation to mercantile transactions from a global perspective. The author has also endeavoured to explore legal intricacies involved in such transactions while tracing the judicial approach as to how the Courts have applied the existing legal regulations and interpreted the relevant principles while striking a balance between smooth trade activities and the interest of relevant parties.

Keywords: Letter of Credit; UCP 600; autonomy; strict compliance and fraud exception.

I. INTRODUCTION

The Letter of Credit (LoC) stands as one of the most trusted and secure payment methods, especially for international mercantile transactions. The letter of credit clears the air of deadlock in mercantile transactions where the seller wants payment of the consignment at the time of sending it whereas the buyer is not interested in making any payment until receipt of the goods. In cross-border mercantile transactions, the presence of a letter of credit assures sellers of payment and buyers of due compliance of the terms and conditions of the credit agreement. A letter of credit is a promise to pay.² A letter of credit is generally referred to as “a letter issued

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² Justin Pritchard, *Letter of Credit - How Letters of Credit Work*, The Balance (June 7, 2024, 11:23 AM) <http://banking.about.com/od/businessbanking/a/letterofcredit.htm>.

by the banker of the foreign buyer at the latter's request, in favour of the exporter informing him that the issuing banker undertakes to accept the bills drawn in respect of exports made to the foreign buyer specified therein." It upholds the principle of prompt payment by the banking institutions to the seller irrespective of any fraudulent transactions committed by the parties in the basic underlying contract of sale.³ The Letter of Credit allows the cautious parties to enter into a transaction as they can rely upon payment assurance.

The term 'Letter of Credit' comes from the French word '*accréditif*' (the power of doing something), which in turn derives from the Latin word '*accreditus*' (trust).⁴ A letter of credit is neither a negotiable instrument nor a guarantee. According to Black's Law Dictionary, "*Letters of credit is an engagement by a bank or other individual made at the behest of a client that the lender will honor draughts or other requests for payment upon complying with the terms stated in the credit.*" Also, in the case of *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.*⁵ the Court aptly remarked: "*the letters of credit are the means by which goods are supplied all the world over. It is vital that every bank which issues a letter of credit should honour its obligations. The bank is in no way concerned with any dispute that the buyer may have with the seller. A letter of credit is like a bill of exchange given for price of the goods. It ranks as cash and must be honoured. No set-off or counter-claim is allowed to detract from it.*"

II. PARTIES TO A LETTER OF CREDIT

A Letter of Credit (LoC) transaction entails the involvement of five parties generally. The first two parties are the seller (applicant) and buyer (beneficiary) transacting mercantile business whereas the remaining three parties are the issuing bank (which issues the letter of credit), Confirming Bank and Negotiating bank respectively.

Confirmation and Confirming Bank

The requirement of confirmation of LoC by another Bank appears when the beneficiary (seller) is not familiar with the credit of the Issuing bank because of geographical distance or otherwise. In such cases, the LoC is confirmed by some domestic bank in his country only which adds its confirmation to make the payment. Confirming Bank not only confirms the LoC rather obligate itself to ensure payment to any beneficiary as if it were an issuer. Confirmation of LoC infers an undertaking for payment, or to negotiate drafts without recourse to the drawer. In the case of

³ Susmitha P Mallaya, *Documentary Credit Frauds: Need for Regulation of Banking Sector in India*, 60 JILI, 216 (2018).

⁴ Robert Bulger, *Letters of Credit: A Question of Honor*, 16 N.Y.U. J. INTL L. & POL. 799 (1983).

⁵ [1978] QB 159.

*Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.*⁶ the Court observed that "when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and the seller must be settled between themselves. The bank must honour the credit."

Negotiation and Advising Bank

Negotiation of documents in any Letter of Credit (LoC) transaction refers to the presentation of the required documents and their examination by the Issuing bank or Confirming Bank. Article 2 of the UCP 600 defines Negotiation to mean "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." When the documentary compliance is established at this level, the LoC is honored by the bank. Without negotiation of documents, an LoC transaction cannot be completed unless otherwise provided.

