

The Effects Of Fraud/Forgery On A Letter Of Credit: An International Perspective.

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ABSTRACT.

With a view to canvassing the principal potential problems in advising upon letters of credit, this article considers the following topics: (i) the documents of a typical credit transaction; (ii) the doctrine of autonomy; (iii) the doctrine of strict compliance and incidence of non-complying documents; (iv) the documents used to check letter of credit terms; (v) the types of fraud; and (vi) the level of burden of proof required in establishing fraud.

In particular, this article by looking at case law raises three questions. First, is the doctrine of strict compliance effective when in a majority of transactions the documents tendered are discrepant due to actual fraud and mere fraud? Secondly, what is the appropriate degree of burden of proof used by the courts to justify non-payment for standby credits given the ease of perpetrating fraud there under? And lastly, what has caused the demise of the traditional Bill of Lading to a more electronic mode of negotiability?

INTRODUCTION.

The Uniform Customs and Practice for Documentary Credits¹ (UCP 400) states clearly "In documentary credit operations all parties concerned deal in documents and not in goods. Payment against document which appear on their face to be in accordance with the terms and conditions of a credit by a bank authorised to do so, binds the party giving the authorisation to take up the documents and reimburse the bank." The banks are thus only concerned with the documents, and if they are apparently in order the seller will be paid.

WHAT IS A LETTER OF CREDIT?

All commercial letters of credit, given for the benefit of exports, are subject to the Uniform Custom and Practice for Documentary Credits, Publication No. 500 (UCP 500) of the International Chamber of Commerce. Banking associations and individual banks voluntarily accept this code worldwide. It was revised in January 1994 to reflect 10 years changes in the technology of shipping and banking, and serves to further strengthen the reliability of letters of credit as a means of payment. It came

into effect by replacing UCP 400. One of the developments in UCP 500 is to provide a detailed list of the elements of acceptability for each category of transport document.

The simple reason why an exporter gets involved in any business transaction is payment and profit. Regardless of how well a transaction has gone, payment is the essential ingredient and desire. One of the most reliable traditionally employed methods of payment is the letter of credit. When structured and documented properly, an export letter of credit can afford the seller protection against nonpayment of his shipments. Payments, however, are made against documents rather than goods. As a result, if all the terms and conditions of the letter of credit are not met, all the protection is lost.

A TYPICAL CREDIT TRANSACTION THE PARTIES AND DOCUMENTS.

A Letter of Credit is also referred to as a "Commercial Letter of Credit", an "International Letter of Credit" or a "documentary credit". It is, by definition, a legal instrument that states the obligation of its issuing bank to pay a seller on behalf of the buyer. It is the conditional undertaking of a bank (issuing bank) given to a seller (beneficiary) at the request and in accordance with the instructions of a buyer (applicant), to pay a fixed sum of money, within a prescribed time and against stipulated documents. Fundamentally, a Letter of Credit becomes the guarantee of the buyer's payment capabilities.

There are normally four parties involved in a Letter of Credit transaction - the buyer, the seller and their two respective banks. The basic procedure is as follows: The buyer requests the issuing bank to open a Letter of Credit for the benefit of the seller. The request is evaluated using the same criterion as that of a commercial loan application. When approved, a Letter of Credit is issued which states the documentary requirement under which the seller can expect to be paid under the credit. It further guarantees the acceptance and payment of all drafts which comply with the terms and conditions of the credit.

The issuing bank then sends the credit to its correspondent bank (the advising bank) located closest to the seller. The correspondent bank is then responsible for informing the seller that the credit has been received. The seller reviews the terms and conditions of the credit and determines if he can comply. The credit may be amended if necessary, but only if all parties involved agree with the amendment. It should be recalled that the issuing bank would guarantee payment against documents only if all the terms and conditions of the credit are met.

When the seller determines that he is able to comply with the terms of the credit, he proceeds to ship the goods to the buyer. At the same time, he will start preparing the necessary documentation and send it to his bank for negotiation of payment. Documents commonly called for include: Bill of lading, customs invoice, commercial invoice, packing slip, and insurance certificate. The seller's bank forward these documents to the issuing bank where they are checked against the terms of

the credit. If there is no discrepancy, the issuing bank will pay or accept the draft drawn by the seller. In the event of discrepancy, the issuing bank will not make payment until told to do so by the buyer².

