Chapter

Fraud in Letters of Credit under English Law: Issues and Cases (the Three Dimensions)

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Abstract

According to many cases, it has been demonstrated that sellers with bad intentions have manipulated letters of credit system in many ways, including fraud. Thus, many legal jurisdictions have recognized the fraud exception rule. In order to apply such exception, some conditions must be met. Among these conditions, the bank's knowledge and a requirement of a clear evidence. Notably, the bank's knowledge is crucial, meaning that the establishment of the sole exception will depend upon the status of the bank's knowledge. Meaning that if the bank is aware of existing fraud, it is under a duty to refuse presentation. Otherwise, it should not. In turn, the establishment of clear evidence by the English courts is somewhat hard to achieve, consequently, such condition criticized often. Further, if the beneficiary himself commits the fraud, or has knowledge of the fraud, then the fraud exception rule will apply.[1] This raises the question of whether the fraud exception should also bite where the fraud is committed by a third party but without the beneficiary's knowledge. From these facts, this chapter will try to analysis the status of the bank's knowledge and the hardship related to the clear evidence requirement in conjunction with the third-party fraud.

Keywords: letters of credit, fraud, legal basis, English law

1. Introduction

Fraud is one of the most common threats to international business transactions (see **Figures 1** and **2**), especially when a mechanism such as documentary credit is utilized.[2] It is believed that letters of credit (see **Figure 3**) transactions are the "ideal vehicle for money laundering."[3] In one comment from the ICC commission "fraud is one of the oldest and best-known phenomena in the business world. As long as there have been commercial systems in place, there have been those who have tried to manipulate these systems."[4] Admittedly, fraud in documentary credits is a worldwide problem of ever-increasing proportions, which is committed not only against importers and banks but also against exporters [9]. It costs insurance

[1] See in general [1]; where the beneficiary was party to an agreement with the carrier and its brokers to antedated the bill of lading. See also [2–5].

[2] [6]; ([7], 140).

[3] [8], 120.

[4] [7], 140.

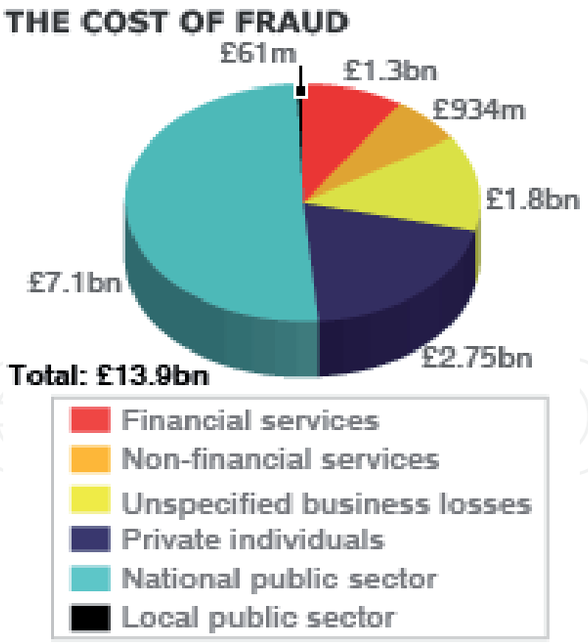

Figure 1.
The cost of fraud lost in some sectors.

Recent Cases of Trade Finance Fraud

YEAR	COMPANY	AMOUNT	BANKS INCLUDING
2020	Hontop Energy	$473 million	CIMB
2020	Agritrade	$670 million	ING
2020	Hin Leong Trading	$3.5 billion	HSBC +22 banks
2020	Zenrock Commodities	$166 million	HSBC
2019	Coastal Oil	$354 million	OCBC, DBS, UOB
2019	Inter-Pacific Petroleum	$168.5 million	SocGen

Figure 2.
Recent cases of trade finance fraud; name of banks and companies including the amount of finance lost.

companies millions of dollars each year.[5] Therefore, due to the concedes that it is as a serious threat to the commercial utility of the letter of credit.

Unfortunately, the UCP 600 do not address this issue [11, 12]. The International Chamber of Commerce justified this omission by arguing that "it should be left to national jurisdictions to fill the gap" [13–15]. As such, most national jurisdictions recognize the "fraud exception rule" as a caveat to the autonomy principle [14, 16]. Although this exception is internationally accepted, there has been diversity among lawmakers and courts in relation to its interpretation.[6] This has led to unconvincing judgments and a variety of outcomes.[7]

[5] [10], 183

[6] [17]; see also [18].

[7] [17]; see also [18].

