



LEGAL ASPECT OF DOCUMENTARY LETTER OF CREDIT FRAUD IN INTERNATIONAL COMMERCE

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SUMMARY

Documentary letter of credit is the most important payment method in international commerce. The purpose of a letter of credit is to share risks to the parties equally and provide confidence for payment. However, a letter of credit fraud disrupts confidence and creates risk for actors in international commerce. Therefore, it's legal aspects are very important and shall be discussed in this paper.

KEY WORDS

Documentary Letter of Credit, Fraud, Payment Method in International Commerce

INTRODUCTION

In international trade, buyer and seller are located in different countries and goods are naturally transported from country to country. Immediate payment is practically impossible. Various factors such as political risks, currency exchange restrictions and physical distance between the buyer and the seller create a lack of trust for parties. From the seller's perspective, he will be reluctant to get expenses for the shipment of the goods from the buyer and needs assurance of payment. From the buyer's perspective, he is unwilling to make payment before delivery of goods without assurance that he will receive goods. If he does not receive goods upon payment in advance, he may have difficulty pursuing the seller in a foreign jurisdiction.² It is the result of the fact that parties do not belong to the same legal system. Immediate payment is

¹ Author is a Lawyer (Antalya Bar Association).

² LOW Hang Yen, Grounds for Withholding Payment in Documentary Credits, Doctor of Philosophy Thesis, University of Birmingham, page 2.

naturally impossible due to the fact that it is very hard to take legal action in different jurisdiction for one party. Therefore, a documentary letter of credit was created to reduce the risk related to such transactions. Its history traces back to the 12. century. Actually, a wealthy individual issued a letter promising payment to induce a trader to deliver goods or give money to that individual's agent or servant.³ ICC issues UCP 600 Rules governing documentary letter of credit in international commercial law. In a documentary letter of credit relationship, the buyer(the "account party") requests a bank(the "issuing bank") to issue a documentary letter of credit in favour of the seller(the "beneficiary") so as to pay the amount of contract of sale between the buyer and the seller. "A documentary letter of credit can be considered as an undertaking to pay a certain amount to the beneficiary upon receipt of the documents listed in the same documentary letter of credit." Therefore, the issuer has payment obligation only if it confirms that the documents conform with the conditions in the documentary letter of credit.⁴ There is the most important issue that the basic character of a documentary letter of credit is an independent from the contract of sale(underlying contract) between the buyer and the seller. While a contract of sale is two party relationship, a documentary letter of credit is triparty relationship involving also issuing bank and is independent from an underlying contract between the buyer and the seller. In the operation of a letter of credit, there are three independent relationships:⁵

- the underlying contract: a contract of sale between the buyer(the applicant) and the seller(the beneficiary)
- the application: a contract between the buyer(the applicant) and the issuing bank to open a letter of credit
- the issuing bank's obligation to honour the letter of credit for the beneficiary if requirements are met.

Letters of credits are widely enjoyed in international commercial life. For example, it is estimated that letters of credit are enjoyed around 30 percent of China's imports and exports in 2006. The amount of these transactions is approximately 600.000.000\$ US dollars.⁶ Therefore, it is a clear fact that letters of credit are very important part of *lex mercatoria*.⁷

³ Miller, supra note 2, at 162-63.; LEON Christopher, Letters of Credit: a Primer, Maryland Law Review, Volume:45, Issue:2, 1986, page 433.

⁴ GIAMPIERI Alberto-NARDULLI Giovanni, Enforceability of International Documentary Letters of Credit: An Italian Perspective, The International Lawyer, Vol.27, No.4, Winter 1993, page 1013. Bank Indonesia defines letter of credit as "a promise from the issuing bank to pay a sum of money to the exporter as long as it is able to meet the terms and conditions of the Letter of Credit." see also; LENG Pwee/HUGAN Handjaya A., Bank Criminal Act: Case of Fraud Using Letter of Credit-Bank as a Victim, Chinese Business Review, Mar. 2018, Vol. 17, No. 3, p.124.

⁵ FRIAS GARCIA Roberto Luis, The Autonomy Principle of Letters of Credit, Mexican Law Review, Vol.III, No:1, page 72.

⁶ XIANG Gao, The Fraud Rule in Law of Letters of Credit in the P.R.C., The International Lawyer, Vol:41, No:4, Winter 2007, page 1068.

