A COMPARATIVE ANALYSIS OF THE STANDARD OF FRAUD REQUIRED UNDER THE FRAUD RULE IN LETTER OF CREDIT LAW

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National courts have required different standards of fraud to justify non-payment, or restraint of payment, under a letter of credit. The United Nations Commission on Trade Law (UNCITRAL) has adopted its own position. The issue is far from settled in any legal system. Based on an analysis of the law in the United States, United Kingdom, Canada and Australia, and under the Convention, this article proposes a standard that is a distinct improvement on the various standards applied around the world and suggests a means for its implementation.

The fraud rule allows the issuer of a letter of credit or a court to disrupt the payment of a letter of credit when fraud is involved. The *raison d'etre* of letters of credit is to provide an absolute assurance of payment to a seller, provided the seller presents documents that comply with the terms of the credit. The fraud rule thus goes to the very heart of the letter of credit obligation. The fraud rule is necessary to limit the activities of fraudsters, but its scope must be carefully circumscribed so as not to deny commercial utility to an instrument that exists to serve as an assurance of payment.[1]

This article explores the kind of fraud required to invoke the fraud rule or, in other words, what does fraud mean under the fraud rule in the law governing letters of credit? This is a challenging ques-

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1. The policy tension behind the fraud rule was well expressed by Justice Le Dain in the leading Canadian case, Bank of Nova Scotia v. Angelica–Whitewear Ltd., [1987] D.L.R. 161, 168 (Can. 1987), in these terms:

> The potential scope of the fraud exception must not be a means of creating serious uncertainty and lack of confidence in the operation of letter of credit transactions; at the same time the application of the principle of autonomy must not serve to encourage or facilitate fraud in such transactions.

tion because fraud is an "inherently pliable concept."[2] Some argue that the fraud rule must be applied in a strict fashion, or in cases where only egregious fraud is involved. These commentators emphasize that the letter of credit is a unique commercial device that must be protected from simple contract disputes, which are often difficult to distinguish from certain fraud claims.[3] Others favor a more flexible approach to the concept.[4]

This article investigates how this question has been answered in the United States, United Kingdom, Canada and Australia, and under the United Nations Convention on Independent Guarantees and Standby Letters of Credit (the UNCITRAL Convention).[5]

I. THE POSITION IN THE UNITED STATES

A large number of letter of credit fraud cases have been decided in the United States. In addition, Article 5 of the Uniform Commercial Code (U.C.C.) contains state-of-the-art provisions with respect to the fraud rule. Therefore, the U.S. position deserves much attention. To facilitate the discussion, the U.S. position will be examined in three categories: the pre–U.C.C. position, the Prior U.C.C. Article 5 position, and the Revised U.C.C. Article 5 position.[6]

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2. Gerald T. McLaughlin, *Letters Of Credit and Illegal Contracts: The Limits of the Independence Principle*, 49 OHIO ST. L.J. 1197, 1203 (1989).

3. For example, in a commercial letter of credit transaction, "it is not always easy to determine whether an alleged discrepancy between the description of the goods in the documents and their actual nature is indicative of a fraud. Unless there is a blatant fraud, the banker cannot assert the deficiency of the goods against the seller." ANTHONY G. GUEST, BENJAMIN'S SALE OF GOODS 1716 (5th ed. 1997).

4. *See, e.g.*, Greg A. Fellinger, *Letters of Credit: The Autonomy Principle and the Fraud Exception*, 1 J. BANKING & FIN. L. & PRAC. 4, 22 (1990).

5. The International Criminal Court's (ICC) Uniform Customs and Practice for Documentary Credits are silent on the issue of fraud. *See* THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (1993 Revision, ICC Publication No. 500).

6. Articles of the U.C.C. are revised by a drafting committee specifically appointed for the task by the two sponsoring organizations of the U.C.C.: the National Conference of Commissioners of Uniform State Laws and the American Law Institute. For a list of the jurisdictions that have adopted Article 5, see *Introductions & Adoptions of Uniform Acts: U.C.C. Article 5—Letters of Credit*, *available at* http://nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-ucca5.asp (last visited Mar. 2, 2003) and Article 5: Letters of Credit, *available at* http://www.law.cornell.edu/uniform/ucc.html#a5 (last visited Mar. 2, 2003).

A. Pre-U.C.C. Position

1. *Pre*-Sztejn *Cases*. The seminal case on the fraud rule in letter of credit law was *Sztejn v. J. Henry Schroder Banking Corp*.[7] While a U.S. decision, *Sztejn* has influenced and shaped the fraud rule in virtually all jurisdictions worldwide. Before *Sztejn* was decided, a number of letter of credit cases in the United States touched on the issue of fraud, but none considered the fraud rule in detail. Little discussion appeared in those cases about what kind of fraud might invoke the fraud rule. One of the few passages mentioning the issue was the dissenting judgment of Justice Cardozo in *Maurice O'Meara Co. v. National Park Bank*,[8] which read, in part:

> We are to bear in mind that this controversy . . . arises between the bank and a seller who has *misrepresented* the security upon which advances are demanded. . . . I cannot accept the statement of the majority opinion that the bank was not concerned with any question as to the character of the paper. If that is so, *the bales tendered might have been rags instead of paper*, and still the bank would have been helpless, though it had knowledge of the truth, if the documents tendered by the seller were sufficient on their face.[9]

This paragraph shows that, in the view of Justice Cardozo, fraud under the fraud rule in the law governing letters of credit means misrepresentation. Cardozo's statement later in the paragraph that "the bales tendered might have been rags instead of paper," was suggesting that, to invoke the fraud rule, a misrepresentation might have to go as far as complete non–performance of the contract, a kind of gross misrepresentation.[10]

Some eminent commentators of the time seemed to take a different and more flexible view, however. In their view, the issuer should be allowed to dishonor a draft drawn under a letter of credit where the goods did not conform to the description of the superficially regular documents even if the misrepresentation was made innocently. This view was founded on the idea that, under such circumstances, "the seller has failed as effectively as in the case of outright

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7. 31 N.Y.S.2d 631 (N.Y. Sup. Ct. 1941).

8. 146 N.E. 636 (N.Y. 1925) (Cardozo, J., dissenting).

9. *Id.* at 641 (emphasis added).

10. Fellinger has suggested that "Justice Cardozo's dissenting opinion . . . envisions a scenario where there is a total lack of consideration in the underlying sales contract . . . ." Fellinger, *supra* note 4, at 11. *See also* Gordon B. Graham & Benjamin Geva, *Standby Credits in Canada*, 9 CAN. BUS. L.J. 180, 197 (1984).

fraud to give the bank what the parties contemplated, that is, control over merchandise of a specific description."[11] Some commentators went further and suggested that "the issuing bank may defend the action brought by the seller on the ground of inferiority of quality . . . ."[12] These suggestions have been classified as the "breach of warranty or innocent misrepresentation standard" and have been rejected by modern commentators.[13]

2. *The Test of* Sztejn. In *Sztejn*, Justice Shientag applied the fraud rule where the dispute was not, in the Justice's words, "between the buyer and seller concerning *a mere breach of warranty* regarding the quality of the merchandise; [but where] the seller has *intentionally* failed to ship any goods ordered by the buyer . . . where the merchandise is not merely inferior in quality but consists of worthless rubbish."[14]

Despite the use of the word "intentionally," divergent views have emerged among courts and commentators on the standard of fraud adopted in *Sztejn*. Some say *Sztejn* set forth a standard of "intentional fraud."[15] Some have read it more narrowly: "*Sztejn* on its facts exhibits an 'egregious fraud' standard."[16] But others would argue that the apparently severe standard in *Sztejn* arose out of its special procedural context: a motion to dismiss. If the case had been heard in the context of an equitable injunction, *Sztejn* would have set forth "a more flexible equitable standard of fraud."[17] Still others are of the view that the "judgment [in *Sztejn*] does not tell what degree of knowledge of fraud is necessary to justify the issuing bank in refusing to pay . . . ."[18]

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11. Phillip W. Thayer, *Irrevocable Credits in International Commerce: Their Legal Effects*, 37 COLUM. L. REV. 1327, 1336–37 (1937).

12. Morton C. Campbell, *Guaranties and Suretyship Phases of Letters of Credit*, 85 U. PA. L. REV. 261, 275 (1937).

13. Edward L. Symons, Jr., *Letters of Credit: Fraud, Good Faith and the Basis for Injunctive Relief*, 54 TUL. L. REV. 338, 340 (1980).

14. *See Sztejn*, 31 N.Y.S.2d at 634–35 (emphasis added).

15. *See* Symons, *supra* note 13, at 361.

16. *See* Fellinger, *supra* note 4, at 12; Henry Harfield, *Enjoining Letter of Credit Transactions*, 95 BANKING L.J. 596, 603 (1978).

17. Herbert A. Getz, *Enjoining the International Standby Letter of Credit: The Iranian Letter of Credit Cases*, 21 HARV. INT'L L.J. 189, 206 (1980).

18. Maurice Megrah, *Risk Aspects of the Irrevocable Documentary Credit*, 24 ARIZ. L. REV. 255, 258 (1982).

It has been suggested that one year later, in another letter of credit fraud case, *Asbury Park & Ocean Grove Bank v. National City Bank of New York*,[19] Justice Shientag himself provided some hint of what he had meant in *Sztejn*.[20] In *Asbury Park*, Silverman Brothers entered into contracts to purchase clothing from the U.S. Army. Payment was to be made by way of letters of credit. At the buyer's request, the plaintiff itself issued letters of credit in favor of the sellers, but as the amount involved in the transaction was large, the seller required further letters of credit to be issued by other banks. The plaintiff accordingly applied to the defendant for it to issue letters of credit. Just prior to the expiration of the credits, the plaintiff requested that the defendant not honor any more drafts drawn under the credits, but the defendant made the payment in disregard of the plaintiff's request because it found that the documents were in compliance with the terms of the credits.

The plaintiff sued the defendant for damages it sustained, alleging that the seller and the buyer were using the letters of credit to defraud the plaintiff, and that the defendant knew it. The plaintiff claimed that: (1) when the seller shipped the goods to the buyer, it made out drafts on the defendant, but instead of presenting the drafts for payment, the seller held them as a sort of guaranty on its open account and did not present them until it appeared that the buyer would be unable to pay the account; (2) such use of the credits had not been contemplated by its agreement with the buyer; and (3) the defendant knew that its credits were being used as guaranty even before the plaintiff requested that the defendant honor no more drafts. Justice Shientag rejected the plaintiff's arguments and observed:

> The authorities . . . agree that the letters of credit are contracts which are independent of the contract of purchase between the seller and the purchaser *unless there was such a fraud on the part of the seller that there were no goods shipped* . . . .
>
> It therefore follows that a notice given by the correspondent bank [the plaintiff] to the issuing bank [the defendant] to the effect that the former was defrauded by either the buyer, the seller or both, is ineffective to void or suspend the operation of the letter of credit. Any other rule would destroy the effectiveness of this valuable commercial device. The *common–law fraud* action is one of the most difficult to prove, and the issuing bank cannot be expected to

19. 35 N.Y.S.2d 985 (N.Y. Sup. Ct. 1942).

20. JOHN F. DOLAN, THE LAW OF LETTERS OF CREDIT: COMMERCIAL AND STANDBY CREDITS §§ 7-45–7-46 (rev. ed. 1996); Symons, *supra* note 13, at 362.

> evaluate the soundness of the correspondent bank's claim. Thus, in the instant case it is not at all clear whether the plaintiff could prove a cause of action for fraud against the Army or Silverman Brothers or both. It would be improper to hold up the payment of drafts by the issuing bank pending the result of such litigation between the correspondent bank and the buyer or seller.[21]

If *Asbury Park* can lend assistance to the interpretation of *Sztejn*, it might have suggested that Justice Shientag would have applied the fraud rule only in such situations where no goods are shipped, common–law fraud is involved, or the seller has intentionally failed to ship any goods ordered by the buyer. It is therefore open to question whether Justice Shientag would apply the fraud rule if the beneficiary's misconduct were less serious.

B. Prior U.C.C. Article 5 Position

Although the prior fraud provision in U.C.C. Article 5, Section 114(2), codified *Sztejn*, it disappointed in that "[n]either the Code nor its comments [gave] any hint as to what type of fraud [gave] the bank an option to pay or not to pay under this section."[22] As a result, a number of standards of fraud were suggested in the cases applying the Prior U.C.C. Article 5.