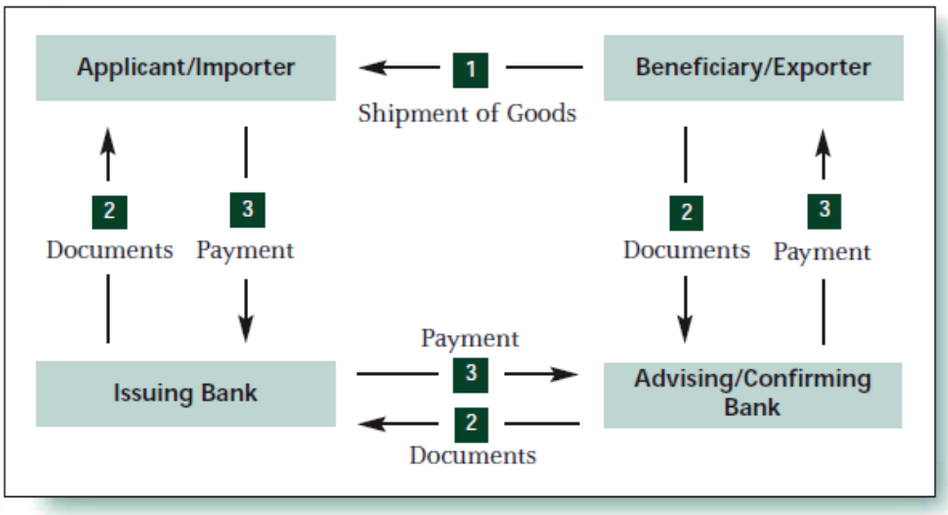

Figure 3.
Description of letters of credit mechanism.

The *Sztejn* case was the starting point of the fraud rule exception, where there was both fraud in the presented documents and fraud in the underlying contract.[8] The facts of this case can be briefly summarized as follows; "an allegation from the plaintiff that the beneficiary shipped cow hair and other rubbish instead of bristles as contracted. In this regard, the court commented that in such circumstances the autonomy principle should not protect the not honest seller because the fraud was called to the bank's attention before the drafts and documents were presented for payment" [20].

Although the court in this milestone case did not explicitly state on which basis the fraud had been found, it is implicit that the fraud here can be characterized as both fraud in the documents and fraud in the underlying transaction.[9] That is to say the presented documents did not represent the actual goods shipped.

In contrast, in the English (the *American Accord*), the court held that the fraud rule exception can only be established if the fraud appears in the presented documents [5]. The facts of this benchmark case can be briefly summarized as follows: "an English company entered into a contract to sell glass fiber making equipment to a Peruvian company and payment was to be made by an irrevocable letter of credit. It was agreed that the shipment was to be on or before 15 December 1976, however, shipment actually took place on 16 December. Mistakenly and without the knowledge of the sellers, the loading broker's employees, who are not acting for the seller, fraudulently entered 15 December as the date of shipment on the bill of lading. Upon presentation, the bank refused such tender and held that the presentation was fraudulent because the goods were loaded on 16 December and not on 15 December as agreed."[10]

It is clear from these milestone cases that there is a dispute as to whether the fraud rule exception can be established either if the fraud accords in the presented documents or in the underlying transaction.

As it is stand in the law, a bank's obligation is to honor the credit against confirming documents, where article 15(a) of the UCP 600 states that "When an issuing bank determines that a presentation is complying, it must honor." However, there are times when the bank might be obliged to dishonor the credit based on its

[8] See [19].

[9] See [19].

[10] See [19].

own decision[11] e.g. in case if fraud. Meaning that if the bank is aware of existing fraud, it is under a duty to refuse presentation. Conversely, in connection with the implementation of the fraud exception rule in English law, the claimant must gain an injunction, which will force the bank to postpone payment under the credit until the end of the hearings.[12] In order to gain such an injunction, the claimant must provide clear evidence of fraud.[13]

It is established in the law that if the beneficiary himself commits the fraud, or has knowledge of the fraud, then the fraud exception rule will apply.[14] This raises the question of whether the fraud exception should also bite where the fraud is committed by a third party but without the beneficiary's knowledge. The judgment of the *American Accord* case has opened the door for such issue and has been a battleground for many studies. Accordingly, this chapter will answer this question; "will the fraud exception rule apply if the fraud was committed through a third party without the beneficiary's knowledge?"

Based on these points, this chapter will focus on a bank's knowledge, clear evidence and third-party fraud.

2. Bank's knowledge

Although the bank's obligation is to honor the credit against presenting confirming documents, yet, it is believed that the bank must dishonor the credit if it learns of fraud prior to honoring the credit.[15] In this regard, the fraud exception rule cannot be established if the bank is not aware of the fraud.[16] That is to say, the lack of knowledge of the fraud conduct will not prevent the bank from honoring the credit.

In one case [33] the court was against the issuing of an injunction to stop the payment because the bank was not aware of the fraud.[17] The fact that there is suspicion of fraud, which the bank is aware of it, will put the bank in a rejection position. Thus, to fall within the ambit of the bank's knowledge, the fraud must come to light before releasing the payment, meaning that the knowledge condition will be fulfilled if the bank is aware of the fraud prior to payment.[18] However, if the bank becomes aware of the fraud and honors the credit, they will be liable in front of the applicant.[19] This penalty is because the bank can be seen as a participant in the fraudulent act [34]. Therefore, if the bank ignored such conduct and the payment was honored wrongfully, the bank must not recover that payment from the beneficiary.[20] In this occasion, the bank must not disregard such knowledge.

