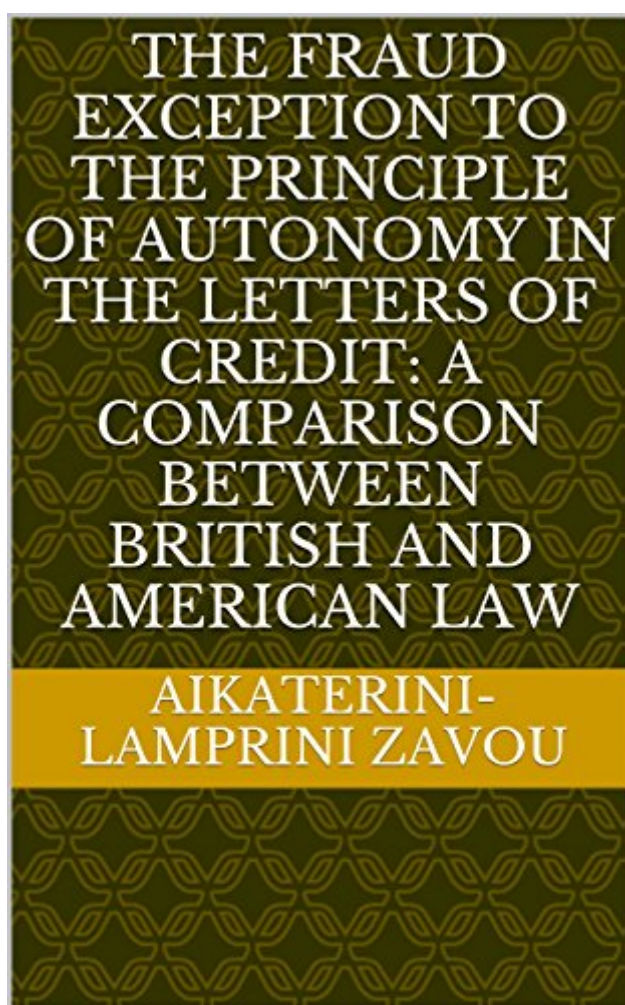


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# The Fraud Exception To The Principle Of Autonomy In The Letters Of Credit: A Comparison Between British And American Law



## Synopsis

The long history of letters of credit can be revealed from the fact that they became part of the English law merchant by the year 1200 and by 1700 they were part of the English common law . The long existence of letters of credit has also been recognised by the American jurisprudence. As the Second Circuit Court of Appeals put it "these single instruments survived despite their nearly 3000-year-old lineage because of their inherent reliability, convenience, economy, and flexibility" . The long usage of the letters of credit in international sales transactions convinces of their major importance. They are enabling foreign parties to come to an agreement, which would probably not be otherwise possible, by providing for a secure and unconditional payment in full, free from important risks inherent in international commerce. In particular, in case the contractual parties agree for a letter of credit in line with their payment term in the base contract, they are more confident towards commercial (there may be a breach of the underlying contract, or a party may become insolvent), litigation (it may be hard to obtain a favorable remedy, enforceable possibly in a foreign jurisdiction) and political risks (there may be war or insurrection in a country, a government may impose embargos or other sanctions, the foreign exchange may change, even dramatically). The agreed machinery for the discharge of the buyer's duty to pay the seller for the goods, is enabled by the principle of autonomy. Principle of autonomy: a foundation stone. The principle of autonomy is of fundamental importance to credit transactions and its observance secures the continuance of the documentary credit system as a primary means of payment in international trade. According to this principle, the credit is to be treated as an independent transaction. Behind every documentary credit there is an underlying transaction, usually a contract of sale. The principle of autonomy stipulates that the credit is independent from the contract giving rise to it and therefore the performance of the latter is independent to the performance of the former. In other terms the performance of the base contract is irrelevant to the performance of the credit. The principle of autonomy follows from the principle that the documentary credit is a transaction in documents and in documents alone. If the tendered documents are right, the bank must honor its payment obligations under the credit. Any allegations concerning the base contract, i.e. that the goods are not in compliance with the terms of the base contract, are irrelevant to the credit. The independence of the credit from the base contract and the promise of payment made by a bank makes it possible for parties which are reluctant to trust one another to come under an agreement. The bank which operates the credit is concerned only whether the documents tendered by the beneficiary correspond to those specified on the instructions. Those documents must strictly conform with the terms of the credit otherwise the bank is entitled to reject them. This legal principle is referred to as

the doctrine of strict compliance. The essence of this principle can be found in an authority case where it was stated that "there is no room for documents which are almost the same, or which will do just as well". The principle of strict compliance requires the parties to strictly follow the terms of the autonomous credit agreement. From one hand the letter of credit is independent from the underlying agreement and from the other its operation is entirely dependant upon the observance of the principle of strict compliance. Therefore, those two principles are of fundamental importance to the letter of credit. The principle of autonomy is stated in articles 3 (a) and 4 of the Uniform Customs and Practice for Documentary Credits .

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