A banker which advises any beneficiary of the letter of credit while negotiating documents for the purpose of processing the bills/draft, is called 'Advising Bank'. These banks are generally located in the same country where the beneficiary carries on mercantile activities. UCP Art. 7 directs that banks "must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit." In the case of *Federal Bank Ltd. v. V.M. Jog Engineering Ltd.*⁷, it was held that the negotiating Bank has duty of care and ascertain that documents have been presented in compliance with LoC. Further, provisions of the UCPDC stipulate that if the documents are found not to be in consonance with the terms of credit, a notice to that effect (not later than the close of the fifth banking day following the day of presentation), stating the reasons thereof, must also be given.

III. LETTER OF CREDIT (LOC) TRANSACTION

While explaining the Letter of Credit transaction, Paul R. Verkuil⁸ notes: "The letter of credit is a contract. The issuing authority usually a bank promises to pay the 'beneficiary' traditionally a seller of goods on demand if the beneficiary presents whatever documents may be required by the letter. There are normally the only two parties involved in the contract. The bank which issues a letter of credit acts as a principal, not as agent for its customer, and engages its own credit. The letter of credit thus evidences irrevocable obligation to honour the

⁶ Ibid.

⁷ (2001) 106 Comp Cas 267 (SC).

⁸ Paul R. Verkuil, *Bank Insolvency and Guaranty Letters of Credit*, 25 Stan. L.R. 719 (1972).

draft presented by the beneficiary upon compliance with the terms of the credit.”

In a letter of credit transaction, the Buyer originally agrees to apply for a letter of credit with the issuing Bank which issues an undertaking to pay the beneficiary/honour drafts upon presentation of the complying documents. We can say that a Letter of Credit transaction is executed through three different transactions. The first transaction takes place between a seller and a buyer leading to an agreement on the part of the seller to deliver goods to the buyer. The second transaction is executed between the buyer's bank (issuing bank) and the buyer, wherein the issuing bank initiates LoC in favour of the seller (beneficiary). The last transaction postulates a relationship between the issuing bank and the seller, whereby the issuing bank undertakes to make payment for goods upon presentation of the required documents in accordance with the terms and conditions of the LoC.⁹

Halsbury's Laws of England¹⁰ notes: *“The contractual relationship between the issuing bank and the buyer is defined by the terms of the agreement between them under which the letter opening the credit is issued; and as between the seller and the bank, the issue of the credit duly notified to the seller creates a new contractual nexus and renders the bank directly liable to the seller to pay the purchase price or to accept the bill of exchange upon tender of the documents.”*

Contents of Letter of Credit (LoC)

- (a) The amount for which the credit is to be opened;
- (b) Nature of credit (whether fixed or revolving; revocable or irrevocable; ‘with recourse’ or ‘without recourse’ to the drawer);
- (c) Details of the imported goods and their prices and other terms (whether FOB or CIF);
- (d) Details of shipment (including partial shipment and trans-shipment);
- (e) The documents which are required to be presented for payment;
- (f) The date/time for the presentation of documents for payment or negotiation;
- (g) Whether the letter of credit is to be confirmed by the advising bank;
- (h) Details of the import licence, if applicable;
- (i) Currency in which payment is to be made;

⁹ UCPDC Art. 5 mandates an issuing bank *“to exercise good faith, observe general banking usage, and examine documents with care to determine compliance.”*

¹⁰ (Vol. 34, Paragraph 319 at page 185).

IV. CLASSIFICATION OF LETTER OF CREDIT

(A) Commercial LoC

A commercial letter of credit is a contractual agreement between the issuing bank on behalf of the buyer and advising or confirming the bank, to make payment to the seller. This LoC operates as a commercial instrument of payment to the beneficiary (seller) when the conditions of the same are adequately complied with. The issuing bank lends the benefit of his good name and reputation to the buyer who can import the goods on the basis of the letter of credit.

(B) Standby LoC

The Standby LoC is compensatory in nature and indemnifies parties when something goes wrong or parties did not get what was promised in a contract. In this kind of LoC, default/failure to discharge obligations on the part of the issuing bank's customer initiates the liability of the banker to make payment/honour the bill of exchange issued by the beneficiary. Standby LoC is the secondary payment instrument serving as an assurance and to be active if the primary payment instrument fails.

