



LEGAL ISSUES RESULTING FROM THE
AUTONOMY OF LETTER OF CREDIT IN
INTERNATIONAL SALE OF GOODS
(MALAYSIAN POSITION)

BY

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ABSTRACT

Letters of credit have historically been an important and popular method of payment in international trading transactions. The principle of autonomy is one of the foundation stones of the law of letters of credit. Letter of credit has been considered by the law governing the letter of credit, the Uniform Custom and Practice (UCP) as a separate and autonomous contract from the underlying contract of sale of goods or other transactions. The essence of this separation or this doctrine of autonomy, was aimed to make letters of credit, the most secure method of payment in international sales transactions, by protecting the interests of both seller and buyer and balancing the risk between them, where the beneficiary (seller) may greatly reduce the risk of not being paid. However at the same time this autonomy principle guarantees payment to the seller as long as he tenders and complies with all the necessary documents stipulated by the buyer independent of the underlying contract for sale of goods. The bank representing the buyer is bound to fulfil its duty to pay the seller and cannot withhold or deny payment until the goods have safely reached the buyer. Banks only deal with documents presented for negotiation under the letter of credit and do not have any involvement with the commercial contracts or goods being shipped.

ملخص البحث

خطابات الاعتماد (الإئتمان) من الناحية التاريخية هي وسيلة مهمة للدفع وذات شعبية في المعاملات التجارية الدولية. مبدأ الحكم الذاتي يعتبر من أحد أحجار الأساس لقانون خطابات الاعتماد. هذه الخطابات اعتبرت من طرف القانون الذي يحكمها، الأعراف والممارسات الموحدة (UCP) مفصلاً ومستقلاً عن العقد الأساسي لبيع السلع والبضائع أو غيره من العقود. الجوهر من هذه الإستقلالية أو مبدأ الحكم الذاتي هو الهدف لجعل خطابات الاعتماد، الوسيلة الأكثر أماناً للدفع في معاملات البيوع الدولية، من خلال حماية مصالح كل من البائع والمشتري وموازنة المخاطر بينهما، بحيث يمكن للمستفيد (البائع) أن يقلل بشكل كبير من خطر عدم الدفع. لكن في الوقت نفسه هذا المبدأ (مبدأ الحكم الذاتي) يضمن الدفع للبائع طالما أنه يتوافق مع المعطيات وجميع الوثائق اللازمة التي ينص عليها المشتري، مستقلاً عن العقد الأساسي لبيع السلع والبضائع. البنك الذي يمثل المشتري ملزم بالدفع للبائع ولا يمكن له أن يحجب أو ينفي الدفع الى غاية وصول البضاعة بسلام للمشتري. البنوك فقط تتعامل مع الوثائق المقدمة للتفاوض في إطار خطاب الاعتماد وليس لديهم أي دخل بالعقود التجارية أو السلع التي سيتم شحنها.

APPROVAL PAGE

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DECLARATION

I here declare that this dissertation is the results of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for my other degree at IIUM or other institutions.

Hamza Bendifallah

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TABLE OF CONTENTS

CHAPTER ONE: OVERVIEW OF THE STUDY.....	1
1.1 Introduction.....	2
1.2 Statement of problem.....	3
1.3 Objectives of the Research.....	3
1.4 Literature review	4
1.5 Scopes and limitations of the study.....	7
1.6 Methods of the Research.....	8
CHAPTER TWO: INTRODUCTION TO LETTER OF CREDIT AND UNIFORM CUSTOMS AND PRACTICE.....	10
2.1 Definition of letter of credit	10
2.2 The Law governing letter of credits (UCP)	11
2.3 Parties involved in a letter of credit.....	12
2.4 Mechanism of letter of credit transaction	13
2.5 The two fundamental principles.....	15
2.5.1 The autonomy principle	15
2.5.2 The doctrine of strict compliance	16
2.6 Types of letter of credit.....	19
2.7 Documents to be tendered to the bank.....	23
2.8 Contracts arising from the use of a letter of credit.....	27
CHAPTER THREE: THE AUTONOMY PRINCIPLE OF LETTER OF CREDIT AND ITS LEGAL CONSEQUENCES.....	31
3.1 The principle of autonomy of letter of credit contract	31
3.1.1 The principle of autonomy under UCP 600	34
3.2 The autonomy principle and the fraud exception.....	35
3.2.1 Limited fraud approach (fraud in documents).....	37
3.2.2 Extended fraud approach (Fraud the underling contract)	43
3.3 The consequences of applying the strict autonomy principle.....	48
3.3.1 Transferring the risks from the seller (beneficiary) to the applicant and Banks.....	48
3.3.2.1 Risks to the buyer (applicant)	49
3.3.2.2 Risks to the issuing banks (IB and CB).....	51
CHAPTER FOUR: BANKS AND APPLICATION OF LTTER OF CREDIT AND ITS PRINCIPLE OF AUTONOMY IN MALAYSIA.....	53
4.1 MayBank.....	54
4.1.1 Application and operation of letter of credit in MayBank	54
4.1.2 Benefits of letter of credit under MayBank.....	56
4.2 Bank Islam	57