If the beneficiary is not comfortable with the undertaking of the issuing bank either because it does not know the bank or is not satisfied with the bank's creditworthiness or because it wants a bank in its own jurisdiction if litigation becomes necessary, the beneficiary will ask for a confirmed credit. By confirming a credit at the request or upon the instructions of the issuing bank, the advising bank becomes liable on the credit as if it had issued it (while of course acquiring rights against the issuing bank) and it is then known as the confirming bank. These obligations of the confirming bank are in addition to, and not substitution for, the obligations of the issuing bank under the credit.

Confirmation is usually by a simple sentence to that effect in the letter advising the credit. Most confirming banks follow this practice while a few issue their own form of letter of credit directly to the exporter. There is a good practical reason to seek confirmation of a credit issued by a foreign bank which does not have a branch in Malaysia, if litigation becomes necessary, the exporter can sue the local confirming bank and avoid all the expense, unpredictability and difficulty of a law suit abroad³.

THE DOCTRINE OF AUTONOMY.

One of the maxims on which the letter of credit system is founded, is seen in the autonomy of this institution. This means that the banks engaged in a letter of credit transaction are, in principle not involved in any disputes arising between the parties to the underlying contract of sale such as matters concerning non-delivery, or the quality or quantity of goods delivered⁴. The documentary credit is autonomous and constitutes a contract between the banker and the beneficiary that is independent of the other contractual relationships between buyer and seller. The issuing bank cannot refuse to perform its obligations under an irrevocable credit on the grounds that the seller has shipped defective goods, and any dispute between the buyer and seller has to be resolved independently of the letter of credit transaction⁴. Per se banks subsequently deal only in documents. They do not inspect or guarantee quality or quantity of products shipped.

Consequently, once a commercial letter of credit has been issued, the contract between the seller and the issuing and confirming bank exists independently of the underlying contract for sale of goods between the buyer and the seller. Thus, by this autonomous and independent contract with the beneficiary, the issuing and confirming banks are under a duty to honour the credit by accepting or negotiating bills presented to them if the documents required under the letter of credit are supplied in strict compliance of the terms of the credit.

The beneficiary however is under no obligation to either the issuing or confirming bank to fulfil the terms of the credit; he must in fact do this as a condition precedent to insisting on performance of the bank's obligation. On the

other hand, the banks are absolutely obliged to honour the credit if the proper documents are presented. There is no obligation at all on the banks to check the factual authenticity of the documents that are presented to them. This situation may lead to three possibilities.

Firstly, documents can be forged⁵. Unless the forgery is obvious a bank is liable to pay so long as the documents are apparently correct. It would in fact be in breach of its duty to the seller to do otherwise.

Secondly, many of the documents required under credit originate from the seller. He can therefore fabricate them if he chooses⁶.

Thirdly, the documents usually called for show despatch of the goods; and not their delivery by the carrier. Between payment to the seller and the planned arrival of the goods, they may be stolen or dumped by the carrier. Moreover, what happens if documents are presented for a non-existent cargo? If the documents are apparently correct the confirming bank will pay. It passes the documents to the issuing bank, which also pays, and the buyer reimburses the latter bank. Where no cargo arrives the buyer will have lost all his money because insurers⁷ generally do not pay if cargo has never existed. The same difficulties arise when goods of the wrong type or quantity are shipped. Insurance cover does not generally cover such risks and the burden again falls on the buyer. It is submitted, due to the fact that no protection is afforded to the buyer, it is wise and just that other avenues in relation to this, be made available. The law at any rate must provide escape routes.

THE DOCTRINE OF STRICT COMPLIANCE.

A letter of credit will in detail specify the documents, which the beneficiary is required to present under the credit. Thus, the documents presented must correspond exactly to the requirement of the credit. If it is not strictly adhered to, the issuing or confirming bank is entitled to refuse the documents tendered, even though the goods actually shipped are of the description and quality required to fulfil the underlying contract of sale. In the case of *Moralice (London) Ltd. v E.D. & F. Man. Ltd.*⁸, it was held that a tender of documents for 499,100 kilos of sugar under a credit calling for bills of lading in respect of 5,000 metric tonnes was bad, even though the accompanying invoice made a proportionate allowance in the price.