(C) Confirmed and Unconfirmed LoC

A confirmed letter of credit, is backed by the confirming bank by adding its guarantee to pay the seller on behalf of the buyer's issuing bank. The LoC confirmed by any banker adds an obligation for the confirming bank to make payment/honor bills drawn by beneficiary when he complies with terms and conditions stipulated therein. In such a case, the confirming bank shall verify documentary compliances and will pay the seller. These kinds of LoC are opened where there are real time risks or when the seller is unfamiliar with the issuing bank. In the case of *United Commercial Bank v. Bank of India*¹¹, the Supreme Court of India noted: "*a confirmed Letter of Credit constitutes a bargain between the banker and the seller. A Letter of Credit constitutes the sole contract with the banker and the bank issuing the Letter of Credit has no concern with any question that may arise between the seller and the purchaser of the goods for the purchase price.*" Further, in the case of *Swiss Bank Corp. v. Jai Hind Oil Mills Co.*¹² the Court noted: "*the relationship between the issuing bank and the confirming bank is principal to agent and there is no privity between the purchaser or opener of the letter of credit and the confirming bank.*" When the LoC does not have any kind of confirmation by another banker, it remains an unconfirmed LoC (generally in case of intra-border transactions).

¹¹ AIR 1981 SC 1426.

¹² (1989) 66 Comp Cas 241.

(D) Irrevocable Letter of Credit

As the name indicates, an irrevocable credit cannot be cancelled/modified unless the LoC transaction has been fully executed or the beneficiary himself/herself applies for its modification/cancellation. Here the issuing bank obliges itself absolutely to make payment/honour bills of exchange drawn by the beneficiary. Civil Courts have been quite reluctant to interfere in the irrevocable commitments of banks in terms of LoC. Kerr. J., in the case of *R.D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.*¹³, has rightfully noted that “*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.*” Also, in the case of *Tarapore and Co., Madras v. V.O. Tractors Export, Moscow*¹⁴, the Supreme Court of India noted that “*an irrevocable letter of credit is a mechanism of great importance in international trade. Any inference with that mechanism is bound to have serious repercussions on international trade. Therefore, except under very exceptional circumstances the Courts should not interfere with that mechanism.*” Further, in the case of *U.P. Co-operative Federation Ltd. v. Singh Consultants and Engineers (P.) Ltd.*¹⁵, the Supreme Court held: “*an irrevocable commitment either in the form of confirmed bank guarantee or irrevocable letter of credit cannot be interfered with by the Court except in case of fraud or where a case of apprehension of irretrievable injustice has been made out. This is a well-settled principle of law in England. This is also a well-settled principle of law in India.*”

However, an irrevocable LoC cannot be equated with a bank guarantee. In the case of *State Bank of India v. The Economic Trading Co. S.A.A. and others*, the Calcutta High Court while explaining the difference between these two has rightly noted: “*the more important point of distinction was the autonomy of an irrevocable letter of credit and the dependence of a bank guarantee on a contract between the beneficiary of the guarantee and a third party. Payment under an irrevocable letter of credit does not depend on the performance of obligation on the part of the seller except those which the letter of credit expressly imposes. In such cases the obligation is of the bank to the beneficiary and no third party comes into the picture. In the case of a bank guarantee, by definition a third party is always on the scene.*”

(E) Revocable Letter of Credit

When a letter of credit may be modified or revoked by the issuing bank without notice or consent from the customer or beneficiary, the LoC is called a Revocable LoC. These kinds of

¹³ [1977] 2 ALL ER 862.

¹⁴ AIR 1970 SC 891.

¹⁵ (1988) 1 SCC 34.