⁷ NITIYAVANICH Bowornsinh, Fraud Rule in Independent Guarantees and Stand-By Letters of Credit under the UN Convention, LLM Thesis, Supervisor: Anan Chantara-Opakorn, Thammasat University Faculty of Law, 2015, page 61.

PRINCIPLES OF DOCUMENTARY LETTER OF CREDIT

Strict Compliance Principle

The principle of strict compliance is that the issuing bank has the obligation to make payment to the seller upon the presentation of documents that are stipulated in the letter of credit. This is “*the idea of strict compliance has developed from the general principle of the law of agency that an agent is only entitled to reimbursement from his principal if he acts in accordance with his instructions.*”⁸ The Issuing bank must reject the payment if there is a lack of stipulated documents in the letter of credit which causes disobedience of this principle.⁹ It means that any deviation from specifications in the text of a letter of credit allows the issuing bank not to make payment to the seller.¹⁰ The function of this principle can be exemplified that sometimes, a buyer may wish to end his contract with the seller due to various reasons, most commonly where the market price of the goods is going down, but the seller is protected by this principle because the buyer has an obligation to take delivery of compliant documents and cannot infringe his payment obligation. Shortly, this principle ensures that banks do not go beyond the limits set by the letter of credit.¹¹

Autonomy Principle

Another fundamental principle in the operation of letters of credit is the principle of autonomy. According to the autonomy principle, it is assured that the payment will be due upon the submission of complying documents to the issuing bank for the exporter, while neither the account party nor the issuing bank can reject the payment based on the claims concerning the performance of the underlying contract.¹² Since the bank’s obligation to pay arises upon the submission of conforming documents, not upon the delivery of goods, the financial transaction

⁸ R. King, Gutteridge and Megrah’s Law of Bankers’ Commercial Credits, London 2001, p.14; ALAVI Hamed, Risk Analysis in Documentary Letter of Credit Operation, Financial Law Review, No.1(4), 2016, Page 29.

⁹ R.D. Harbottle(Mercantile)Ltd v. National Westminster Bank Ltd. (1978) QB 146. p. 269.; HAO Yan/XIAO Ling, Risk Analysis of Letter of Credit Based on Principles of Independence and Strict Compliance, International Journal of Business and Social Science, Vol.4, No.9, August 2013, page 202.

¹⁰ LEON Christopher, Letters of Credit: a Primer, p. 452.

¹¹ LOW Hang Yen, Grounds for Withholding Payment in Documentary Credits, p.13.

¹² ALAVI Hamed, Exceptions to the Principle of Independence in Documentary Letters of Credit, PhD Thesis, Supervisor: Prof. Cales Gorriz Lopez, Universitat Autònoma de Barcelona, 2018, pages 55 – 56.

is totally independent from the underlying contract.¹³ Separation of credit transaction from the contract of sale is clearly shrined in Articles 4 and 5 of UCP 600 Rules as follows:¹⁴

“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. Consequently, the undertaking of a bank to honour, to negotiate or fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary.” (Article 4 of UCP 600 Rules)

“A beneficiary can in no case avail itself of the contractual relationship existing between the banks or between the applicant and the issuing bank. An issuing bank should discourage any attempt any by the applicant to include, as an integral part of the credit, copies of the underlying contract, proforma invoice and the like. Finally, banks deal with documents and not with the goods, services or performance to which the document relate.” (Article 5 of UCP 600 Rules)

Based on both provisions, it can be deduced that the banks do not get involved in any conflict arising between the applicant and the beneficiary.¹⁵

FRAUD EXCEPTION

Fraud is one of the oldest and most well-known discussed issue in business life. *“As long as there have been commercial systems in place there have been those who tried to manipulate these systems.”* Since a bank has no the duty to check the documents submitted by the beneficiary and investigate in fact concerning the performance of his duty in the underlying contract, it is considered as *“the most controversial and confused area”*.¹⁶

Fraud is a risk in international trade. This risk is very high for the seller because fraud in a letter of credit transactions can be committed by the parties of a contract of sale or financial intermediary however, the most prevalent fraud in a letter of credit transactions is committed by the seller.¹⁷ For example, falsification of the documents committed by the beneficiary is an

¹³ MONTEIRO Felicity, *Documentary Credits: The Autonomy Principle and the Fraud Exception: A Comparative Analysis of Common Law Approaches and Suggestions for New Zealand*, Auckland University Law Review, Volume:7, 2007, page 147.