1. *Egregious Fraud*. The term "egregious" is not commonly used by courts in connection with letter of credit fraud.[23] Rather, it represents a standard advocated by some commentators.[24] The elements of egregious fraud are not entirely clear, but the term has been used to denote very serious misconduct in the context of letter of

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21. *See Asbury Park and Ocean Grove Bank*, 35 N.Y.S.2d at 988–89 (internal citations omitted) (emphasis added). It should be noted that *Sztejn* was among the authorities mentioned by the Justice.

22. West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1114 (W.D. Pa. 1976). *But cf*. Symons, *supra* note 13, at 340: "A careful review of *Sztejn* and other pre–Code cases, the wording and cross references in section 5–114, and the pervasive standard of good faith in the U.C.C.—defined in section 1–201(19) as 'honesty in fact'—reveal that the middle ground standard, intentional fraud, is the proper interpretation of the pre–Code cases and the U.C.C."

23. Symons, *supra* note 13, at 346. Symons did a LEXIS search of "egregious fraud" on June 4, 1979 in both the General Federal and All States libraries. Two cases were found in the former library and three were found in the latter. *Id.* at n.25. This author did the same search on July 29, 1998 and altogether ten cases were found. On June 4, 2002, the author did another search using "letters of credit and egregious fraud" in the library of "Federal & State Cases Law;" only 13 items were found.

24. *E.g.*, Harfield, *supra* note 16; Jack B. Justice, *Letters of Credit: Expectations and Frustrations (Pt. 1)*, 94 BANKING L.J. 424 (1977); Jack B. Justice, *Letters of Credit: Expectations and Frustrations (Pt. 2)*, 94 BANKING L.J. 493 (1977).

credit transactions. One suggestion is that egregious fraud means "a flagrant violation of the beneficiary's obligation under the letter of credit."[25] Another is that egregious fraud is a kind of "outrageous conduct which shocks the conscience of the court."[26] Some commentators have used "gross fraud" interchangeably with "egregious fraud."[27] In sum, under the standard of egregious fraud "simple intent to deceive is not sufficient; it is the extreme or outrageous nature of the fraud" that matters.[28]

One oft–mentioned case for the standard of egregious fraud is *Intraworld Industries v. Girard Trust Bank*.[29] *Intraworld* involved a contract under which a luxury Swiss hotel was leased. The applicant, the lessee, obtained a standby letter of credit in favor of the beneficiary, the lessor, to guarantee rental payment in advance. Under the letter of credit, the issuer promised to pay a draft accompanied by the beneficiary's signed statement to the effect that the applicant had not paid an instalment of rent due under the lease.

When a dispute arose and the beneficiary presented a draft accompanied by a statement conforming to the terms of the letter of credit, the applicant attempted to enjoin the bank from paying the beneficiary, alleging that although the beneficiary's supporting documents on their face conformed to the credit, they were false and fraudulent on the following grounds: (1) no rent was due because the beneficiary had terminated the lease, which the beneficiary's statement failed to disclose; and (2) the beneficiary was not seeking rent at all but rather seeking the stipulated penalty.

After a hearing, the Supreme Court of Pennsylvania found that the facts were not as the applicant had claimed. Conversely, the court found that correspondence had been exchanged between the parties' lawyers when the dispute arose and that one of the letters from the applicant's counsel to the beneficiary's counsel stated that "[i]f the transfer of the rent . . . should not be made in timely fashion, your client . . . is at liberty to obtain payment by way of [the letter of

25. Harfield, *supra* note 16, at 602. But in the same article Harfield also used the phrase of "actual and intentional fraud" to define the "egregious" fraud he was discussing. *Id.* at 604.

26. Symons, *supra* note 13, at 348.

27. *Id.*

28. Kerry L. Macintosh, *Letters of Credit: Dishonour When a Required Document Fails to Conform to the Section 7–507(b) Warranty*, 6 J.L. & COM. 1, 6 (1986).

29. 336 A.2d 316 (Pa. 1975).

credit]."[30] The court also found that the underlying contract provided that if the applicant should fail to pay the rent, the beneficiary could not only draw under the letter of credit, but also terminate the lease immediately without further notice. Accordingly, the court rejected the applicant's claim for an injunction against payment of the letter of credit, reasoning that:

> In light of the basic rule of the independence of the issuer's engagement and the importance of this rule to the effectuation of the purposes of the letter of credit, we think that the circumstances which will justify an injunction against honor must be narrowly limited to situations of fraud in which *the wrongdoing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served*. A court of equity has limited duty of "guaranteeing that [the beneficiary] not be allowed to take unconscientious advantage of the situation and run off with plaintiff's money on a *pro forma* declaration which *has absolutely no basis in fact."*[31]

One case actually having mentioned the term "egregious fraud" is *New York Life Insurance Co. v. Hartford National Bank & Trust Co*.[32] Here, the plaintiff and a real estate developer entered into a mortgage loan agreement under which the developer committed to borrow from the plaintiff a large sum of money. The defendant issued a standby letter of credit in favor of the plaintiff to satisfy one of the terms of the agreement—that the developer would have to pay the plaintiff a sum as liquidated damages if it failed to take up the loan. The sole condition for payment of the letter of credit was that the drafts were to be accompanied by a signed statement of the plaintiff that the liquidated damages were due. When the developer failed to take up the loan, the plaintiff presented to the defendant the draft accompanied by the required document, but it was dishonored.

The plaintiff sued for wrongful dishonor. The defendant asserted several defenses, but none of them alleged that the plaintiff had practiced fraud. The Supreme Court of Connecticut made its decision for the plaintiff on the basis that no fraud was involved in the case, stating:

> Only in rare situations of *egregious fraud* would . . . [Prior U.C.C. Article 5, Section–114] have justified the issuer, on the facts presented here, in going behind apparently regular, conforming docu-

30. *Id.* at 321.

31. *Id.* at 324–25 (citing Dynamics Corp. of Am. v. Citizens & S. Nat'l Bank, 356 F. Supp. 991, 999 (N.D. Ga. 1973)) (emphasis added).

32. 378 A.2d 562 (Conn. 1977).

> ments; such fraud "must be narrowly limited to situations [of fraud] in which the wrongdoing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served" . . . . There is no such evidence in the record of this case, and the [lower] court correctly found that the documentation presented by New York Life complied fully with the terms of the letter of credit.[33]

The court of *New York Life Insurance* followed the reasoning of *Intraworld*. Taking both cases together, under the standard of "egregious fraud," the fraud rule might be applied only in situations where "the wrongdoing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served," or where the letter of credit was called upon with "absolutely no basis in fact."

In practice, the fraud rule has rarely been activated when the standard of egregious fraud has been applied. Ironically, the standard of egregious fraud has normally been cited in cases where no fraud would have been found to have been involved whatever standard of fraud is applied. For example, in *Intraworld*, the court properly denied the request for an injunction because the letter of credit was used for precisely the purpose for which it was generated—to guarantee payment of the advance rent as liquidated damages.[34] In *New York Life Insurance*, as fraud was not even mentioned as a defense, the statements of the court relating to the standard of fraud were mere dicta. Therefore, it can be seen that the standard of egregious fraud has, in fact, become the term used by those courts and commentators who regard a letter of credit "as something akin to a claim check redeemable at a bank's cash vault."[35] These courts and commentators have to recognize the rationale for the existence of the fraud rule but are very reluctant to allow interference with the payment of a letter of credit due to the application of the fraud rule.

2. *Intentional Fraud*. The idea that intentional fraud can invoke the fraud rule was articulated in the case of *NMC Enterprises v. Columbia Broadcasting System, Inc.*,[36] where the underlying contract was for the purchase of stereo receivers. A commercial letter of credit was issued in favor of the defendant to finance the purchase.

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33. *Id.* at 567 (citing *Intraworld*, 336 A.2d at 324–25) (emphasis added).

34. *See Intraworld*, 336 A.2d at 316.

35. Justice, *Pt. 1*, *supra* note 24, at 424.

36. 14 U.C.C. REP. SERV. 1427 (N.Y. Sup. Ct. 1974).

The plaintiff, the buyer, sought a preliminary injunction restraining the defendant from presenting for payment or negotiating any drafts under the letter of credit.

The affidavit of the plaintiff's president averred that the technical performance specifications for the receivers were substantially below those specified in brochures that formed the basis of the bargain. These allegations were confirmed by a testing laboratory. One critical element of the case was an allegation that one of the beneficiary's officers had admitted the seller was aware of such non–conformity prior to the execution of the contract.

The New York Supreme Court, while acknowledging that questions as to quality or condition of the goods could not form the basis of the request for an injunction, nevertheless granted the requested injunction and stated:

> Where no innocent third parties are involved and where the documents or the underlying transaction are tainted with *intentional fraud*, the draft need not be honored by the bank, even though the documents conform on their face and the court may grant injunctive relief restraining such honor.[37]

Another oft–mentioned case applying the standard of intentional fraud is *American Bell International v. Islamic Republic of Iran*,[38] where American Bell International (Bell) contracted with the Ministry of War of the Imperial Government of Iran (the Imperial Government) to provide the latter with consulting services and telecommunications equipment. A down payment was involved, and, according to the contract, Bell's liability to return this down payment would be reduced in proportion to the work completed. In order to protect the down payment, the Imperial Government required Bell to establish a bank guarantee issued by Bank Iranshahr. The bank guarantee was counter–guaranteed by a standby letter of credit from Manufacturers Hanover Trust Company. According to this letter of credit, payment to Bank Iranshahr would be triggered by a statement

37. *Id.* at 1429 (emphasis added) (internal citations omitted). Taken away from the facts of the case, this paragraph is sound and well reasoned. Against the factual background of the case, however, the result of the case is disappointing as "the dispute between the customer and the beneficiary appears to have been a classic case involving breach of warranty, and it is clear that an injunction should not be granted in such a case." Justice, *Pt. 2*, *supra* note 24, at 502–03.

38. 474 F. Supp. 420 (S.D.N.Y. 1979). For special treatment of the case, see Patrick C. Reed, *A Reconsideration of American Bell Int'l Inc. v. Islamic Republic of Iran*, 19 COLUM. J. TRANSNAT'L L. 301 (1981).

from Bank Iranshahr to the effect that it had received a call for payment under the guarantee from the Imperial Government.

Subsequently, the Imperial Government in Iran was replaced by the Islamic Republic, and Bank Iranshahr made demands under the standby letter of credit for payment of the remaining balance of the down payment. Bell filed an action in the Supreme Court of New York, New York County for a preliminary injunction against honoring the demand, claiming, *inter alia*, that the demand was fraudulent because the old and new Iranian governments had repudiated the underlying contract. The new Islamic Republic nevertheless caused Bank Iranshahr to demand payment under the letter of credit, thus asserting rights in a transaction it had otherwise repudiated. Rejecting Bell's argument, Judge MacMahon said:

> Even if we accept the proposition that the evidence does show repudiation, plaintiff is still far from demonstrating the kind of *evil intent* necessary to support a claim of fraud. Surely, plaintiff cannot contend that every party who breaches or repudiates his contract is for that reason culpable of fraud. . . . [T]he evidence is ambivalent as to whether the purported repudiation results from nonfraudulent economic calculation or from *fraudulent intent to mulct* Bell. . . . On the evidence before us, fraud is no more inferable than an economically rational decision by the government to recoup its down payment. . . .[39]

It seems that the standard of intentional fraud requires a misrepresentation made knowingly or recklessly with the intention of inducing another to rely thereon. It is thus similar to common law fraud, requiring: (1) a false presentation of the fact; (2) knowledge or belief on the part of the defrauder; and (3) an intention to induce the other party to act or to refrain from action in reliance upon the misrepresentation.[40] If cases of common law fraud are treated as equivalent to cases of intentional fraud, the number of cases supporting the standard of intentional fraud is significant.[41]

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39. *American Bell Int'l*, 474 F. Supp. at 425 (emphasis added).

