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Documentary Fraud under
Letters of Credit—

A Comparative Study of English and Chinese Law

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Summary

Almost 90% of the international trade is managed by ship, which has been dominated the international transportation over hundreds of years. The role of Documents in international trade, has turned the “money and goods” transaction into later “money and documents” transaction and in the process of improving international trade, a lot of by-products have formed at the mean time, one such being documentary fraud.

Since we know, after the document-oriented trading system formed, the documentary fraud has appeared accordingly. Under documentary fraud, the letter of credit is always involved since now it has also become one of most essential method for payment in international transaction.

It is clearly that currently, there is increasing number of documentary fraud which has already, to some extent, blocked the normal order of international trade. Under such environment, lots of international participants are involved in it as victims. Thus, in the middle of searching a better remedy, the voice for developing current letter of credit system has been proposed by international society.

Apart from the current legal regime, The Uniform Customs and Practice for Documentary Credits (UCP)is quite expected by the public to make certain reforms. Although UCP is updated at regular intervals to meet the expectation of the trading community in providing an effective system to carry out international transactions, changes seem to be not very easy since the nature of letter of credit and the rules set in it which are driven from the longstanding customs by merchants involved in international trade.

This thesis mainly and closely exams the legal perspective relating to documentary fraud bought from the English law perspective which happens to be the popular legal

system and also the Chinese law perspective keeping in mind that China is one of the major centre of production.

Preface

The development of shipping industry, although having induced the prosperity of international trade, accordingly triggers documentary fraud in maritime field which is now deemed as one of the major threats to intentional transactions. The letter of credit, serving as the blood of international payment, gives way for documentary fraud on the ground of its nature and general rules set in it. In view of its passive effect to the international trade, this thesis comes into discussing the legal issues of documentary fraud under letters of credit.

I always resist to thinking about that the 2-years master study will finally come to its end because I really enjoy the time in Lund University, where I meet those kindly teachers and classmates. For accomplishing this thesis, I really appreciate my supervisor, Abhinayan Basu, who is so kind to me and can always inspire me for his insightful suggestions. I also want to thank Professor Mukherjee, who gave me a lot in these two years and motivated me to build my future career in maritime field. I really want to thank my parents for giving me all their supports and always respect my decisions. Also, I should thank my brother for never complaining anything about me and always be there for me. Further, I want to thank my best friend Qiurong, who helps me a lot. Moreover, I also appreciate that I can have the chance to meet my dear friends Tian, chun, Muzi in Lund. Finally, I would thank all those people I meet in Sweden. All of you constitute my cherish memory here.

Abbreviations

B/L(s)	Bill(s) of Lading
L/C(s)	Letter(s) of Credit
ICC	The International Chamber of Commerce
UCP 500	The Uniform Customs and Practice for Documentary Credits 500
UCP 600	The Uniform Customs and Practice for Documentary Credits 600
CIF	Cost Insurance & Freight
CFR	Cost and Freight
FOB	Free on Board
P&I	Protection and Indemnity Insurance

1 Introduction

1.1 Background of the thesis

The invention of the steamships led to the first revolution in shipping, where it gave rise to liner and tramp vessels carrying cargo across continents. Although changes in legal-economic matters during the beginning of the 20th century were not attractive, the shipping industry ushered its spring from 1955.¹ In light of this, the shipping industry, for over 300 years history, being developed on a revolutionary change on a basis of custom and commercial practice, has been totally overhauled in less than thirty years.²

So, if our former predecessor dealt with their business by word of mouth in the past, which is called “our word is our bond”, the later counterparts prefer documents, which present in different formats and are also by different cargo types.³

Since we know, the most important interest for a buyer is to get the cargo as described under a contract. As for the seller, that is to get paid undoubtedly. However, dealing with the international business could not always proceed in a face-to-face way, where the payment and delivery of the goods may always finish in different time. Under such trading environment, lots of shipping-related documents appeared and over the hundreds years of business practices, different methods of payment also emerged where the letter of credit becomes a very essential one for its close connection with those shipping documents hereinbefore.

¹ Peter Kappor & Richard Gray, “Maritime Fraud: An Overview”, Plymouth Polytechnic, September 1985], at p. 2.

² Ibid, at 2.

³ Ibid, at 3.

As the ICC interpreted on its publication, Guide to Prevention of Maritime Fraud, it mentioned,

Documentary fraud “involves the sale and purchase of goods on documentary credit terms—and some or all of the documents specified by the buyer to be presented by the seller to the bank in order to receive payment are forged. The forged documents attempt to cover up the fact they are not of the quality ordered by the buyer.”⁴

It also said that,

No part of the world is immune from instances of maritime fraud and areas that have so far been troubled free may find themselves in for a few surprises in the future.⁵

The introduction of the letter of credit offers “a unique and universally used method of achieving a commercially acceptance comprise by providing payment to be made against documents that represent the goods, and make possible the transfer of rights to those goods.”⁶ It was produced by commercial convenience as well as for protecting trading parties against risks of interaction with some one in an uncertain financial and credit status.

However, under L/Cs, everything depends on the statements in several pieces of paper. Those, as long as pretending documents complied with the terms and conditions in a letter of credit on prima facie, the bank is entitled to honor payment without the knowledge of the underlying contract. Namely, the bank deals in documents rather than in goods, which is widely known as autonomy principle under L/Cs.

In light of such autonomy principle, the international trade could proceed in the expected efficient-economic way. But like no rose without its thorn, no system in the

⁴ “Guide to Prevention of Maritime Fraud” , ICC NO 370 P. 4

⁵ Ibid, at 4.

⁶ Peter Kappor & Richard Gray, “Maritime Fraud: An Overview”, Plymouth Polytechnic, September, 1985, at p. 6.

world shall be with perfection and the L/C makes no exception. Because the bank should pay against the apparent confirming-documents instead of substantially examination of the real facts, the loopholes in which just provide possible conditions for fraud.

So, in order to prevent fraud, there is *fraud exception* proposed in the long-term practice which, although having been widely accepted under some jurisdictions, is seldom applied in real sense.

On the other side, in order to deal with those traders, especially those little-known ones, the commercial participants could have a lot to be done by self-development.⁷ However, not all the parties are qualified enough to fully protect their own interests and it is also not easy to discover who the reliable trader is and who is not since the complicated economic environment.⁸ And due to that, the voices of reform from parties have arisen accordingly for resisting documentary fraud.

However, changes seem to be not easily achieved since the nature of international trade.

In the long history of international trade, the international commercial system was “driven by consideration of speed, convenience, and cost, and a desire to protect trading parties against the bankruptcy of those with whom they deal.”⁹ Indeed, most of those objections have come true. Yet the desire to prevent a fraud was apparently not motivated.¹⁰

⁷ “Guide to Prevention of Maritime Fraud”, ICC NO 370 P. 4

⁸ “Guide to Prevention of Maritime Fraud”, ICC NO 370 P. 8.

⁹ Paul Todd, *Maritime fraud and piracy*, 2nd Edition, London: Lloyd’s List, 2010 at p. 56

¹⁰ Ibid, at 56.

Like the Paul Todd describes in his recent book,

The vulnerability of fraud is an inevitable by-product of the system, and indeed fraud is facilitated by the system. The court to some extent assume that this is a compromise chosen by the trading parties

.....

The whole system depends on low transaction costs, and would be impossible to operate were the parties to implement elaborate checks at every stage inevitably therefore the system is not very secure, but commercial parties appear to accept a small incidence of fraud as an unfortunate, but inevitable cost of running a system which is generally very efficient. No doubt it would be possible to prevent fraud, or at least substantially to reduce its prevalence, but cost in terms of convenience might be regarded as too high.¹¹

1.2 Purpose, scheme and research methodology of the thesis

1.2.1 Purpose of the thesis

There are mainly three types of maritime fraud¹² in practice, charter party fraud, shipping fraud, and documentary fraud. Here, this thesis focuses the research on documentary fraud¹³ under L/Cs.

¹¹ Ibid, at 56.

¹² The IBM has defined the maritime fraud as follows:

“an interpretation trade transaction involves several parties- buyer, seller, shipowner, charterer, ship’s master or crew, insurer, banker, broker or agent. Maritime fraud occurs when one of these parties succeeds, unjustly or illegally, in obtaining money or goods from another party to whom, on the face of it, he has undertaken specific trade, transport and financial obligations.”

See, “Guide to Prevention of Maritime Fraud” , ICC NO 370 P. 2

¹³ The definition of “document fraud”, see, Page 8.

Although in practice, “document” could be explained in a wider way, including all paper-based documents, and, taking into consideration of electronic commerce, electronic B/Ls as well. However, this thesis only limits the “document” on *paper-based documents* with the function of document of title, and on the other hand, *letter of indemnity* has also been part of this thesis. Further, documents like electronic B/Ls and seaway bills, etc, shall not be discussed in this thesis.

The thesis will examine the position of English law in some details and will investigate the situation on the Chinese Law where possible improvements will be suggested for consideration of Chinese legislation. However, for a better explanation of the thesis, other laws rather than English and Chinese laws have also been mentioned somehow as a supplement.

The focus of the thesis is to introduce the legal challenge of documentary fraud associated with L/Cs and present the legal framework which operates the L/C system. The thesis also tries to attempt to present the legal relationship and connection between the documentary fraud and fraud exception under L/Cs.

Following this introduction, the thesis provides an overview of the L/C system and also provides a critical legal analysis of preventing a fraud, especially from the side of the buyer.

1.2.2 Scheme of the thesis

In the chapter 2, different kinds of documents fraud is be introduced and also there is legal analysis towards them especially the issue on nullity of the documents.

In the chapter 3, the thesis emphasizes on letter of credit matters, where the autonomy principle and fraud exception could be interpreted under English law jurisdiction. Moreover, UCP 600 will also be discussed in this chapter.

In the chapter 4, the thesis gives series of laws and cases under Chinese jurisdiction, which provides an overview of current Chinese legal and practical situation in the documentary fraud under L/Cs.

In the final chapter, the thesis makes a summary of the whole research primarily and indicts possible reform which could be done to reduce documentary fraud under L/Cs and to protect the buyer.

In all, although other laws also being introduced, the thesis emphasizes on English law and then compares it with Chinese law. Further, for the purpose of the research, the thesis will study relating cases and laws under both jurisdictions. In addition, as the authoritative principle in the field of L/Cs, UCP from ICC is also one part of the thesis.

1.2.3 Research Methodology

The thesis applies the descriptive method of research for giving a brief picture of the history of documentary fraud under L/Cs and the how usually a fraud proceeds.

Also, case study is employed where the thesis introduces some cases under both English law and Chinese law, which combines with comparative method, telling the similarity and differences under there two jurisdictions.