The rule of strict compliance with the terms of the letter of credit is imposed for two reasons, namely:

First, should the issuing bank be entitled to reimbursement by its customer, (the buyer) for the sum paid to the beneficiary under the credit, the document it accepts must conform strictly to the terms of the customer's instruction reflected in the letter of credit.

Secondly, the documents must be in order so that if the goods covered by the letter of credit are destroyed, lost or damaged, the bank and its customer will have documents on which they can found claims against the responsible parties, usually the carriers of the goods.

In addition, the banks have also been held entitled to refuse to honour the credit on certain grounds, which is, the forgery of the documents presented or falsification of those documents. On the part of the beneficiary⁹, these grounds do not involve formal non-compliance with the terms of the credit. The documents tendered are only acceptable if all of them are genuine. The banks may reject them even if all but one is a genuine document. Furthermore it has been established by the courts that forged documents confer no rights and are worthless pieces of paper, which the issuing or confirming bank may reject.

DOCUMENTS USED TO CHECK LETTER OF CREDIT TERMS.

Ranges of different documents are often used for checking against the terms of the letter of credit¹⁰. Banks rely on bills of lading, invoices stating quantities and qualities of goods and other documents such as insurance and certificates of origin all of which are easily forged¹¹.

This is extremely worrying particularly as a bill of lading is evidence of shipment, a document of title capable of being negotiated or transferred and as evidence of the contract between shipper and carrier. As a result bills of lading can be exploited to evidence goods that in fact do not and never did exist, or to misrepresent the quantity and/or quality of shipped goods.

Parties who are not legally entitled to them can also use false bills to obtain goods. In addition, the ability for a bill to be negotiated and transferred allows for a number of individuals to innocently hold false bills independently and without knowledge of other holders believing that they are the owners of shipped goods that allows the criminal to defraud a number of people on the same single consignment of goods.

FURTHER OPPORTUNITIES FOR FRAUD.

By its very nature, the bills of lading system allows title to pass during the carriage of goods by sea. This introduces further uncertainty of ownership and thus opportunity for fraud. For example, in carriage of Malaysian palm oil exports, it is common for title to pass up to twenty or thirty times between different parties before the oil arrives at its destination. According to section 17 of the Contracts Act 1950, Fraud includes any of the following acts committed by a party to a contract, or with his connivance, or his agent with intent to deceive another party thereto of his agent, or to induce him to enter into the contract:

- (a) the suggestion, as to a fact, of that which is not true by one who does not believe it to be true;

- (b) the active concealment of a fact by one having knowledge of belief of the fact;
- (c) a promise made without any intention of performing it;
- (d) any other act fitted to deceive; and
- (e) any such act or omission as the law specifically declares to be fraudulent.

There are two types of forgery or falsification, which may affect documents presented under a letter of credit. Firstly, the bill of exchange drawn under the letter of credit may be forged, and secondly, the bill presented may be genuine, but the shipping documents under the credit may be forged or falsified. For example, if a forged bill of lading or insurance policy is tendered, the bank is entitled to reject the documents tendered. Moreover, if the bill of exchange bears any alteration or forged signature, rejection is imminent since its mandate only extends to honouring the credit on the presentation of genuine documents. As a result, it was established that a document was a forgery not only if it contained a forged or unauthorised signature, but also if it purported to be a different kind of document from what it really was. Here, rejection of the document is the bank's entitlement regardless of the identity of the person who committed it.

LACK OF STANDARDIZATION IN THE CHECKING PROCESS.

There is a lack of standardization in the checking process. There appears to be a range of acceptable documents and amount of information required for a letter of credit to be honoured. In any event if all the available documents are scrutinized there is still no guarantee that fraud will be avoided. This is because banks do not necessarily know who the true owners of the goods are especially after bills have been repeatedly transferred during transport. In addition this is not helped by the fact that banks only rely on documentation rather than making enquiry into the goods themselves or the underlying commercial transaction.

THE BURDEN OF PROOF.