¹⁴ ALAVI Hamed, *Limits of Autonomy Principle in Documentary Letters of Credit; Perspective of English Law*, Journal of Legal Studies, Volume:19, Issue:33, 2017, page 19. Moreover, Pursuant to Article 5 of Uniform Commercial Code, the U.S. also accepts autonomy principle as follows:

“the rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or non-performance of the contract or arrangement out of which the letter of credit arises or which underlie it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.”

¹⁵ HAN Ki Moon, *Interpretation of 3rd Party’s Fraud Exception Rule under Law of Letters of Credit*, The International Commerce & Law Review, Vol.36, December 2007, page 29.

¹⁶ ALAVI Hamed, *Exceptions to Principle of Autonomy in Documentary Letters of Credit; A Comparative View, Actual Problems of Economics and Law*, 2016, vol. 10, No.3, page 126.

¹⁷ Lee,2009; Miller,1959; CHEHASHIM R./MAHDZAN N.S., *Fraud in Letter of Credit Transactions: The Experience of Malaysian Bankers*, International Journal of Law, Crime and Justice, 2014, page 2.

example of fraud for obtaining the payment from the issuing bank if there is no cargo.¹⁸ The Director of International Commercial Crime describes such a situation as follows:¹⁹

“False documents that comply with LC terms are presented by the seller to the bank. The confirming bank then pays and sends documents to the issuing bank. The buyer believes that the cargo has been loaded and is on its way to its destination. In many cases, it is only when the vessel is due to arrive at the destination port that the buyer discovers that the cargo, as contracted, has not been loaded on board. He has paid for the deal but is put under spurious documents.”

It is seen that both principles of letter of credit intend to facilitate international commercial transactions but are suitable to be abused by fraudsters. Since merchants from developing countries have no enough experience and knowledge in a letter of credit transactions, they are often the targets of letter of credit fraud.²⁰ The Executive Director of the ICC Commercial Crime Services stated that letter of credit fraud in international commercial transactions has become more complex and its’ new schemes have emerged. Each year, merchants and banks lose huge amounts of money as loss due to letter of credit fraud. In the LONECO case, it was revealed that US\$400 million were lost due to the letter of credit fraud.²¹ This situation may create a devastating effect on the buyer. Moreover, the banks assume no responsibility due to fraud in a letter of credit since the bank has no obligation to verify the authenticity of documents and signatures. Article 34 of the UCP 600 Rules states as follows:²²

“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.”

This situation increases the risk on parties in documentary letter of credit transactions. It should be emphasized that neither exemption clauses in contracts nor provision cannot exclude the responsibility of the buyer or the seller who committed fraud.²³

It should be emphasized that fraud is the only exception to the party autonomy principle which has global recognition. Other exceptions which are unconscionability, nullity, illegality and recklessness of beneficiary are recognized or rejected in a different jurisdiction and there is

¹⁸ ALAVI Hamed, Risk Analysis in Documentary Letter of Credit Operation, Financial Law Review, No.1(4), 2016, page 36.

¹⁹ CHEHASHİM R./MAHDZAN N.S., p. 2.

²⁰ Xiaomg and Ruping, 2005; ZHANG Yanan, Documentary Letter of Credit Fraud Risk Management, Journal of Financial Crime, Vol.19, No.4, 2012, page 344.

²¹ ZHANG, p. 344.

²² CHEHASHİM R./MAHDZAN N.S., p. 2.

²³ ELIZABETH MACDONALD, EXEMPTION CLAUSES AND UNFAIR TERMS 300 (Butterworths 1999). See also S. Pearson & Son v. Dublin Corp (1907) AC 351, 362, 365 (House of Lords); Scheider v. Heath (1813) 3 Camp 506; Garden Neptune Shipping Ltd. v. Occidental Worldwide Inv. Corp. (1990) 1 Ll Rep 330; Skipskredittforeningen v. Emporor Navigation (1997) CLC 1151, 1165.; DAVIDSON Alan, Fraud and the UN Convention on Independent Guarantees and Standby Letters of Credit, George Mason Journal of International Commercial Law, Vol.1, Issue:1, Fall 2010, page 34.