LoC are issued when the customer of the issuing bank (applicant of LoC) is concerned about other party's insolvency or inability to perform to promise on his part or price relating to the traded goods constantly fluctuate in market. However, even these LoC cannot be revoked unless the condition stipulated is fulfilled or once demand for payment has been made with presentation of the required documents have been presented in compliance of the terms and conditions thereof. This kind of LoC are not considered secure instruments of payment as the same may be cancelled even without informing the beneficiary. Now, UCP 600¹⁶, has removed the concept of revocable LoC from market prevalence.

(F) Clean and Documentary Letters of Credit

When the issuing bank undertakes to make payment to a beneficiary upon presentation of a draft or demand for payment without any requirement of documents, the LoC is called Clean. Here the promise to pay is unconditional or without reference to the attachment of documents of title to goods. Whereas, if the issuing bank's obligation to make payment has been conditioned on the presentation of certain documents (invoice, the bill of lading, the policy of insurance etc.), the LoC is called Documentary. In such a case, the issuing bank is obliged to make payment only if required documents in compliance with the terms of LoC have been presented.

(G) Back to Back Letters of Credit

In case of a Back to Back Letter of Credit, the initial beneficiary of the credit (the exporter) asks its bank to open a line of credit for its own supplier. This is referred to as a credit that is "backed" to the first one opened in its favour. Here, the beneficiary requests his banker to issue a letter of credit in favour of the beneficiary's supplier to help him with the procurement of raw materials and goods required to fulfil the contract made on the terms of the letter of credit.

Letter of Credit on Sight and Time Letter of Credit

When any Letter of Credit becomes payable just upon presentation of the required documents, it is called as Sight Letter of Credit. Payment obligation arises against the issuing or confirming bank when beneficiary provides proper documents. Although the banker is, as a matter of practice, provided with reasonable time to verify the documents and ensure their validity otherwise. In case of a Time LoC, the issuing banker have an obligation to pay/honor drafts drawn by the beneficiary only upon expiration of a specific time stipulated in the LoC itself. Before, such time, a beneficiary is required to present necessary documents in compliance of documentary requirement. Payment is not made directly until the certificates are approved even

¹⁶ Article 3 of the UCP 600.

for this kind of letter of credit.

Red Clause and Green Clause LoC

In the case of Red Clause letter of credit, the seller can avail advance payment from the issuing bank to purchase supplies, produce or merchandise. A buyer (applicant) may request the issuing bank to make an advance partial payment to the seller (beneficiary) before the final completion of the mercantile transaction. Whereas, if the LoC further covers other expenditures in stages like insurance, shipping cost etc. it is named as Green Clause Letter of Credit.

Fixed and Revolving Credit

When the issuing bank specifies in the letter of credit the amount up to which one or more bills may be drawn by the beneficiary within the specified period of time, it is called Fixed LoC. Here, the credit limit is valid only if exhausted within the specified time for a specific transaction between the parties concerned. In the case of Revolving credit, a single letter of credit is used for multiple transactions within a specified tenure. In a revolving LoC, a maximum liability amount is stated for which the issuing banker undertakes to make payment to the supplier any number of times.

With and 'Without Recourse' Credit

Where the beneficiary of a letter of credit is the drawer of a bill of exchange who holds himself liable to the holder of a bill, if dishonoured, the LoC is said to be with recourse. In case of "with recourse" bills, the banker, can recover the amount of the bill from its drawer, if the drawee of the bill fails to honour it. In case he does not hold himself responsible, the credit is said to be "without recourse".

Transferable and Non-transferable

Where the terms of LoC allows any beneficiary to transfer his right to ask for payment/draw a bill to a third party, it is called Transferable. The UCPDC¹⁷ define a transferable credit as "*a credit under which the beneficiary has the right to give instructions to the bank called upon to effect payment or acceptance or to any bank entitled to effect negotiation to make the credit available in whole or in part to one or more third parties (second beneficiaries).*" Whereas, in a non-transferable LoC, the beneficiary does not enjoy the privilege of transferring his right to claim payment/draw bills.

¹⁷ Art. 2 of the UCP 600.