However, if the bank was not aware of the fraud while examining the presented documents, but the fraud came to light after payment, and decided to honor the credit, in this occasion the applicant will be under a duty to reimburse the bank [19]. In *Banco Santander SA v Bayfern Ltd* [37] case, the court stated that "If the

[11] [21]; see also [22]; see also [23].

[12] [24], see also [25], see also [26].

[13] See [27] see also [28], see also [29].

[14] See in general [1] where the beneficiary was party to an agreement with the carrier and its brokers to antedated the bill of lading. See also [2–5].

[15] [30]; see also [22]; see also [21]; see also [11], 176; see also [31]; see also [32]; see also [18].

[16] [30]; see also [22]; see also [21]; see also [11], 176; see also [31]; see also [32]; see also [18].

[17] [33], 1153.

[18] See [19].

[19] See [19].

[20] [35], see also [36]

bank was not aware of the fraud and agreed to honor the credit, the applicant is still bound to reimburse the bank when the fraud comes to light."[21]

In one case [40], the documents were fraudulent; in particular, the signature was forged. However, the bank honored the credit as it was unaware of the fraud, and the court ruled in favor of the bank.[22] Nevertheless, in my opinion, if the bank had rejected the presented documents on the ground of discrepancies and the fraud was discovered later, in this respect bank is already in a safe position.

In any case, the question is "*whether the bank can rely on this defense if it becomes aware of the fraud prior to examining the documents*."[23] Although there are no cases in regard to the bank's position if the fraud become to light prior to examination but, in my judgment, the bank must examine the presented documents and decide whether it should honor the credit or not unless fraud comes to light during the examination. This suggestion is based on the good faith duty upon the bank. In *Nareerux Import Co. Ltd v Canadian Imperial Bank of Commerce* [41] case, the court held that the bank is under a duty of good faith to the beneficiary.[24] A duty of a good faith is recognized in the American courts where such duty is stipulated in Section 5-109 (a) (2) of the U.C.C which states "the issuer, *acting in good faith*, may honor or dishonor the presentation in any other case."

Despite the fact that this occasion is not clear in the law but, in my judgment, from both the autonomy principle and a good faith principle, the bank is under a duty to honor the credit, regardless of knowing of the fraud prior to examination, only if the presented documents are in compliance.[25] Bearing in mind that banks deal with documents and not facts as stipulated in Article 5 of the UCP 600. The said article states that; "Banks deal with documents and not with goods, services or performance to which the documents may relate." Unless the presentation itself indicates a possibility of fraud, the bank must honor the credit if the documents are compliant.[26]

What can be drawn from the proceeding discussion is that "a bank's knowledge of the fraud must emerge from the bank itself and not from any other party."[27] If another party e.g. *the applicant*, becomes aware of fraud and through providing a clear evidence of the fraud,[28] they must ask for an injunction from the court to stop the payment.

Most importantly, the "bank's knowledge" must emerge from the presented documents and not from any external source.[29] That is to say, the knowledge must be particularly from the apparent data. This is justified because a bank deals only with documents (article 5) and, more importantly, by virtue of the autonomy principle (article 4). Moreover, besides the bank's knowledge, it should be noticed that the awareness of the fraud must be while the examination process and prior to the payment decision.

The rationalization for this condition is twofold. Firstly, this payment method aims to secure the bank and not the parties,[30] hence, any dispute regarding the underlying transaction will not effect in the bank's involvement in litigation.

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[21] [37]; see also [38], see also [39]; see also [24].

[22] [40], 1238.

[23] See [19].

[24] For general discussion see [42]; see also [43]; see also [44].

[25] See [19].

[26] See [19].

[27] See [19].

[28] See [19], which will be explained in Section 2.

[29] See [19].

[30] See [19].

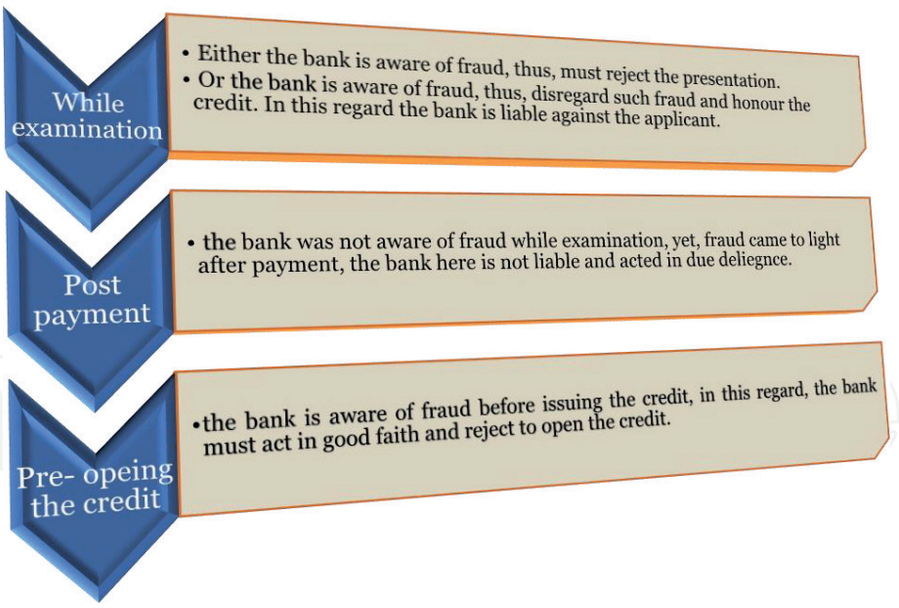

Figure 4.
Bank's status in regard to fraud during examination process.