no the same approach for their recognition.²⁴ However, Although UCP 600 Rules are the most popular set of applicable rules, it does not govern a set of rules governing fraud. It remains silent and some national laws govern fraud exception.²⁵

The U.S. Law

Development of Fraud rule in the U.S. can be classified in three main periods: Pre-UCC, The previous UCC Article 5 and Revised UCC Article 5. In the course of pre-UCC, the Fraud rule was shaped by case law in the United States. After *Sztejn vs. Henry Schroder Banking Corporation* became a landmark case, the U.S. Congress made a legislative amendment governing the letter of credit fraud rule. Jurist Gao Xiang interprets this case as “*It has shaped the fraud rule in virtually all jurisdictions.*”²⁶

In *Sztejn vs. Henry Schroder Banking Corporation* case, an underlying contract was made between Sztejn (“the buyer”) which was based in the United States and Translea Traders Ltd. (“the seller”) which was based in Lucknow, India. There was hog bristles trade between parties. Sztejn ordered his bank -Henry Schoreder Banking Corporation to issue an irrevocable letter of credit to assure payment. Transea loaded fifty cases of material to ship and thus acquired a bill of lading and relevant documents. Chartered Bank at Cawnpore, India played role as a correspondent bank. When Transea delivered to Chartered Bank the documents stipulated in the letter of credit, Chartered requested payment from Schroder on behalf of Transea. However, it was claimed that Transea’s fifty crates were filled “*with cowhair, other worthless material, and rubbish*” instead of loading with hog bristles.²⁷ Upon this situation, Sztejn requested declaratory and injunctive relief from the courts, asking that the documentary letter of credit and draft are void and prevention of payment.²⁸ Justice Sheintag of the New York Court of Appeal accepted the request of an injunction of Sztejn by considering the situation of fraud as an exception of the principle of autonomy as follows:²⁹

“It is well established that a letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade. Of course, the application of this doctrine [the principle of independence] presupposes that the documents accompanying the draft are genuine and conform

²⁴ ALAVI Hamed, Illegality as an exception to principle of autonomy in Documentary Letters of Credit; A Comparative Approach, Korea University Law Review, 2016, vol.20, pp 3-23; ALAVI Hamed, Contractual Restrictions on Right of Beneficiary to Draw on a Letter of Credit; Possible Exception to Principle of Autonomy, ICLR(International and Comparative Law Review), 2016, Vol.16., No.2., page 68.

²⁵ ALAVI Hamed, Exceptions to Principle of Autonomy in Documentary Letters of Credit; A Comparative View, Actual Problems of Economics and Law, p. 126.

²⁶ ALAVI Hamed, Exceptions to Principle of Autonomy in Documentary Letters of Credit; A Comparative View, Actual Problems of Economics and Law, Vol.10., No.3., 2016, page 126.

²⁷ BLODGETT Marks./MAYER Donaldo, International Letters of Credit: Arbitral Alternatives to Litigating Fraud, American Business Law Journal, Vol.35, pages 449-450.

²⁸ BLODGETT/MAYER, p. 450.

²⁹ ALAVI Hamed, Exceptions to the Principle of Independence in Documentary Letters of Credit, PhD Thesis, Universitat Autònoma de Barcelona, 2018, pages 70-71.

in terms to the requirements of the letter of credit. However, I believe that a different situation is presented in the instant actions. This is not a controversy between the buyer and the seller concerning a mere breach of warranty regarding the quality of the merchandise; on the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, where the seller's fraud had been called to the bank's attention before the drafts 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... Although courts have used broad language to the effect that a letter of credit is independent of the primary contract between the buyer and the seller, that language was used in cases concerning alleged breaches of warranty; no case has been brought to my attention on this point involving intentional fraud on the part of the seller which was brought to the bank's notice with the request what it withhold payment of the draft on this account.”

After *Sztejn vs. Henry Schroder Banking Corporation* case, the U.S. Congress passed letter of credit fraud rule in Uniform Commercial Code(UCC) Section 114(2) of Article 5 as follows:³⁰

“Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document title(Section 7-507) or of a certificated security (Section 8-108) or is forged or fraudulent or there is fraud in transaction:

the issuer must honour the draft or demand for payment if honour is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a certificated security (Section 8-302); and

in all other cases as against its customer, an issuer acting in good faith may honour the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honour.”