V. REGULATIONS

UCPDC 600

The International Chamber of Commerce codified Uniform Customs and Practice for Documentary Credits (UCPDC) in 1933. Thereafter, the same has been revised in the year of 1951, 1962, 1974, 1983 and 1993 and 2007 (UCP 600). Although the UCPDC rules cannot be granted the status of any law/statute, it is commonly used by courts in the countries to resolve letter of credit disputes. Till date, the UCPDC rules have been accepted by more than 175 countries and some of them have even incorporated it under their domestic legal framework. UCPDC applies to all documentary credits including Letters of credit used in financial/mercantile transactions.

ISBP 98

Standby letters of credit although in prevalence for long, there was lack of any specific set of rules that could provide a uniform pattern for these LoC. The Institute for International Banking Law and Practice (ISBP) created specific regulations for standby LoC. These regulations were accepted and adopted in the year of 1998 by the International Chamber of Commerce. The ISBP operates as a supplement to the UCP rules. Effective July 1st, 2023, the latest version of ISBP is 821.

eUCP

The eUCP regulates aspects of electronic presentation for the UCPDC. These rules have been brought into force to promote the electronic equivalent of paper-based credits. It came into force on April 1, 2002. Provisions of eUCP, if incorporated in a documentary letter of credit, will be effective where there are electronic or partially electronic presentation of documents.¹⁸ A Letter of Credit subject to the eUCP is also subject to the UCP 600 even without express incorporation of any reference to UCP 600.

Indian Position

Indian legal regime pertaining to the regulation of LoC transactions also lacks specific statutory regulations. Only the general laws (The Indian Contract Act, 1872 and The Code of Civil Procedure, 1909) are applicable in addition to accepted principles of the UCP 600. Additionally, the Reserve Bank of India vide its circulars regulates Letters of Credit and such business by the banks is conducted under the Banking Regulation Act of 1949. However, principles of English Law are followed in India in connection with the cases relating to letters of credit. In the case

¹⁸ James D. Rosener, *Recent Developments: Letter of Credit Transactions*, 1 J Payment Sys L 627 (2005).

of *Tarapore and Co., Madras v. V.O. Tractors Export, Moscow*¹⁹, the Supreme Court of India noted: “*Banker's commercial credits are virtually without question made subject to the specification named the Uniform Commercial Credit Code.*”

VI. APPLICABLE PRINCIPLE/DOCTRINE

(A) Principle of Autonomy

Principle of Autonomy is also referred to be “*cornerstone of the commercial validity of the letters of credit*”, and “*the engine behind the letter of credit*”. Even the UCP 600 (Article 4²⁰) specifically incorporates this principle. A Letter of Credit (LoC) transaction is a distinct and separate transaction from the underlying contract between the parties (seller and buyer). LoC is “*one-way abstract transaction, in which the emitting bank cannot reject the execution of its obligation by referring to the non-execution of obligations by other parties to the transaction.*”²¹ The issuing bank is not at all concerned with the contract and/or dispute between the opener and the beneficiary.²²

Halsbury's Laws of England²³ notes: “*The contractual relationship between the issuing bank and the buyer is defined by the terms of the agreement between them under which the letter opening the credit is issued; and as between the seller and the bank, the issue of the credit duly notified to the seller creates) a new contractual nexus and renders the bank directly liable to the seller to pay the purchase price or to accept the bill of exchange upon tender of the documents. The contract, thus created, between the seller and the bank is separate from, although ancillary to, the original contract between the buyer and the seller, by reason of the bank's undertaking to the seller, which is absolute. Thus, the bank is not entitled to rely upon terms of the contract between the buyer and the seller which might permit the buyer to reject the goods and to refuse payment therefor; and, conversely, the buyer is not entitled to an injunction restraining the seller from dealing with the letter of credit if the goods are defective.*”

The principle of autonomy restricts bankers to circumscribe their performance of obligation

¹⁹ AIR 1970 SC 891.

²⁰ Article 4 of the UCP 600 reads: “*Credits v. Contracts – a. A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary. A beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank. b. An issuing bank should discourage any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, proforma invoice and the like.*”

²¹ Serguei A. Koudriachov, *The Application of the Letter of Credit Form of Payment in International Business Transactions*, 10 INTL. TRADE LAW JOURNAL 41 (2001).