Further, in order to reach the goals set in this thesis, researches from other scholars are referred for a better explain of the nature over documentary fraud and the possibility for a reform.

2 A brief overview of documentary fraud

In international trade practice, Shipping has been a basic transportation way over hundreds of years. And in the process of such long historical period, the traditional transaction has transformed into a document-based transaction, and due to which, currently, documents are usually served as a major vehicle by maritime fraudster. In practice, such fraud involving documentation may occur directly between fraudsters and victims. However, fraud could also happen even if without such direct connections. “The B/Ls may be presented by someone else, who is not the owner and totally innocent, to effect a theft on the goods, where for example a forged B/L has been put into circulation or original B/Ls are in a set separately negotiated, and the seller taking payment of the goods more than once.”¹⁴

However, unlike the fraud mentioned hereinabove involving a theft, other types of documentary fraud, involves deception instead.¹⁵ “And the worst scenario would be completely fake B/Ls for goods that do not exist at all, and then they are lesser misrepresentations, from B/Ls that are issued for goods that have not been shipped, through to greater or lesser misrepresentations as to what has been shipped.”¹⁶

Thus, in this chapter, the author will mainly focus on the discussing different conditions where a documentary fraud may occur and the legal issues under a documentary fraud. In this chapter, B/Ls and letters of indemnity are focused.

¹⁴ Paul Todd, *Maritime fraud and piracy*, 2nd Edition, London: Lloyd’s List, 2010 at P. 104

¹⁵ Ibid

¹⁶ Ibid.

Before the discussion, something must be clear about the B/Ls. As I mentioned in the introduction, the bank will check the B/Ls if the seller has complied with all the conditions imposed by the bank for granting the credit, like the description about the goods and the date they are shipped, etc. But, the most important characteristic of the B/Ls for the bank is its characteristics as document of title. Thus, it provides security for the credit because if the debtor defaults, the banks can assume control of the goods and recoup their losses. And that is why the B/Ls are so connected with L/Cs.

2.1 Multiple original bills of lading

There is an international tradition that usually there would be more than one original B/Ls will be issued.¹⁷ The historical root behind this tradition may be because there was a high risk of a document being lost in ancient time and therefore if more than one of B/Ls were issued, there would be a good chance that at least one B/L would reach the expected recipient.¹⁸ However, such security for ensuring the representation of B/Ls may induce an occurrence of fraud. “A sample example would be where a shipper sells the same goods three times, each ‘purchaser’ obtaining an original B/Ls, and believing himself to have title to the goods.”¹⁹ Therefore, it seems that for the purpose for protecting himself. It would be reasonable by the buyer of a CIF contract, who demands a tender of a whole set B/Ls from the seller. However, the appeal court in the case *Sanders v. Ma Clean* (1983) harbored the conception that without endorsing the retained B/Ls to the third party, the vendor could keep parts on this hand. Here came into another question that how the vendee could be knowledgeable of the facts about whether the retained B/Ls have been fraudulently

¹⁷ At 108

¹⁸ Ibid.

¹⁹ Ibid.

used.²⁰ So, “it appears that if a vendee wants to defend his possession rights over the contractual goods, he may, from the very first beginning, specify in the sales contract that ‘tender a full set of bills of lading’ .”²¹

In the case *Glyn Mills Currie & Co v East and West India Dock Co*, the court held that even if the delivery was made only based on one of the accomplished B/Ls, the shipowner could be released from the liability to other legal holders of B/Ls. ²²

Goods having been shipped for London consigned to C. & Co. the shipmaster signed a set of three bills of lading marked “First,” “Second,” and “Third,” respectively, making the goods deliverable to C. & Co., or their assigns, freight payable in London, the one of the bills being accomplished, the others to stand void. During the voyage C. & Co. indorsed the bill of lading marked “First” to a bank in consideration of a loan. Upon the arrival of the ship at London the goods were landed and placed in the custody of a dock company in their warehouses; the master lodging with them notice under the Merchant Shipping Act 1862 s. 68 ²³&c. to detain the cargo until the freight should be paid. C. & Co. then produced to the dock company the bill of lading marked “Second” unendorsed, and the dock company entered C. & Co. in their books as proprietors of the goods. The stop for freight being afterwards removed, the dock company bonâ fide and without notice or knowledge of the bank's claim delivered the goods to other persons upon delivery orders signed by C. & Co.:—*Held*, affirming

²⁰ See, *Sanders v. Ma Clean* (1883) (1882-83) L.R. 11 Q.B.D. 327 Court of Appeal

²¹ See, *Donald H. Scott & Co. Ltd. v. Barclays Bank Ltd.* (1923) 2 K. B. 1.

²² See, *Glyn Mills Currie & Co v East and West India Dock Co.* (1881-82) L.R. 7 App. Cas. 591, House of Lord

²³ See, “Merchant Shipping Act, 1862 (25 & 26 Vict. c. 63) ss. 66-78.

‘When goods are shipped under a bill of lading drawn in parts, to be delivered to the consignee “or his assigns, the one of which bills being accomplished, the others to stand void,” the master, or the warehouseman who has the custody of the goods under the Merchant Shipping Act 1862 ss. 66–78, is justified in delivering to the consignee on production of one part, although there has been a prior indorsement for value to the holder of another part; provided the delivery be bonâ fide and without notice or knowledge of such prior indorsement.’ ”

Glyn Mills Currie & Co v East and West India Dock Co. (1881-82) L.R. 7 App. Cas. 591, House of Lord

the decision of the Court of Appeal, that the dock company had not been guilty of a conversion, and that the bank could not maintain any action against them.²⁴

Also, in an ordinary CIF contract in *Sansders v. Maclean*, the court of appeal held, that “the buyer must pay against one, even if the original are issued in set.”²⁵ Thus, it’s clearly that such B/Ls system gives way for a fraud.

2.2 Misrepresentation in bills of lading

2.2.1 Anti-dated bills of lading

.Anti-dated bill of lading is something connected with the cargo shipment, where the carrier signs and issues one kind the bill lading is earlier than the cargo actual shipping date.²⁶ “The goal of anti-dated bill of lading generally is to cause in the bill of lading the loading days to meet letter of credit's requirement, avoids the responsibility of delay payment, so anti-dated bill of lading constitutes to consignor's cheat.”²⁷

2.2.2 Advanced bills of lading

“Because of the letter of credit shipment period and the settlement are due to expire for some reason failed to ship the goods, but has been under the control of the carrier, or have begun shipping, letters of guarantee issued by the shipper to require the

²⁴*Glyn Mills Currie & Co v East and West India Dock Co.* (1881-82) L.R. 7 App. Cas. 591, House of Lords

²⁵Paul Todd, *Maritime fraud and piracy*, 2nd Edition, London: Lloyd’s List, 2010 at P. 108.

See also, *Sansders v. Maclean* (1983) 11 Q.B.D. 327.

²⁶ *The Study of Anti-dated Bill of Lading under UNCITRAL TRANSPORT LAW (DRAFT)* Available at, <http://mt.china-papers.com/3/?p=20208>, visited on April, 10th, 2102.

²⁷ Ibid

carrier advances of the bill of lading,²⁸ like the Anti-date bill B/Ls, the consignor may also commit a fraud by presenting an advanced B/Ls.

2.2.3 Discrepancies

In spite of being on board, the real quantity and condition of the goods may be different from what specified on the B/Ls. So, what is the legal nature of description on B/Ls.

In the book *Carver on Bills of lading*, it mentions that,

In relation to a statement in a bill of lading as to the order and condition of the goods, it has been said that “the word ‘shipped in good order and condition’ are not the words of contract in the sense of a promise” but are merely “an affirmation of fact, or perhaps rather in the nature of an assent by the captain of an affirmation of fact which the shipper may be supposed to make.”²⁹

Therefore, in view of words cited above, for the original seller and the buyer, such descriptions could be the prima facie evidence between them. But, if the a B/L is lately transferred to the third party, then such descriptions may become an absolute proof instead and that third party could base his claim on this description on B/L against the carrier.

Beside of those misrepresentations the author listed hereinbefore, they ate still other kinds of misrepresentations not given in this paper. However, no matter what kind of misrepresentation it is, under most circumstance, it is always used for certain special purpose, like for meeting the conditions under L/C, or just for being served as fraudulent tools, etc.

²⁸ *Explain the various types of bills of lading terms* Available at, http://www.kingwaylogistics.com/EN/news_view_364_179.html, visited on April, 10th, 2012.

²⁹ Sir Guenter Treitel and F.M.B. Reynolds, *Carver on Bills of lading*, 1st Edition, London: Sweet & Maxwell, 2001, at p.22

However, let's leave the purpose part alone first. Sometimes, if a shipper wants to get a B/L which represents the condition deviated from the real condition, like the cases (Anti-Date Bill of lading, Advanced bill of lading, Discrepancies) analyzed in this chapter, a letter of indemnity may be required by the shipowner for a security in case of loss happening. The reason for proposing such requirement by the shipowner is apparent because there is no way for a shipowner voluntarily taking a risk without any guarantee. So, such letter of indemnity seems to be very reasonable and understandable in the international transactions.

But, in the real business world, things could be far more complicated than what we thought. The letter of indemnity, which is planned to be a security for the shipowner, may turn out to be the vehicle of maritime fraud, which the thesis will discuss in the following chapter 2.3.

2.3 Letters of indemnity

When it comes to the letters of indemnity, it is always a controversial issue in maritime practice, where it has been widely used in marine transportation for settlement of contradictions between security and rapidity. However, the letter of indemnity has long been overshadowed under the high possibility of inducing a maritime fraud since its origin. As a consequence of that, how to identify the boundary between the legal letter of indemnity and the fraudulent one seems to be very helpful. In addition, in the chapter 3, this essay puts focus on L/Cs. for its connections with L/C, letter of indemnity is discussed in this chapter. Sometimes, the letter of the indemnity usually serves as an instrument for documentary fraud under L/C because based on which a clean B/L may be issued by the carrier for the requirement from the beneficiary, which allows the credit to be honored by the bank later.

These clean B/Ls under the letters of indemnity, meet the descriptions in the contract apparently, where actually the goods are in faulty. If the shipowner knows clearly of the real situation, he may commit a fraud even if he has no intention for deceiving anyone.

Sometimes, even with the absence of deliberate fraud, the person who issues a false B/L under a letter of indemnity could still possibly be guilty of deceit and will get paid for his misrepresentations.