Secondly, where the seller in such transaction is untraceable, the only available remedy for the bank will be the buyer. Therefore, the insisting on the bank's knowledge condition can be seen as a "withdraw" option from fraud litigation.[31]

While this approach, from my own perspective, no doubt will ensure the ultimate aim of letters of credit in international transactions and will secure the bank, nonetheless, it will harm the applicant. As stated above, it is not an easy task to gain an injunction under English courts in a case where the applicant becomes aware of the fraud. In addition, it is unclear how the court will prove that the bank is aware if there is fraud in the presented documents.[32] Most importantly, another obstacle arises in regard to the implementation of the strict standard required, by asking "*whether the same strict standard will be required by both the applicant and the party who notified the fraud*." The answer is not clear here (**Figure 4**).

3. Clear evidence

A mere allegation of fraud will not be sufficient for courts in England to dishonor the credit.[33] That is to say, once the fraud is established by strong evidence, an injunction from the court will be forthcoming.[34] In one case [27], although the shipment was with a wrong quantity of ordered records delivered, yet the court did not consider such conduct as a fraud and refused to apply the exception.[35] Despite the claimant providing the court with an inspection certificate, the court stated that there was no strong evidence of fraud in this occasion.[36] That is to say, the presented evidence was not considered sufficient enough to convince the court, who refused

[31] See [19].

[32] See [19].

[33] [19].

[34] [45], see also [24]; see also [18].

[35] [27], 446; only 275 of the 8625 records ordered were delivered.

[36] [27], 446, 447.

to issue the injunction.[37] However, in my judgment, the dispute in the said case falls within breach of contract scope and not fraud, where the dispute matter concerned the quantity. Therefore, in my judgment, the court's judgment of not issuing an injunction was correct.

Similarly, in another case, although the presented documents were forged, the court instead refused to issue an injunction [46]. The court justified its judgment by stating that the claimant failed to provide clear evidence.[38] Nonetheless, few English cases issued injunctions[39] including *Themehelp Ltd v West* [48] and *Kvaerner John Brown Ltd v Midland Bank plc* [49].

Initially, in the *Themehelp* case, the clear evidence presented was the fact that the beneficiary, deliberately and recklessly, failed to inform the applicant of the falling-off of future demand from the defendant [50]. The applicant argued that the beneficiary were aware of by the date of the contract.[40] In this regard, the court held that "The failure to provide the contracted goods in the future was strong established evidence that the beneficiary was aware that it would cause dishonest demand for payment under the credit."[41] "On appeal, the court held that '*the December correspondence showed that the sellers knew that the loss was possible and that this loss could have a very damaging effect on the appellant defendants future prospects'. The court continued 'there was evidence that these forecasts had been sent to the appellant defendants and no explanation where received*" [51]. Therefore, this evidence was quite sufficient to entitle the court to issue the injunction.[42]

In contrast, the subject matter of the contract in *Kvaerner John Brown Ltd (KJB) v Midland Bank plc* [49] case was a standby letter of credit. KJB; the plaintiff, failed to fulfil his obligation and, as a result, *Polyprima* issued a notice, wrongfully, demanding the payment under the credit due to such failure [52]. In this respect, the court held that:

"*In the wholly exceptional case where a demand under a performance bond or standby credit purports to certify that a written notice has been given as required by the underlying agreement when it plainly has not been given, the court will, in the exercise of its discretion, grant an injunction to restrain the beneficiary from maintaining the demand accompanied by what is in fact a false certificate. To grant an injunction in such a case is not inconsistent with the general principles set out above. It is, in my view, clearly arguable in the present case that the only realistic inference is that the demand was made fraudulently and it is, in my view, further arguable that it is, in the circumstances, dishonest to maintain the demand*."[43] That is to say, issuing the required notice was fraudulent as it was issued wrongly and contrary to a nominated clause in their agreement.[44] Therefore, the court was correct in issuing the injunction.

So far, under the English law the majority of the cases refused to issue an injunction to stop the payment because of the absence of clear evidence provided by the applicant.[45] It is believed that English courts require a high standard of proof of fraud; therefore, this excessive requirement will justify the court rejection for issuing the injunction.[46] That is to say, this condition under the English courts

[37] [27], 447, 448.

[38] [46] at 177.

[39] [24], see also [47].

[40] [50], 99.

[41] See [19].

[42] See [19].

[43] [52], 450.

[44] See [19].