4.2.1 Application and operation of letter of credit in Bank Islam.....	57
4.2.2 Benefits of letter of credit under Bank Islam	60
4.3 HSBC Bank.....	60
4.3.1 Application and operation of letter of credit in HSBC Bank	60
4.3.2 Benefits of letter of credit under HSBC Bank.....	62
4.4 CIMB Bank	63
4.4.1 Application and operation of letter of credit in CIMB Bank	63
4.4.2 Benefits of letter of credit under CIMB Bank.....	66

CHAPTER FIVE: LETTER OF CREDIT FROM ISLAMIC PERSPECTIVE	68
5.1 General principles of sale transactions and banking in Islam.....	68
5.1.1 Items being prohibited by the <i>SharĒÑah</i> in all commercial Transactions	69
A) <i>RibĒ</i> (Interest).....	69
B) <i>Gharar</i> (Ambiguity).....	71
C) <i>Gambling</i>	73
5.2 Islamic concepts and its application to letter of credit	75
5.2.1 Letter of credit under the principle of <i>al-wakĒlah</i> (Agency)....	75
5.2.2 Letter of credit under the principle of <i>al-MurĒbaĒah</i> (cost-plus) 78	
5.2.3 Letter of credit under the principle of <i>al-MuĒrabah</i>	80
5.2.4 Letter of credit under the principle of <i>al-MushĒrakah</i> (Participation).....	81
5.2.5 Letter of credit under the principle of <i>BaiÑ al-Dayn</i> (sale of debt).....	85
CHAPTER SIX: CONCLUSION.....	86
BIBLIOGRAPHY.....	88

CHART OF TRANSLITERATION

Arabic letters	Trans. in Roman	Arabic Letters	Trans. in Roman	Arabic Letters	Trans in Roman	Arabic Letters	Trans in Roman
ء	'	ب	B/b	ت	T/t	ث	TH/th
ج	J/j	ح	×/Ī	خ	KH/kh	د	D/d
ذ	DH/dh	ر	R/r	ز	Z/z	س	S/s
ش	SH/sh	ص	Ø/Ī	ض	Ö/Ī	ط	Ū/Ī
ظ	Ú/Đ	ع	Ń	غ	GH/gh	ف	F/f
ق	Q/q	ك	K/k	ل	L/l	م	M/m
ن	N/n	و	W/w	هـ	H/h	ى	Y/y

Vowels:

Short Vowels		Long Vowels	
ـَ	A	ا+ـَ	Ē
ـِ	I	ا+ـِ	Ê
ـُ	U	ا+ـُ	Ë

LIST OF CASES

- Bank of Nova Scotia v Angelica-Whitewear Ltd* [1987] 1 SCR 59.
- Banque Saudi Fransi v Lear Siegler Services* [2007] 2 Lloyd's Rep 47.
- CDN Research and Development Ltd v Bank of Nova Scotia* (1980) 18 CPC 62 (Ont HC).
- Discount Records v Barclays Bank* [1975] 1 All ER 1071.
- Equitable Trust Co of New York v Dawson Partners Ltd* [1927] 27 Lir 49 at 52.or at[1954] 2 Lloyd's Rep. 526.
- Hamzeh Malas & Sons v British Imex Industries Ltd* [1958] 2 QB 127.
- Harbottle Coal Co Ltd v National Westminster Bank Ltd* [1977] 2 All ER 862.
- Kiramas Sdn Bhd v Federal Land Development Authority* [1991] 2 MLJ 1998
- Mid-America Tire, Inc v PTZ Trading Co.* 768 NE 2d 619 (Sup Ct, Ohio, 2002).
- New York (O'Meara (Maurice) Co v National Park Bank* 146 NE 636 [1925].
- NMC Enterprises Inc v Columbia Broadcasting System Inc* [1974] 14 UCC Rep Serve 1427.
- Power Curber International Ltd v National Bank of Kuwait* [1981] 2 WLR at 1241.
- Power Curber International Ltd v National Bank of Kuwait* [1981]2 WLR at 1241.
- Rosen v Pullen* [1981]126 DLR (3d) 62.
- Ruckversicherung AG v Walbrook Insurance Co Ltd & Ors* [1995] 1 WLR 1017 at p 1027.
- Seaconsaar Far East Ltd V Bank Markazi Jomhouri Islami Iran* [1993] 1 Llyod's Rep. 236.
- Shaffer v Brooklyn Park Garden Apartments* [1977] 250 NW 2d 172.
- Soproma SPA V Marine and Admiral By-Products Corporation* [1966] 1 Llyod's Rep. 367.
- Sztejn v. J. Henry Schroder Banking Corporation* 31 nys 2d 631[1941] [us].
- United City Merchants v Royal Bank of Canada* [1983] 1 AC 168.

CHAPTER ONE

OVERVIEW OF THE STUDY

1.1 INTRODUCTION

In an international sales transaction, a problem often arises between the interest of the parties (buyer and seller) as to the payment procedure. The seller's obvious desire is to receive the payment once delivery is done prior to shipment; while on the other hand, the buyer's major concern is that, payment be done only after receiving the goods so he can verify that the goods delivered are in conformity with the specifications set forth in the sales contract.¹

It is commonly accepted that there are four traditional methods of payments used in international trade, prepayment or clean payment in Advance, Open Account or clean payment, bill of exchange – B/E or draft and letter of credit. This last method is the most common method of payment for goods in international trade. Its use has been considered so important that it is referred to as the “lifeblood”² of international commerce, as it is the most suitable payment mechanism which can provide security to all parties concerned.

Letters of credit³ are also, known as a documentary credit or bankers’ documentary credit. It has been used for more than 150 years to facilitate trade, by providing payment against the presentation of documents concerning the transaction

¹ William J. Shannon. “International sales transactions confirmed irrevocable letters of credit”, <www.shannonsakamoto.com/IntLettersofCredit.pdf>.

² Per Stephenson L. J. in *United City Merchants (Investments) Ltd v. Royal Bank of Canada* [1982] Q.B. 208 at 222; Per Kerr L.J; in *R.D. Harbottle (Mercantile) Ltd v. National Westminster Bank Ltd* [1978] Q.B. 146 at 155; *Hong Kong and Shanghai Banking Corporation v. Kloeckner & Co AG* [1989] 2 Lloyd’s Rep. 323, at 330.

³ This thesis focuses on “commercial letters of credits as a mode of international trade” and not standby letters of credit.

as instructed in the credit. They are used widely for international trade, covering transactions valued from few hundred pounds to many millions. They are used primarily at the request of the commercial parties for effecting payment; they may also be used because, some importing countries require letters of credit as the mode of payment to be a part of their exchange control regulations.⁴

Payment under letter of credit is based on certain documents. The seller will be paid as long as he can tender documents as stipulated by the buyer. The banker's duty representing the buyer is to pay the seller when the latter tenders the correct document; therefore it cannot withhold or deny payment until the goods have been safely received by the buyer. The bank has to make payment in any case, even where there is a defect in the goods at the time they are received by the buyer. The fundamental rule is that all parties to a letter of credit deal with documents and not with goods.⁵ The bank will not be involved in the underlying contract between the buyer and the seller and in most cases, the bank does not even have an idea what kind of goods are sold. This is what is known as the autonomy of a letter of credit.⁶ Letter of credit contract is considered an autonomous contract separate from the underlying contract of sale of goods. This principle is stated in article 3 of the Uniform Customs and Practice (UCP 500)⁷, the provisions of which are generally incorporated in letters of credit.

UCP applies to all types of letter of credit where they are incorporated into the text of the Credit. They are binding on all parties there to. This is stated by Art. 1 of

⁴ See, SITPRO, Report on the Use of Export Letters of Credit, SITPRO's Letter of Credit Report, <<http://www.sitpro.org.uk/reports/letteredr/letteredr.pdf>> (accessed 08 January 2010).