As time goes by, UCC Article 5 remained insufficient and it became subject to many legislative amendments. Article 5 of UCC has been revised and fraud rule changed substantially in different periods. Article 5 of Current UCC is stated as follows:

“(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honour of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant: (1) the issuer shall honour the presentation, if honour is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honoured its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and (2) the issuer, acting in good faith, may honour or dishonour the presentation in any other case.

³⁰ ALAVI Hamed, Exceptions to the Principle of Independence in Documentary Letters of Credit, Page 73.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honour 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 honouring 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 honour does not qualify for protection under subsection (a)(1).”

Current principles of fraud exception in Article 5-109 of UCC can be listed as follows:³¹

First of all, committing fraud affect the operation of letter of credit negatively. This effect include: the refusal of the issuing bank to honour the letter of credit after the presentation of documents by the beneficiary and granting an injunction to the account party for the prevention of payment by the bank.

Secondly, apart from setting the standard of proof for fraud, article 5-109 confirms that fraud exception includes not only in documents but also in the underlying contract under American law.

Thirdly, Article 5-109(b) classifies four groups of immune people for the application of the fraud exception rule.

Fourthly, forgery and materially fraudulent documents are set as an injunction granting reasons.

The most important difference between the current and previous text of Article 5-109 of UCC is the term of “material fraud” which was later added. Official comment states that the beneficiary must have committed fraud on the applicant or issuer or fraud must be found in documents. The use of the word material means that the fraudulent aspect of a document to the buyer for that document or that the fraudulent act is at a significant level for the participants in the underlying transaction.³² Therefore, the U.S. courts must examine whether there is an allegation of material fraud in the underlying transaction. It must be of a certain standard to fulfill the material level criterion.³³ If the level of fraud is set very low, the application of fraud rule is open to be abused and payment of the letter of credit is disrupted, the basic functions of the letter of credit such as allocation of risk prompt payment shall disappear. Later, the reliability and commercial function of letters of credit shall lose their effect.³⁴ Although a certain level of

³¹ ALAVI Hamed, Exceptions to Principle of Autonomy in Documentary Letters of Credit; A Comparative View, page 127.

³² MONTEIRO Felicity, Documentary Credits: The Autonomy Principle and the Fraud Exception: A Comparative Analysis of Common Law Approaches and Suggestions for New Zealand, Auckland University Law Review, page 156.

³³ MONTEIRO Felicity, Documentary Credits: The Autonomy Principle and the Fraud Exception: A Comparative Analysis of Common Law Approaches and Suggestions for New Zealand, pp. 156, 157.

³⁴ XIANG Gao/ BUCKLEY Ross B., A Comparative Analysis of the Standard of Fraud Required under the Fraud Rule in Letter of Credit Law, Duke Journal of Comparative & International Law, Vol.13., p. 309.

fraud(“material fraud”) is necessary to satisfy the court to issue an injunction, applicants may enjoy this approach to file a case to prevent or delay payment based on the underlying contract.³⁵

English Law

Under English law, the letter of credits plays a very important role but a letter of credit fraud is a very controversial area because it affects the operation of letter of credit in international trade. Unlike American law, English legislation does not regulate letter of credit fraud. Naturally, this issue has been governed by case law since the late 1970s. Historically, English case law choose a restrictive approach not to interfere in the obligation of bank to pay unless there is strong evidence regarding committing letter of credit fraud by the beneficiary.³⁶

Fraud is not defined in English legislation. Therefore, its borders are drawn by case law. It is analysed case by case. However, there are four main types of letter of credit fraud conflicts under English law. First, the beneficiary may file a case against the bank on the basis of the bank’s rejection to make payment in spite of receiving a compliant presentation. Second, issuing bank makes payment to the beneficiary but, files a lawsuit against the beneficiary because of the presentation of a fraudulent document for the restitution of the payment. Third, confirming bank files a lawsuit against the issuing bank in the request for reimbursement after the effectuation of payment and refusal of issuing bank based on fraud for reimbursement. Fourth, the applicant request injunction from national courts before the issuing bank makes payment based on the beneficiary’s fraud.³⁷ Especially, the last situation shows that injunction is a very important legal remedy against letter of credit fraud.