Actual fraud however, must be adequately proven. There needs to be a high balance of probabilities to prove actual fraud. This is seen in the case of *Lau Yaw Seng v Cooperativa Ceramica d'Imola*¹². In this case the plaintiff, Lau purchased some ceramic tiles at a trade fair in Spain, on terms that payment was to be by way of a confirmed irrevocable letter of credit issued by Banca Commerciale Italiana. The bank duly issued the letter of credit and sent it to the defendants. When the tiles were delivered, they did not correspond with sample. The plaintiff rejected the tiles and orally demanded that the defendants ship back the tiles. His solicitors then wrote requiring that the defendants to arrange for return shipment and claiming damages. They also threatened to take out an injunction to stop the payment on the letter of credit. There was no response from the defendants, and Lau obtained an ex parte interim injunction against the defendant restraining payment under the letter of credit. The bank applied to discharge the interim injunction. Lau alleged

that the defendants' failure to respond to him and his solicitors showed that there was fraud on the defendants' part. The High Court of Singapore discharged the injunction due to insufficient evidence of fraud. It was ruled that fraud in its essence must be established. It was also stated that the injunction would interfere with the bank's obligation and might cause greater damage than Lau could pay on an undertaking as to damages.

CIRCUMSTANCES WHEREBY PAYMENTS CAN BE DECLINED IN ESTABLISHING ACTUAL FRAUD¹³.

The buyer may obtain an injunction to prevent the bank paying the seller, or to prevent the seller drawing on the credit. It is however narrowly construed. The House of Lords considered its ambit in *United City Merchant (Investment) Ltd v Royal Bank of Canada*¹⁴. In this case the contract and the credit called for a machine to be shipped by 15 December 1975. The sellers presented a bill of lading showing that it had been shipped on 15 December but unknown to them it had been fraudulently altered by the shipping brokers and shipment had actually taken place on 16 December. The defendant bank refused to accept the documents. The House of Lords emphasised that the documentary credit is separate from the contract of sale and held that the bank was in breach; the documents were good on their face and conformed to the credit and it was irrelevant that the buyer would be entitled to reject the goods for breach of contract. The bank would only be entitled to reject the documents if the beneficiary was party to the fraud affecting them or fraudulently presented documents that he knew contained untrue statements of fact.

Consequently, the House of Lords pronounced that the issuing or confirming bank can reject the documents if the bill of lading tendered was one on which the shipment date apparently complied with the terms of the credit but the date was in fact a falsified one.

In *Sztejn v J. Henry Schroder Banking Corporation*¹⁵, it was established that the issuing or confirming bank can reject documents which are tainted by the personal fraud of the beneficiary or of someone for whose actions he is responsible and cannot be compelled to accept shipping documents which fraudulently misdescribe the goods shipped. In this case, the defendant bank issued an irrevocable letter of credit to a seller in India for the price of a consignment of bristles. Instead of bristles, the cases contained worthless rubbish. The sellers then presented the draft and documents to the issuing bank for payment. The plaintiffs, who were the buyers on discovering the true state of affairs, brought an action against the issuing bank and the beneficiary to restrain the issuing bank from paying the draft. The plaintiff's claim succeeded and the court said "Where the seller's fraud has been called to the banks attention before the draft and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller".

Similarly, in *Davis O'Brien Lumber Co. v Bank of Montreal* the beneficiary falsely certified that the goods, in respect of which the letter of credit was issued, had been available for loading at a certain period before the expiration of the credit in order to avoid the need to present bills of lading for the goods. It was held that the beneficiary could not compel the issuing bank to accept his draft in return for the worthless certificate. The loss of right to claim is due to his own fraud. It was also held in *Discount Records Ltd v Barclays Bank Ltd*¹⁶, that only if a sufficiently grave reason could be shown, can the court interfere to grant an injunction against the beneficiary of the credit from receiving payment under the credit.

Accordingly, the courts will not compel the issuing or confirming bank to honour the credit if the beneficiary deliberately acted wrongfully in seeking to avail him of credit when he knows that the goods of totally different nature from those that is specified by the terms of the credit were shipped.

CIRCUMSTANCES WHEREBY PAYMENTS CAN BE DECLINED IN ESTABLISHING MERE FRAUD¹⁷.