40. Derry v. Peek, 14 App. Cas. 337, 347 (H.L. 1889) (Lord Herschell).

41. It has been said that "[i]ntentional fraud could be shown by establishing the common law elements of fraud." Aetna Life & Casualty Co. v. Huntington Nat'l Bank, 934 F.2d 695, 698 (6th Cir. 1991). On June 4, 2002, the day when the search for "egregious fraud" was done, this author also did searches in the same library for the other standards of fraud discussed here using the following phrases: "letters of credit and intentional fraud," "letters of credit and common law fraud," "letters of credit and letter of credit fraud," "letters of credit and flexible fraud," and "letters of credit and constructive fraud," and found 61, 284, 42, 8, and 93 items, respectively. Although these figures could not necessarily reflect what standards of fraud courts actually had applied in the cases and might reflect only the frequency courts had used the terms in

The critical requirement for the application of the standard of intentional/common law fraud (treating the two as one) is to prove the fraudster's intention or state of mind to defraud, which is notoriously difficult.[42] This is especially so in a standby letter of credit scenario where few documents are required to effect a call on a letter of credit. If the fraudster's intention can be proven, however, the standard of intentional fraud does not seem to be as high as that of egregious fraud. So, in *NMC Enterprises* the fraud rule was applied because the court was satisfied the buyer had proven that the seller knew of the inferior quality of the goods yet had induced the purchaser into the contract and drawn on the letter of credit.[43]

Given that the purpose of the fraud rule is to stop *dishonest* beneficiaries from abusing the letter of credit system, the standard of intentional fraud seems to be an appropriate one, even though the term is a general one and does not specifically reflect the characteristics of letters of credit.

3. *Letter of Credit Fraud*. The concept of "letter of credit fraud" was fashioned in *Emery–Waterhouse Co. v. Rhode Island Hospital Trust National Bank*,[44] where a back–to–back letter of credit was involved. In *Emery–Waterhouse*, Hospital Trust National Bank (HTNB) financed the business of a stove importer, Franklin. As security for the financing, Franklin gave HTNB rights to its accounts receivable, which were backed by letters of credit issued by banks of Franklin's customers. Emery, a Franklin customer, arranged with its own bank, First National Bank of Boston (FNBB), to provide Franklin with a standby letter of credit guaranteeing Emery's purchases. The credit stated that to draw upon it Franklin must present FNBB with a signed statement that "the amount of your draft represents funds due as a result of the failure of the Emery–Waterhouse company to pay invoices within its terms, that demand for payment has

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their discussions, they could serve as an indication showing what kind of terms and standards courts are more likely to use in the United States.

42. Ross P. Buckley, *The 1993 Revision of the Uniform Customs and Practice for Documentary Credits*, 6 J. BANKING & FIN. L. & PRAC. 77, 97 n.278 (1995).

43. If the intention of the beneficiary to defraud had not been proven, *NMC Enterprises* might have been well treated as "a breach of warranty matter." *See* Report of the Task Force on the Study of U.C.C. Article 5, *An Examination of UCC Article 5 (Letters of Credit)*, 45 BUS. LAW. 1521, 1614 (1990).

44. 757 F.2d 399 (1st Cir. 1985).

been made, and that payment has not been received by you from the Emery–Waterhouse Company or any other source."[45]

When Franklin became insolvent, HTNB took it over and asked an individual, Donnelly, to call upon letters of credit that named Franklin as a beneficiary. Donnelly presented three drafts to FNBB with documents apparently complying with the terms of the credit. FNBB honored two of them immediately, then held up the third and notified Emery. Emery told both HTNB and Franklin that it did not owe the money. Franklin's Chief Executive Officer told HTNB that Emery did not owe the money. HTNB's own investigation found the same result. Donnelly told HTNB that it was wrong to draw the drafts on Emery in such circumstances. HTNB nonetheless continued to press for payment and refused to return any of the money obtained.

Emery brought an action to recover the money paid, claiming that it owed nothing to Franklin and that HTNB's call was fraudulent. The trial court agreed and awarded the plaintiff punitive damages. HTNB appealed. Affirming the judgment of the trial court, the United States Court of Appeals for the First Circuit observed:

> Hospital Trust Bank argues that, even if the record contains facts showing a "fraudulent" document or "fraud in the transaction," we must pretend that it does not because the jury refused to find Hospital Trust Bank liable on Emery's separate charge of common law fraud. The elements of "common law fraud" as charged by Emery, however, are significantly different from *the elements of fraud in the statutory letter–of–credit exception.* Even if we assumed that both required some showing of a "false" statement, common law fraud as charged by Emery also requires a showing that Emery "justifiably relied" upon the false statement.[46]

This is one of the most important cases with respect to the development of the notion of fraud under the fraud rule. It is clear that the beneficiary called on the letter of credit with "absolutely no basis in fact," but the court did not use "egregious fraud" or similar terms that arguably reflect an overly rigid attitude towards the fraud rule. Nor did the court use the term "intentional fraud," although the beneficiary knowingly called on the letter of credit without a legitimate basis. It chose instead to use the phrase "statutory letter of credit exception," an expression proper and responsive to the special characteris-

45. *Id.* at 402.

46. *Id.* at 405 (emphasis added).

tics of letters of credit. This can be branded as a new page in the development of the standard of fraud in the fraud rule.

4. *Flexible Standard*. The term "flexible standard" was used in *United Bank Ltd. v. Cambridge Sporting Goods Corp*.,[47] where Cambridge contracted to buy boxing gloves from Duke. Duke arranged with United Bank and another Pakistani bank to finance the sale. Cambridge was asked by the financing banks to cover the payment of the purchase price by opening an irrevocable letter of credit with its bank, Manufacturers Hanover Trust Company. Manufacturers Hanover issued the letter of credit. When the shipments arrived, inspection revealed Duke had shipped "old, unpadded, ripped and mildewed gloves rather than the new gloves" Cambridge required.[48] Cambridge commenced an action against Duke, joining Manufacturers as a party, obtained a preliminary injunction prohibiting the issuer from paying the drafts, and, subsequently, levied on the funds subject to the credit.

The Pakistani financing banks instituted proceedings to vacate the levy and to obtain payment of the drafts, claiming they were holders in due course of the drafts and hence were entitled to the proceeds thereof irrespective of any defenses against the beneficiary. In refusing the petitioners' request, the New York Court of Appeals observed:

> It should be noted that the drafters of section 5–114, in their attempt to codify the *Sztejn* case and in utilizing the term "fraud in the transaction," have eschewed a dogmatic approach and adopted *a flexible standard* to be applied as the circumstances of a particular situation mandate. It can be *difficult to draw a precise line between cases involving breach of warranty* (or a difference of opinion as to the quality of goods) *and outright fraudulent practice* on the part of the seller. To the extent, however, that Cambridge established that Duke was guilty of fraud in shipping, not merely nonconforming merchandise, but worthless fragments of boxing gloves, this case is similar to *Sztejn.*[49]

Factually, as mentioned by the court, this case resembles *Sztejn*. It might be argued that the court in *Cambridge Sporting Goods* itself takes a "dogmatic approach" towards the issue of fraud in advocating a "flexible standard" of fraud under the fraud rule. Nevertheless, it

47. *See* 392 N.Y.S.2d 265, 271 (N.Y. 1976).

48. *Id.* at 268.

49. *Id*. at 271 (emphasis added).

does set out the range of the flexibility: the degree of fraud is somewhere between "breach of warranty . . . and outright fraudulent practice."[50] At the extremes, if only a warranty is breached, the fraud rule will not be brought to play; on the other hand, if "outright fraudulent practice" is established, the fraud rule will certainly apply. Under these guidelines, the relevant standard of fraud requires of the beneficiary's misconduct something more serious than mere breach of warranty.

This decision is laudable and the standard of fraud adopted is a good one if it can be implemented because it exactly matches the purpose of the fraud rule: the stopping of fraud in letter of credit transactions without becoming enmeshed in simple contract disputes. Because the standard is labeled "flexible," however, it may be susceptible to misinterpretation and might be misapplied in practice in unanticipated "flexible" ways.[51]

5. *Constructive Fraud*. The standard of constructive fraud was suggested in *Dynamics Corp. of America v. Citizens & Southern Nat'l Bank*,[52] where Dynamics, the plaintiff, and the Indian government entered into a contract whereby the former agreed to sell to the latter defense–related equipment. The plaintiff agreed further to have the defendant bank issue standby letters of credit by which the issuer promised to pay drafts drawn by the Indian government, and accompanied by the Indian government's certification in quite general terms that Dynamics had failed to carry out certain of its obligations under the underlying contract.

While part of the contract remained unperformed, war broke out between India and Pakistan. The U.S. government announced an embargo on military supplies to the region, thereby making further delivery of the equipment impossible. The Indian government thereafter refused to pay for some of the supplies previously delivered and

50. *See* Note, *Letters of Credit: Injunction As a Remedy for Fraud in UCC Section 5–114*, 63 MINN. L. REV. 487, 500 (1979) (internal citations omitted).

51. The Task Force noted that "[m]ost of the cases favoring a flexible standard have nonetheless been supported by a showing of serious misconduct equivalent to the shipment of rubbish." Task Force Report, *supra* note 43, at 1614. This result might be affected by the fact that Prior U.C.C. Article 5 was silent with respect to the standard of fraud, however. Whenever the "flexible standard" was quoted, it was read together with the facts of *Cambridge Sporting Goods*. If the term "flexible standard" was used in a statute and courts had applied it without reading the facts of *Cambridge Sporting Goods*, the situation might have been different.

52. 356 F. Supp. 991 (N.D. Ga. 1973).

presented a draft accompanied by a certificate purporting to comply with the terms of the letter of credit. The plaintiff filed a complaint seeking an injunction to prevent the issuer from honoring the draft, alleging that the certificate provided by the Indian government was fraudulent in that the plaintiff had actually performed its obligations under the contract. The United States District Court for the Northern District of Georgia granted the injunction and stated:

> The law of "fraud" is not static and the courts have, over the years, adapted it to the changing nature of commercial transactions in our society. . . . [I]n a suit for equitable relief—such as this one—it is not necessary that plaintiff establish all the elements of actionable fraud required in a suit for monetary damages. . . . "*[F]raud has a broader meaning in equity* and *intention to defraud or to misrepresent is not a necessary element. Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another, or by which an undue and unconscious advantage is taken of another.*"[53]

In accordance with this judgment, any conduct of the beneficiary that breaks even an equitable duty may lead to the application of the fraud rule. Such a standard of fraud is unquestionably too low, for it neglects the nature of a letter of credit transaction, normally a commercial transaction between sophisticated parties who can and should look after their own interests.

If the standard for the application of the fraud rule is set too low, as in the instant case, it may lead to the abuse of the rule by the applicant. Temptation to abuse always exists: "[f]raud is, in practice, virtually the only defence available when one seeks to escape payment. . . ."[54] In the commercial world, there are almost limitless ways in

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53. *Id.* at 998–99 (citing SEC v. Capital Gains Research Bureau Inc., 375 U.S. 180, 193–95 (1963)) (emphasis added). Because of this statement, *Dynamics* became the oft–quoted case for the standard of "constructive fraud," *see, e.g.*, Fellinger, *supra* note 13, at 13; Ho Peng Kee, *The Fraud Rule in Letters of Credit Transactions*, *in* CURRENT PROBLEMS OF INTERNATIONAL TRADE FINANCING 235, 246 (Christine Chinkin ed., 1983), or "ordinary breach of contract," *see, e.g.*, United Trading Co. v. Allied Arab Bank, 1985(2) Lloyd's Rep. 554, 561 (Ackner L.J.) (C.A.). It should be noted, however, that because the court of *Dynamics* also made the statement that "the court views its task in this case as merely guaranteeing that India [the beneficiary] not be allowed to take unconscientious advantage of the situation and run off with plaintiff's money on a *pro forma* declaration which *has absolutely no basis in fact*," a statement cited in many cases for the standard of "egregious fraud," this case has occasionally been classified as a case of "egregious fraud." *See* Symons, *supra* note 13, at 338–81 (quoting *Dynamics*, 356 F. Supp. at 999).