In the case *Brown Jenkinson & Co Ltd v. Percy Dalton (London) Ltd*, the court held, although the shipowners in issuing clean bills of lading did not intend that anyone should be defrauded, they had made a representation of fact, which was known to be false, with intent that it should be acted upon; therefore they were guilty of the tort of deceit and the indemnity was unenforceable.³⁰

Also, there is another case, *Standard Chartered Bank v. Pakistan National Shipping Corp* (1995), regarding to issuing an anti-date B/Ls.³¹ The court held,

With PNSC's authorization, Seaways signed and released a bill of lading which it knew to contain the false representation that the cargo had been loaded on or before

³⁰ *Brown Jenkinson & Co Ltd v. Percy Dalton (London) Ltd*, [1957] 2 Q.B. 621

³¹ "By a contract of sale the fourth defendant ('Oakprime') agreed to sell bitumen to Vietranscimex OF Haiphong/Da Nang or Ho Chi Minn City. At the request of Vietranscimex, Incombank HCMS opened a letter of credit, The plaintiff bank ('SCB') confirmed the letter of credit, which provided in terms that the documents included clean shipped on board bills of lading, shipment was to be effected not later than 25 October 1993. Oakprime chartered the Lalazar from the first defendant shipowner ('PNSC') to carry bitumen. However, Oakprime was consequently unable to present conforming documents under the letter of credit. There was no evidence that PNSC was aware of the terms of the letter of credit. Oakprime persuaded PNSC to authorise the second defendant ('Seaways') to sign on behalf of PNSC a bill of lading dated 25 October 1993 which PNSC knew to be false, by offering PNSC an indemnity against liability under the antedated bill of lading. Oakprime sent documents to SCB, which paid US\$1,155,772.77 to Oakprime. On discovering loading completed after specified date, SCB claimed damages for deceit against PNSC and agent." See, *Standard Chartered Bank v Pakistan National Shipping Corp* (No.1) [1995] C.L.C. 1293

25 October in order to meet a condition in the letter of credit It followed that PNSC and Seaways intended the bank to which the bill of lading was presented to be misled by the misrepresentation, or were reckless as to whether or not the bank would be misled. PNSC and Seaways therefore had no arguable defense that they did not intend to deceive the bank to which the bill of lading would be presented, namely SCB. It was immaterial that PNSC and Seaways did not know the precise terms of the letter of credit or the name of the bank. Where a master or agent signed a false bill of lading knowing it to be false and intending to deceive someone into whose hands it was likely to come he was liable in tort. *Therefore, although Seaways was acting as agent for PNSC in signing the bill of lading, because Seaways had knowledge of the misrepresentation, Seaways was liable for deceit.*³²

Based on the case before, here rises another question, that is, if a shipowner who is actually aware of the discrepancy truth, issues a clean bill of lading under an alleged guarantee document---“letter of indemnity”. Then, after compensating the claimants (buyers or other consignees), can the shipowner still ask for an indemnity on the ground of such letter of indemnity I think the answer would be a total denial because the characteristic of an illegal letter of indemnity, like the nature of an illegal contract, is void. Therefore, there is no way for a shipowner taking recourse against a void letter of indemnity. Even worse, the shipowner, without deliberate, may be guilty of a fraud. So, although there must be considerable interests, accounting into the risk himself may take, a shipowner should be more cautious when issuing such bill of lading with discrepancy.

Notwithstanding the discussion above, it doesn't mean the shipowner would become a party to fraud under all conditions if there is a letter of indemnity issued. In *BP Oil International Ltd v. Surena Delmar Navegacion SA* [1988], although the quantity mentioned in the B/Ls differed with the one got on board, fraud was not the point of this case.³³

³² Ibid

³³ *BP Oil International Ltd v Surena Delmar Navegacion SA* [1988] 1 Lloyd's Rep. 253.

Also, a shipowner may always face the situation where he has to take delivery under a letter of indemnity in case of no production of a B/L. Even there is no fraud here, the shipowner should still give more cautions on this issue since the P&I clubs hold a “discretion” tone as to whether to reimburse a member for a liability and so far most P&I clubs expressly make clear that liabilities, costs and expenses shall not be covered in delivery of cargo without production of a B/L.³⁴ “Thus, if a consignee does offer a letter of indemnity in respect of any liability which the carrier may face, acceptance by the shipowner will be a commercial decision for him.”³⁵

2.4 Nullity of the documents

Like the question Paul Todd points out in his book,

If what tendered can not be described as a document at all, can the buyer reject it, without having to prove fraud by beneficiaries? Is there also a concept of non-genuine document which though not a nullity, contains sufficient inaccuracies that it can also be rejected.³⁶

See, also “the United States District Courts have recently developed a line of case which established the principle that a shipper or consignee will not make out a prima facie case of short-delivery when he bases his claim on shore tank figures cannot be used against a carrier, since they represent measurements taken when the cargo has passed out of the carrier’s possession.”

Yang Liangyi, *Bill of lading, and other shipping documents*, the revised edition, Beijing: CUPL Press, 2001 at p. 564.

³⁴ Stephen D. Girvin, “Presentation of forged bills of lading”, *Journal of Business Law*, Jan (2000), at p. 85-86.

³⁵ *Ibid*, at 86.

³⁶ Paul Todd, *Maritime fraud and piracy*, 2nd Edition, London: Lloyd’s List, 2010 at p. 112.

A closer case relating to this question hereinabove may offer us some clues. In *Hindley & Co v. East Indian Produce Co* (1973),

Sellers of Siamese jute, grade A, sold c. & f., tendered a bill of lading, obtained from T from whom they bought the jute, which stated that grade A jute had been shipped. No jute of the contract description had been shipped in fact.

Held, that seller's c. & f. were obliged to ship goods of the contract description and c. & f. contracts contain an implied term that material statements in the bill of lading should be true and accurate in fact. Accordingly the bill in this case was improper and the buyers were entitled to return of the price paid and damages. It was irrelevant that the buyers could have sued the carriers.³⁷

However, this case showed no settlement of deciding whether a production of a null B/L is a breach of contract and that the seller's breach would have entitled the buyers to reject the document that was tendered.³⁸

Later, there was a CIF contract, where

By a contract of sale by sample the sellers sold to the buyers 500 tonnes of beans in a cif contract. The contract provided, inter alia, for "payment against shipping documents on first presentation and that a certificate of quality at port of discharge given by GSC should be final." but only 445 tonnes were discharged finally and the seller's present of shipping documents for payment was rejected. The buyers contended that they were entitled to reject the goods for breaches of description which were not covered by the GSC certificate of quality and that in any event the GSC certificate was valid in respect of 445 tonnes only. Accordingly the buyers sought damages for non-delivery. The sellers contended that the GSC certificate covered description as well as quality and was final. Finally the house of Lord found in favour of the seller.³⁹

³⁷ *Hindley & Co v East Indian Produce Co*, [1973] 2 Lloyd's Rep. 515.

³⁸ Paul Todd, *Maritime fraud and piracy*, 2nd Edition, London: Lloyd's List, 2010 at P. 113.

³⁹ *Berger & Co. Inc. Appellants v Gill & Duffus S.A. Respondents*, [1984] 2 W.L.R. 95

At the very least, in Lord Diplock's view, if the documents appear to be in order, the buyer cannot later justify rejecting them, having discovered only subsequently that the goods were non-conforming.⁴⁰

Gill & Duffus is authority for the general proposition that a CIF buyer cannot reject shipping documents that apparently conform, absent fraud by the seller, where Lord Diplock equated the CIF position with that under the documentary credit⁴¹

In *Gill & Duffus v. Berger & Co Inc*, Lord Diplock was prepared to contemplate as an exception to the principle elaborated therein that that, "if you contract to sell peas, you cannot oblige a party to take beans"⁴².

However, from the above case there was no see of a clearly definition of "nullity". Instead, the question for recognition of nullity exception has been put on the table.

But, what is nullity? When deciding a nullity, the courts prefer to check the extent and nature of the falsity in a document.⁴³ And it has been told that if the destroy of "the whole essence of the instrument" will be considered as a nullity.⁴⁴

"By using such an interpretation, it would be relatively easy to assess whether a document is a nullity once the facts of a case were known."¹⁴ Adopting a 'without legal

⁴⁰ Paul Todd, "Non-genuine shipping documents and nullities", *L.M.C.L.Q*[2008]547 at 565.

⁴¹ Paul Todd, "Non-genuine shipping documents and nullities", *L.M.C.L.Q*[2008]547 at 565.

⁴² Paul Todd, *Maritime fraud and piracy*, 2nd Edition, London: Lloyd's List, 2010 at P. 113-114.

See, also *Bowes v. Shand* (1877) 2 App. Cas. 455

⁴³ Chin, L.Y. and Wong, Y.K. "AUTONOMY—A NULLITY EXCEPTION AT LAST?" *L.M.C.L.Q.* [2004] 14. at.17.

⁴⁴ Dora Neo, "A Nullity Exception in Letter of Credit Transactions" , (2004), *Singapore Journal of Legal Studies* 46, at p.71.

effect' approach greatly simplifies the inquiry and for that reason is desirable. Nonetheless, the extent and nature of falsity in a document will be extremely relevant to determining whether a document is 'without legal effect'.⁴⁵

However, there are quite of reasons which may induce a nullity. It could be caused by only mistake, or fraud. And, in this thesis, the focus is on the nullity caused by a fraud.

Indeed, the results of fraud can be represented in many ways, and nullity is one of them. And the nullity of documents always has a connection with fraud exception under L/Cs.

Further, as in the former discussion of this chapter, the thesis makes introduction to several main expressions of documentary fraud, like anti-dated B/L, misrepresentation, etc, where some of those fraud are also always related to L/Cs. therefore, the introductions of such expression could provide a brief view of how at the very first beginning a documentary fraud happens and then we have the later discussion of this thesis, documentary fraud under L/Cs.

⁴⁵ Kieran Donnelly, "Nothing for nothing: a nullity exception in letters of credit?", *J.B.L.* 2008(4) 316, at p. 318. See, also

"The bill of lading with the wrong date of loading placed on it by the carrier's agent was far from being a nullity. It was a valid transferable receipt for the goods giving the holder a right to claim them at their destination ... and was evidence of the terms of the contract under which they were being carried.' It is suggested that this finding is consistent with the "without legal effect" approach discussed above. Clearly, an incorrect date on a bill of lading neither renders the documents being without legal effect, nor destroys the whole or essence of the instrument."

Ibid, at 318-319.

3 Letters of credit

3.1 Overview of letters of credit

In the former chapters of this article, the author makes introduction to several documentary fraud, where some of those fraud are always connected with a L/C and as a consequence of that, this chapter will mainly put focus on fraud under documentary credits.

Basically, *a letter of credit* can be defined as an instrument issued by a bank where the bank furnishes its credit which is good and well know, instead of the buyer's credit, which may be good but is not so well.⁴⁶

As we know, since the origin of documentary credits from 19th century, it has sprawled around the world and become one of the most leading and common payment, which definitely put international trade a step further.