[45] See [19].

[46] [53]; see also [24], see also [54].

with respect to proof of fraud makes it impossible for the courts to apply the fraud exception rule and a hard ship for the alleged party [55]. Therefore, due to the "high standard of proof" required, it is difficult to bring an action against the banks in England.[47] However, in my judgment, requiring a high standard is justified. This rigid approach by English courts is important to affirm on the autonomy principle in letters of credit. Further, to ensure that "the claim is not frivolous or vexatious."[48] Moreover, issuing an injunction will affect on the banking system integrity [57].

However, it should be noted that none of the English courts specified what type of evidence was required or what would be considered as a convincing evidence for the courts to apply the fraud exception rule.[49] It is argued that "the standard of proof in England depends on the stage of the proceedings." In this regard, the proof standard was settled merely on the basis of intentional, rather than material fraud.[50] However, in proceedings, a mere allegation is not sufficient to estop a bank from honoring a credit [58]. Instead, it is necessary to establish clearly that the bad intention beneficiary is not honest and that the bank is aware of fraud [59]. In this regard, "the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge."[51] In contrast, the standard of fraud embraced by the United States courts is more logical. The American courts focuses on the demand for payment, meaning that if such demand has absolutely no basis in fact or the conduct of the beneficiary has vitiated the entire transaction, in this regard, an injunction will be granted.[52]

Although the justification for a high standard of evidence for fraud required by the courts is, sometimes, to affirm on the autonomy principle and secure the parties [18], yet this is not always the case. In my judgment, granting an injunction in order to postpone the demand for payment under an alternative method of payment; for instance; performance bond, demand guarantee, or standby letter of credit, apparently, is not a difficult task in England compared to such a demand under a "commercial" letter of credit. Generally speaking, the right of payment under these three instruments; e.g. performance bond, demand guarantee or standby letter of credit is based on the applicant failing to fulfil the required obligations under them.[53] In contrast, under a commercial letter of credit the right of payment is legitimate once the beneficiary has fulfilled their obligation [68]. Therefore, in my judgment, proving that the demand for payment by the beneficiary in a fraudulent way under commercial letters of credit is not an easy task.

This difficulty emerged due to a two involved context in such contract, namely; goods and documents. Apart from the fact that presenting documents is a compulsory requirement in the other three instruments mentioned above. Consequently, in my judgment, sometimes requiring clear evidence might not be possible with regard to a commercial letter of credit, especially when the fraud rule in England is restricted only to fraud in documents.[54] Therefore, it is difficult to see how the applicant can prove that the beneficiary is not honest. Bearing in mind that the applicant will be under a duty to prove the fraud conduct within a short period of five banking days and depending on the face of the documents alone. Therefore, in my judgment, it is not clear that the requirement for clear evidence will be fulfilled through providing, for example, a formal document indicating that there is no ves-

[47] See [19].

[48] [56], see also [25].

[49] See [19].

[50] See [18].

[51] see [60], see also [61]; see also [62].

[52] [63], see also [64].

[53] See in general [2, 50, 52]; see also [65, 66], see also [67].

[54] See [69]; see also [70].

sel existing with the name (ZZZ). It is doubtful that such a document would prove that the beneficiary has no right for payment under the credit. Assume that the applicant provides an evidence that the documents are forged due to the fact that a beneficiary is no longer trading for (Y) reason; for instance, a *liquidation*, thus, will not be able to provide the required goods, the question arises here as to whether this evidence could be used to postpone payment. In my judgment, "the court should ask for 'sufficient' or 'convenient' evidence instead of 'clear' evidence in order to issue the injunction. This convenient evidence is subject to the case's facts."[55]

Bearing in mind that banks are not experts in such transactions nor required to go beyond the documents, and by referring to the first condition; the bank's knowledge, it does not make any sense that the court is more convinced with the banker's evidence and consider it as sufficient to prove that they are aware of the fraud while, in contrast, the applicant's evidence is not.[56] The applicant is the main party in such transactions and they have more expertise in the status of the transaction than the banks. Therefore, the applicant's knowledge should be vital in this occasion.

In my opinion, the party who claimed the existence of the fraud must provide the court with a monetary fee that will be held by the court until the end of the trail[57] besides with this monetary fee, the alleged party must provide a "sufficient" or "convenient" evidence.[58] From a purely civil law point of view, "[T]hese fees can be imposed as compensation if the allegation is found to be invalid, which will guarantee the other parties' interest. If the allegation was legitimate, the fees are released back to the owner. Otherwise, it will be given to the beneficiary – the defendant – as compensation for postponing their right of payment due to the false allegations".[59]

In conclusion, English courts focus more on evidence of the fraud rather than making unnecessary distinctions pertinent to the fraud exception. As seen from the proceeding discussion, injunctions are not easily granted in England where the requirement for a clear evidence and proof of the bank's knowledge will be obstacles. Therefore, the absence of clear evidence will not trigger the fraud exception rule. In short, banks in England are more protected due to the fact that courts want to uphold the integrity of the banking system and maintain the autonomy principle.