⁵ Article 3(a) & 4(a) of UCP 500, (1993).

⁶ Rosmawani Che Hashim, "Principle of Autonomy in Letter of Credit: Prejudice on the Buyer?," *MLJA*, Vol.2, 2003:183. Lexis-Nexis, via IIUM, <<http://lib.iiu.edu.my/index.jsp?action=onlinedb.jsp&module=ROOT>> (accessed 15 January 2010).

⁷ UCP, is the law governing letters of credit. The ICC (International Chamber of Commerce) issued for the first time in 1993, its Uniform Customs and Practice for letter of credits.

the UCP rules .The ICC has very recently adopted the latest UCP 600 in July 2007 which is the amendment to the UCP 500.⁸

This research will be focusing on the nature of the principle of autonomy in letter of credit, and its impact and consequences in international sale transactions.

1.2 STATEMENT OF PROBLEM

Since letter of credit is considered as a separate contract from the underlying contract of sale of goods or other transactions, as stated in Art 3 of UCP 500 and articles 4 and 5 under UCP 600 the questions that arise here are:

Is there any complementary relationship between the main international sale of goods contract and the letter of credit? Does the principle of autonomy serve the interest of both parties (seller and buyer) or is it just in favour of the seller on the buyer's account? Is the exception of fraud in documents, enough to protect the applicant's (Buyer's) interests? What is the Islamic view pertaining to the letter of credit and its principle of autonomy?

1.3 OBJECTIVES OF THE RESEARCH

- 1- To analyze the nature and the legal adaptation of letter of credit contract as a separate contract in international sale of goods, which will specify accordingly the types and the limitations of duties and rights of the parties in the letter of credit. Furthermore, the research subsequently will critically assess the principle of autonomy in letter of credit, and find out the legal interpretation for the issues derived from the independency doctrine, which stand as an obstacle in utilizing letter of credit contract as a mode of payment in an international sales

⁸ See, Uniform customs and Practice.< <http://lawchroniclesonline.blogspot.com/2007/04/ucp-600-new-rules-on-documentary-credit.html>> (accessed 02 January 2010).

transaction. As a result, the balance and allocation of the risks among parties will be examined.

- 2- To evaluate and examine the law pertaining to the letter of credit contract, basically UCP rules 500 which have been amended recently to UCP 600 (2007), and any other international convention related to the letter of credit contract.
- 3- To provide new suggestions, which might be considered as a more effective method in protecting the rights of the buyer since the bank has to fulfil its obligation (payment), regardless of any dispute between the seller and the buyer under the principal contract of sale of goods. This research will be conducted in such a way that could provide such mechanisms to make the letter of credit more useful.

1.4 LITERATURE REVIEW

There have been a considerable number of books and articles written on the issue of letter of credit as a mode of an international payment scheme. Most of the books referred to contain writings on the nature of the system of payment and how it is protecting the rights of the parties involved in an international business or contract of sale of goods, by discussing the two main principles of letter of credit: the principle of strict compliance with the autonomy principle and the exception of fraud, however they did not go deeply into the consequences and disadvantages of the principle of autonomy.

Most books do not even attempt to criticise this principle as they consider it the soul of letter of credit. Some writers in limited number of articles have examined the letter of credit and its independency principle and relevant issues in the letter of credit. Furthermore, they also discuss the law governing this contract which is the UCP 500

and the latest amendments UCP 600, this has assisted into adding up the input while completing this research.

Rosmawani Che Hashim, in his Article, Principle of Autonomy in letter of credit: Prejudice on the Buyer?⁹ has discussed the autonomy principle and its fraud exception, with the effect of this principle on the buyer, and how the buyer cannot avoid legal repercussions when using a letter of credit as a method of payment.

Roy Goode, in his article: "Abstract payment undertakings and the rules of the International Chamber of Commerce",¹⁰ examines the UCP 500 rules and the functionality of ICC, in addition to the nature of the banks undertaking; autonomy of letter of credit and its operation.

Ross P. & Xiang Gao, in their article, "The development of the fraud rule in letter of credit law: The journey so far and the road ahead,"¹¹ discuss the letter of credit as a mode of payment and its utility, the principle of autonomy of letter of credit and the fraud exception, and how to make this exception wider in order to protect the buyers' interest.