In spite of those benefits behind a L/C, in my opinion, the documentary credits were produced mainly for the benefits of the seller technically and under a L/C, the risk a buy may suffer is far more serious than the seller.

Generally, the most typical characteristics and merits of L/Cs is bank credit. By means of dividing from the underlying contract, payment is independent on records specified in written documents. So, the only guarantee of both parties under L/Cs is

⁴⁶ *Requirement of exporter and importer, available at, <http://www.scribd.com/doc/3980255/12-letter-of-credit>, visited on July, 2nd, 2012.*

those facial evidences on the paper without consideration of the real facts. Although the facial-confirming system provides a more convenient and rapid payment system for the international transaction, the potential defects existing in this system trigger the occurrence of fraud, which somehow shakes the confidence between the buyer and seller. There are critics who even said that “although no doubt of the importance of certainty and precision in international trade, it is suggested that the fallout from a failure to maintain trust and sanctity in the documentary credits would far outweigh the benefits of certainty and precision.”⁴⁷

So, there would be an interesting phenomenon in the real world that you enter into a bank for withdrawing 100 dollars, where you have to show your ID, code, even signature may be checked seriously. However, in respect of 100 millions dollars under a L/C, the bank may honor the payment more easily. So, I would say, the system of both payment and the international trade are really tricky things, where you get and lose.

3.2 No responsibility of the banks

ARTICLE 15 of UCP 600,

Disclaimer on Effectiveness of Documents

Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s), or for the general and/or particular conditions stipulated in the document(s) or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by any document(s), or for the good faith or acts and/or omissions, solvency, performance or standing of the consignors, the carriers, the forwarders, the consignees or the insurers of the goods, or any other person whomsoever. ⁴⁸

⁴⁷ Hooley, “Fraud and Letters of Credit” , *C.L.J.* ,[2002] 279 at 281.

⁴⁸ UCP 600, Article 15.

So, according to this article, the bank will be discharged from any liability in case of documentary fraud. Therefore, rather than making consideration for the validity of those documents under a L/C, what a bank really cares about under UCP rules is the facial coherence of those documents- weather they meet the terms and conditions under a L/C apparently. So, things happens that Under a FOB contract, when a confirming bank in UK honors the seller (UK) a payment on the ground of the documents which apparently meet the terms under L/Cs. Following, if the issuing bank in China makes a notice to the Chinese buyer that they will accept to pay the confirming bank in US, the Chinese buyer may at that time find a clue for fraud because at that moment the vessel assigned by the buyer has not arrived at the loading port yet. Under this condition, can the buyer claim for a suspension of the payment? Before settlement of this question, we should be necessarily to learn something about one of the most fundamental principles under L/Cs.

3.3 Autonomy principle and fraud exception

3.3.1 Autonomy principle

What is autonomy principle implied under a documentary credit?

The letter of credit is separate from and independent of the underlying contract in respect of which it is issued, Which means any claim arising out of the underlying contract do not affect the bank's obligation to honor a L/C. As the basic principle underlying the L/C, it endows L/C a unique character which could separate it from

any other kind of payment and also make it as one of the most important way for payment.⁴⁹

However, in spite of the documentary credits seem very secure for both of the parties⁵⁰, the voice of opposite still exists, as there is always an open door for fraud under autonomy principle mainly because of such facial censorship.

Further, in practice, “English courts are very reluctant in giving injunctions for that they are not willing to interfere with the autonomy of documentary credits, which is the reason why the requirements of fraud exception are highly demanded.”⁵¹

So, in the long term development of international practice, there is an exception established gradually, which is called “fraud exception”. For analyzing this issue, we will start from study some English cases which can normally tell a general history origin of fraud exception and how the English court’s attitude toward this.

⁴⁹ See also, “Described by Donaldson J in *The Bhoja Tradera* vs the ‘ifeblood of commerce’, it is well established that documentary credit transactions are separate from the underlying contract which the documentary credit seeks to finance. This doctrine of autonomy lies at the heart of documentary credit law. The general rule is that banks in a documentary credit transaction deal with only documents. Upon the presentation of conforming documents by the beneficiary, the confirming/negotiating bank must make payment to the beneficiary, irrespective of any dispute in the underlying sales transaction,⁵ save in the limited case of fraud on the part of the presenting beneficiary.”

L.Y. Chin, Y.K. Wong, “AUTONOMY—A NULLITY EXCEPTION AT LAST?” *L.M.C.L.Q.* [2004] 14 at 15.

⁵⁰ See, also, “Yet the value of the principle ought not to be overstated. Nor should the principle be allowed to become so rigid and inflexible that it undermines other important policy concerns of the law. Thus, it is now widely accepted that the autonomy principle may be breached in certain exceptional circumstances in order to give effect to other important policy considerations, such as the need to combat fraud.” Nelson Enonchong, “The autonomy principle of letters of credit: an illegality exception?” *L.M.C.L.Q* [2006] 404 at 405.

⁵¹ Yeliz Demir-Araz. International trade, “maritime fraud and documentary credits”, (2002), *Int.T.L.R.* 8(4), at.129.

3.3.2 Fraud exception

3.3.2.1 Gian Singh & Co Ltd v Banque de l'Indochine [1974]

In the case *Gian Singh & Co Ltd v. Banque de l'Indochine*,

The respondent (“the issuing bank”) opened an irrevocable documentary credit on the instructions of the appellant customer in favor of T.L. (“the beneficiary”) to finance the purchase of a fishing vessel. Payment under the credit was to be made against presentation of a sight draft drawn on the customer and accompanied by signed commercial invoices and a certificate of origin. However, the signature has been forged and the bank has paid against forged documents without knowledge of the truth. Finally the court made a judgment in favor of the issuing bank.⁵²

From *Gian Singh*, it then appears that no fraud principle operates as between the issuing bank and the applicant for the credit.⁵³

3.3.2.2 United City Merchants v Royal Bank of Canada [1981]

As the remarkable case in the field of documentary fraud under L/C, although no application of fraud exception in this case, the City Merchants somehow officially put fraud exception on table at the first time.

In the case, the trial court, relying on the principle of *ex turpi causa non oritur actio*, concluded that “only fraud by the beneficiary could invoke the fraud rule and thus Justice Mocatta therefore did not apply the fraud exception in the case at hand because a third party had perpetrated the fraud.”⁵⁴

⁵² See, *Gian Singh & Co Ltd v Banque de l'Indochine*, [1974] 1 W.L.R. 1234(Privy Council (Singapore))

⁵³ Paul Todd, “Non-genuine shipping documents and nullities”, *L.M.C.L.Q* [2008]547 at 554-555.

⁵⁴ *United City Merchants (Investments) Ltd v Royal Bank of Canada* (The American Accord), [1983] 1 A.C. 168

Later the Court of Appeal, repeated this issue through analyzing the nature of the tendered documents, holding that “it was the nature of the documents, not their origin, which mattered”.⁵⁵ And if the documents were not genuine, or were in some respects forged, the fraud rule should be applied regardless of who had perpetrated the fraud.”⁵⁶

Griffiths, L.J said, “It was a dishonest document, it was not a genuine document and, in my view, the bank was entitled to reject it”.⁵⁷

Nevertheless, the judgment made by the appeal court was revised by the House of Lords, holding that the inaccuracy on the B/L did not discharge the confirming bank of its contractual obligation to pay the seller.⁵⁸ The court addressed that in a confirmed L/C transaction that the seller and the confirming bank “deal in documents

See, also, Gao, Xiang, The Identity of the Fraudulent Party Under the Fraud Rule in the Law of Letters of Credit, available at, <http://www.austlii.edu.au/au/journals/UNSWLJ/2001/14.html>, visited on April 21th, 2012.

⁵⁵ Ibid.

⁵⁶ Ibid.

⁵⁷ *United City Merchants (Investments) Ltd v Royal Bank of Canada*, [1981] 3 W.L.R. 242.

See also,

“The decision of the Court of Appeal represents sound commercial sense. In particular, its decision that a bank should not honor a letter of credit if, to its knowledge, a fraudulent bill of lading is tendered, is correct, and it is immaterial in this connection whether the seller was a party to the fraud or the fraud was committed by a third party without the knowledge of the seller. Banking business could not be carried on with the necessary expedition if the bank were compelled to make detailed inquiries into the nature of the fraud”. Clive M Schmitthoff, “Export Trade” ,(1981) *Journal of Banking Law* 381, at p. 383

⁵⁸ *United City Merchants (Investments) Ltd v Royal Bank of Canada*, [1983] 1 A.C. 168

and not in goods".⁵⁹ Therefore, there is a rule established in this case that if the documents presented by the seller to the confirming bank comply with the conditions and terms on face under the credit, the bank is under a contractual obligation to make payment, which holds true notwithstanding that the bank have already realized the existence of fraud where a breach of the sales contract may induced and that would entitle the buyer to rescind underlying contract.⁶⁰

The final judgment of this case preserves the strength of L/Cs as an instrument of international trade financing,⁶¹ In requiring actual part of the seller and by applying a narrow test of materiality the court avoids what would otherwise have resulted in a weakening of the independence of confirmed L/Cs transactions.⁶²

Indeed, the case did not fall within the fraud exception, yet Lord Diplock clarified the *fraud exception* with the following words:

To this general statement of principle as to the contractual obligations of the confirming bank to the seller, there is one established exception: 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 untrue.*⁶³

This statement of Lord Diplock clearly established that for the application of fraud exception, the beneficiary who tenders the documents shall not be deprived of his

⁵⁹ Ibid.

See, also: *United City Merchants (Investments) Ltd. v. Royal Bank of Canada.* (1982) 2 W.L.R. 1039.

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² Ibid.

⁶³ Ibid.

see also, , Yeliz Demir-Araz, "International trade, maritime fraud and documentary credits", (2002), *Int. T.L.R.*, 8(4), at p.130.

right to be honored by the bank *except he is privy to statements of facts* which are false within these documents.⁶⁴

The decision of this case has received tons of criticism from other scholars, where it has been said that, as a result of the House of Lords' decision,

English law ... appears to protect shrewd sellers who utilize the services of third parties discreet enough to keep their fraudulent practices to themselves. The law in effect encourages sellers not to inquire into the details of the activities of third parties involved in their transactions so long as the bills of lading appear valid, for any knowledge of wrongdoing would jeopardize the sellers' chances of being paid. A bank which receives firm evidence external to the documents of fraud by a third party does not even have the option of refusing to honor a credit governed by English law as stated in the American Accord.⁶⁵

We could say, the principle contained in the case makes easier for the seller pushing a bank to honor a credit. Indeed, as a means of payment, the main purpose of L/Cs should let the process of business far from those fussy procedures, so as to meet the rapidity and convenient standard set in international trade. However there are always voice from outside that the L/Cs system should be built upon a relationship of balance between the purchaser and seller rather than showing partiality to any party, or even providing an unintended umbrella for a fraud.