4. Fraud committed without the beneficiary's knowledge: will the fraud exception rule apply?

Generally speaking, banks are not required to check whether the beneficiary has fulfilled its obligations in the underlying contract of sale. This is established in Article (4) of the UCP 600, which stipulates that letters of credit are isolated from the main transaction. This is known as the "Autonomy Principle." As will be seen from the discussion of the case law in this area, the principle of autonomy has been used by dishonest sellers as a vehicle for fraud (**Figure 5**).

In *the American Accord* case, the court held that the fraud exception can only be established if the fraud appears in the documents [71]. The facts of this case is where an English company entered into a contract to sell glass fiber making

[55] See [19].

[56] See [18].

[57] See [19].

[58] See [19].

[59] See [19]. This suggestion will secure rights for both parties; this suggestion is emerged from Jordanian legislations practice, which is applied in most civil law litigations in Jordan.

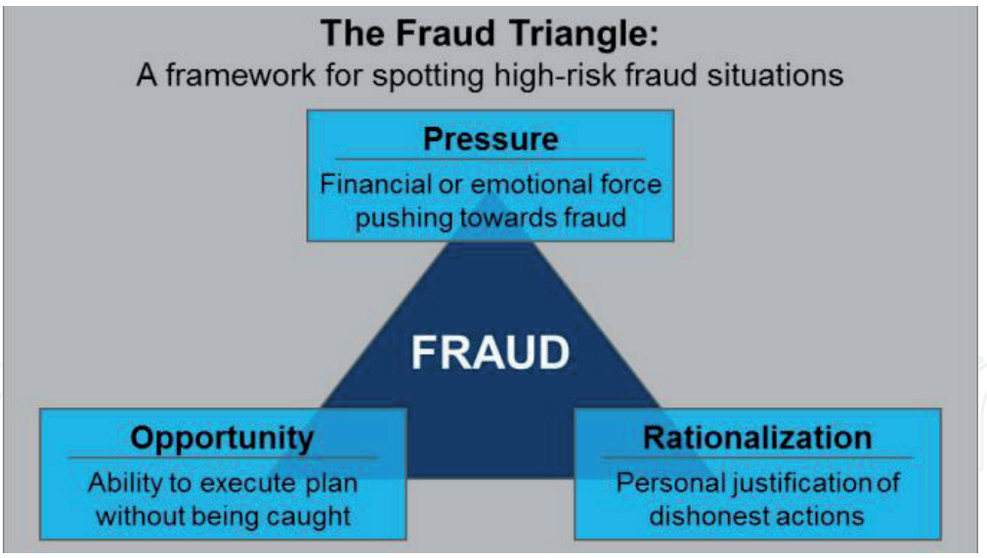

Figure 5.
Fraud triangle explaining the "dishonest person thinking" which led to emerge of fraud acts in finance sector.

equipment and payment was to be made by an irrevocable letter of credit. Shipment was agreed to be on or before 15 December 1976. However, shipment actually took place on 16 December. Without the knowledge of the sellers, the loading broker's employee fraudulently entered 15 December as the date of shipment. In this regard, the bank refused such tender and held that the presentation was fraudulent because the goods were loaded on 16 December, not on 15 December as agreed.

Lord Diplock held that if the fraud was conducted with the beneficiary's knowledge, the fraud rule will be applied [72]. His Lordship stated: "*there is one established exception [to the principle of autonomy]: that is, where* **the seller**, *for the purpose of drawing on the credit,* **fraudulently presents** *to the confirming bank* **documents that contain, expressly or by implication, material representations of fact that to his knowledge are untru***e*."[60] From this passage it is clear that to establish the fraud exception in England, the beneficiary must commit the fraud or have awareness of it. This raises the question of whether the fraud exception should also be invoked when it is conducted by a third party but without the beneficiary's knowledge. It is clear that this is a grey area, subject to inconsistent interpretations across different jurisdictions. Therefore, this section will deal with the issue of the implementation of the fraud exception rule from different legal systems' views; namely the United Kingdom and the United States, by answering "will the fraud exception rule apply if the fraud was committed by a third party without the knowledge of the beneficiary?"

4.1 The position in the UK

The facts of the milestone case, the *American Accord*, are an appropriate example to highlight the position in England. In the said case, as a result for the bank's decision of rejecting the presentation, the plaintiffs, brought an action against the defendant bank for the wrongful dishonor. The court refused the bank's decision and stated that: "[H]ere I have held that there was no fraud on the part of the plaintiffs, nor can I, as a matter of fact, find that they knew the date on the bills of lading to be false when they presented the documents. Accordingly, I take the view... that the plaintiffs are... entitled to succeed".[61]

[60] [72], 183.

[61] [72], 278.