In *United City Merchant v Royal Bank of Canada*¹⁸, the Court of Appeal distinguished a situation where fraud can be imputed on the part of the beneficiary personally from the invalidity of shipping documents, even though it is the result of action by a third person for whom he is not vicariously liable. Furthermore, following *Etahissment Esefka Int Austalt v Central Bank of Nigeria*¹⁹ where a bill of lading was issued for a fictitious cargo, it was held that once a shipping document is shown not to create the rights it purports to create, it is invalid and the issuing and confirming bank are entitled to reject the document although the beneficiary when acquiring them was unaware of the invalidity and was not vicariously liable for the acts of the person who actually caused it. The Court of Appeal also held in the *United case* that the issuing or confirming bank can reject the shipping documents where the falsification of the documents is of a material particular. Intrinsicly, here the test is whether the terms of credit make it material, by including it as a condition with which the shipping documents must comply. Thus as ascertained in the case, a false date of shipment in the bill of lading will amount to a material falsification and would justify rejection of the documents by the issuing or confirming bank although the beneficiary of the credit is not personally responsible for the falsification.

The case of *Kwei Tek Chao v British Traders and Shippers Ltd*²⁰ supported the conclusion established by the Court of Appeal. Here, the bill of lading was presented with a false shipment date of 31 October 1951 instead of the actual date of shipment, which was 3 November 1951. It was held that although apparently in order, the bill of lading bears a false shipment date because it relates to a voyage which should have commenced on that date when in fact no such voyage had then begun.

As a result, the buyers were entitled to reject both the shipping documents and the goods when the falsification was discovered. Prior to that, the case of

*Guaranty Trust Company v Hannay*²¹ held that the beneficiary need not warrant a proof that the documents attached to the draft are in fact genuine if he was not the consignor named in them. Consequently no action would lie against him either by the buyer or the issuing bank to recover money paid under the credit unless he acted in bad faith and was guilty of fraud.

The cases of *Kwei Tek Chao* and *Guaranty Trust* had established that falsification of shipping documents was treated as a species of forgery. It was not until the *United City Merchants* that a refinement was introduced referring to the present kind of fraud as a falsification. The consequences of forgery and falsification are, however, the same.

THE DIFFERENCE BETWEEN MATERIAL AND IMMATERIAL FALSIFICATION.

Now that the situations of mere fraud²² and fraud which affects the shipping documents²³ are established, it is vital that the distinction between material and immaterial falsification be explained. The differences depend on the conditions that must be complied with under the letter of credit. If the credit fixes no final date for shipment of the goods to be specified in the bill of lading, the shipment date is immaterial and the issuing and confirming bank will not be justified in rejecting the documents tendered on the grounds that the goods were not shipped on that date. The shipment date is only material if it is required by the letter of credit to be specified in the bill of lading so as to show that the goods were shipped by the last date allowed by the letter of credit. If there is a term in the letter of credit requiring the goods to be packed in a specific way, and there is false notation in the bill of lading that the goods are packaged in accordance with the description in the letter of credit, it would amount to a material falsification and will justify the issuing or confirming bank in rejecting the documents when they are presented to them.

THE DIFFERENCE BETWEEN FRAUD OF THE BENEFICIARY AND MATERIAL FALSIFICATION BY A THIRD PARTY.

In distinguishing between the fraud of the beneficiary and material falsification by a person other than the beneficiary, the Court of Appeal held that the result is in fact the same, namely, the issuing or conforming bank is entitled to reject the documents on presentation. Furthermore, in falsification of shipping document cases, the fact that the beneficiary acted in good faith makes no difference. Therefore the Court of Appeal held that the Royal Bank of Canada was justified in rejecting the shipping document bearing a falsified shipment date.

On appeal, the House of Lords however overruled the Court of Appeal and entrenched that there is solely one ground for rejecting shipping documents, which are apparently in order, which is that of the personal fraud of the beneficiary. An example is seen where the beneficiary presents forged or falsified documents which he has all along known to be forged or falsified or where he knowingly ships

rubbish. The confirming or issuing banks cannot reject the shipping documents and refuse to honour the credit when shipping documents are forged or falsified by a third party for whom the beneficiary cannot be held responsible.