At the time of this case, however, it was still not clear whether the fraud of anyone apart from the beneficiary would sufficient to trigger the exception.⁶⁶ “This statement of Lord Diplock clearly established that for the fraud exception to be applied the beneficiary who tenders the documents must be privy to statements of facts which are false, within these documents, otherwise he is not deprived of his right to be paid.”

⁶⁴ Ibid.

⁶⁵ Guy G Smith, “Irrevocable Letters of Credit and Third Party Fraud: The American Accord”, (1983) *Virginia Journal of International Law*, 24 Va.55, at p.70-71.

⁶⁶ Paul Todd, “Non-genuine shipping documents and nullities”, *L.M.C.L.Q.* [2008]547 at 550.

⁶⁷But the court had clearly repeated the autonomy principle in the case, which stressing that the obligations of the bank under the sale contract were *independent* of the underlying sale contract between seller and buyer and the notion for “dealing in documents and not in goods” of the bank. ⁶⁸.

However, against the United City Merchants case, in *Montrod Ltd v. Grundkotter Fleischvertriebs GmbH*, the existence of a fraud exception was doubted by English law again.

3.3.2.3 Montrod Ltd v. Grundkotter Fleischvertriebs GmbH [2002]

Potter LJ, realized that it would make “undesirable inroads into the principles of autonomy and negotiability universally recognized in relation to letter of credit transactions”, and also “it would place banks in a further dilemma as to the necessity to investigate facts which they are not competent to do and from which [the UCP] is plainly concerned to exempt them” did not favor a general nullity exception.” ⁶⁹

This decision is tend to be strongly against a fraud exception under English law, but the Court of Appeal did not go so far as conclusively to deny its existence.⁷⁰

⁶⁷. Yeliz Demir-Araz, “International trade, maritime fraud and documentary credits”, (2002), *Int. T.L.R.*, 8(4), at p.130.

⁶⁸ Paul Todd, “Non-genuine shipping documents and nullities”, *L.M.C.L.Q.* [2008]547 at 549.

⁶⁹ *Montrod Ltd v. Grundkotter Fleischvertriebs GmbH* [2002] 1 WLR 1975 (EWCA Civ)

⁷⁰ Paul Todd, “Non-genuine shipping documents and nullities”, *L.M.C.L.Q.* [2008]547 at 559.

3.3.2.4 Mahonia Ltd v JP Morgan Chase Bank (No.1)[2003]

In *Mahonia Ltd v. JP Morgan Chase Bank (No.1)*, Judge Colman, J. said,

.....refusing the application, that a contract which was lawful on its face but which had been entered into for an unlawful purpose could not be enforced in the English court. The important function of letters of credit in international trade required that they should not be revoked unless their use would result in benefits from an illegal act, and to enforce letters of credit in such circumstances would be to enforce part of a transaction which would otherwise be unenforceable.⁷¹

Another conclusion was made by Colman J that “the autonomy of a letter of credit does not prevent it from being tainted by the illegality of the underlying transaction.”⁷²

“Cooke J’s opinion on the availability of the illegality exception is no doubt a strong indication of the direction of English law. However, it is strictly speaking, obiter.”⁷³

Clearly, there is still no clear answer from the case that whether the English court refused to enforce a L/C under a fraud in the underlying contract and due to which the position of English law is less than settled even after *Mahonia*.⁷⁴

3.3.2.5 Burden of proof : fraud exception remains noting but a theory

Fraud exception, from the above *case*, it has been interpreted in an extremely rigid way and “mere allegation or suspicious of fraud is not enough for a bank to stop

⁷¹ *Mahonia Ltd v JP Morgan Chase Bank (No.1)*, [2003] EWHC 1927 (Comm)

⁷² Nelson Enonchong, “The autonomy principle of letters of credit: an illegality exception?” *L.M.C.L.Q* [2006] 404 at 410.

⁷³ *Ibid.*

⁷⁴ *Ibid.*

payment and for a court to give an injunction”.⁷⁵ Unlike the American law where a temporarily restraining order could be given if suspicion of fraud exists, the burden of proof under English law system is heavier.⁷⁶ And, there are few cases in the real practice where the fraud could be established for an injunction restraining a payment of the bank.⁷⁷

In the case *Bolivinter Oil SA v. Chase Manhattan Bank NA*, the court held

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.⁷⁸

Like the author talked about before, the courts are not willing to give injunctions against autonomy principle in a letter of credit, which definitely explains why they set

⁷⁵ Yeliz Demir-Araz, “International trade, maritime fraud and documentary credits”, (2002), *Int. T.L.R.*, 8(4), at .p.131.

⁷⁶ *Ibid*, at 131 See also, Article § 5-109 of Uniform Commercial Code states, that

“(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer; (2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted; (3) all of the conditions to entitle a person to the relief under the law of this State have been met; and (4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (a)(1).⁷⁶”

⁷⁷ *Ibid*, at 131.

⁷⁸ *Bolivinter Oil SA v Chase Manhattan Bank NA*, [1984] 1 W.L.R. 392.

“Unless there is a substantial challenge to the validity of an irrevocable letter of credit or a purchase bond or guarantee ex parte, injunctions restraining performance by the bank should not be granted save in the exceptional case of clear proof that the bank knew that any demand for payment would clearly be fraudulent.”

such strict standard to prove a fraud. Thus, “it will be impossible to see application of fraud exception in practice and fraud exception will remain nothing but a theory.”⁷⁹

3.4 ICC Uniform Customs and Practice for Documentary Credits

3.4.1 Short introduction of UCP

Before the first war, international trade was largely carried on by trading parties who knew and trust each other. When this traditional customs were broken down by the war for doing business with firms whom one did never know, not mention of trust, the documentary credit came into its own.⁸⁰

“Although the Uniform Custom originated from an initiative form the world banking, since 1993 they have developed and risen above the level of a kind internationalized body of general conditions laid down by banks.”⁸¹

Since the first uniform rules published by ICC in 1933, following the revised edition issued in 1951, 1962, 1974, 1983 and 1993, UCP has become major rules governing the L/Cs. However, for the very first beginning of the origin of UCP, the loopholes containing in the rules could be hotbeds for fraud, where ICC has been always making effort to balance its function for facilitating flow of international trade and also its intention for reducing fraud.

⁷⁹ Yeliz Demir-Araz, “International trade, maritime fraud and documentary credits”, (2002), *Int. T.L.R.*, 8(4), at .p.131.

⁸⁰ Frans P. DE Rooy, *Documentary Credits*, US: Kluwer Law and Taxation Publishers, 1984 at P.9

⁸¹ *Ibid*, at 16.

Thus, UCP 600, approved on 25 October 2006 by the ICC Commission on Banking Technique and Practice, is the latest version of the rules that governs L/Cs transactions worldwide which have been effective since 1 July 2007.⁸²

In this chapter, the thesis tries to introduce the fraud-related articles under UCP 600 and makes further analysis.

3.4.2 UCP 600

3.4.2.1 Irrevocable letter of credit

Article 3 of UCP 600 clearly mentions “credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation”⁸³ and “a credit is irrevocable even if there is no indication to that effect”⁸⁴. Those new rules are different from the conception set in UCP 500 of that in the absence of such indication the credit shall be deemed to be irrevocable⁸⁵. And under UCP 500 the issuing bank could at any time and without prior notice to the Beneficiary for amending or canceling such credit if it is a revocable credit.⁸⁶

Unlike the UCP 500 allowed existence of revocable L/Cs, UCP 600 holds tone of resistance in respect of revocable L/Cs. The best beneficiary of this change should be the seller as under a revocable L/Cs he may be throw into a passive situation, suffering the risk of either getting no paid by the bank, or being a potential victim for

⁸²UCP 600, Available at
, http://www.letterofcredit.biz/UCP_600.html, visited on April, 13th, 2012.

⁸³ UCP, Article2.

⁸⁴ Ibid, Article 3.

⁸⁵ UCP 500, Article 6(c).

⁸⁶ Ibid, Article8(a)

a fraud by the importer. The decision for such change may be made by ICC with consideration of seller's risk. However, the root for this change, in the view of the author, is that, under UCP 500, the revocable L/Cs deviated from the initial purpose of L/Cs and lost of its basic function as a credit, which made it no distinctions from other kind of payment.

3.4.2.2 Changes on prima facie censorship

Article 13 b of UCP 500 stated that "Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, *on their face*, to be in compliance with the terms and conditions of the Credit."⁸⁷

However, such strict "prima facie" regulation gets further developed under UCP 600. Article 14 of UCP 600 mentions, "Data in a document, when read in context with the credit, the document itself and international standard banking practice, *need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit.*"⁸⁸ Further, "if a credit requires presentation of a document other than a transport document, insurance document or commercial invoice, without stipulating by whom the document is to be issued or its data content, banks will accept the document as presented if its *content appears* to fulfill the function of the required document and otherwise complies with sub-article 14 (d)".⁸⁹

It's clearly that those revisions in UCP 600 have made change of traditional conception to "prima facie" principle as well as transformed the absolute mirror rule for decision of that the documents appears on its face to be in compliance with the terms and conditions of the Credit.

⁸⁷ Ibid, Article 13(b).

⁸⁸ UCP 600, Article 14 (d).

⁸⁹ Ibid, Article 14 (f).

Therefore, this new regulation starts a new situation where the conditions for honoring a credit will be closer to the real conditions of the underlying contract, which definitely shall limit the possibility of documentary fraud.

3.4.2.3 Transferable credit

The article 38 (b) of UCP 600 stipulates that,

Transferable credit means a credit that specifically states it is "transferable". A transferable credit may be made available in whole or in part to another beneficiary ("second beneficiary") at the request of the beneficiary ("first beneficiary").⁹⁰

The main revision made in the UCP 600 regarding to the transferable should be article 38, where stipulates that,

If the first beneficiary is to present its own invoice and draft, if any, but fails to do so on first demand, or if the invoices presented by the first beneficiary create discrepancies that did not exist in the presentation made by the second beneficiary and the first beneficiary fails to correct them on first demand, the transferring bank has the right to present the documents as received from the second beneficiary to the issuing bank, without further responsibility to the first beneficiary.⁹¹

Also, the new rule formulates that documents under the transferred L/C, presentation of documents by or on behalf of a second beneficiary must be made to the transferring bank, which means that no allowance of the second beneficiary to present the documents directly to the issuing bank.⁹²

Further, it is important to note that, under UCP 600, the issuing bank may also be the transferring bank, for example, in the case where the transferring bank is not willing

⁹⁰ Ibid, Article 38 (b).