²² *Fargo Freight Ltd. v. Commodities Exchange Corprt.*, (2004) 122 Comp Cas 38 (SC).

²³ (Vol. 34, Paragraph 319 at page 185).

only upto compliance with the presentation of documents, and not to indulge itself with actual or intended performance (shipping of the goods/quality of goods etc.) by the parties concerned. According to this principle, the issuing bank does not need to inquire into the underlying agreement from the applicant of the LoC. Having the protection of this principle, a beneficiary is assured of payment to be made upon presentation of required documents as the same cannot be denied on the ground of non-performance of the promise between applicant and beneficiary. Once the issuing bank examines all documents and find that they are in compliance with the terms and conditions of the credit, the liability of the banker comes into existence. The issuing banker's commitment to make payment is subject only to the fulfilment of the conditions of LoC and the liability of the issuing banker remains unaffected even if the underlying agreement between applicant and beneficiary is not executed in the intended manner. In the case of *Tarapore and Co., Madras v. V.O. Tractors Export, Moscow*²⁴, the Supreme Court of India noted that “*a letter of credit is independent of an unqualified contract of sale of underlying transactions. The autonomy of an irrevocable letter of credit is entitled to protection. As a rule, Courts refrain from interfering with that autonomy.*”

Recently, the Indian Supreme Court in the case of *Standard Retail Pvt. Ltd. & Ors. Vs. M/s G.S. Global Corps & Ors.*²⁵ also refused to interfere in a Letter of Credit (LoC) transaction, where an injunction was sought by the applicant of the LoC on the ground that the performance of their obligations was not possible due to the pandemic. The court decided that LoC transactions are not concerned with the original contract between parties. Therefore, the Bank was held liable to make payment to the beneficiary in consonance with LoC terms.

(B) Doctrine of strict compliance

The issuing Bank incurs liability to make payment thereto only when the seller (beneficiary) submits all relevant documents. According to the principle of Strict Compliance, “the issuing bank's undertaking to honour the credit is effective only upon presentation of complying documents by the beneficiary which are stipulated in the letter of credit.”²⁶ That is why, it is often said that in the case of LoC transaction, “*parties deal with documents and not with goods*”. The beneficiary can claim payment once he has presented to the bank documents²⁷ in strict compliance of the LoC requirements. Any deviation even small, in documentary compliance of

²⁴ AIR 1970 SC 891.

²⁵ COMMERCIAL ARBITRATION PETITION (L) NO. 404 OF 2020.

²⁶ R.D. Harbottle (Mercantile)Ltd v. National Westminster Bank Ltd. (1978) QB 146.

²⁷ Documents which are generally required to be produced for payment in LoC transaction are: (i) Invoice (ii) Bill of Lading (iii) Railway Receipt/Air Consignment Note', 'Post Parcel Receipt, 'Forwarding Agent's Receipt' showing the consignment of the goods. (iv) Marine Insurance Policy or Certificate.

the LoC, confers upon the issuing bank, a right to refuse to discharge its promise to make payment in consonance with the terms and conditions of the letter of credit.

Article 14 of UCP 600 while setting the standard for examination of documents reads: “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.” Some of the general mistakes in the presentation of documents include: (a) damaged documents (b) inconsistent data²⁸ (invoice and LoC) (c) defective drafts (d) inadequate insurance etc. In the case of *National Oils Chemicals Industries v. Punjab and Sind Bank Ltd. and Anr.*²⁹, the Supreme Court noted: “The banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit. The banker’s right of re-imburement depends on its accepting from the seller a faultless tender.” Although, Bankers enjoy Immunity whereby, banks assume no liability for the genuineness, falsification or legal effect of any documents.³⁰

(C) Fraud in Letter of Credit (LoC) and Judicial Intervention

Fraud is the only exception to the autonomy principle which has global recognition. Fraud on the part of concerned parties relating to documentary compliances frustrates the whole process of the letter of credit transaction. The fraud exception is an example of applying the principle *ex turpt causa non ontur action*. The ‘fraud exception’ means that banks obey the principle of independence in general situation; however, if banks comes into knowledge of the fraud behavior of beneficiary, banks can refuse to pay.³¹ However, the UCP 600 does not regulate the act of fraud rather the same needs to be adjudicated in accordance with the domestic laws. Applicant can require the bank to reject, or apply the payment injunctive from the court.