In letter of credit fraud cases, a mere allegation of fraud is not sufficient before courts in England to dishonour the letter of credit. Once the fraud claims are submitted by strong evidence, an injunction shall be issued by courts in English law.³⁸ In majority cases, injunction request was refused to stop payment because of the absence of strong evidence. Since the high proof standards are necessary, it is very difficult to file a case against banks in England. However, high proof standards are convincible. Such a rigid approach is very important to confirm the principle of autonomy in the operation of letter of credit and ensure that there is a serious claim.³⁹ In the *United Trading Corporation SA and Murray Clayton Ltd v. Allied Arab Bank Ltd* case, Justice Ackner describes the high standard of proof as follows:

³⁵ MONTEIRO Felicity, *Documentary Credits: The Autonomy Principle and the Fraud Exception: A Comparative Analysis of Common Law Approaches and Suggestions for New Zealand*, p. 157.

³⁶ Alavi, H., “Autonomy Principle and Fraud Exception in Documentary Letters of Credit, a Comparative Study between United States and England”. *International and Comparative Law Review*, Vol. 15, No. 2,(2015), pages 45-67.; ALAVI Hamed, *Remedies to Fraud in Documentary Letters of Credit: A Comparative Perspective*, *EU Agrarian Law*, Volume:5, Issue:1, 2016, page 6.

³⁷ ALAVI Hamed, *Remedies to Fraud in Documentary Letters of Credit: A Comparative Perspective*, pp.6-7.

³⁸ ALADWAN Zaid, *Legal Basis for the Fraud Exception in Letters of Credit under English Law*, *Journal of Financial Crime*, Vol.27, Issue:1, 2020, page 792.

³⁹ ALADWAN Zaid, *Legal Basis for the Fraud Exception in Letters of Credit under English Law*, page 793.

“The evidence of fraud must be clear, both as to the fact of fraud and as to the bank’s knowledge. The mere assertion or allegation of fraud would not be sufficient. [...] We would expect the Court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. In general, for the evidence of fraud to be clear, we would also expect the buyer to have been given an opportunity to answer the allegation and to have failed to provide any, or any adequate answer in circumstances where one could properly be expected. If the Court considers that on the material before it the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case of fraud.”⁴⁰

Turkish Law

Turkish legislation does not regulate the letter of credit. Since there is no provision on letter of credit, there is no any provision governing letter of credit fraud. Two approaches may be accepted for letter of credit fraud under the Turkish perspective.

First of all, Pursuant to Article 1 of the Turkish Civil Code, if there is no applicable provision for the dispute, customary law is applied. If there is no applicable provision and customary law, the judge must create law like a legislator for the relevant dispute or case. Since Turkish law does not lay down rules governing letter of credit transaction, the Turkish judge must create law like a legislator for the relevant dispute or case.

Secondly, letter of credit fraud may be considered as an unjust enrichment. Under Turkish Obligation Code, unjust enrichment is an enrichment of one person from another person which is considered as unjust by law. If one person is unjustly enriched from another person, he must make restitution to another. Taking into consideration of the nature of the documentary letter of credit fraud, it can be considered as unjust enrichment.⁴¹

As a legal remedy, it is also possible to request provisional measure to stop payment from the issuing bank to the confirming bank in Turkey although letter of credit rules is not governed by legislation because the Turkish Civil Procedural Code sets issuing conditions of provisional measures. Under the Turkish Civil Procedural Code, if the impossibility of acquisition of any right or a condition that there is irretrievable harm is about to occur, it is possible to request provisional measure from the courts. Letter of credit fraud is a clear example of provisional measure condition. Especially, strong evidences are necessary to issue provisional measures for letter of credit fraud.⁴²

The common point of these above-mentioned systems is that the fraud rule is applied through provisional measure if there is strong doubt regarding the letter of credit fraud at a material or high level. It should be emphasized that in the event that the standard is very low, an applicant who would like to abstain from making payment can easily commit fraud. It affects the

⁴⁰ United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd [1985] 2 Lloyd’s Law Reports 554, 561., ALAVI Hamed, Exceptions to the Principle of Independence in Documentary Letters of Credit, page 82.