This conclusion was justified by Lord Diplock on the grounds that the issuing or confirming bank has the right to be indemnified by the buyer, if it accepts invalid documents which are apparently in order, if it acts in good faith and had exercised reasonable care to ensure that they are genuine. Moreover, this right must correspond with an obligation on the bank to take up such shipping documents tendered by the beneficiary, because it, would be impracticable as to the bank's obligation to the beneficiary not to match exactly its right to an indemnity.

It is submitted that Lord Diplock's confusion is unwarranted and erroneous because an issuing or confirming bank having done the entire necessary obligation as laid down by Lord Diplock acts as principal in dealing with the beneficiary of the credit. As such, its obligation to him however, is only limited to accepting documents which in fact are valid. Thus a bank's right to an indemnity if it acts properly cannot be matched to the obligation it owes to the beneficiary to accept the documents. That obligation is qualified by the condition that the beneficiary must first present valid shipping documents. Therefore falsification here, is only treated by the House of Lords as personal fraud and if followed in subsequent cases, the result if the beneficiary presented documents which were insufficient because they set out the true fact, would amount to allowing the bank to reject the document as non-conforming. On the other hand if the beneficiary presented falsified documents, the bank could not reject the documents at the time the documents were presented.

As a consequence, the judgement opens the gate to the seller, who does not conform to the terms of a letter of credit by allowing him to enforce the obligation of the issuing or conforming bank under a letter of credit even though he tenders only apparently confirming documents. This grants him protection by removing the burden from the seller to ensure that the documents he tenders are not false or forged.

REMEDYING THE SITUATION.

Electronic commerce offers tremendous business opportunities as well as challenges. It is an important vehicle for increased economic growth and development worldwide. Small traders, worldwide, previously unable to obtain trade information and find trading partners abroad, today have access to the global market through the Internet. In the case of developing countries, electronic commerce can be an important tool for development, enabling them to participate more actively in the global economy²⁴. The paper trail, which is generated using a paper bill of lading, is extremely costly and results in a slow rather than an efficient means of transfer, as banks would require. The cost of producing all these documents in a paper format is estimated to be approximately 10% of the invoice value of the goods and the weight of all the documents for the consignments aboard a single

vessel is estimated to be in the region of 40 kilograms²⁵. This brings one to the next problem. Their bulk makes them too slow. Containerization and other changes in ship design and navigation have greatly enhanced the speed and efficiency with which goods can be transported.

Furthermore it is not uncommon, especially with respect to bulk cargoes, such as oil, that the cargo will be sold many times over while still in transit, requiring this vast array of documents to be couriered around the world for endorsement. The result is that the cargo often arrives at the port of discharge prior to the relevant documentation. These results in delays, deterioration of the cargo and demurrage costs, as the cargo will often not be released to the consignee unless the relevant documents are presented.

Another inherent risk in transferring bulk cargoes using paper Bills of lading is that an endorser/transferor may become insolvent prior to the endorsee/transferee acquiring possession of the bill of lading. In such a situation, it is not uncommon for the trustee of the transferor to claim the cargo as an asset in that estate, thereby tendering subsequent negotiation of the bill, and thereby the goods uncertain. Another disturbing trend, which has emerged, is the practice of carriers to deliver goods without the production of a Bill of Lading in exchange for an indemnity by one of the traders involved in the transactions. It appears ultimately that the paper Bill's inability to be translated into an electronic format has led to its decreased usage.

The bill of lading system is also vulnerable to fraud for a number of other reasons. There is no standardized form of a bill of lading and the system of issue, negotiation and transfer remains unregulated. There has been little, if any, movement by most governments to alter or introduce new legislation to improve the situation²⁶.

Effective fraud risk management programmes and ship owners acting diligently can substantially reduce maritime documentary fraud. Also, a further development, which may have a profound impact in reducing fraud, comes from the Bolero Project. This will be an electronic system introduced to deal with bills of lading, title and transfer. It is believed the system will have a beneficial spin off effect by reducing the use of letters of indemnity throughout the shipping industry. The system would be centralized and controlled by one organization, thus improving the scrutiny and fidelity of title. The reception of the Bolero Project by the shipping industry has been good. The project looks hopeful and will be fully operational throughout within two years²⁷.