The exception of fraud to the principle of autonomy was developed in the American case of *Sztejn v. J. Henry Schroder Banking Corporation*³². In this case, the seller shipped rubbish materials and obtained a fraudulent bill of lading from the carrier mentioning that the shipment

²⁸ Article 18(c) of the UCP 600.

²⁹ AIR 1979 DELHI 9.

³⁰ Article 34 of the UCP 600 states: “A bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document, or for the general or particular conditions stipulated in a document or superimposed thereon; nor does it assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods, services or other performance represented by any document, or for the good faith or acts or omissions, solvency, performance or standing of the consignor, the carrier, the forwarder, the consignee or the insurer of the goods or any other person.”

³¹ It is to be noted that fraud exception in LoC transaction recognises fraud on documents only and not any other kind of fraud committed in the underlying contract between the applicant and beneficiary of LoC.

³² 31 N.Y.S.2d 631 (1941).

contained the promised goods. An injunction suit was filed by the buyer to restrain the issuing bank from accepting the documents from the seller and making his payment. Sheintag J., noted, “Where the seller’s fraud has been called to the bank’s attention before the drafts and documents have been presented for payment, the principle of the independence of the bank’s obligation under the letter of credit should not be extended to protect the unscrupulous seller.”

Letter of Credit imposes an obligation on the banker to honour the documents presented in conformity of credit irrespective of the sale agreement between the parties. This exclusiveness on the other hand, provides an opportunity for unscrupulous persons to indulge in transaction which results in the commission of financial fraud.³³ If the letter of credit is fraudulent or forged, the banker is justified to refuse the payment as well and if it is found that there is an existence of fraud in the transactions of the underlying sales contract between the buyer and seller, the buyer can restrain the banker from making payment.³⁴ Some prevalent kinds of frauds in LoC transactions are the falsification of documents by the beneficiary in order to obtain the payment from the issuing bank when no cargo exists in practice, another is when the goods delivered by the beneficiary do not comply with the contract of sales in terms of quantity or quality, selling the same cargo to more than one person and the fourth type is issuing a document of title i.e. bill of lading twice for the same cargo.

However, mere suspicion is not sufficient to deny the payment based on fraud, it should be beyond reasonable doubt.³⁵ A mere allegation of fraud by the trader does not affect the obligation of the banker to make payment to the seller on his presentation of required documents.³⁶ Civil Courts usually refrain from granting injunctions to restrain the performance of the contractual obligations arising out of a letter of credit between banker and beneficiary. If such temporary injunctions were to be granted readily in LoC transactions, allowing a bank to stop payment, the whole banking system across the globe would fail. It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. LoC must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged. In the case of *Discount Records Ltd v. Barclays Bank Ltd*.³⁷, Megarry J., while refusing to grant an injunction on the alleged ground of fraud, observed: “I would be slow to interfere with banker’s irrevocable credits, and not lease in the sphere of international banking, unless a sufficiently good cause is shown; for

³³ Susmitha P Mallaya, *Documentary Credit Frauds: Need for Regulation of Banking Sector in India*, 60 JILI, 216 (2018).

³⁴ *Ibid.*

³⁵ *Gian Singh Ltd. v. Banque de L’Indochine* [1974] 2 All E.R.754.

³⁶ Hans Van Houtee, *The Law of International Trade* (2002).