Anthony Connerty, in his article: "Fraud and documentary credits: The approach of the English courts"¹² discusses the payment under letters of credit generally, and this article deals with the fraud exception from the approach of the English courts, and the historical development of this exception referring to relevant cases to clarify and support his opinions and views.

⁹ Rosmawani, "Principle of...."

¹⁰ Roy Goode, "The development of the fraud rule in letter of credit law: The journey so far and the road ahead," *Saint Louis University Law Journal*, 39 St, (1995): 725 Lexis-Nexis, Via IIUM library.

¹¹ Ross P. & Xiang Gao, "The development of the fraud rule in letter of credit law: The journey so far and the road ahead," *23 U. Pa. J. Int'l Econ. L.* (2002):663, Lexis-Nexis, via IIUM library, <<http://lib.iiu.edu.my/index.jsp?action=onlinedb.jsp&module=ROOT>> (accessed 03 February 2010).

¹² Antony Connerty, "Fraud and documentary credits: The approach of the English courts," <www.wwserv.co.uk/anthonyweb/FRAUD%20AND%20DOCUMENTARY%20CREDITS.pdf>

Vishny, in his article “Letters of Credit an Overview”,¹³ discusses the ways in which the new UCP 600 rules improved the financing of international trade.

Kate Stephen, in his article: “The fraud exception”¹⁴ discusses the autonomy principle of letter of credit, and analyses of the case law relevant to the fraud exception.

Bargami, in his article: “Will the UCP 600 Provide Solutions to Letter of Credit Transactions?,”¹⁵ generally discusses letter of credit, outlines major areas of concern and examines provision of the proposed UCP 600 in providing solutions.

Jack, in his book: “Documentary Credit”,¹⁶ has discussed the UCP rules and other legal rules and practices relating to documentary credit in such a manner which will be of assistance to importers, exporters and banks who use credits; the relevant law which lawyers need to know in order to practice in cases involving letter of credit as a mechanism of payment in an international sale of goods. He also analyzed the operations and procedures in documentary credits by examining their contractual framework in the light of legal principles which govern their operation. He discusses the autonomy of documentary credit and its enforcement by reference to Article 3 of the Uniform Custom and Practice and the decision of court in the case of *United City Merchant ltd v Royal bank of Canada*¹⁷. He deals with the principle of autonomy and the fraud exception in Chapter 9 of the book.

¹³ Vishny, “Letters of Credit An Overview,” <http://files.ali-aba.org/thumbs/datastorage/skoobesruoc/source/CN056_Routh-Letters%20of%20Credit_thumb.pdf> (accessed 08 January 2010).

¹⁴ Kate Stephen, “The fraud exception,” *New Law Journal, Elsevier (UK) Ltd* (2006):1634 .Lexis-Nexis, via IIUM library.

¹⁵ Bargami, “Will the UCP 600 Provide Solutions to Letter of Credit Transactions?,” *International Review of Business Research Papers*, Vol.3 No.2(2007): 41-53. Lexis Nexis, via IIUM library, <<http://lib.iiu.edu.my/index.jsp?action=onlinedb.jsp&module=ROOT>> (accessed 17 February 2010)

¹⁶ Raymond Jack, *Documentary Credit*, (London, Butterworths. 2nd edition 1993).

¹⁷ [1983] 1 AC 168.

El Gaily Ahmed, in his book “Legal Principles of Documentary credits,”¹⁸ discusses the documentary credit as a method of financing, its importance in international transactions and the position under Islamic Banking Act 1983 of Malaysia.

Johnson Pang, in his book “Documentary Credits (letter of credit) & Collections for the Export and Import Trade”,¹⁹ has emphasized in chapters 14 to 26 the historical introduction in foreign trade of letters of credit, the purpose of using letters of credit, types of letter of credit, and he has analyzed the legal relationships of the parties concerned.

Sarna, in his book: “Letter of Credit the Law and Current Practice,”²⁰ deals with letters of credit in general and explains the nature of the letter of credit as a mode of payment in foreign trade.

Although, most of the writers introduce the principle of autonomy of letter of credit in their writings, they do not treat this issue in great detail. They mostly mention it as one of the principles of letter of credit, while discussing the fraud exception in depth. From this we can infer that it is an area which requires further investigation.