54. R. BERTRAMS, BANK GUARANTEES IN INTERNATIONAL TRADE 257 (2d ed. 1996). Illegality can be another one, but cases are scarce in this respect. *See, e.g.*, United City Mer-

which an applicant's bargain with a beneficiary may go sour. When this happens, the applicant will be tempted to use every means to escape from its original bargain. Exploitation of the fraud rule may be one of its choices. Not only is the risk of such abuse inherent, but the signs of abuse have already appeared. As put by Bertrams:

> Through the years, a huge volume of case law concerning the issue of fraud has grown up . . . . It is only natural for the account party, when the risk of a call has materialized, to claim that the demand for payment in his case is indeed fraudulent. He may, therefore, initiate proceedings in order to attempt to prevent payment and, of course, it hardly matters whether he believes honestly or . . . with little conviction, that the demand is totally unjustified.[55]

If the standard of fraud is set too low so that the fraud rule is abused and payment of letters of credit repeatedly disrupted, the inherent commercial functions of the letter of credit instrument—such as prompt payment, allocation of risks and shifting of the forum—will disappear. In turn, this will ultimately vitiate the reliability and commercial utility of letters of credit. Accordingly, the standard of constructive fraud should be avoided.

6. *Summary*. As has been seen, Prior U.C.C. Article 5 cases did not provide a consistent answer to the question of notion or standard of fraud. As Prior U.C.C. Article 5 was silent over what kind of fraud could invoke the fraud rule, almost every Prior U.C.C. Article 5 case involving letter of credit fraud cited *Sztejn* as authority and, not surprisingly, the standards of fraud adopted by the courts in those cases were as divergent as the views already considered regarding the position expressed in *Sztejn*. Some courts stuck to a strict and restrictive approach and adopted an egregious standard of fraud, while others were ready to take a much different approach, adopting a con-

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chants v. Royal Bank of Canada, 1979(1) Lloyd's Rep. 267 (Q.B.). For discussion about the illegality defense, see McLaughlin, *supra* note 2. In Australia, another defense, unconscionable conduct within the meaning of section 51AA of the *Trade Practices Act* 1974, has unfortunately become available since the case of Olex Focas Pty. Ltd. v. Skodaexport Co. (V.S. Ct. 1996) 134 F.L.R. 331. For a discussion about *Olex*, see *infra* notes 123–128 and accompanying text.

55. BERTRAMS, *supra* note 54, at 257. According to Professor Kozolchyk, during the last 20 years, with the increasing abuse by beneficiaries of their power to demand payment of letters of credit whose

> literal tenor could be read to support such demands, courts and commentators had to reassess the meaning of strictness in the letter of credit law. The judicial dilemma was frequently perceived to be as serious as choosing between formalism and assumed certainty of the law on the one hand and equity and uncertainty on the other.

Boris Kozolchyk, *Preface*, 24 ARIZ. L. REV. 235 (1982).

structive standard of fraud. Still others fell somewhere between the two extremes. This author has tried to place the mentioned standards of fraud "on a continuum where the suggested standard ranges from, at the one extreme, where fraud must be egregious, to the other extreme, a broader constructive fraud approach, where an intention to defraud is not a necessary element."[56] This is not an easy task, however. It may be easy to tell the difference of the level of fraud between the two extreme standards—the standard of egregious fraud and the standard of constructive fraud—and people may also say that the flexible standard of fraud is higher than the standard of constructive fraud because the breach of warranty is excluded under the former, but it is not easy to tell the difference between the standard of intentional fraud and that of letter of credit fraud. If there is any difference, it may be that the former looks more to the state of mind of the fraudster, while the latter emphasizes the severity of the effect of fraud on the transaction.

C. Iranian Cases

The Iranian Revolution of 1979 gave rise to considerable litigation in the United States regarding standby letters of credit. These cases are known as "the Iranian cases." The Iranian cases raise novel legal questions and prompt heated discussion upon a range of issues, particularly the standard of fraud of the fraud rule, not only at that time but also thereafter.[57]

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56. Kee, *supra* note 53, at 242. Kee mentioned four kinds of standards without including the standard of "letter of credit fraud."

57. For a list of U.S. cases, see Getz, *supra* note 17, at 248–52. Besides litigation, other channels were created for U.S. companies to block payments under standby letters of credit. On November 14, 1979, the President of the United States issued an executive order to block the transfer of "the property and interests in property of the Government of Iran, its instrumentalities and controlled entities and the Central Bank of Iran." Exec. Order No. 12,170, 44 Fed. Reg. 65,729 (Nov. 14, 1979) (quoted in Touche Ross & Co. v. Manufacturers Hanover Trust Co., 434 N.Y.S.2d 575, 576 (N.Y. Sup. Ct. 1980)). To implement the Order, the U.S. Treasury promulgated the Iranian Assets Control Regulations, which at first allowed American issuing banks to discharge their liabilities under their standby letters of credit by paying into blocked accounts of the Iranian beneficiaries, but later directly blocked payment of the standby letters of credit themselves. *See* Mark P. Zimmett, *Standby Letters of Credit in the Iran Litigation: Two Hundred Problems in Search of a Solution*, 16 L. & POL'Y INT'L BUS. 927, 941 (1984). On January 19, 1981, as part of the agreement to release the American hostages, the United States and Iran agreed to establish the Iran–U.S. Claims Tribunal at the Hague, for claims and counterclaims of nationals of the United States against Iran and claims of Iranian nationals against the United States. For a detailed treatment of the Tribunal, see Symposium, *On The Iran–United States Claims Tribunal*, 16 L. & POL'Y INT'L BUS. 667 (1984). For some articles about the Iranian cases, see Joseph D. Becker, *Standby Letters of Credit and Iranian Cases: Will the Inde-*

The Iranian cases can be divided into two groups: pre–hostage cases and post–hostage cases. The pre–hostage cases were decided before hostages were taken at the U.S. Embassy in Teheran in November 1979, while the post–hostages cases were decided after that event occurred. The post–hostage cases are extreme examples of how the fraud rule, if the standard or concept of fraud is not clearly defined, can be misused by the parties and misapplied by the courts.

The facts of the Iranian cases were similar to one another. Prior to the Iranian Revolution, the Imperial Government of Iran spent billions of dollars modernizing the country. Many U.S. companies poured into Iran on this gold rush[58] and were awarded lucrative contracts by the Imperial Government. At the same time, they were required to procure independent guarantees, counter–guaranteed by standby letters of credit, to secure the good performance of those contracts or the return of advance payments. All transactions involved four parties—a U.S. company, an Iranian government agency, an Iranian bank, and a U.S. bank. The U.S. company contracted with the Iranian government agency to provide goods or services in Iran. The contract required the U.S. company to provide for the Iranian agency independent guarantees as above. The independent guarantees were issued by the Iranian bank and counter–guaranteed by standby letters of credit issued by the U.S. bank in favor of the Iranian bank at the request of the U.S. company. In the event of a dispute the Iranian government agency would demand payment under the guarantee from the Iranian bank, the Iranian bank would demand payment under the standby letter of credit from the U.S. bank, and the U.S. bank would in turn look to the U.S. company for reimbursement.

In the wake of the Iranian Revolution, U.S. companies, fearing that the new Iranian regime would arbitrarily demand payment under the letters of credit, flocked to U.S. courts, in most of the cases on the grounds of fraud, to prevent the letters of credit from being paid and their accounts from being charged. They had "only marginal success

pendence of the Credit Survive?, 13 UCC L.J. 335 (1981); Comment, *Fraud in the Transaction: Enjoining Letters of Credit during the Iranian Revolution*, 93 HARV. L. REV. 992 (1980); Richard J. Driscoll, *The Role Of Standby Letter Of Credit In International Commerce: Reflections After Iran*, 20 VA. J. INT'L L. 459 (1980); Getz, *supra* note 17; George Kimball & Barry A. Sanders, *Preventing Wrongful Payment of Guaranty Letters of Credit—Lessons from Iran*, 39 BUS. LAW. 417 (1984); Reed, *supra* note 38; George Weisz & Jonathan I. Blackman, *Standby Letters of Credit after Iran: Remedies of the Applicant*, 1982 U. ILL. L. REV. 355.

58. Driscoll, *supra* note 57, at 475.

in the courts"[59] in the pre–hostage cases. There were only two reported pre–hostage cases in which U.S. companies were granted preliminary injunctions, and they were soon vacated.[60] In other pre–hostage cases, injunction motions were either denied, or only "notice injunctions" were granted.[61] For example, in *American Bell International v. Islamic Republic of Iran*,[62] a paradigm pre–hostage case which "typifies the Iranian cases with regard to the facts, relief sought, arguments raised, and results,"[63] the court rejected the applicant's claim of fraud because it failed to meet the test of intentional fraud by showing the beneficiary had "evil intent" or "fraudulent intent to mulct" the applicant.[64] In the post–hostage cases, in striking contrast with pre–hostage cases, U.S. courts changed their attitudes dramatically. They issued preliminary, and in some cases permanent, injunctions when U.S. companies came back to them after the hostage crisis. Payment of letters of credit in many cases was enjoined without an opinion. According to one commentator, out of 14 injunction motions made in federal district courts, 12 were granted, and only two were denied.[65] Of those twelve enjoined cases, only three were issued with written opinions, eight were decided without an opinion, and the remaining case was decided without a formal written judgment. No–opinion judgments were not limited to federal courts; a similar approach was taken by some of the state courts.[66]

In those cases where an opinion was given, the reasons provided were hardly convincing to letter of credit specialists. For example, in *Touche Ross & Co. v. Manufacturers Hanover Trust Co.*,[67] Touche had entered into a contract with the Ministry of War of the Imperial Government to audit, examine, and review the financial aspects of military contracts that various American contractors were performing for the Government. To assure performance, Touche was required to

59. Zimmett, *supra* note 57, at 930.

60. *Id.* at 937.

61. *Id.* Notice injunctions were widely used in the Iranian cases. They were injunctions under which plaintiffs were not seeking injunction of the payment, but only that they be given notice prior to payment by the issuer so that they could investigate the facts and determine whether the demand for payment was fraudulent. *Id.* at 938.

62. *Bell Int'l*, 474 F. Supp. at 420.

63. Driscoll, *supra* note 57, at 475.

64. For another pre–hostage case with a similar view, see KMW Int'l v. Chase Manhattan Bank, N.A., 606 F.2d 10 (2d Cir. 1979).

65. Zimmet, *supra* note 57, at notes 78–82 and accompanying text.

66. *Id.*

67. 434 N.Y.S.2d 575 (N.Y. Sup. Ct. 1980).

provide by Bank Saderat 10 percent of the contract price as a performance guarantee, which was counter–guaranteed by a standby letter of credit issued by Manufacturers. The letter of credit was payable upon presentation of a sight draft together with documents consisting of either Bank Saderat's statement signed by one of its officers or its tested telex that Bank Saderat had made payment to the Ministry of War pursuant to the guarantee.

There was a force majeure clause in the contract, under which the contract could be voided if events of force majeure occurred. The contract also provided that the bank guarantee would be released in the event the contract was voided due to force majeure. After the hostages were taken in Teheran, Touche invoked the force majeure clause and cancelled the contract unilaterally. Nevertheless, Touche was advised that Bank Saderat had made a demand on Manufacturers for payment of the letter of credit.[68]

Touche moved for a preliminary injunction *pendente lite* enjoining Manufacturers from making any payment under the letter of credit, but it is not clear from the report when Touche made the move, whether before or after the demand for payment was made, and on what basis, whether fraud or something else.[69] The Supreme Court of New York granted the plaintiff's motion, and said:

> As a result [of the cancellation of the contract], the guaranty has been released, and no legitimate call could be made on the guaranty or the letter of credit . . . .
>
> As all financial institutions in Iran, including Bank Saderat, have been nationalized, Bank Saderat is owned by the Islamic Republic of Iran. Bank Saderat could not have legitimately paid on the guaranty, as Bank Saderat would be simply paying itself. Therefore, any call on the letter of credit would be fraudulent.[70]

The court in *Touche* cited two grounds for its application of the fraud rule. The first was the effect of the invocation of the force majeure clause by the applicant. The soundness of this ground is questionable on two fronts:

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68. It is not clear why the issue of force majeure was not raised in the pre–hostage cases. It is inconceivable, however, that there were no such clauses in them because the amount of money involved was huge and the parties involved were sophisticated multinational corporations.

69. The report is relatively brief and many aspects of the case are not clear.

70. *Touche Ross*, 434 N.Y.S.2d at 577–78 (Schwartz, J.). Reading the word "guaranty" in the report, it can be concluded that it is merely another word used for the term "independent guarantee" under discussion.