Surprisingly, the judgment was reversed by the Court of Appeal, which held that the fact that the fraud had been committed by a third party could not prevent the bank from raising the defense of fraud against the beneficiary.[62] The Court held that "it is the character of the document that decides whether it is a conforming document and not its origin, then it must follow that if the bank knows that a bill of lading has been fraudulently completed by a third party, it must treat that as a nonconforming document in the same way as if it knew that the seller was party to the fraud".[63] However, the House of Lords unanimously reversed the decision of the Court of Appeal and reinstated the trial judge's decision.[64] The House of Lords held that the beneficiary should obtain the payment unless it was a party to the fraud.[65]

Notably, it can be seen that each of the courts that dealt with the *American Accord* case approached the issue of third-party fraud from different points of view. From the trial judge's perspective, the fraud was neither conducted by the seller nor with his knowledge. In turn, the Court of Appeal pointed out that the case fell within the scope of the fraud exception because the document was forged, although without the beneficiary's knowledge. However, from Lord Diplock's perspective, besides the documents themselves, what is important in such transactions is the knowledge of the beneficiary. His Lordship believed that the bank is under a duty to honor the credit if there is no knowledge on the part of the beneficiary in regard to fraud conducted by a third party [73]. This duty is based on the fact that ignoring the beneficiary's knowledge as a requirement for establishing the fraud exception rule might undermine the reliable system of letters of credit [73].

A few years earlier, Brown LJ answered the question regarding fraud by a third party in *Edward Owen* [74], finding that the implementation of the fraud exception under the English courts could be applied if the beneficiary presented forged or fraudulent documents and knew that the presented documents were not true.[66] Therefore, the general rule is that if the seller fraudulently presents documents that contain, expressly or by implication, material misrepresentations of fact that to his knowledge are untrue to the confirming bank, the fraud exception will be applied. Consequently, to qualify the fraud rule, such conduct needs to be committed by the beneficiary[67] or with their intention and knowledge. Therefore, if the beneficiary is not aware, similar to the *American Accord* case, the rule will not be applied.

On the grounds discussed above, it follows that if the fraud was committed through a third party without the beneficiary's knowledge, the fraud exception will not be applied. Therefore, the bank should honor the credit. The justification for such a ruling is because the beneficiary, on this occasion, is also the victim of the fraud; hence, it would not be appropriate to deny them the right of payment [75, 76].

Generally speaking, English courts focus more on the intention of the seller when looking at cases of fraud. As noticed above, the three courts did not accept the idea that the exception should be applied if the fraud was conducted by a third party without the knowledge of the seller. What is important is the knowledge of the seller. Consequently, the fraud rule will only be applied if the fraud act was conducted by the beneficiary or when the beneficiary has knowledge of a fraud committed by a third party. That is to say, the focus on the intention of the fraudster is the standard for the rule to be applied in England. This approach was justified as

[62] [72], 239.

[63] [72], 248.

[64] [72], 183.

[65] [72], 183-184.

[66] [74], 984.

[67] See in general [1] where the beneficiary was party to an agreement with the carrier and its brokers to antedated the bill of lading.

English courts retain the requirement of a beneficiary's knowledge to maintain the efficacy of the letter of credit as a system of payment [77].

4.2 The position in the USA

In turn, in the US, although there are codified letters of credit rules in legislation and a specific provision for the fraud exception rule, Section 5-114 of the previous version of the UCC 1978 does not identify its position regarding the third-party fraud issue. This matter was left to the courts to deal with. In the previous version, the UCC 1978 was concerned only with the nature of the documents, not the identity of the fraudulent party [78] meaning that the fraud exception rule was applied regardless of the identity of the perpetrator and the knowledge of the beneficiary.

After amending the UCC in 1995, the new standard is not concerned with the intentions of the seller but rather examines "the severity of the effect of the fraud on the transaction" [79]. This means that the US legislation focuses more on the effect of the fraud, neither on the intention of the beneficiary nor on the identity of the fraudster.[68] This, implicitly, means that the fraud exception rule will apply if the fraud was committed by a third party, even without the seller's knowledge. From the US courts' perspective, the effect of such a matter on international trading is detrimental, regardless of who perpetrates the fraud or the knowledge of the beneficiary. Therefore, the effect of fraud on the right of payment should have no correlation to the identity of the perpetrator or to the beneficiary's knowledge. Briefly, for US courts, fraud is fraud despite who commits it and whether the beneficiary has knowledge because bank and buyer will still be at risk as a result of such action. Moreover, what matters are the existence and the effect of the fraud, not the source or the knowledge and intentions of the parties.

4.3 Concluding remarks

In my judgment, although fraud will still harm the utility of a letter of credit transaction, shifting the court focus from the illegal act to the identity of the fraudster or the beneficiary's knowledge will be ineffective. There is no merit in focusing on the identity of the fraudster or on the beneficiary's knowledge at this point. As it stands, a documentary credit is an independent contract between bank and beneficiary; consequently, fraud conducted by a third party without the beneficiary's knowledge, in my judgment, is not a relevant consideration when establishing the fraud rule. What is important here is the conduct of fraud and not the identity of the fraudster nor the knowledge of the beneficiary for these reasons.