⁹¹ Ibid, Article 38(i).

⁹² Ibid, Article 38(k).

to transfer the L/Cs⁹³. This regulation would be to some extent decrease the circumstance of the discrepancies on the documents shown by the second beneficiary and consequently avoid the risk of a fraud.

3.4.2.4 Autonomy principle still dominates UCP 600

Article 5 of UCP 600 expressly mentioned that, “Banks *deal with documents and not with goods*, services or performance to which the documents may relate.”⁹⁴ Further, in article 34 of UCP 600, it still regulates that

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. ⁹⁵

From two articles hereinabove, it's apparently that, although those revisions, there is no substantive change of UCP 600. The dominative principle – fraud exception, still exists to govern the new version.

3.5 Comments on documentary credits fraud

The unique character and considerable effect on international method of international payment has made the documentary credit as irreplaceable. The autonomy principle, which has served as basis of documentary credit, seems to be unshakable currently notwithstanding the pressure and criticisms form the outside.

⁹³ NEW UCP on Transferable Credits, *Window-dressing or Remodeling?*, available at, http://www.lcvviews.com/transferable_credits.htm, visited on April 13th, 2012.

⁹⁴ UCP 600, Article 5.

⁹⁵ Ibid, Article 34.

Undoubtedly, the main function of the documentary credit is a secure for payment—honoring a credit against documents apparently confirmed. If the exception applied always, the banks should be put into a predicament.

For an outsider of the underlying contract, how a bank could easily find the fraudulent evidences in the underlying sale contract without the knowledge of the real negotiation facts between the buyer and seller. And, how could it be possible for a bank with plentiful professionals in maritime field who are equipped well for identifying a fraud document. Anyway, even if the banks are willing to do so, more dollars shall be cost undoubtedly in this case. Most importantly, who is willing to buy the bills?

As I know, under current paper-based censorship system, the charge for a L/C from the bank has already made business men hesitated when considering of their costs, not even mention about the substantive censorship which would cost more. An other point worthy mentioned is that, supposing that a bank receives this “hot potato”, examining the documents substantially, a longer time shall be taken compared with the paper-based censorship, and accordingly the requirement for a quick payment set in the rules must be influenced negatively, which could further possibly bar the wills for employment of documentary credits.

Like the author talked in the introduction, it's the choice of international trade participants who abandon some of their rights of security, and it's a nature principle of the world that if you want to get something, something should be paid in return.

So, the less-cost and more-speedy way of L/Cs should be on the premise of sacrificing security to some extent and such sacrifice is a voluntarily option of the international

participants in a long history, who have taken credits of L/Cs system and the it makes sense for them to receive its bad sides.

However, we can not roughly to reach a passive answer that there is no way to reform the current L/Cs system. Face the possible fraud sensibly does not mean to face all of the fraud blindly.

Although it's not easy, there is always a way could try, like that the thesis later describes in the conclusion, the “super service” from the banks may be a reasonable solution.

4 Brief introduction of Chinese Law and Chinese practice on fraud exception under letters of credit

As the one of the major instrument of international payment, L/C plays a very important role for the international trade. China, as an essential participant, has been involved in L/Cs matters every year. Therefore, apart from the convenience obtained from the L/Cs, due to lack of experiences in this field, Chinese participants have always being involved in L/Cs fraud issues. Especially during the financial crisis in 2008, in Shanghai, there were 10 foreign-related cases involving L/Cs received by the Intermediate Court, with the amount over 20 million US dollars.⁹⁶ Further, the blank of a specific and effective law in this field also cause current situation where in practice courts are always on dilemma.

In this chapter, the current Chinese laws are introduced in order to present a real legal situation on fraud exception in China.

4.1 Statute laws

The article 195 of Criminal Law of Peoples Republic of China provides a crime relating to L/Cs fraud.⁹⁷ However, the former article only aims to deal with the L/Cs

⁹⁶ Mingyan Ren, *Three legal issues when hearing the foreign-related cases*, available at, <http://finance.people.com.cn/GB/10318247.html>, visited on July, 15th, 2012.

⁹⁷ See, Criminal Law of People's Republic of China, Article 195.

“A person who, under any of the following circumstances, conducts swindling activities of letters of credit, shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention

fraud from a criminal law perspective, where we can still not find a specific guidance to seek a civil remedy in it. Therefore, in view of this, we have following regulations that will talk about as follows.

4.1.1 Notice for Meeting Summary on Judicial Issues in Coastal Regions, Hongkong and Aomen (1982)

Since 1982, the Supreme People's Court of China released a press, part of which provided a guidance principle of how to deal with the fraud exception under a documentary credit, it stated,

L/Cs, as a general method of payment in the international transaction, is a document where a bank secures a payment to the seller with its own credit. The documentary credit, independent from the underlying sales contract, entitle the bank to honor a payment if the documents provided by the beneficiary meet conditions on the L/Cs on prima facie. And if the beneficiary fails to do so, the bank could refuse a payment without any preservation measures from the court. L/Cs and sales contract are two different issues, where, any randomly action of freezing a bank account may negatively influence the reputation of Chinese bank. Therefore, on the ground of international experience, only the sufficient proof raised for a fraud and no payment under a reasonable period by the bank, then, the court is allowed to restrain a payment on request of the buyer.⁹⁸

and concurrently to a fine of not less than 20,000 yuan and not more than 200,000 yuan; if the amount involved is huge or any other serious circumstance exists, to fixed-term imprisonment of not less than five years and not more than ten years and concurrently to a fine of not less than 50,000 yuan and not more than 500,000 yuan; and if the amount involved is especially huge or any other especially serious circumstance exists, to fixed-term imprisonment of not less than ten years or life imprisonment and concurrently to a fine of not less than 50,000 yuan and not more than 500,000 yuan or confiscation of property: 1. to use a forged or an altered letter of credit or attached note or document; 2. to use an invalid letter of credit; 3. to defraud a letter of credit; or 4. to conduct swindling activities of letters of credit by any other manner.”

⁹⁸ See, Meeting Summary on Judicial Issues in Coastal Regions, Hongkong and Aomen (1982).

From the former words it was clearly that, although strict requirements for application, the Chinese courts hold a positive tone in respect of both autonomy principle and fraud exception. However, such notice was merely guidance and the legal status of it still remained unclear. In practice, the national court may use it as grounds when deciding a judgment. Also, based on recent 2007 Provisions on Judicial Interpretation of the Supreme People's Court, judicial interpretations are expressed in four types -- "interpretation", "provisions", "reply", "decision".⁹⁹ As a consequence of this provision, 1982 Meeting Summary was neither a law nor judicial interpretation. Thus, how a decision made on the ground of this notice could be recognized by foreign court? Later, following this outline guidance, more detailed regulations were produced by authorities.

4.1.2 Notice of the Supreme People's Court on Strictly Prohibiting the Random Stop Payment for Letters of Credit(2003)

With the attention to maintain the international status of banks of China, the relevant regulations are notified hereby, where we could say Chinese authority harbors an affirmative attitude toward autonomy principle and pay more discretion on applying fraud exception.¹⁰⁰

⁹⁹ Rules on Judicial Interpretation of the Supreme People's Court, 2007, Article 6.

¹⁰⁰ See, Notice of the Supreme People's Court on Strictly Prohibiting the Random Stop Payment for Letters of Credit, Article 1,2.

1. The principle of independence of letters of credit shall be strictly abided by. The letter of credit falls within document transaction independent from the underlying transaction. As long as the documents provided by the beneficiary apparently accord with the requirements of the letter of credit, the issuing bank is obligated to pay within the specified time limit. Since the letter of credit and the underlying transaction belong to different legal relations, the court is not allowed generally to order stop payment

4.1.3 The Provisions of the Supreme People's Court on Some Issues in the Adjudication of Letter-of-Credit-related Cases(2006)

The Provisions of the Supreme People's Court on Some Issues in the Adjudication of Letter-of-Credit-related Cases, got effective on January 1st, 2006, has become the most authoritative and specific judicial interpretation in dealing with L/Cs disputes.

Based on article 8 of this provision,

Any of the following circumstances shall be considered to constitute L/Cs fraud:

- (I) The beneficiary has forged or incorporated false contents in any of the presented documents;
- (II) The beneficiary, in bad faith, delivers no goods or delivers goods of no value;
- (III) The beneficiary, in conspiracy with the applicant or any third party(ies), presents documents while no real underlying transactions exist;
- (IV) Other circumstances where fraud under an L/Cs may be found.¹⁰¹

for the letter of credit issued by the issuing bank simply because of disputes resulting from the basic transaction. 2. The conditions of application of the principle of exception of fraud on letters of credit shall be strictly adhered to. Only when there are sufficient evidences to prove the fraud through letters of credit and the bank has not yet paid in a reasonable period, the people's court may order stop payment in the light of the request of the applicants and on condition that they provide guarantee. However, if the letter of credit has been accepted and transferred, or the payment has been negotiated, the court shall not order stop payment. The people's courts at all levels shall think much of the order of stop payment for letters of credit. Random order of stop payment under unqualified conditions is prohibited. And the relevant people's courts shall immediately make correction to the stop payment order that has been improperly awarded. It is hereby notified.

¹⁰¹ The Provisions of the Supreme People's Court on Some Issues in the Adjudication of Letter-of-Credit-related Cases, Article 8.

Also, article 9 of the provision states that, “The applicant, issuing bank or any other stakeholder(s) may apply for an order to suspend payment under an L/Cs from a competent People’s Court when it discovers any of the circumstances stipulated in Article 8 and determines that the payment will cause irreparable damage to its interests.”¹⁰²

In Article 10, it mentions that after the court determines that L/Cs fraud exists, the court shall render an order to suspend or judgment to terminate payment under the L/Cs, except in any of the following circumstances:

- (I) A party nominated or authorized by the issuing bank has made payment in good faith according to the issuing bank’s instructions;
- (II) The issuing bank or a party nominated or authorized by it has accepted the draft under the L/Cs in good faith;
- (III) The confirming bank has paid in good faith;
- (IV) The negotiating bank has negotiated in good faith.¹⁰³

So far, the 2006 provision is the most detailed civil regulation in documentary credit fraud issues. However, like the author mentioned about the 1981 meeting summary, the legal status of 2006 provision, still leaves something should go further. Currently, neither in the general provision of civil law, or other specific laws like law of bills, we could find anything for pointing out a direction of how to deal with a letter of credit issues. English law, with hundreds of years, has contributed to the development of a relatively complete legal system in documentary credit field. However, the legislation of China in this field remains blank. Only a judicial interpretation is not enough to face the complicated real situation.

