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SOME CONSIDERATIONS ON THE DOCTRINE OF STRICT COMPLIANCE AND THE AUTONOMY PRINCIPLE IN DOCUMENTARY CREDIT

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1. Introduction

Documentary credit is the most common mode of payment for goods in the export trade and a primary instrument for financing international commerce.

The operation of documentary credit has been highly harmonized by the Uniform Customs and Practice for Documentary Credits ("UCP"). Such "*set of rules*" (as defined in Article 1 of the latest version of the UCP, the "UCP600"), to a certain extent, coincides with the common law regime.

Under both the UCP600 and the common law, documentary credits are based on two fundamental principles: the doctrine of strict compliance and the autonomy of letters of credit. The latter is naturally at variance with so-called fraud exception.

In the present work we will consider two issues: *(i)* how do the UCP600 deal with the doctrine of strict compliance and the autonomy principle and *(ii)* what are the effects of the UCP600's attitude towards the autonomy principle on fraud exception. It is suggested that these two issues are strongly intertwined with each other.

2. Introducing letters of credit and the UCP600

Letters of credit (also known as documentary credits or commercial credits) are an extremely popular method of payment in international trade. They address most of the concerns of sellers and buyers by involving banks in the negotiation of commercial documents between the exporter and the importer.

Stated in its plainest terms, a letter of credit is a contract between the buyer and his bank (the so-called issuing bank) which allows documents and money to move in opposite directions, giving the buyer a thorough documentary screening before payment is made and giving (at least in the case of confirmed letter of credit) the seller an additional debtor within his own jurisdiction (the so-called confirming bank).

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However, considering a letter of credit as a unique contract is somehow limiting. In fact, setting up a letter of credit gives rise to several relationships between the various parties involved, governed by as many contracts.

The Uniform Customs and Practice of Documentary Credits 2007 version, publication No 600 (hereinafter, the "UCP600") are the sixth and latest revision of a successful instrument of harmonisation devised by the International Chamber of Commerce. They govern many aspects of the operation of letters of credit, upon express incorporation (they do not have force of law), by providing a detailed – although not comprehensive – set of rules for documentary credits.

3. The two basic principles of letters of credit

Letter of credits are based upon two key underpinning principles:

(i) the doctrine of strict compliance: the documents presented by the seller-beneficiary to the bank in order to obtain the payment must conform strictly on their face with the terms of the credit;

(ii) the autonomy of the letter of credit: the documentary credit is separate from and independent of the terms of the underlying (sale) transaction.

Both principles are already found in the common law regime for documentary credit.

As to the doctrine of strict compliance, common law requires every single document tendered to tally precisely with the instructions in the letter of credit. The leading case is Equitable Trust Co of New York v. Dawson Partners Ltd[1], where Lord Sumner set the rule, engraved in his oft-quoted sentence: "*there is no room for documents which are almost the same, or which will do just as well*".

Consistently, in the case Moralice (London) Ltd v E D and F Man[2] it was specified that the maxim *de minimis non curat lex* (i.e., the rule of insignificance) did not apply and the bank was entitled to reject the goods (in that case the discrepancy between the quantity of shipped goods required by the letter of credit and the goods that from the documents which had actually been shipped was equal to 0.06%).

The principle of autonomy has been clearly stated by Jenkins LJ in the case Hamerh Malas and Sons v British Imex Industries Ltd[3]: "*it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not*".

Later, Lord Diplok, in the case United City Merchant (Investments) Ltd v Royal Bank of Canada (The American Accord)[4], reaffirmed such a rule: "*the whole commercial purpose for which the system of confirmed irrevocable documentary credit has been developed in international trade is to give to the seller an assured right to be paid before he parts with control of the goods that does not permit of any dispute with the buyer as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment of payment*".

4. The doctrine of strict compliance and the UCP 600: a relaxation

The provisions of the UCP600 largely reflect those of common law. However, they have adopted a different, more relaxed approach to the strict compliance rule.

In fact, they allow a certain amount of leeway in the description of the goods in most of the documents (Article 14.d: "*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*"; 14.e: "*in documents other than the commercial invoice, the description of the goods, services or performance, if stated, may be in general terms not conflicting with their description in the credit*"). They tolerate certain discrepancies in credit amount, weight and value of the goods (Article 30, particularly letter b: "*a tolerance not to exceed 5% more or 5% less than the quantity of the goods is allowed* […]"). They permit – provided that certain requirements are complied with - the use of documents which are not or appear not to be originals (Article 20.b), whereas under common law only originals are acceptable.
At the same time the strict compliance rule is fully preserved in relation to the commercial invoice: "*the description of the goods, services or performance in a commercial invoice must correspond with that appearing in the credit*" (Article 18).

This approach should not a surprise. The entire structure of the UCP600 tends to limit and circumscribe the responsibilities and the duties of banks; letters of credit are largely, though not only, banking instruments. This is particularly clear in Articles 34 ("*Disclaimer on Effectiveness of Documents*"), 35 ("*Disclaimer on Transmission and Translation*") and 36 ("*Force Majeure*").
It is certainly true that the UCP600 benefit every party involved in a documentary credit transaction (*i.e.*, beneficiaries, applicants and banks), for they set forth an intelligible and extended code of rules. However, it can hardly be put into question that the primary beneficiary of the UCP600's provisions is the bank. After all, the role of banks can be considered the most crucial and problematic in the documentary credit transaction.

5. The autonomy principle and the UCP600

The aforementioned bank-oriented attitude of the UCP600 also explains the reason for their confirmation and reinforcement of the doctrine of independence. As long as banks limit their task to the examination of the documents, regardless of the transaction underneath the letter of credit, their position is significantly simplified.