Initially, the utmost principle in letters of credit is its autonomy and independence from any dispute in regard to the underlying transaction. That is to say, instead of examining the documents and their compliance, banks will be required to examine the intentions behind the documents. Or in other words, whether the beneficiary is aware of such fraud or not. This is not acceptable and contradicts with Article 5 of the UCP, which will bind banks to go beyond the documents. If the documents complied "on their face" but the applicant alleged that there is fraud, why should the bank stop the payment on this ground. Why should the bank postpone the payment until investigate whether if the beneficiary is aware of the fraud or not? According to Article 34 of the UCP rules "*A bank assumes no liability or responsibility ... 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.**" This dispute of awareness between the applicant and

[68] [80]; [8], 124; [81].

the beneficiary, in my judgment, should be out the scope of the bank's authority and the autonomy principle. The most important condition when applying the fraud rule is to establish that fraud exists in the documents regardless the identity.

Further, the fraud rule will be applied if the fraud accords in the documents only.[69] Moreover, it is the beneficiary's duty to present complying documents; therefore, the beneficiary is under a duty to check their compliance. In my judgment, I cannot see any merit in considering the beneficiary's knowledge a material condition when applying the fraud rule. Arguably, claiming that the beneficiary is not aware of the fraud in the required documents is, in my point of view, a "release" key from such allegation. Such claim might create more hardship for the applicant through trying to prove first that fraud exist and later, that the beneficiary is aware of it. No doubt such point of view will not be welcomed from the innocent beneficiary, who might be a victim, yet it is the beneficiary's duty to check their compliance. Therefore, the only exception for this independent right is when the fraud is conducted in the documents regardless of the identity of the fraudster or the beneficiary's knowledge.

5. Conclusion

There is no doubt that the autonomy principle is the cornerstone of the letters of credit mechanism. This principle aims to provide banks with immunity and affirm the unique character of letters of credit. Nonetheless, it could be considered as a double-edged sword, meaning, such a principle might be seen as a device for the fraudster to manipulate the system.

This chapter concludes that to trigger the fraud exception rule in England, two conditions must be met. That is to say, if a clear evidence is provided besides with the bank's knowledge, the fraud exception rule, will be applied; a part from the fact that it must appear in the presented documents. In this regard, the bank should be aware of the fraud before the payment in order to fulfil the bank's knowledge condition; as explained in most of the English cases. However, if the bank is not aware of the fraud and the presented documents are in compliance, the bank will be under a duty of honor the credit. Meaning that the paying bank is protected if the documents against which it made payment are tainted with fraud, even if it is not aware of the fraud. Most importantly, the UCP rules always assured that it is not a bank's responsibility to investigate allegations of fraud. Nonetheless, this chapter showed that there are some reservations regarding the bank's knowledge and the clear evidence conditions. In short, such an approach does not lead to justice and fairness for the applicant.

With regard to third party fraud, England, restricted application of the rule to cases of fraud either initiated by the seller, or where the beneficiary has knowledge of the third party's fraud. This approach is important to secure each party's interests. From the applicant's perspective, if the beneficiary committed the fraud, the beneficiary will lose their right of payment. In contrast, from the beneficiary's perspective, it is not logical to include third parties' actions in the fraud exception rule where the beneficiary is a victim, especially when the act of fraud is committed without the knowledge of the beneficiary. From the banks' standpoint, they will suffer hardship when it comes to dealing with third party fraud as they are unable to determine if the fraud was committed by the beneficiary or someone else. In addition, if that is the case, the bank is unable to determine whether the beneficiary is aware of that bad conduct or not. Again, banks are not required to go beyond the

[69] [72], [74], 172.

documents in this mechanism. It is true that the applicant will not be pleased with this approach, yet this is how the autonomy principle works.

Glossary of commonly used terms

Fraud: The term "Fraud" evolved from the Latin word "fraus," which refers to "deception, false or wrongful acts which deceive people." This term, in essence, commonly includes activities such as theft, corruption, conspiracy, money laundering and others. It also includes all acts or omissions, which involve a breach of a legal or equitable duty or by taking advantage of another.

Fraud in letters of credit: A prohibitive activity in which either importer or exporter violate their obligations under a sale of goods contract, in order to obtain a financial benefit by manipulating the loopholes of the letters of credit mechanism, thereby resulting in financial loss to either exporter or importer.

Letter of credit: A commitment given by the bank to pay the seller (beneficiary) upon the timely presentation by the latter of documents conforming to the terms and conditions of the credit.

Applicant: The buyer of the goods or services supplied by the seller, who requests the bank to open a letter of credit per as his instructions.

Issuing bank: The bank that issues a letter of credit at the request of an applicant or its own behalf, sometimes it is known as the "issuer."

Confirming bank: The bank that is under a duty of examining the presented documents, and decide to honor the credit, if the documents are complaint.

Advising bank: The bank that is usually provide an advice of the letter of credit that is sent by the issuing bank.

Beneficiary: A party under letter of credit, whose the credit is opened for his favor. This party receives the stipulated amount under the credit.

Injunction: A judicial order restraining a person from beginning or continuing an action threatening or invading the legal right of another, or compelling a person to carry out a certain act.

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