Issues, like whether the fraud exception would be applied if the third party was the only party guilty of such fraud, give no answers in the provision, with only a

¹⁰² Ibid, Article 9.

¹⁰³ Ibid, Article 10.

ambiguous article wording “other circumstances where fraud under an L/Cs may be found”¹⁰⁴ in the article 8 of 2006 Provisions.

Still, one thing we could be sure from the former regulations is that, although the Chinese court holds a positive attitude toward the fraud exception, where the vague of those regulations and the real cases in practice only make the Chinese court a non-dissident rather than a supporter to fraud exception.

4.2 Practices in China

As a consequence of the legislation in China which always falls behind the industry development, as well as the late start of the legal practice in L/Cs fraud, common understanding has not reached by Chinese court in L/Cs fraud, which induces chaos on the legal practice. In this chapter, the author just points out several aspects in Documentary fraud under L/Cs, for a brief understanding of the practical situation in China

4.2.1 Recognition of fraud exception

On September, 1997, there was a sales contract signed between the buyer Europe-Asia Company, Sichun, China and the seller Shinho Company, Korea, with letter of credit agreed as the only payment method. Later, the buyer issued a L/C in China agriculture bank and the seller was marked as the beneficiary. However, neither providing nor shipping the cargo promised, the seller presented a forged bill of lading. Therefore, the buyer launched litigation against the seller, requiring the nullity of the L/C. Finally, the supreme court of China made a decision in favor of the seller, where

¹⁰⁴ The Provisions of the Supreme People’s Court on Some Issues in the Adjudication of Letter-of-Credit-related Cases, Article 8.

the court stressed that “the fraud exception could only be formed when there is a material fraud in the basic contract”. For the first time, the material fraud was expressly applied by Chinese court, based on which a foundation has been built for later legal practice.¹⁰⁵ Till now, cases relating to L/Cs credit fraud still support such principle.

4.2.2 When the letter of credit has been honored: suspend or not?

There was a case in 1996, where Guangda Corporation issued a L/C in Wuhan Transport bank for the beneficiary, a Germany company, FOR—TRAMEYERGMBH. For the purpose of obtaining the payment, the beneficiary presented an anti-dated B/L and that L/C was honored by the confirming bank. After being aware of the fraud, Guangda Corporation applied for suspending the payment under the L/C and such recourse got supported from the court without consideration of the L/C had already been honored by the bank.¹⁰⁶

However, things changed after the 2006 provisions implemented. The article 10 (II) clearly mentions no application of suspending a payment by the court where “the issuing bank or a party nominated or authorized by it has accepted the draft under the L/Cs in good faith.”¹⁰⁷

105 See, Korean Shinho Company vs. Sichuan Euro-Asia Economy and Trade General Company Available at: <http://vip.chinalawinfo.com/newlaw2002/slc/SLC.asp?Db=art&Gid=335545003>, visited on May, 7th, 2012.

106 See, *Hubei Guangda corporation, China vs. FOR—TRAMEYERGMBH, Germany*. Available at, <http://china.findlaw.cn/info/case/zxal/363825.html>, visited on May, 7th, 2012.

107 The Provisions of the Supreme People’s Court on Some Issues in the Adjudication of Letter-of-Credit-related Cases, Article 10(II).

Therefore, on the ground of former provisions, in a recent case, with the beneficiary having been honored by the bank, the court refused the application from a local food company for suspending a payment under a L/C where the beneficiary, a Korea seafood company who was suspicious for perpetrating fraud.¹⁰⁸

4.2.3 Guilty of the third party

Under English jurisdiction, where we discussed in the former chapter, the fraud exception shall only be applied if the beneficiary or his agents are privy to such fraud, which means, the bank will not be entitled to dishonor a credit if the fraud is only made by a third party.

Back to Chinese law, based on article 8 of 2006 provisions, “the beneficiary, in conspiracy with the applicant or any third party(ies), presents documents while no real underlying transactions exist”.¹⁰⁹ Although the article herein refers to that the third party, incorporation with the beneficiary with bad faith, shall fall into a fraud exception, yet it fails to answer that when the third party is the only one to be guilty of a fraud, the fraud exception could be applied or not?

Indeed, in practice, we could see lots of cases which holds true of the article 8(III). However, the answer to the questions hereinabove still maintains unclear.

Currently, in China, although the fraud exception principle has been widely accepted by the court, neither the statute laws, nor the practical cases give a positive settlement

¹⁰⁸ See, *Dalian Baolong Marine Product Company v. Korea Sander Marine Product Company*. Available at, http://court.dl.gov.cn/info/136_41990.vm, visited on May, 7th, 2012.

¹⁰⁹ The Provisions of the Supreme People’s Court on Some Issues in the Adjudication of Letter-of-Credit-related Cases, Article 10 (III).

to the issue of third party fraud, which certainly, to some extent, hinders the court to make a decision.

4.3 An overview of the present situation in China

Today, we can always hear complains from the international society that too much injunction are used by Chinese courts to suspend payment under L/Cs.

As we mentioned in this thesis, Chinese importers have become victims by documentary fraud. Due to that, under either a CIF or CFR contract, which serves as the main choices by Chinese purchasers, the buyer could usually fall into a passive position. In spite of somehow being knowledge of the risk in the documents, for lacking of effective mechanism, most of them only find a documentary fraud after the L/Cs has been honored. Even if they could be aware of the fraud truth before the payment, they may still fail to provide sufficient evidence to convince the court for a suspending order. How could we image the feeling of the buyers who suffer the pain of giving away millions of dollars when they have already learned the fraud truth.

Therefore, under so much pressure, Chinese court may abuse the suspending order in an improper way which consequently received tons of condemnation form international society. Indeed, under such situation, those foreign banks and sellers shall become the major innocents.

As a consequence of that, China also faces the stress from outside, where China has been warned that they would suffer the consequence of its own action because no foreign banks are willing to confirm the L/Cs from Chinese banks. Indeed, one of the most essential factors for a foreign banks to conform a L/C is the credit of the issuing bank and they have to balance whether such 1% profits (usually) is worthy for taking

a risk. Therefore, if the L/Cs from a Chinese bank can not get honored, China's external trade shall be deeply affected.

How to face such dilemma? The author thinks, apart from being more cautions when deciding a suspending of a payment by the court, The Chinese buyers, should also improve their own capability of preventing a documentary fraud. Instead, they could choose a FOB contract in case of communicating with those unfamiliar foreign exporters rather than a CIF or CFR contract.

As the one of the rapid developing country in the world, how to effectively settle the cases in L/Cs should be given more attention. However, like the thesis discussed in this chapter, the current legal system could not effectively handle the real practice and provide sufficient protection to the victims.

Although currently we have the newest 2006 judicial interpretation which lists a series of detailed regulations about how to settle the L/Cs fraud cases, the short provision leaves a lot to be supplemented and it seems that there is still a long way ahead. In practice, the poor quality of legislation leads the court in dilemma. Also, the legal status of such provisions somehow made it not a very effective one and as a consequence of that the legislation in this filed seems to be more reasonable and needed.

In addition, those advance foreign legislation and legal practices should be absorbed by China, from the substantial law to the procedure law, in light of which a better legal system could be constructed in this filed. Moreover, in view of the highly technical nature of L/Cs, hearing the advices form the banking professionals maybe a good choice.

5 Conclusion

Through the discussion of the former chapter, we could say, neither under English law jurisdiction nor Chinese jurisdiction, there is no way for any participants of international trade absolutely out of fraud, which is definitely corresponded with what the thesis clarified in the introduction--- no system in this world could entirely prevent fraud.

Thus, no matter how hard we try to prevent a documentary fraud, it yet seems to be unachievable for a complete avoidance. Almost anything in this world could be duplicated. Some world-famous paintings are even proved as faked ones over decades of years. The high-developed technique today gives way further for documentary fraud because any documents could be forged. Sometimes such forged documents could be even comparable to that real ones. However, the prima facie censorship system, which focuses on the appearance, shall not easily find the hiding secrets under documents.

In such a long period, we could see, the autonomy principle under L/Cs, has been deeply embedded in both English law and Chinese law. Like the author discussed in the former chapter, the court determine to keep the domination of autonomy principle may take into account a lot of considerations and the most import one among which should be that the L/C is invented for securing a payment, not a vehicle for prevention of fraud. Thus, although there is fraud exception introduced, the court, especially the English court, is very cautious for applying so and even kind of being reluctant to such fraud exception. Hereby, the effect from fraud exception seems very limited and due to that, it's not easy to get a remedy form the court. Whereas the Chinese courts hold a loosen attitude to apply fraud exception, the stress from other countries makes them have to “think about seriously” before giving a decision.

As a consequence of this, other voice of asking for a reform of L/Cs system itself has arisen. “There have been several calls for the reform of the existing system of documentary credits and also for the re-examination of the UCP view of the equitable allocation of responsibility between the parties with regard to their respective functions, duties and opportunities to act to prevent occurrence of the fraud.”¹¹⁰ Since the public think those terms under UCP could be changed and thus that may, more or less, force the banks to check verity of the documents.

However, no banks shall be volunteers for such changes. First, there must be consideration that how could them easily to find the truth behind the documents since the banks are on behalf of none of the contractual parties. Further, as they could be exempted from such strict liability, why they would invite troubles?

So, notwithstanding the critique and pressure from the outside, ICC almost makes no changes in the bank’s responsibility. And the position of the ICC seems quite determined in this issue that,

Disclaimer on Effectiveness of Documents

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.¹¹¹

The former article uses a repetitive ton, clearly showing the bank’s attitude of no responsibility to the validity of the documents.

¹¹⁰ Peter Kappor & Richard Gray, “Maritime Fraud: An Overview”, Plymouth Polytechnic, September 1985, at p. 2.

¹¹¹ UCP, Article 34.

Also, the decision made by the ICC may take into account the speed, cost and convenience factors in the international trade, where much more money and time will cost if the substantive check system was applied, not even mention about convenience.

So, there is no way for the banks to ask for permissions from the buyers that whether they could honour a credit or not. And if they do so, the seller shall worry their interests because the core function of L/Cs is to secure a payment. If the confirming banks would consult the issuing banks and so do the issuing banks. Then, who comes to protect the interests of the seller. And if the proceeding carries out like this, it shall be against the original purpose set in the L/Cs.

Therefore, the L/C is really a tricky matter which is always full of the power struggle between the buyer and the seller. The bank, of course, only always tries to find a balance in order to be far away from those responsibilities. So, how could we expect a reform from the banks, which would lead to more responsibilities for themselves. Anyway, naturally, no one would ask for a trouble voluntarily and put himself in a dilemma.