The sanctity of the separation of the documentary credit from the underlying transaction is carved in Articles 4 ("*a credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit* […]") and 5 ("*banks deal with documents and not with goods, services or performances to which the documents may relate*") of the UCP600.
These provisions state in various ways, from different points of view, that a letter of credit – although it springs out of an underlying transaction – becomes insulated from it.
Article 4.b of UCP600 ("*an issuing bank should discourage any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, proforma invoice and the like*") goes even further, suggesting that banks dissuade the applicant/buyer from putting in the letter of credit any kind of link to the underlying transaction.

6. The autonomy principles and the fraud exception: a trade-off

The doctrine of autonomy meets an essential need of the documentary credit transactions, often expressed by English courts and clear on the face of the UCP600's provisions. In short, letters of credit can perform their role

smoothly only as long as they can operate without interference from "outside".
Documentary credits are "*the life blood of international commerce*", as scenically declared by Ackner LJ in the case United City Merchant (Investments) Ltd v Royal Bank of Canada (The American Accord). The necessity of proper operation outweighs the undisputable importance of the sale relationship between buyer and seller.

However, there is another aspect to be mentioned, perhaps the most delicate issue in the field of documentary credit, strictly entwined with the principle of autonomy: the matter of fraud, which can concern either the documents or the transaction. The UCP600 do not address the effect of fraud on the documentary credit arrangement and the matter is, therefore, left to the domestic applicable law.

Letters of credit are the lifeblood of commerce, it has been declared. On the other hand, fraud may be considered the "cancer" of international trade. There are powerful policy reasons for counteracting fraud. The primary legal instrument against fraud is the so-called fraud exception. Based on such an exception the buyer may request an injunction to stop the bank from paying the seller on the credit.
The problem here is that fraud usually concerns the documents or the underlying transaction; therefore, invoking the fraud exception inevitably conflicts with the preservation of the autonomy principle. In other terms, allowing banks or applicants to put forward the fraud ground in order to avoid or recoup payment amounts leads to creating a link between the letter of credit and the contract, breaching the golden rule of autonomy.

English courts are extremely diffident towards fraud exception. However, following the US case law (Sztejn v Henry Schroder Banking Corp[5]) the House of Lords has recently held that "*the exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim ex turpi causa non oritur actio or, if plain English is to be preferred, 'fraud unravels all'. The courts will not allow their process to be used by a dishonest person to carry out a fraud*" (*per* Lord Diplock, United City Merchants, cit.). Therefore, fraud exception is part of the common law which, consequently, accepts a limitation to the principle of autonomy.

Moreover, if the case of fraud is clearly established (that is, if the claimant can prove clear and obvious fraud and the bank's knowledge), it may even be possible to obtain an injunction against beneficiaries and banks preventing them, respectively, from requesting the payment and from paying.
Injunctions have been upheld in a handful of English cases, among which Themehelp Ltd v West and Other[6] and Kvaerner John Brown Ltd v Midland Bank plc[7].
A more restrictive construction has been advocated by Kerr J in Harbottle (RD) (Mercantile) Ltd v National Westminster Bank Ltd[8], where it has been held that "*except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration*". Kerr J dismissed the claimant's request of injunction on the grounds of the balance of convenience test, considered more harmful granting than refusing the remedy sought.
Similarly Rix J, in the case Czarnikow-Ronda v Standard Bank[9], refused to grant the injunction of the grounds of balance of convenience alone, holding that "*all that can be said is that the circumstances in which it should be done* [i.e., prevent a bank from making payments under the letter of credit] *have not so far presented themselves, and that it would of necessity take extraordinary facts to surmount this difficulty*". Rix J critically commented the dictum of Diplock J in United City Merchants: "*when, therefore, Lord Diplock stated that the fraud exception was an application of the doctrine that 'fraud unravels*

all", he was not, in my respectful opinion, speaking as broadly as might be thought. It would be less pithy but more accurate to fill out the dictum by saying that fraud unravels the bank's obligation to act on the appearance of documents to be in accordance with a credit's requirements provided that the bank knows in time of the beneficiary's fraud".

It is clear that in respect of the doctrine of independence of letters of credit, fraud is the other side of the coin. It represents the only, limited exception to the autonomy of letters of credit.

So far, we have considered how the UCP600 deal with the autonomy principle. It is now possible to answer the question of the effects of the UCP600's attitude towards the autonomy principle on fraud exception.
It is submitted that if the UCP600 have, as they do, reinforced the doctrine of independence, it must follow that they have somehow weakened the other side of the coin.
Therefore, it is argued that incorporating the UCP600 in a letter of credit would shift the balance on the relevance of the principle of autonomy and, as a consequence, it could make it even harder for a buyer to try to avoid the obligations of a letter of credit by invoking fraud exception.

7. Conclusion

Borrowing the words of Rix J in the case Czarnikow-Ronda v Standard Bank, the balance of convenience is more and more in favour of the letter of credit itself. The "iron grip" of Kerr J in Harbottle (RD) (Mercantile) Ltd v National Westminster Bank Ltd is difficult to be solved under English law.

In the light of the aforementioned considerations, it is contended that the policy of the UCP600 is to accept the existence of some "cancers" to prevent the overall lifeblood of international commerce.
Whether this will be a winning approach, it is still to be seen.

S. Ferrero, *Some considerations on the doctrine of strict compliance and the autonomy principle in documentary credit*, 4 BusinessJus 25 (2013)

[1] [1926] 27 Ll L Rep 49 (HL)
[2] [1954] 2 Lloyd's Rep 526
[3] [1958] 2 QB 127
[4] [1983] 1 AC 168
[5] (1941) 31 NYS 2d 631
[6] [1996] QB 84
[7] [1998] CLC 446
[8] [1977] 2 All ER 862
[9] [1999] 2 Lloyd's Rep 187