(1) It seems that the parties were in dispute over whether events such as the Iranian Revolution were within the force majeure clause, for one party invoked the clause and claimed that the independent guarantee had been released while the other party called on the independent guarantee in ignorance of it. This raises the question of whether the case ought not to have been decided on the basis of simple breach of contract rather than fraud.
(2) Even if the independent guarantee were released under the force majeure clause in the contract, it is doubtful whether that release would automatically release the issuer's obligation under the letter of credit, because there was no provision for that in the letter of credit and the two were independent under the law of letters of credit.[71]

What has struck commentators most is the second ground for the judgment: that nationalization of the Iranian institutions meant that "any call" by the Iranian bank on the letter of credit would be fraudulent because any payment made by the bank under the independent guarantee would not be legitimate. According to the logic of this statement, the fraud rule may be applied by looking into the identity of the beneficiary, not at what the beneficiary has done. This seems to take the fraud rule a very long way indeed from its purpose.[72]

While the Iranian cases were extreme cases arising from extreme circumstances, the sudden change of attitude by the U.S. courts shocked the letter of credit world and prompted commentators to ask whether the post–hostage decisions were really "influenced by the widespread sentiment that Iran should be punished."[73] Whatever the

71. *Cf.* Arthur Loke, *Standby Letters of Credit and Performance Bonds: The Lesson of the Iranian Experience*, *in* CURRENT PROBLEMS OF INTERNATIONAL TRADE FINANCING 283, 289 (Christine Chinkin ed., 1983) [hereinafter CURRENT PROBLEMS]. For circumstances where payment of a counter-guarantee may be stopped, see Article 19(2)(e) of the UNCITRAL Convention, *available at* http:www.uncitral.org/English/texts/payments/guarantees.htm (last visited Mar. 2, 2003).

72. Bertrams noted that, in the post–hostage Iranian cases, not only the standard of fraud was lowered, but all the other requirements for equitable relief such as the likelihood of success were not as stringent as they should have been. *See* BERTRAMS, *supra* note 54, at 270–71, notes 58–61 and accompanying text.

73. Zimmett, *supra* note 57, at 946. *See also* Wofgang Freiherr von Marschall, *Recent Developments in the Field of Standby Letters of Credit, Bank Guarantees and Performance Bonds*, *in* CURRENT PROBLEMS, *supra* note 71, at 260, 282 ("[T]he Iranian experience seems to be a good illustration of the saying that hard cases make bad law. Cases deciding problems arising

answer, the Iranian cases made abundantly plain that the fraud rule needed urgent improvement by the provision of a proper definition or standard of fraud.

D. Revised U.C.C. Article 5 Position

1. *Observations and Recommendations of the Task Force.* Before the revision of U.C.C. Article 5 was commenced, a task force was formed to study the previous case law and make recommendations for the revision. With respect to the standard of fraud implemented in the U.S. courts when applying the fraud rule, the Task Force made the following observations:

(1) The reported cases indicate a general agreement that the defense of fraud in the transaction must be based on serious conduct that has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligations would no longer be served.[74]

(2) The reported cases differ, in rhetoric if not result, as to whether fraud in the transaction refers to "egregious fraud" or "intentional fraud" or involves application of a flexible fraud standard. Most of the cases favoring a flexible standard have nonetheless been supported by a showing of serious misconduct equivalent to the shipment of rubbish.[75]

(3) The "fraud-in-the-transaction" defense has generally been construed to require proof of an active intent and proof of no colorable or plausible basis under the underlying contract for the beneficiary to call the credit.[76]

The Task Force further observed that "[n]ot every instance of misconduct by the beneficiary should interrupt payment or excuse honor of a letter of credit. Ordinary contract disputes must be settled by the beneficiary and applicant between themselves and entirely apart from the credit obligation."[77] It agreed with the position taken

out of the Iranian revolution should be examined carefully and it should always be asked whether their reasoning is generally acceptable or whether the judge may have acted with a mind influenced by a recent television-picture of a commercially irresponsible Ayatollah.") (internal citations omitted).

74. Task Force Report, *supra* note 43, at 1613 (citing Intraworld Indus., Inc. v. Girard Trust Bank, 336 A.2d 316, 324 (Pa. 1975)).

75. *Id.* at 1614 (internal citations omitted).

76. *Id.* at 1613 (internal citations omitted).

77. *Id.* at 1614.

by the court in *Emery–Waterhouse*: "letter of credit fraud—i.e., conduct warranting judicial interference—is not the same as common law fraud."[78] The Task Force stated however, that "[h]ow to formulate the requisite fraud standard is not easy"[79] because there is a "grey area of misconduct which is wrongful but not so serious as to justify interruption"[80] of the normal operation of the letter of credit. The Task Force pointed out:

> Because of the serious possibility of confusion of letter of credit fraud with common law fraud and other types of fraud as well as the critical importance of a narrowly gauged standard, the Task Force believes that an attempt must be made to alert parties and courts that not just any fraud will suffice.[81]

The Task Force finally recommended that a different standard should apply for commercial letters of credit as opposed to standbys.[82] For commercial letters of credit, the focus should be whether "the purpose of the underlying transaction must be rendered virtually without value,"[83] while for standby letters of credit, the question should be "whether the drawing has occurred with no colorable basis whatsoever."[84]

2. *The Position in the Statute*. The Drafting Committee, after deliberating upon the Task Force's recommendations and after extensive discussion and consultation, set forth a legal standard of fraud for letters of credit in Revised U.C.C. Article 5. Revised U.C.C. Article 5, Section 109, reads:

> (a) If . . . a required document is *forged or materially fraudulent*, or honor of the presentation would facilitate a *material fraud* by the beneficiary on the issuer or applicant, . . . the issuer, acting in good faith, may honor or dishonor the presentation . . . .
>
> (b) If an applicant claims that a required document is forged or *materially fraudulent* or that honor of the presentation would facilitate a *material fraud* by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or

78. *Id.* at 1615.
79. *Id.*
80. *Id.* at 1614.
81. *Id.* at 1615.
82. Robert S. Rendell, *Fraud and Injunctive Relief*, 56 BROOK. L. REV. 111, 113 (1990).
83. Task Force Report, *supra* note 43, at 1615.
84. *Id.*

> permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons.[85]

Revised U.C.C. Article 5 adopted "material fraud" as the standard of fraud under the fraud rule. While the Article itself does not define "material fraud,"[86] the Official Comment on Section 109 has made some effort to explain it. For commercial letters of credit, it indicates that material fraud "requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction."[87] An example has been provided to illustrate the point:

> Assume . . . the beneficiary has a contract to deliver 1,000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice for 1,000 barrels. If two barrels in a 1,000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary's act, though possibly fraudulent, is not materially so and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent.[88]

For standby letters of credit, the Official Comment states that "[m]aterial fraud by the beneficiary occurs only when the beneficiary has *no colorable right to expect honor* and where there is *no basis in fact to support such a right to honor.*"[89] For further illustration, it quotes the following passage from *Ground Air Transfer v. Westates Airlines*:

> We have said throughout that courts may not "*normally*" issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also explained in Itek, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "*plainly*" show that the underlying contract forbids the beneficiary to call a letter of credit; where they show that the contract deprives the beneficiary of even a "*colorable*" right to do so; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact"; where the beneficiary's conduct has "so vitiated the entire transaction that the

85. Revised U.C.C. Article 5, § 109 (emphasis added).

86. *See also* Paul S. Turner, *Revised UCC Article 5: The New U.S. Uniform Law on Letters of Credit*, 11 BANKING & FIN. L. REV. 205, 225 (1996).

87. Official Comment to Article 5 of the Uniform Commercial Code, para. 2.

88. *Id.*

89. *Id.* para. 3 (emphasis added).

> legitimate purposes of the independence of the issuer's obligation would no longer be served."[90]

Neither Section 5–109 nor its Official Comment suggests that the beneficiary's intention to defraud should be proven, so it seems that "material fraud" under Revised U.C.C. Article 5 looks "more to the severity of the effect of the fraud on the transaction rather than the state of mind of the beneficiary."[91] The thrust of Revised U.C.C. Article 5 is very encouraging. Section 5–109 of the Article has not only laid down a standard of fraud in the law of letters of credit, but it has also set forth a standard of "a unique kind of fraud"—"letter of credit fraud,"[92] a standard specially designed to fight fraud in that mercantile specialty. In so doing, Revised U.C.C. Article 5 has accepted the Task Force's recommendations and has endorsed the approach espoused in the case of *Emery–Waterhouse*.

One aspect of the Official Comment is not entirely satisfactory, however: the example provided for the illustration of the meaning of the standard of fraud for standby letter of credit cases is not as typical as it might be. In the example of *Ground Air Transfer v. Westates Airlines*,[93] Westates provided Charter One with planes and crew services for charter flights, and Charter One arranged for a standby letter of credit to guarantee that Westates would not suffer harm should Charter One fail to carry out its contractual obligations. It was agreed that a copy of a ten–day default notice would be provided if the letter of credit was to be called.

When a dispute arose and each party claimed that the other had broken the contract, Charter One reacted by withholding certain fees and, anticipating Westates' draw on the letter of credit, sought a preliminary injunction to enjoin Westates from obtaining payment under the credit. An injunction was issued by the trial court on the basis that the beneficiary would be unlikely to win the underlying contract dispute with the applicant.[94] But the decision was reversed by the First Circuit, because

> Westates, the beneficiary, can truthfully say that it satisfied the letter of credit's express conditions; it mailed a ten day notice to Charter One . . . . More importantly, since Westates has at least a "col-

90. *Id.* (quoting Ground Air Transfer v. Westates Airlines, 899 F.2d 1269, 1272–73 (1990) (internal citations omitted)).

91. Buckley, *supra* note 42, at 97. *See also* Task Force Report, *supra* note 43, at 1615.

92. DOLAN, *supra* note 20, at 7–47.

93. 899 F.2d 1269 (1st Cir. 1990).

94. *Id.* at 1274.

> orable" claim that it acted lawfully under the contract in doing so, Westates' call would not fall within the traditional exception for forgery or fraud.[95]

Reading the facts, *Ground Air Transfer* is a typical case of a dispute over a simple contract, which involved a possible call on a letter of credit. There was no fraud at all in the case, let alone "material fraud." Yet an example that provides guidance for the understanding of typical "material" fraud should be one in which fraud is not only involved but also "material."

3. *Case Studies.* Although the revision of Article 5 of the U.C.C. was completed just seven years ago, it has already been adopted by nearly all of the U.S. states and was first applied by U.S. courts as early as September 1997. Nonetheless, the standard of fraud set out in Section 5–109 of the Article has not often been tested.[96]

In *Western Surety Co. v. Bank of Southern Oregon*,[97] Western Surety Company (WSC) issued performance bonds on behalf of Black Oak Construction Company (BOC) for work BOC was performing in the State of Washington. WSC also issued performance bonds for work BOC was performing in Oregon. To counter–guarantee the performance bonds, the defendant, the Bank of Southern Oregon (the Bank), opened two letters of credit in favor of WSC. The two letters of credit were essentially identical except for the serial

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95. *Id.*

96. There may be a number of reasons for this. The main reason is that most of the cases tried until recently were still applying Prior U.C.C. Article 5 because letters of credit involved in those cases were issued before Revised U.C.C. Article 5 was adopted. Another reason may be that "[t]he number of reported cases involving fraud declined significantly" following the promulgation of Revised U.C.C. Article 5. James G. Barnes & James E. Byrne, *Letters of Credit: 1995 Cases*, 51 BUS. LAW. 1417, 1425 (1996). According to the two authors, the decline was one of the "signs of the impact of the . . . revised U.C.C. Article 5." *Id.* at 1418. This may be a reasonable observation because, by setting forth the standard of material fraud, Section 5–109 has provided courts some guidance in dealing with cases of this kind, and has showed letters of credit users that litigation reasons such as "constructive fraud" will not be supported. As a result, parties who might have used such reasons prior to the promulgation of Revised U.C.C. Article 5 may have stopped doing so. This author searched the LEXIS library "Federal and State Cases" a number of times, the last on June 5, 2002. Only three cases were found. *See* Mid-America Tire v. PTZ Trading Ltd. Import and Export Agents, 2000 Ohio App. LEXIS 5402 (Ohio Ct. App. Nov. 20, 2000); New Orleans Brass v. Whitney Nat'l Bank and the La. Stadium and Exposition Dist., La. App. LEXIS 1764 (La. Ct. App. 4th Cir. May 15, 2002); and W. Surety Co. v. Bank of S. Or., 1999 U.S. Dist. LEXIS 8863 (D. Or. June 9, 1999), *aff'd*, 257 F.3d 933 (9th Cir. 2001).