However, does that mean there will be no solution for the problem?

It may not. There are authors proposing a settlement where on the basis of the requirement from their customers, banks, with charging more from the application, could provide a service of checking the validity of documents under a L/C. Being voluntary, of course, should be the base of such service, especially the willingness of banks. In light of such service, the buyer could get more guarantee when dealing business with little-know traders or doing a big business with millions of dollars.

Then the sacrifice of such extra money shall be reasonable and worthy although there is no absolute security for preventing a fraud. ¹¹²

After courts and banks, I would like to talk something about the buyers. Because if the protection from those two are not very effective, the potential victims should do something for protecting its own, at least with the knowledge of that how to proceed a remedy. Usually, following steps may at be worthy to try. First, the victim should immediately launch a litigation in the court and apply for evidence preservation if needed. Further, application for a ship arrest may be a good option if the location of the subject ship is acquired. In addition, they could also apply the court for freezing the property of the defrauder as well as injunction which could be applied for suspending a payment under L/Cs.

In addition, the buyer, should be more cautions when dealing business with foreign traders. It's very important to know who the counterpart is and how his credit is. Do not always depend on banks or others since only the buyer himself could be the one with knowledge of the contract best.

So, all in all, the international trade can not always escape from shipping and it always happens that one party could possibly be without money and cargo. Therefore, the best situation for a buyer is to take the payment after delivery of the goods. In contrast, for the seller, getting paid before the delivery shall be the best for him. In light of such contradictory, L/Cs had been introduced which provides a compromise way for the buyer and the seller both.

¹¹² Li Li, "Study on Bill of Lading in Legal Perspective", *Shanghai Jiao Tong University Academic Report*, January, 2007, at P.27.

However, no system in the world could be produced without any loophole and no system in this world could prevent fraud completely.

Like Judge Bowen said in the case *Sanders Bros v. Maclean & Co*,

The object of mercantile usages is to prevent the risk of insolvency, not of fraud; and any one who attempts to follow and understand the law merchant will soon find himself lost if he begins by assuming that merchants conduct their business on the basis of attempting to insure themselves against fraudulent dealing. The contrary is the case. *Credit, not distrust, is the basis of commercial dealings*.....¹¹³

Indeed, there is no system could prevent fraud completely. Hereby, if there is any existence of fraud and “if there is a lesson to be learned, it is not that banks should eschew their traditional of financing commerce by way of letter of credit”, but rather that the international participants should be more carefully in selecting their business partners.¹¹⁴

¹¹³ *Sanders Bros v Maclean & Co, (1882-83) L.R. 11 Q.B.D. 327.*

¹¹⁴ *Future Express, [1993] 2 Lloyd's Rep. 542*

Supplement

Provisions of the Supreme People’s Court on Some Issues Concerning the Trial of Cases of Disputes over Letter of Credit

Interpretation of the Supreme People’s Court [2005] No. 13

According to the General Principles of the Civil Law of the People’s Republic of China, Contract Law of the People’s Republic of China, Guaranty Law of the People’s Republic of China and Civil Procedural Law of the People’s Republic of China, and in light of the Uniform Customs and Practice for Documentary credits of the International Chamber of Commerce and other relevant international practices, and by taking into consideration the adjudication practices, these Provisions are formulated to address some issues concerning the trial of cases of disputes over letter of credit.

Article 1 For the purposes of these Provisions, the term “case of dispute over the letter of credit” shall mean the case of dispute arising in the links such as issuance, notification, revision, revocation, confirmation, negotiation and acceptance of letter of credit.

Article 2 When the people’s court hears a case of dispute over letter of credit, if any stipulation is made by the parties concerned that the relevant international practices or other provisions should be applicable in the case of dispute over letter of credit, such stipulation shall prevail; if no stipulation is made by the parties concerned, the Uniform Customs and Practice for Documentary credits of the International Chamber of Commerce and other relevant international practices shall be applicable to the case.

Article 3 These Provisions shall apply to the arrearage disputes between an applicant for the issuance of a letter of credit (hereinafter referred to as the applicant) and the issuing bank which arise from the application for the issuance of a letter of

credit, disputes between an entrusting party and the entrusted party which arise from the entrustment for the issuance of a letter of credit, disputes over the guarantor's provision of a guaranty for the application for the issuance of a letter of credit, or for the issuance of a letter of credit upon entrustment, as well as the disputes over the financing under a letter of credit.

Article 4 The relevant laws of the People's Republic of China shall be applicable to the arrearage disputes arising from the application for the issuance of a letter of credit, disputes arising from the entrustment for the issuance of a letter of credit, disputes arising from the guaranty therefore as well as the disputes over the financing under a letter of credit, unless the parties to a foreign-related contract stipulate otherwise for the application of law.

Article 5 After the issuing bank makes a commitment on the payment or acceptance of a letter of credit or performance of other obligations under the letter of credit, the issuing bank shall perform the payment obligation within the time limit as specified in the letter of credit as long as the documents conform to the clauses of the letter of credit and the documents conform to each other on the surface. If a party concerned initiates a protest for the reason of the basic transaction between the applicant and the beneficiary, the people's court shall not support it, except under the circumstances as prescribed in Article 8 of these Provisions.

Article 6 When the people's court needs to check the documents in hearing the case of dispute over the letter of credit, it shall comply with the relevant applicable international practices or other provisions as stipulated by the parties concerned. If the parties concerned fail to make any stipulation, it shall, in accordance with the Uniform Customs and Practice for Documentary Credits and other relevant standards provided for by the International Chamber of Commerce, determine whether or not the documents conform to the clauses of the letter of credit and whether or not the documents conform to each other on the surface.

If the documents under a letter of credit do not completely conform to the clauses of the letter of credit, and the documents do not completely conform to each other on

the surface, but there is no discrepancy between them, the people's court shall not deem that any discrepancy has constituted.

Article 7 An issuing bank shall have the right and obligation to check the documents independently. It shall have the right to decide, on its own initiative, whether or not the documents conform to the clauses of the letter of credit and whether or not the documents conform to each other on the surface, and whether to accept or reject the discrepancies between the documents and clauses of the letter of credit or between the documents.

After the issuing bank finds that there is a discrepancy under the letter of credit, it may, on its own initiative, decide whether or not to contact the applicant to accept the discrepancy. The applicant's decision of whether or not to accept the discrepancy will not have any influence on the issuing bank's final decision of whether or not to accept the discrepancy unless the issuing bank and the applicant have stipulated. Otherwise, if the issuing bank clearly expresses to the beneficiary its acceptance of the discrepancy, it shall bear the payment obligation.

If the issuing bank refuses to accept the discrepancy and if the beneficiary requests the issuing bank to bear the payment obligation the under the letter of credit on the grounds that the applicant has accepted the discrepancy, the people's court shall not support the request.

Article 8 The letter of credit fraud shall be determined as constituted under any of the following circumstances:

- (1) The beneficiary forges documents or provides documents containing false information;
- (2) The beneficiary maliciously refuses to deliver the goods, or delivers goods of no value;
- (3) The beneficiary provides false documents by colluding with the applicant or a third party and there isn't any true basic transaction; or
- (4) Other circumstances under which letter of credit fraud is conducted.

Article 9 If the applicant, issuing bank or any other interested party finds any of

the circumstances as prescribed in Article 8 of these Provisions, and believes that irremediable losses will be caused to it, it may file an application with the competent people's court for suspending the payment under the letter of credit.

Article 10 If the people's court maintains the occurrence of the letter of credit fraud, it shall make a ruling on suspending the payment or a judgment on terminating the payment under the letter of credit, except for any of the following circumstances:

(1) The nominee or entrusting party of the issuing bank, in bona fide, has made the payment according to the instructions of the issuing bank;

(2) The issuing bank or the nominee or entrusting party thereof, in bona fide, has honored the instrument under the letter of credit;

(3) The confirming bank, in bona fide, has performed the payment obligation; or

(4) The negotiating bank, in bona fide, has negotiated the payment.

Article 11 Where a party concerned files an application for suspending the payment under the letter of credit before it initiates legal proceedings, and if the following conditions are met, the people's court shall accept the application:

(1) The people's court that accepts the application has the jurisdiction over the case of dispute over the letter of credit;

(2) The evidential materials presented by the applicant prove the existence of any of the circumstances as prescribed in Article 8 of these Provisions;

(3) If no measure is taken to suspend the payment under the letter of credit, the legitimate rights and interests of the applicant will be damaged beyond remedy;

(4) A reliable and full guaranty has been provided by the applicant; and

(5) None of the circumstances as mentioned in Article 10 of these Provisions exists.

A party concerned shall satisfy the conditions as prescribed in Items (2) through (5) of the preceding paragraph if it, in the court action, applies for suspending the payment under the letter of credit.

Article 12 The people's court should make a ruling within 48 hours after accepting the application for suspending the payment under the letter of credit. Such a

ruling, if made by the people's court, shall be executed at once.

The people's court shall state the applicant, the party against whom the application is filed and the third party in the ruling on suspending the payment under the letter of credit.

Article 13 Where a party concerned has any objections to the ruling made by the people's court on suspending the payment under the letter of credit, it may apply for reconsideration to the people's court at the next higher level within 10 days from the day when the ruling is served. The people's court at the next higher level shall make a ruling within 10 days as of the date of receipt of the reconsideration application. The original ruling shall not be suspended from execution during the period of reconsideration.

Article 14 In the course of hearing a letter-of-credit fraud case, the peoples' court may, where necessary, put on trial the dispute over letter of credit together with the dispute over the basic transaction.

Where a party concerned initiates legal proceedings for basic transaction fraud, it may list the issuing bank, negotiating bank or other interested parties, which are involved in the case for the legal relationship with the letter of credit, as third parties. The third parties may apply for participating in the lawsuit. The people's court may also notify them to participate in the lawsuit.

Article 15 In case the people's court, through substantial trial, determines that a letter of credit fraud is constituted and that none of the circumstances as prescribed in Article 10 of these Provisions exists, it shall make a judgment on terminating the payment under the letter of credit.

Article 16 In case the guarantor makes the request of exempting it from the guarantee obligations on the grounds that the issuing bank or the applicant accepts discrepancies without getting the consent of the guarantor, it shall not be supported by the people's court, unless it is otherwise stipulated in the guaranty contract.

Article 17 In case the applicant and the issuing bank revises the letter of credit without getting the consent of the guarantor, the guarantor shall only assume the

guarantee obligations on the basis of the time limit and scope as stipulated in the original guaranty contract or provided for by the law, unless it is otherwise stipulated in the guaranty contract.

Article 18 These Provisions shall go into effect as of January 1, 2006.

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