CONCLUSION.

The result of *United City Merchants* severely restricts the cases where a bank can refuse payment on the grounds of fraud. If the documents are good on their face, the bank may only reject them where there is compelling evidence of a fraud which the beneficiary (or its agents) is a party, or where the document are forged so as to a nullity (this was not the case in *United City Merchants*). Suspicion of fraud is insufficient to justify non-payment²⁸. However, the court will not require the bank

to prove fraud beyond reasonable doubt: the bank must be able to satisfy the court at trial that there was fraud; and the court will conclude that there was fraud, if the beneficiary has been given the opportunity to explain the situation and has been unable satisfactorily to do so, or where that is the realistic inference²⁹.

As a précis, in ascertaining whether fraud is admissible as an exception, three cases have to be distinguished. First, where there is only an allegation, communicated by the buyer to the bank that fraud has occurred. This allegation may be founded on suspicion; even a grave one or the bank itself without instigation by the buyer may entertain such suspicion. If no more can be established, the bank should pay.

Secondly, where it is clearly established to the satisfaction of the bank that a fraud has occurred and thirdly, that the bank has positive proof that a fraud has been committed, and that the beneficiary knew of this fraud. If both these facts are clearly established to the satisfaction of the bank, it must not honour its obligation under the credit.

In conclusion, it can be said that the cases mentioned above, go quite far in upholding the sanctity of the documentary credit transaction. Their effect is to place the buyer in a very weak position. As mentioned earlier, an illustration of this can be seen in the *United City Merchants Case*. True, the buyer may have a claim against the seller for breach of contract but he will be unable to reject the documents. At any rate, the seller will have to be paid and the bank will be entitled to be reimbursed by the buyer.

ENDNOTES

*Lecture, Faculty of Law, Universiti Kebangsaan Malaysia.

¹See article 8 (a) (b) Uniform Customs and Practice for Documentary Credits 1974.

²Buckley Ross P, *Potential Pitfalls with Letters Of Credit*, (1996) 70 ALJ 217

³*Lau Yaw Seng v Cooperativa Ceramica D'Imola* (1991) 1 MLJ 393.

⁴*Hamezh Malas & Sons v British Imex Industries Ltd.* (1958) 2 QB 127.

⁵*Ibid* at para 18, page 6.

⁶See, eg *Kreditbank Cassel GmbH v Schenkers Ltd* (1927) 1 KB 126 (Court of Appeal, England)

⁷presuming an insurance policy exists.

⁸(1954) 2 Ll. Rep. 256.

⁹E.g. a false shipping date in a bill of lading.

¹⁰*Ibid* para 7, page 3.

¹¹*Ibid* para 12, page 4.

¹²(1991) 1 MLJ 393.

¹³*Ibid* footnote 23 at page 10.

¹⁴(1982) QB 208.

¹⁵(1941) 31 NY SURP. 2d. 631.

¹⁶(1975) 1 All ER 1071.

¹⁷*Ibid* footnote 22 at page 10.

¹⁸*Ibid* at para 21 & footnote 14, page 7.

¹⁹(1982) 3 CMLR 29.

²⁰(1954) 2 QB 459.

²¹(1918) 1 KB 43.

²²where the bank may reject the shipping documents only if the beneficiary is personally guilty of the fraud, although the fraud need not relate to the shipping documents.

²³where the bank may reject them irrespective of the identity of the person guilty of the fraud.

²⁴Faghfour Mahin, *Electronic Commerce and Law: International Developments*, Women International Shipping and Trading Association, UNCTAD 1999.

²⁵Greiner Edmund, *EDI and the Traditional Bill of Lading*. University of Cape Towns LL.B Research Option, 1997

²⁶Ellen Eric, *Shipping at Risk – The rising Tide of Organized Crime*.

²⁷Williams Ty, *Countering Maritime Fraud*, Price Water house Coopers, 1998.

²⁸See *Discount Records v Barclays Bank Ltd.* (1975) 1 All ER 1071.

²⁹Also see *United Trading Corp. v Allied Arab Bank* (1985) 2 Lloyd's Rep. 554n, CA.