1.5 SCOPE AND LIMITATIONS OF THE STUDY

The focus of this study is on the Uniform Customs and Practice for Documentary Credits, (UCP 500), as well as other relevant statutory and/or case law of England, Malaysia and other Commonwealth jurisdictions including Australia. Similarly, the research shall also focus on the principle of autonomy of letter of credit and the fraud

¹⁸ El Gaily, *Legal Principles of Documentary Credits*, (Malaysia: International law book services.1998).

¹⁹ Johnson Pang, *Documentary Credits (letter of credit)&Collections for the Export and Import Trade*, (Malaysia: Pelanduk. 1999).

²⁰ Sarna, *Letter of Credit the Law and Current Practice*, (1986).

exception, and the legal issues that may arise from applying this principle of autonomy, under the UCP (500 and 600) rules.

1.6 RESEARCH METHODOLOGY

The materials obtained for the purpose of writing this research will be relevant law journals; online articles, books, besides the internet are dictionaries, legal authorities, statutes and some relevant legal materials, in addition to a field study where the researcher will visit some banks in Malaysia to see how they deal with letter of credit and its principle of autonomy.

The principles in the cases will be analyzed in terms of their *ratio decidendi* and other *dicta*; the ways in which these components have been used to develop the law related to this type fraud.

The study will also examine the ways in which the courts have examined the provisions of the UCP.

The researcher will use the analytical research method to discuss and interpret the case law, by examining the legal principle in cases relevant to the autonomy of letter of credit, and the fraud exception, where the researcher will analyze the decisions of the courts, and the rationale for making such judgments. Furthermore, this thesis will examine the interpretations of the rules of the Uniform Custom and Practice (UCP). The researcher will also conduct interviews with some banking practitioners in Malaysia, in order determine the practical application of letter of credit, and its autonomy principle, as well as for obtaining the views and observation of experts in the domain.

The researcher will assume a comparative approach and will seek to strike a balance between the views of writers from the civil law background and with those

from the common law background. The researcher will bear in mind the objectives of the whole research, when evaluating certain opinions regarding the topic chosen. Meanwhile, in order to have a good understanding of the modern and established principles, and nature of the letter of credit contract, and to know the differences and similarities of the letter of credit contract in these different legal systems, this research will focus on the most recent materials that deal with the legal issues arising from the autonomy of letter of credit in the international sale of goods.

CHAPTER TWO

INTRODUCTION TO LETTER OF CREDIT AND UNIFORM USTOMS.

2.1 DEFINITION OF LETTER OF CREDIT

The terms letter of credit, documentary credit or banker's documentary credit and commercial credit, are all currently in use, and there is no distinction among them. The Uniform Customs and Practice (UCP)¹ refer to 'documentary credits' in articles 1 and 2 and thereafter simply as 'credit'².

A letter of credit is defined as an undertaking by an issuing bank to the interest of the beneficiary (seller) to make payment within a specific time, against the presentation of documents which strictly comply with the terms of the credit.³

Prof. Pennington provides a more detailed definition. He defines a letter of credit as:

.....an undertaking by a bank to pay a sum of money to the person for whom the credit is addressed, or to accept or purchase a bill of exchange drawn or held by that person, and the undertaking is either absolute, or, more usually, is given on the condition that the person fulfils the requirements set out in the credit, for example the presentation to the bank of documents showing that the goods have been shipped or dispatched by sea, land or air and will be available for collection by the bank or someone nominated by it.⁴

The Uniform Customs and Practice sponsored by the International Chamber of Commerce contains the following definition in article (2):⁵

.....any agreement, however named or described, whereby a bank (the issuing bank), acting at the request and in accordance with the instruction of a customer (the "applicant" for credit) or in its own behalf.

¹ See, Definitions, UCP (500, 600).

² Raymond Jack, at 1.

³ SITPRO, at 5.

⁴ El Gail, quoted from, Pennington, Hudson and Mann, *Commercial Banking Law*, (M&E, 1978), at 309

⁵ Art. 2. UCP (600).

(i) Is to make payment to or to the order of a third party (the beneficiary) or, is to accept and pay bills of exchange (draft(s)) drawn by the beneficiary,

Or

(ii) Authorizes another bank to effect such payments, to accept and pay such bills of exchange (draft(s)).

(iii) Authorizes another bank to negotiate, against stipulated documents, provided that the terms and conditions of the credit are complied with.

For the purpose of these articles, branches of the banks in different countries are considered another bank.