97. W. Surety Co. v. Bank of S. Or., 1999 U.S. Dist. LEXIS 8863 (D. Or. June 9, 1999), *aff'd*, 257 F.3d 933 (9th Cir. 2001).

number, the issuing date, the expiration date, and the aggregate amount. When BOC defaulted on its project in Washington and the performance bonds were called, WSC presented the Bank with drafts under the letter of credit for payment. The Bank dishonored on the basis that it believed one of the letters of credit was issued for the project in Oregon and had nothing to do with the project in Washington.

WSC brought suit against the Bank for wrongful dishonor. Because the Bank could not prove that the letter of credit was limited to a specific job, the court ruled for the plaintiff by applying the standard of "material fraud" set forth in Revised U.C.C. Article 5, Section 109, stating that:

> The relevant Oregon statute provides that an issuing bank, acting in good faith, may dishonor a draft on a letter of credit, if the presentation of the draft would facilitate a *material fraud* by the beneficiary. . . . However, *fraud*, as an affirmative defense to the obligation *under a letter of credit is to be narrowly construed. Fraud is not a viable defense if the beneficiary has even a colorable claim or any basis in fact to funds from the letter of credit.*[98]

By so ruling, although the court claimed it was applying the standard of "material fraud" embodied in Section 5–109, its position was similar to that adopted in the cases of "egregious" fraud considered above.

In *New Orleans Brass v. Whitney National Bank and the Louisiana Stadium and Exposition District*,[99] New Orleans Brass ("Brass") applied for a standby letter of credit with the Whitney Bank in favor of the Louisiana Stadium and Exposition District ("LSED") as a guarantee for rental payments. A dispute arose about the rental payments and LSED presented documents under the letter of credit. Brass sought an injunction to prevent the honoring of the letter of credit on the basis that the documents submitted contained false representations, and drawing on the letter of credit would cause irreparable injury, but its request was denied.

On appeal, the decision was affirmed by the Fourth Circuit because no "material fraud" as defined in Revised U.C.C. Article 5, Section 109, was found in the case. In reaching its conclusion, the court applied the standard of "material fraud" set forth in Revised U.C.C. Article 5, Section 109, particularly as elaborated in the Offi-

98. Western Surety Co., 1999 U.S. Dist. LEXIS 8863, at *10–*11.

99. 2002 La. App. LEXIS 1764 (La. Ct. App. 4th Cir. May 15, 2002).

cial Comment, and cited the whole paragraph of *Ground Air Transfer* quoted above to the effect that the fraud rule can only be invoked when the demand for payment has "absolutely no basis in fact" or the beneficiary's conduct has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served."[100] By so ruling, the court was taking a similar position to that taken in *Western Surety*—an approach closely resembling that employed in the "egregious" fraud cases.

In *Mid-America Tire v. PTZ Trading Ltd. Import and Export Agents*,[101] the dispute arose out of extensive negotiations for the purchase of Michelin tires by Mid-America Tire (MAT) and Jenco from PTZ Trading Ltd. (PTZ) through agents of PTZ, financed by a letter of credit. Throughout the negotiations, PTZ's agents made specific representations to the buyers as to the quantity, quality, and price of the tires. When the agreement was made, the quantity, quality, and price of the tires all failed to match what had been promised. The buyers sought an injunction to prevent honor and payment of the letter of credit. The trial court granted the injunction on the basis that the sellers' agents had made material misrepresentations to the buyers.

The decision was reversed by the majority judgement on appeal, however. The appellate court first asked: "how should 'material fraud' . . . be interpreted?"[102] After lengthy discussions, it answered that it "must be narrowly limited to situations of fraud in which the wrongdoing of the beneficiary has . . . vitiated the entire transaction"[103] and/or the demand for payment under the letter of credit "has absolutely no basis in fact,"[104] taking exactly the same approach to the standard of fraud as adopted in the case of *New Orleans*. Justice Valen disagreed with the majority view, however, and stated:

> By committing fraud, it is my opinion that PTZ violated its obligations of "*good faith, diligence, reasonableness, and care.*" . . . [I]f the beneficiary, PTZ, fails to act in good faith in its dealings and

100. *See supra* note 90 and accompanying text.

101. 2000 Ohio App. LEXIS 5402, 43 U.C.C. Rep. Serv. 2d 964 (2000) (Ohio Ct. App. Nov. 20, 2002) (Young, P.J.; Walsh, J. concurring, Valen, J. dissenting).

102. *Id.* at 972.

103. *Id.* at 979 (citing Roman Ceramics Corp. v. People's Nat'l. Bank, 714 F.2d 1207, 1212 n.12 (3d Cir. 1983) (quoting Intraworld Indus., Inc. v. Girard Trust Bank, 461 Pa. 343, 359; 336 A.2d 316, 324–25 (1975))); *see also supra* note 26 and accompanying text.

104. *Id.*

> perpetrates a fraud upon the applicant, MAT, the letter of credit may be enjoined."[105]

By regarding the beneficiary's violation of its obligation of "good faith, diligence, reasonableness and care" as the commitment of "material fraud," Justice Valen seems, with respect, to have inadequately advocated "an overly broad fraud exception . . . . Material fraud under revised U.C.C. Section 5–109 is explained in the official comments, and nowhere is that concept equated with the concept of 'good faith.'"[106]

This short survey of cases reveals that the U.S. courts, in applying the standard of "material fraud" embodied in Revised U.C.C. Article 5, appear to have generally taken a similar approach to the "egregious" fraud cases mentioned above. They have taken the position that the fraud rule may only be applied in limited situations where the demand for payment under the letter of credit "has absolutely no basis in fact." This is "an unduly narrow" approach.[107] It is more disturbing, however, to find that some judges have interpreted the standard of "material fraud" as equivalent to a violation of the obligation of "good faith, diligence, reasonableness, and care." This is close to the standard of "constructive fraud" mentioned above and utterly inappropriate. This indicates that divergent views as to the standard of fraud may still appear in future in the United States although a uniform and appropriate standard of "material fraud" has been set forth in Revised U.C.C. Article 5, Section 109.

II. THE POSITION IN THE UNITED KINGDOM

English courts have traditionally adopted a relatively rigid and narrow approach towards the application of the fraud rule, requiring a high standard of proof of fraud: "clear," "obvious," or "established" fraud known to the issuer. Accordingly, fraud has been very difficult to establish in English courts. When no fraud is found to have been committed in a transaction, there is no need for a court to consider the standard of fraud or other specific issues relating to the application of the fraud rule. Since there have been only a limited number of cases in which the fraud rule is applied, the discussion of what kind of fraud can invoke the fraud rule has also appeared in just a few cases.

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105. *Id*. at 989–90 (emphasis added).

106. James G. Barnes & James E. Byrne, *Letters of Credit: 2000 Cases*, 56 BUS. LAW. 4 (2001), *reprinted in* ANNUAL SURVEY OF LETTER OF CREDIT LAW & PRACTICE 13, 18 (2002).

107. *Id.*

In *United City Merchants (Investments) Ltd. v. Royal Bank of Canada*,[108] when considering the issue of third party fraud, Lord Diplock touched on the issue under discussion:

> To this general statement of principle [of independence] as to the contractual obligations of the confirming bank to the seller, there is one exception: that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, *material representations* of fact that to his knowledge are untrue.[109]

According to Lord Diplock, material misrepresentation is the kind of fraud that can invoke the fraud rule under the English law. Raymond Jack has interpreted material misrepresentation as follows: the word misrepresentation "is very close to a statement of the elements of fraudulent misrepresentation which constitute the tort of deceit."[110] The tort of deceit contains the following elements: "(1) knowing the representation to be false; (2) without belief in its truth; or (3) recklessly, careless whether it be true or false."[111] The word "material" means "material to the bank's duty to pay, so that if the document stated the truth the bank would be obliged to reject the documents,"[112] which is close to the interpretation of material fraud in Official Comment on Revised U.C.C. Article 5, Section 109. Jack's interpretation seems to be at odds with Lord Diplock's own words, however:

> [T]he answer to the question: "to what must the misstatement in the documents be material?" should be: "*material to the price* which the goods to which the documents relate would fetch on sale if, failing reimbursement by the buyer, the bank should be driven to realise its security." But this would not justify the confirming bank's refusal to honour the credit in the instant case; the realisable value on arrival at Callao of a glass fibre manufacturing plant made to the specification of the buyers could not be in any way affected by having been loaded on board a ship at Flexistowe on December 16, instead of December 15, 1976.[113]

In accordance with Lord Diplock, the misrepresentation should be "material" to the real value of the goods. Predating the bill of lading in the case was not considered material because it did not affect the

108. (1979) 1 Lloyd's Rep. 267.

109. (1983) 1 A.C. 168, 183 (Diplock, L.J.) (emphasis added).

110. RAYMOND JACK ET AL., DOCUMENTARY CREDITS 196 (3d ed. 2001).

111. *Id.* at 197.

112. *Id.*

113. *United City Merchants*, 1 A.C. at 186.

value of the goods. But according to Jack's interpretation, predating the bill of lading should be considered material because the bank would have been obliged to reject the documents if the bill of lading had stated the truth of the loading date. It is, with respect, submitted that Jack's interpretation is a far better statement of principle (though not an accurate interpretation of Lord Diplock's judgment) and Lord Diplock's observation is out of step with the wider law and practice of letters of credit.

Lord Diplock's observation in *United City Merchants* that material misrepresentation is the kind of fraud that can invoke the fraud rule has been accepted by subsequent English cases. In *Themehelp Ltd. v. West*,[114] one of the few English cases where an injunction was granted, the Court of Appeal followed the words of Lord Diplock quoted above with respect to the standard of fraud and affirmed the trial court's decision.

In *Banco Santander S.A. v. Bayfern Ltd.*,[115] the confirmer discounted the obligation of a deferred payment letter of credit before its maturity. Shortly after the discounting, some of the documents presented were found to be fraudulent. Subsequently, the issuer refused to pay the confirmer. The confirmer brought the action against the issuer in the Queen's Bench Division for reimbursement and sought summary judgment, claiming it should be immune from the fraud rule despite fraud. For trial of preliminary issues, fraud was assumed to have been established in the case. The trial court ruled for the issuer on the basis of established fraud. On appeal, the decision was upheld by the Court of Appeal. Both courts cited with approval Lord Diplock's above passage relating to the standard of fraud.

"Material misrepresentation" thus appears to have been settled as the standard of fraud in the law governing letters of credit in the United Kingdom. In language the English position is close to that of the United States in Revised U.C.C. Article 5, Section 109: "material fraud." As both of them have not been sufficiently tested, it is too early to make a reasonable comparison. If a comparison has to be made, however, the difference between the two appears to be that the U.S. position is enshrined in a statute, but the U.K. position is embodied in the common law. This may mean that courts in the United States will "look more on the severity of the effect of the fraud on the

114. (1995) 4 All E.R. 215 (C.A.).

115. 1999 WL 250019 (Q.B. June 9, 1999), *aff'd*, 2000 WL 191098 (C.A. Feb. 25, 2000).

transaction rather than the state of fraud of the beneficiary,"[116] whilst courts in the United Kingdom, at least if Jack is correct, will require proof of the state of the mind of the fraudster. Be that as it may, with the development of the fraud rule, the two systems are coming closer together: lower standards of fraud such as "constructive fraud," seem to have been abandoned by U.S. courts following the promulgation of Revised U.C.C. Article 5; and the more recent English cases to have applied the fraud rule seem to be shifting from the traditional rigid standard of proof, "established" or "clear" fraud, to the less rigid standard of proof, "the only realistic inference . . . is that of fraud."