³⁷ [1975] 1 All E R 1071 (C.D.).

interventions by the court that are too ready or too frequent might gravely impair the reliance which, quite properly, is placed on such credits."³⁸

The courts have made it quite clear that fraud should be established against the beneficiary which is of an egregious nature and must be established beyond reasonable doubt. The courts in India also are hesitant to invoke the fraud rule in the documentary credit transactions, mainly because of the sensitivity of this document in the area of financing both national and international trade. In the case of *United Commercial Bank v. Hanuman Synthetics Ltd. and Ors.*³⁹ the Calcutta High Court held that "*in order to come within the exception of fraud, it is not enough to allege fraud but the buyer must clearly establish that the documents that were presented by the beneficiary were forged or fraudulent.*" In this case, the buyer alleged that the goods imported were not of the same description as agreed with the seller. The buyer wanted to prevent the bank from paying, contending that there was a fraud on the part of the beneficiary (the seller). The Court held that this was only an allegation which had not been established till then and therefore, the bank cannot be restrained.

In the case of *U.P. Co-operative Federation Ltd. v. Singh Consultants and Engineers (P.) Ltd.*⁴⁰, the Supreme Court of India noted that "*an irrevocable commitment either in the form of confirmed bank guarantee or irrevocable Letter of Credit cannot be interfered with by the Court except in case of fraud or where a case of apprehension of irretrievable injustice has been made out. This is a well-settled principle of law in England. This is also a well-settled principle of law in India.*" Further, in the case of *Le Montrod Ltd. v. Grundkotter Fleischvertriebs GmbH*⁴¹, the Court noted: "*A party required to make a payment under a letter of credit could not avoid payment on the basis that a document presented with the letter of credit in apparent conformity with its terms was fraudulent in itself or devoid of commercial value, independent of the knowledge and bona fides of the party demanding payment, even if the beneficiary himself created the document said to be a nullity, provided it was created without any fraudulent intent.*"

(D) Acceptance under Reserve

A payment 'under reserve' is understood in banking transactions to mean that the recipient of

³⁸ Also see the case of *State Bank of India v. Economy Trading Co.* (AIR 1975 Cal 145), wherein it was held that Courts are slow to interfere in the letters of credit in its operation not merely due to their importance in international trade but also on the ground that beneficiary is assured of the payment by the bank, once he has complied with the terms and conditions of the letter of credit irrespective of his non-compliance with the contract into which he had entered with the third party or in other words on the ground of autonomy of the letter of credit.

³⁹ AIR 1985 CAL 96.

⁴⁰ (1989) 65 Comp. Cas. 283 (SC).

⁴¹ (2003) 114 Comp Cas 441.

money may not deem it as his own but must be prepared to return it on demand. It is a common practice amongst banks to accept the documents 'under reserve' when the bank has either some doubt about the accuracy of the documents or requires more time to peruse the same. On presentation of documents for negotiation, the bank can either accept the documents or reject the same or in a given case could require some more documents before accepting the same. In such cases, it is not only permissible but it is the practice of the bank to accept the 'documents under reserve'. The expression 'payment under reserve' was considered by the Court of Appeal in *Banque De L'Indochine Et De Suez S.A. v. J. H. Rayner (Mincing Lane) Ltd.*⁴², and it was held that the payment to be made 'under reserve' means that the beneficiary would be bound to repay the money on demand if the issuing bank should reject the documents, either on its own initiative, or on the buyer's instructions.

VII. CONCLUSION

Concluding the research, we can note that the sheer distances involved in international trade, different laws and regulations, and the changing political landscape are just some of the reasons for sellers need a guarantee of payment when they deliver goods through the maritime route to their sellers. All in all, the UCP 600 seems to have a more successful approach in regulating L/C transactions. Traders have not challenged its application since it establishes the required framework for enforceability, is sensitive to bankers' and businesses' needs, and complements international business practices. The Letter of Credit transactions are accordingly carried on in consonance with the accepted international norms. Although there are certain specific global standards set up for letter of credit transactions, but there is lack of any domestic law relating to the same. Lack of specific domestic legal framework regulating LoC transactions creates problems interfering with rights/interests of all the parties concerned. Effective policy decisions are required to be taken to address these issues and establish best practices in financial regulatory regime. Lastly, reluctance on the part of Civil Courts to interfere with commercial disputes involving letters of credit is necessary to continue considering the commercial utility of the instrument and also because of the banking institutions involved in these transactions.

⁴² [1983] 1 Lloyd's Rep. 228.

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