2.2 THE LAW GOVERNING LETTER OF CREDITS

Letter of credit, under its modern aspect, was first introduced at the end of the 19th century through international banking practice, and without any legislative process. As an international mode of financing and warranty, banks soon expressed their concern that it has to be regulated by rules independent of any national laws. For that reason, during the first quarter of the 20th century, some private bankers' associations (in Paris, New York and UK) created some rules governing the documentary credits issued by the banks members of those associations, whereas in 1933 the ICC (International Chamber of Commerce) issued for the first time, its Uniform Customs and Practice for letter of credits.⁶ These UCP rules were revised successively in 1951, 1962, 1974, 1983, 1993. This UCP rules came into force since 1st of January, 1994, and was published as the ICC publication n°500, known as the "UCP 500". The latest revision, the UCP text which was approved on October 25, 2006, and came into force on the 1st of July, 2007: they are known as "UCP 600". It is The 2007 Revision of the Uniform Customs and Practice for letter of credits, published as the ICC publication

⁶ "Banking Techniques and Practices," <<http://www.iccwbo.org>> (accessed 05 March 2010).

n° 600, by the ICC Services Publications Department, at 38 Cours Albert 1er, Paris 75008,

In order to take into account the movement from “paper-based” letter of credits to electronic credits, the ICC prepared, in 2002, a complement to the UCP 500, under the short form “eUCP”, which has not gained widespread use. These eUCP have been revised as well – revision of which is known as Version 1.1 – in order to take into account the change in style and terminology resulting from the 2007 revision of the UCP.⁷

2.3 PARTIES INVOLVED IN A LETTER OF CREDIT

In a letter of credit contract there will be several parties involved:

- **Applicant:** the importer (buyer) or the party who requests the letter of credit to be issued in favour of the seller.⁸
- **Issuing Bank (IB):** the bank issuing the credit on the instructions of the applicant.
- **Beneficiary:** the exporter (seller) or the party to whom the letter of credit is addressed.⁹
- **Advising Bank(AB):** usually the correspondent bank (appointed by the issuing bank) in the exporter’s country, which verifies the authenticity of the letter of credit and forwards it to the beneficiary, and it is the bank where the beneficiary must present the documents in compliance with the applicant’s instructions.¹⁰

⁷ Dominic Doise, “The 2007 Revision of The Uniform Customs and Practice for Documentary Credits (UCP 600),” RDAI/IBLJ, N 1, 2007, <<http://www.alerionnews-nc2b01-janv08-vang.pdf>>.

⁸ Scotiabank, “International Trade Finance Services, DOCUMENTARY LETTERS OF CREDIT, a practical guide,” at 19, <http://www.scotiabank.com/images/en/files_business/1180.pdf> .

⁹ Ibid.

¹⁰ Institute Bank-Bank Malaysia, *financial sector talent enrichment programme conventional : banking handbook*, (Kuala Lumpur: Institute Bank-Bank Malaysia, First Edi April 2010), at 47,

- **Nominated bank:** the bank authorized, within the letter of credit (named in the letter of credit) to make payment to the beneficiary and to whom the documents are presented.

It is not necessarily the issuing bank, but often a branch of the issuing bank or its correspondent.

- **Confirming bank (CB):** usually the advising bank in the beneficiary's country, which adds its confirmation (usually required by the seller) to the credit and accept to undertake an independent obligation to pay the beneficiary, provided the documents conform to the terms and conditions set out in the letter of credit and presented at a specified place and time. Therefore the beneficiary with this additional promise of payment will have three separate promises of payment, the applicant's, issuing bank's and conforming bank's promise.¹¹

It is very important to the buyer and seller to negotiate, at contractual stage, which party will bear the bank's charges.

2.4 MECHANISM FOR LETTER OF CREDIT TRANSACTION

1. The first step, which leads to the issuance of a letter of credit, is the making of the contract of sale between the buyer and the seller. Buyer and seller in this stage (the contract of sale of goods) agree to conduct business and the payment shall be made under letter of credit (The seller wants a letter of credit to guarantee payment).¹²

<<http://www.fstep.org.my/media/File/CONVENTIONAL%20BANKING%20MANUAL.pdf>> (accessed 30 February 2010).

¹¹ SITPRO Report, at 6.

¹² Credit Research Foundation, "Understanding and Using Letters of Credit," Part I, (n.p.,1 999). <<http://www.crfonline.org/orc/cro/cro-9-1.html>> (accessed 27 January 2010).