III. THE POSITION IN CANADA

Canadian courts have generally focused on the standard of proof rather than the standard of fraud when considering the application of the fraud rule. When considering the kind of fraud that can invoke the fraud rule, Canadian courts, like their English counterparts, are likely to ask whether "clear or obvious" fraud or "a strong prima facie case of fraud" has been shown, not how serious the fraud was in the sense of the standard of fraud being discussed here. Canadian courts have also considered whether the application of the fraud rule should be confined to cases of forged or fraudulent documents or extend to fraud in the underlying transaction. This is well illustrated by the case of *Bank of Nova Scotia v. Angelica–Whitewear Ltd*.[117]

In *Angelica–Whitewear*, the court considered four issues with respect to the application of the fraud rule, but the standard of fraud under discussion was not among them. When the court was considering the alleged fraud in the case, that is, the inflation of the prices in the invoice by some 17 dollars per dozen above those agreed to in the sales contract, it was not interested in how serious the fraud was, but whether the fraud (1) had been "sufficiently established to the knowledge of the Bank before payment of the draft to make it clear or obvious to the Bank,"[118] and (2) could "be regarded as having made invoice 0014 a false document in so far as its representation of the applicable prices was concerned, or whether it be regarded as fraud in the performance of the underlying sales contract."[119] The court put the question simply, was this "fraud of the kind that comes within the

116. Buckley, *supra* note 42, at 97.
117. [1987] 36 D.L.R. 161.
118. *Id.* at 178.
119. *Id.*

fraud exception,"[120] which seems to indicate that fraud is a simple concept, the meaning of which is known by everybody in Canada.

Due to the general approach of the Canadian courts towards the standard of fraud, the issue, even when it is mentioned in a Canadian case, has normally been addressed in a very simple way. For example, in *CDN Research & Development Ltd. v. Bank of Nova Scotia*,[121] when issuing an injunction restraining the issuer from paying the demand, Justice Galligan stated:

> It is my opinion, in this case, an injunction ought to be granted. In my view, it ought to be granted for at least two reasons. The first is that the plaintiff has made out a strong prima facie case that the demand made by the agent of the Ministry of War is fraudulent. Delivery has clearly been made and claim for a payment of a delivery guarantee necessarily implying that delivery was not made is *clearly untrue and false*.[122]

This issue has been said to have been "dealt with in some depth"[123] in the case of *Cineplex Odeon Corp. v. 100 Bloor West General Partner, Inc*.[124] In *Cineplex*, a limited partnership was formed to develop a multifunctional complex. The parties had entered into a number of agreements, according to which the plaintiff, Cineplex, provided a letter of credit to secure its obligations under certain agreements. Cineplex defaulted in its obligation to build the project, and the letter of credit was called upon. The plaintiff moved to enjoin payment, claiming that it was not in default in the obligation that the letter of credit was meant to guarantee, any draw by the defendants would be fraudulent and thus the fraud rule should be applied. After reviewing the facts and the principle of independence, before dismissing the plaintiff's motion, Justice Blair pointed out:

> I pause at this point to note, in passing, a factor which occasionally seems to be lost amidst the melee in these sorts of disputes, disputes which more and more are finding their way to the courts in times of economic stress: the exception is "fraud", not something less than fraud.[125]

Then he went on:

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120. *Id.*

121. 18 C.P.C. 62 (Ont. High Ct. of Justice 1980).

122. *Id.* at 65 (emphasis added).

123. S.P. Jeffery, *Standby Letters of Credit: A Review of the Law in Canada*, 14 BANKING & FIN. L. REV. 505, 528 (1999).

124. 1993 A.C.W.S.J. LEXIS 43709 (Ont. Gen. Div. Jan. 19, 1993).

125. *Id.* para. 29.

> In the eyes of the party seeking to prevent payment on the letter of credit, almost any conduct or position of the beneficiary which does not accord with the aggrieved party's view of the universe may appear to be fraud, and therefor justify non–payment. Such, of course, cannot be the case, given the recognized characteristics of a letter of credit. . . . Fraud is a straightforward five–letter word, meaning just what it says: "fraud". Fraud is not simply a legitimate dispute or disagreement over the interpretation of a contract, however one–sided that dispute may appear. While the notion of fraud may elude precise definition, it is a concept well–known to the law, and it must, in my view, import some aspect of impropriety, dishonesty or deceit. . . . Fraud is not mistake, error in interpreting a contract; fraud is "something dishonest and morally wrong, and much mischief is . . . done, as well as much unnecessary pain inflicted, by its use where 'illegality' and 'illegal' are the really appropriate expressions." Cases where the demand on the letter of credit can be said to be "clearly untrue or false", or "utterly without justification", or where it is apparent there is "no right to payment", all fall within the foregoing principles and must be read in the context of those "fraud" principles.[126]

If this can be taken as a summary or generalization of the Canadian position on the standard of fraud, the Canadian position is somewhat confusing or contradictory. As can be seen, the quoted passage, on one hand, is saying that fraud in Canada means something of "dishonesty" or "deceit," or "clearly untrue or false," which is similar to common law fraud, requiring the intention of the fraudulent party. But on the other hand, it is saying that a call on the letter of credit that is "utterly without justification" or "where it is apparent there is 'no right to payment'" can also mean fraud in Canada, which is similar to the American position, looking more to the sharpness of the fraudulent conduct. This may be the true reflection of the Canadian position, however: on one hand, being a country of English tradition, understandably the Canadian courts traditionally follow the approach of their English counterparts closely, adopting the standard of common law fraud; on the other hand, the influence of the U.S. position in the area of letter of credit law, can be seen everywhere in the world, and at least some of the Canadian courts are also closely following the U.S. approach on these issues.

126. *Id.* paras. 30–32 (internal citations omitted).

IV. THE POSITION IN AUSTRALIA

In Australia, in the small number of cases that have considered the fraud rule, two kinds of standard of fraud have been suggested: intentional fraud and gross equitable fraud.

A. Intentional Fraud

The standard of intentional fraud was set forth in the case of *Contronic Distributors Pty. Ltd. v. Bank of New South Wales*.[127] When issuing the injunction, Justice Helsham said:

> It seems to me that the case could be decided on a simple basis of fraud. I think it is sufficient to enable . . . Balfour . . . , in any event to get relief in these proceedings, to establish *an intention to obtain money by deceit* on the part of GEC at the time that the letter of credit is to be presented by it for payment. GEC would then be obtaining money by the use of documents it knew to be false and which were brought into being by it and with its connivance.[128]

B. Gross Equitable Fraud

The standard of gross equitable fraud was suggested in *Hortico (Australia) Pty. Ltd. v. Energy Equip. Co. (Australia) Pty. Ltd.*,[129] where Energy Australia had a contract with Hortico for the design, supply, and installation of a boiler. Hortico arranged for the issuance of a bank guarantee in favor of Energy Australia. Later the contract was terminated by both parties and Energy Australia made a demand on the guarantee for damages. Hortico brought the action to enjoin the payment under the guarantee, alleging, *inter alia*, that the guarantee was contemplated only to be security for the performance of the contract by the plaintiff and not also for damages, as the defendant claimed.

The plaintiff's argument was dismissed by Judge Young of the Supreme Court of New South Wales. The respected judge said in obiter, however:

> [W]ith commercial transactions such as the present, the courts have consistently taken a "hands off" approach, and it does not seem to me that anything short of actual fraud would warrant this Court in intervening, though it may be in some cases (not this one), the *un-*

127. (1984) 3 N.S.W.L.R. 110 (N.S.W. S.Ct.).

128. *Id.* at 114 (emphasis added). For more discussion of the case, see *supra* notes 90–93.

129. (1985) 1 N.S.W.L.R. 545 (N.S.W.S. Ct.).

> *conscionable conduct may be so gross* as to lead to exercise of the discretionary power.[130]

The view that gross equitable fraud might invoke the fraud rule was restated some ten years later by the same justice in the case of *Inflatable Toy Co. v. State Bank of New S. Whales*.[131] In *Inflatable*, the plaintiff, the buyer, ordered from the seller inflatable plastic toys to be delivered in instalments and paid for by letters of credit. For one instalment, some discrepancies appeared between the documentation and the facts. The buyer accepted the discrepancies when the seller told it what had happened, but changed its mind later and brought an action to prevent the issuer from paying the accepted bill of exchange, alleging that the seller was guilty of fraud in presenting documents, which it knew to be untrue. Judge Young rejected the buyer's claim. But again as a passing dictum, after citing *Sztejn*, *Hortico* and other cases relating to the fraud rule, he stated, "I should note, in case what I said is read later too widely, that it is still wise to keep open the possibility that *unconscionable conduct may be an exception.*"[132]

The idea that gross equitable fraud may invoke the fraud rule was rejected by Judge Batt of the Supreme Court of Victoria in *Olex Focas Pty. Ltd. v. Skodaexport Co*.,[133] however. In that case, Olex Focas entered into a contract with Skodaexport for the supply and installation of telecommunications, telesupervisory and instrumentation systems in connection with the construction of an oil pipeline in India. Skodaexport was the head–contractor for the project, and Olex was one of the subcontractors engaged by Skodaexport.

Skodaexport agreed to pay Olex what was termed mobilization/procurement advances for 15 percent of the contract price. As security for the repayment of the advances, Olex was required to provide independent guarantees to Skodaexport, termed mobilization/procurement guarantees (mobilization guarantees). In addition, Olex was required to provide another type of guarantee, termed performance guarantees, for 10 percent of the contract price, to secure the good performance of its obligations under the underlying contract. All the guarantees were payable "at sight forthwith on first

130. *Id.* at 554 (emphasis added).

131. (1994) 34 N.S.W.L.R. 243 (N.S.W.S. Ct.).

132. *Id.* at 251 (emphasis added).

133. (1996) 134 F.L.R. 331 (V.S. Ct.).

demand . . . without protest or demur or proof."[134] Skodaexport was allowed to call upon part of the guarantees.

When disputes arose, Skodaexport allegedly threatened to call upon the full amount of the guarantees unless Olex would accept its terms for the settlement of the disputes.[135] By this time, the advances secured by the mobilization guarantees had largely been repaid. The plaintiffs also claimed that collectively 95 percent of the equipment had been supplied and 78 percent of the design, construction, integration and commissioning services had been provided. Olex sought interlocutory injunctions to prevent the independent guarantees from being paid on two grounds: (1) that Skodaexport, by threatening to make demand on the guarantees, was acting fraudulently, without a belief that it was entitled to the sums secured by the guarantees; and (2) that Skodaexport, by threatening to call up the guarantees, was committing unconscionable conduct within the meaning of Section 51AA of the Trade Practices Act 1974 (Cth).

Judge Batt, when considering the plaintiff's first basis, followed the traditional line of English cases requiring a high standard of proof and, at the beginning of his analysis, stated:

> Now in Victoria, as in England, the law is clear. The principle is clearly established that payment by a bank and a demand therefor by a beneficiary under an unconditional performance bond or guarantee, as under a confirmed irrevocable letter of credit, will not be restrained *except in a clear case of fraud*, of which the bank is clearly aware at the time of, probably, the proposed payment, or in the case of forgery of documents (which is probably applicable only to letters of credit) or, perhaps, in the case of illegality of the underlying contract.[136]

Then the learned Judge Batt considered a number of English and Australian cases, cited long quotations from them to the effect that only clear fraud could activate the fraud rule,[137] and rejected the plain-

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134. *Id.* at 340 (for mobilization guarantees) and 342 (for performance guarantees).

135. In fact Skodaexpert instructed its bank, the Czechoslovakian Commercial Bank, to call up all of the guarantees, and the bank did so. *Id.* at 345. For more information on proceedings in the case and a detailed summary of the beneficiary's call on the guarantees, see Ross P. Buckley, *Sections 51AA and 51AC of the Trade Practices Act 1974: The Need for Reform*, 8 TRADE PRAC. L.J. 5, 6 n.6 (2000).

136. *Olex*, 134 F.L.R. at 348 (emphasis added). For a comment on this passage, see Alan L. Tyree, *Performance Bonds and Section 51AA of the Trade Practices Act*, 8 J. BANKING & FIN. L. & PRAC. 338, 339 (1997).