⁴¹ DEMİR Gönenç, Vesikalı Kredilerde(Akreditifte) Hile Kuralı, Master of Law Thesis, Dokuz Eylül University Social Science Institute Private Law Department, Supervisor: Yaşar Can Göksoy, page 72.

⁴² DEMİR Gönenç, Vesikalı Kredilerde(Akreditifte) Hile Kuralı, page 175.

commercial function of an undertaking. On the other hand, if the standard is quite strict, it causes fraudulent transactions on the side of the beneficiary.⁴³

Although fraud rule is not contained in all national legislations, it is generally an accepted exception in legal systems in similar manner, not the same manner. Although the U.S. legislation regulates fraud rule in very detail, English case law and Turkish doctrine have similar approaches in the letter of credit fraud practice. Whereas, both countries do not have letter of credit fraud rule. English case law and Turkish doctrine reach the same approach with the U.S. legislation although there is a loophole in theirs' legislations. Gao Xiang explains the rationale behind the fraud rule with three reasons:⁴⁴

- **Closing Loophole:** Absolute application of autonomy principle may cause the seller to present forged but complying documents to the issuing bank to get payment without performing his duty in the underlying contract. If there is a strong doubt regarding the existence of letter of credit fraud, the lack of relevant legislation may create serious crises created by the autonomy principle for the buyer.

- **Public Policy:** Fraud is a danger against the public policy. If a beneficiary enjoys a letter of credit fraud in the operation of a letter of credit by presenting forged or false documents, there is a public policy violation. Naturally, national courts do not allow dishonest the beneficiary to commit fraud.

- **Maintaining Commercial Utility:** Since presented documents provide security function of banks having guarantor role in international trade, letter of credit fraud disrupts the security function of the banking system. If banks are defrauded upon the presentation of forged documents, the faith of all parties will lose.

CONCLUSION

1. While the principle of strict compliance provides protection of rights of the buyer by putting obligation the seller on providing genuine documents which comply with terms of letter of credit, the purpose of the principle of autonomy provides the seller's rights by separating the underlying contract from letter of credit. In this way, two basic principles of letter of credit transaction provide balance between conflicting interests of the buyer and the seller and facilitate the process of international commerce. However, absolute application of the principle of autonomy causes abusive situations. It creates an undebatable risk for parties. If it is absolutely practiced, the issuing bank must make payment to the beneficiary upon forged documents. Therefore, the fraud rule is an exception of the absolute application of autonomy.⁴⁵ The non-existence of letter of credit fraud rule with the absolute principle of autonomy protects the fraudsters.⁴⁶

⁴³ NITIYAVANICH Bowornsith, Fraud Rule in Independent Guarantees and Stand By Letters of Credit under the UN Convention, Thammasat Business Law Journal, Vol.5, 2015, pp. 44-45.

⁴⁴ ALAVI Hamed, Exceptions to Principle of Autonomy in Documentary Letters of Credit; Comparative Review, pp. 125-126.

⁴⁵ ALAVI Hamed, Exceptions to Principle of Autonomy in Documentary Letters of Credit; A Comparative, Actual Problems of Economics and Law, vol.16., no.3, 2016. page 135.

⁴⁶ MERAL Nevin, The Fraud Exception in Documentary Credits: A Global Analysis, Ankara Bar Review, Vol.2, 2012, page 73.

2. The fraud rule is an indispensable part of the applicable law governing letters of credit and was created and developed to fill a lacuna that law to prevent dishonest beneficiaries from abusing the confidence of the letter of credit system and defrauding the buyer and the issuing bank. The fraud rule is an extraordinary rule in the operation of documentary letter of credit because it has a direct conflict with the principle of autonomy that is a fundamental principle of letter of credit system.⁴⁷ As it is seen from the U.S., English, and Turkish legal systems, it is practiced if there is a strong doubt under exceptional situations. It should be practiced carefully and strictly for its purpose.⁴⁸

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⁴⁷ XIANG Gao/BUCKLEY Ross P., The Development of the Fraud Rule in Letter of Credit Law: The Journey So Far and The Road Ahead, *University of Pennsylvania Journal of Economic Law*, Volume:23, Issue:4, 2002, page 711.

⁴⁸ XIANG Gao/BUCKLEY Ross P., The Development of the Fraud Rule in Letter of Credit Law: The Journey So Far and The Road Ahead, page 711.

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SANTRAUKA

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