137. *See, e.g.*, Edward Owen Eng'g Ltd. v. Barclays Bank Int'l Ltd., (1978) 1 All E.R. 976 (C.A.); and Bolivinter Oil S.A. v. Chase Manhattan Bank, (1984) 1 Lloyd's Rep. 251 (C.A.).

tiffs' request for injunction on the basis of fraud. When considering the point espoused by Judge Young in *Hortico* that gross equitable fraud might invoke the fraud rule, Judge Batt said:

> In my view his Honour was speaking in very guarded terms, prefacing his mention of that concept by reference to the general "hands–off" approach taken by courts with respect to commercial transactions. . . . *I would not* with respect, having regard to all the other cases I have cited, *treat gross unconscionability falling short of actual fraud as a ground for an injunction.*[138]

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138. *Olex*, 134 F.L.R. at 354 (emphasis added). Remarkably, Judge Batt enjoined the payment of the mobilization guarantees on the basis of the plaintiffs' second argument: Skodaexport's calling up the guarantees was committing unconscionable conduct within the meaning of section 51AA of the Trade Practices Act, 1974 (Austl.). This ruling has "surprised most commentators, and the criticism of it has been direct and frequent." *See, e.g.*, Buckley, *supra* note 135, at 6. By and large, criticism so far has focused on the point that the decision has misapplied section 51AA of the Trade Practices Act and "the accepted scope of the section may have been broadened considerably." Ross P. Buckley, *Unconscionability Amok, or Two Readily Distinguishable Cases?*, 26 AUST. BUS. L. REV. 323, 326 (1998). This approach also represents an undesirable development in the law of letters of credit, however, because it appears to have created another basis for the interference with the payment of letters of credit and independent guarantees at least in Australia: statutory unconscionable conduct, which may severely affect the commercial utility of letters of credit because "[t]he effect of the statute, applying as it does to international trade and commerce, is to work a substantial inroad into the well–established common law autonomy of letters of credit and performance bonds and other bank guarantees." *Olex*, 134 F.L.R. at 358. More alarmingly, this decision may have opened a "Pandora's box" in Australia and led to more "exceptions" to the letter of credit payment system. For example, other sections of the Trade Practices Act, such as section 52, dealing with misleading and deceptive conduct, and section 53 dealing with false or misleading representations, may also be applied in future to letters of credit and independent guarantees. If this happens, the commercial utility of letters of credit and independent guarantees will be seriously eroded. For a series of articles criticizing this ruling, see the interaction of section 51AA of the *Trade Practices Act 1974* (Cth.) (Austl.) which provides that "[a] corporation shall not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time, of the States and Territories" with the fraud exception is yet to be clarified in Australia. For the first, quite possibly incorrect clarification attempt, see *Olex*, 134 F.L.R. at 331. For further comment on this case, see Robert Baxt, *Are Bank Guarantees Safe from the Unconscionable Conduct Provisions of the Trade Practices Act?*, *in* THE AUSTRALIAN BANKER 62 (1997); Robert Baxt, *A Bombshell on Unconscionable Conduct*, 25 AUSTRALIAN BUS. L. REV. 227 (1997); Robert Baxt, *Unconscionability Taken One Step Too Far?*, 25 AUSTRALIAN BUS. L. REV. 301 (1997); Robert Baxt, *Unconscionable Conduct under Trade Practices Act*, 71 AUSTRALIAN L.J. 432 (1997); Robert Baxt and Joel Mahemoff, *Unconscionable Conduct Under the Trade Practices Act—An Unfair Response By the Government: A Preliminary View*, 26 AUSTRALIAN BUS. L. REV. 5, 13–15 (1998); Jeffrey Browne, *The Fraud Exception to Standby Letters of Credit in Australia: Does it Embrace Statutory Unconscionability?*, 11 BOND L. REV. 98 (1999); Ross P. Buckley, *Sections 51AA and 51AC of the Trade Practices Act 1974: The Need for Reform*, 8 TRADE PRAC. L.J. 5 (2000); Alan Tyree, *Performance Bonds and Section 51AA of the Trade Practices Act*, 8 J. BANKING & FIN. L. & PRAC. 338 (1997); Warren Pengilley, *Unconscionability: Are the Litigation Floodgates Opening in Relation to Commercial Transactions?*, 13 TRADE

Therefore, in Australia to date, while two kinds of misconduct that may invoke the fraud rule have been suggested, only "intentional fraud" has been applied. As for gross equitable fraud, it has been mentioned twice by the same justice in obiter in the Supreme Court of New South Wales, but has not been applied in any case. Moreover, it has been rejected by the Supreme Court of Victoria. Whether the standard of gross equitable fraud can become a real ground for the application of the fraud rule in Australia remains to be seen.

V. THE POSITION UNDER THE UNCITRAL CONVENTION

The United Nations Convention on Independent Guarantees and Standby Letters of Credit (the UNCITRAL Convention) has taken a different approach to fraud from that of Revised U.C.C. Article 5. While the latter has provided a general standard of fraud for the application of the fraud rule—material fraud—the former has avoided the "terms 'fraud' and 'abuse of right'"[139] and identified in Article 19 three substantive grounds to invoke the fraud rule:

(a) Any document is not genuine or has been falsified;

(b) No payment is due on the basis asserted in the demand and the supporting documents; or

(c) Judging by the type and purpose of the undertaking, the demand has no conceivable basis.[140]

As for demands that have "no conceivable basis," Article 19(2) of the Convention further refined this aspect as follows:

(a) The contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialized;

(b) The undertaking obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking;

(c) The underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary;

(d) Fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary; or

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PRAC. L. BULL. 11 (1997); and Ben Zillmann, *A Further Erosion Into the Autonomy of Bank Guarantees*, 13 BLDG. & CONSTR. L. 354, 357 (1997).

139. Eric E. Bergsten, *A New Regime For International Independent Guarantees and Stand–By Letters Of Credit: The UNCITRAL Draft Convention On Guaranty Letters*, 27 INT'L LAW. 859, 872 (1993).

140. UNCITRAL, art. 19.

(e) In the case of a demand under a counter–guarantee, the beneficiary of the counter–guarantee has made payment in bad faith as guarantor/issuer of the undertaking to which the counter–guarantee relates.

This list may not be exhaustive, but it is an impressive and encouraging way in which to define the kind of misconduct that may invoke the fraud rule. It undoubtedly stands as the most detailed provision so far with respect to clarification of the misconduct that may bring the fraud rule into play. These provisions are "clear and narrow in scope and provide an excellent international standard."[141] They will undoubtedly provide good guidance for courts to enhance their application of the fraud rule.

While the Convention requires "manifest and clear" evidence to invoke the fraud rule, it does not mention that the wrongdoer's intention should be proven. Reading the text, the Convention, like Revised U.C.C. Article 5, seems to emphasize more the nature of the misconduct rather than the fraudster's state of mind. Having rules is one thing, however, properly implementing them is another, because implementation of the rules is in the hands of individual courts. As courts may still apply the standard of proof of some English judgments, the real value of these rules remains to be seen.

VI. CONCLUSION

The fraud rule is "the most controversial and confused area"[142] in the law governing letters of credit, mainly because the standard of fraud is hard to define. The divergent views expressed by courts and commentators with respect to the essence of the standard of fraud reflect the tension between two different policy considerations: "the importance to international commerce of maintaining the principle of the autonomy of documentary credits . . . and the importance of discouraging or suppressing fraud in the letter of credit transaction."[143]

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141. Comment 1, *Litigation Digest: Agritrade Int'l Pte. Ltd. v. Industrial & Commercial Bank of China*, [1998] 3 S.L.R. (Singapore), 4(3) DOCUMENTARY CREDIT WORLD 8, 12 (2000).

142. Comment, *Fraud in the Transaction: Enjoining Letters of Credit during the Iranian Revolution*, *supra* note 57, at 995.

143. *See Bank of Nova Scotia*, [1987] D.L.R at 168. For a typical view favoring a stringent rule, see Henry Harfield, *Identity Crisis In Letter of Credit Law*, 24 ARIZ. L. REV. 239 (1982): "The rigid rules that govern letters of credit are structural. If they are subordinated to more pliable precepts appropriate to equitable resolution of disputes, the very existence of the letter of credit as a useful business device can be destroyed as surely as a wisteria vine can strangle an oak."

On the one hand, if fraud is defined too widely or the standard of fraud is set too low, the fraud rule may be abused by an applicant who does not want the issuer to pay the credit simply because it will not profit from the underlying transaction. If obstruction of payment of a letter of credit is permitted too often, business confidence in letters of credit as effective performance assurances will be destroyed.[144]

On the other hand, if fraud is defined too narrowly or the standard of fraud is set too high, the effectiveness of the fraud rule will be compromised. A very rigid standard of fraud may encourage the growth of fraudulent conduct by beneficiaries, discourage the use of letters of credit by applicants and ultimately harm the commercial utility of letters of credit.[145]

A proper standard of fraud should therefore be one reflecting a sensible compromise between the competing interests. Legally, it should serve the purpose of the fraud rule and be workable for the courts. Commercially, it should facilitate the utility of letters of credit. Based on these considerations, extreme concepts or standards of fraud, such as egregious fraud, which may be too rigid, and constructive fraud, which may lead to the fraud rule being abused, should be avoided, and a proper and practical standard of fraud should be adopted.

A combination of the provisions of Revised U.C.C. Article 5, Section 109, and those of Article 19 of the UNCITRAL Convention, provides the best solution yet devised, to defining the limits of the fraud exception. Under Revised U.C.C. Article 5, Section 109, "material fraud" may invoke the fraud rule. As considered above, the standard of material fraud has not only avoided extreme ideas such as egregious fraud and constructive fraud but also has reflected the unique nature of letters of credit. Because "material" is a general term, however, the implementation of the standard of material fraud provided in Article 5 remains uncertain despite some guidance provided by the case law, because different courts may interpret it divergently, as they have interpreted *Sztejn*. This uncertainty may to some extent be reduced by recourse to the provisions of Article 19 of the UNCITRAL Convention, however, where a detailed list of the types of misconduct that constitute material fraud has been provided. The

144. R.J. Gavigan, *Wysko Investment Co. v. Great American Bank: A New Attack on the Usefulness of Letters of Credit*, 14 NW. J. INT'L L. & BUS. 184, 202 (1993).

145. *Cf.* Stephen J. Leacock, *Fraud in the International Transaction: Enjoining Payment of Letters of Credit in International Transactions*, 17 VAND. J. TRANSNAT'L L. 885, 899 (1984).

misconduct listed in the Convention provides substantial practical guidance to courts and letter of credit users. Accordingly, if the fraud rule can be formulated in a way that combines the standard of material fraud embodied in Section 109, as a general standard, with the provisions of Article 19 of the UNCITRAL Convention as detailed examples, the predictability of the rule will be greatly enhanced.

The best place for the fraud rule to be so formulated is in the terms of the Uniform Customs and Practice for Documentary Credits[146]—the influential rules for letters of credit that are incorporated by reference into virtually all credits issued worldwide. The publisher of the UCP, the International Chamber of Commerce, is the most qualified body to prescribe the fraud rule as it has the greatest expertise in letters of credit matters.[147]

As the UCP is, in form, merely a set of contractual terms, whatever provisions it might include regarding fraud would be subordinate to local law on the issue.[148] There is no reason to expect that courts would not give to UCP provisions on fraud the same weight they have given to its other provisions, however. After all, the UCP prescribes the doctrine of autonomy,[149] so why should it not also prescribe the exception and limits to the doctrine?

It is hoped that in the next revision of the UCP, the revision committee will choose to deal with the issue of fraud, and, in doing so, will take its lead from the U.C.C. and the UNCITRAL Convention. If the UCP embraces the law on fraud as set forth in Section 5–109 of the U.C.C., as amplified by the definition of fraud from Article 19 of the UNCITRAL Convention, the result will be a highly workable ju-

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146. ICC Publication No. 500, *supra* note 5. The UCP is essentially a set of standard terms for banks drafted by bankers. The Working Group that prepared the latest revision was the first to include members other than bankers, in this case a number of bank lawyers and two law professors. The parties documentary credits serve, exporters and importers, are not directly represented in the drafting process. *See* John A. Spanogle, Jr., *The Arrival of International Private Law*, 25 GEO. WASH. J. INT'L L. & ECON. 477, 492 (1992).

147. Courts in most jurisdictions outside the United States are inexperienced with letters of credit, and the litigation of fraud under letters of credit is rare outside the United States. Accordingly, there has been no opportunity elsewhere to develop a sophisticated and coherent body of case law on the issue of fraud in letters of credit. England has a sophisticated and well–developed jurisprudence on letter of credit law in general, but not on the fraud issue in particular.

148. Robert Wight & Alan Ward, *The Liability of Banks in Documentary Credit Transactions under English Law*, J. INT'L BANKING LAW 387, 390 (1998).

149. Uniform Customs and Practice for Documentary Credits 1993 Revision, International Chamber of Commerce Publication No. 500, arts. 3, 4.

risprudence that will serve to enhance the commercial utility of letters of credit and limit their use to perpetrate fraud.