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ON AUTONOMY

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On Autonomy

*Christopher Hare**

This paper examines the import and nature of the autonomy principle as applied to documentary letters of credit and other payment instruments. It argues that, while autonomy appears to have developed a degree of normativity, it is not a mandatory principle, but rather one that is subject in some degree to party autonomy. It follows that parties are free to choose whether they wish the doctrine of autonomy or only certain aspects to govern their dealings, but this is likely to have an impact upon the nature of the resulting instrument. This discussion regarding the nature of the autonomy principle raises the question of whether performance bonds should in principle continue to be treated as autonomous instruments, whether (as suggested academically) they should be placed on a lower point on a supposed scale of autonomy, or whether they are more logically equated with other non-autonomous forms of security. Somewhat controversially, this paper advocates the third of these options.

Keywords: Autonomy, documentary letters of credit, performance bonds, international trade finance

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1 Introduction

The documentary letter of credit is the traditional and long-standing means for effecting payment in international sales transactions.¹ Often invoked as being fundamental to the operation and success of this payment mechanism are the twin pillars of autonomy and strict compliance. Whilst recognized by the common law, both doctrines have long been enshrined in the Uniform Customs and Practice for Documentary Credits (UCP), including its latest iteration in the UCP 600. The autonomy doctrine is usually explained as operating to insulate or abstract the seller/beneficiary's rights and the banks' obligations under a letter of credit from those in the underlying sale contract.² Accordingly, the beneficiary's entitlement under the letter of credit to payment (and the issuing/confirming bank's corresponding duty to pay) crystallises solely upon the presentation of documents complying with the credit, regardless of the state of play between the buyer and seller in relation to the underlying contract.³ Similarly, the payment obligation embodied in the credit is considered to be unaffected by the relations between the issuing bank and either its correspondent or its customer (the applicant for the letter of credit).⁴ This juridical separation between the letter of credit's contractual elements is further bolstered by the principle that, when determining whether to pay, the banks' only concern is strict documentary compliance; payment turns upon the appearance of absolute conformity between the presented documents and the credit and in no way depends upon the 'goods, services or performance to which the documents may relate'.⁵ This same approach has been extended, both at common law,⁶ and under the internationally applicable rules,⁷ to certain forms of default payment undertakings, such as

¹ Whilst the documentary letter of credit has in recent decades dominated the trade finance area by replacing bills of exchange as the principal means of affecting payment, other mechanisms are nowadays increasing in popularity, such as open-account trading, the bank payment obligation and countertrade.

² International Chamber of Commerce, *Uniform Customs and Practices for Documentary Credits* ('UCP 600'), art 4(a).

³ *Ibid.*

⁴ *Ibid.*

⁵ *Ibid.*, art 5.

⁶ *Edward Owen v Barclays Bank International* [1978] 1 Lloyd's Rep 166, 171-172; *Howe-Richardson v Polimpex* [1978] 1 Lloyd's Rep 161, 165; *The Bhoja Trader* [1981] 2 Lloyd's Rep 256, 257.

⁷ International Chamber of Commerce, *Uniform Rules for Contract Guarantees*, 1978 Revision ('URCG 325E'), art 8; International Chamber of Commerce, *Uniform Rules for Demand Guarantees*, 2010 Revision ('URDG 758'), arts 5-6; United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, A/RES/50/48 (11 December 1995), art 3.

first-demand guarantees and stand-by letters of credit — an issue to which this paper will return towards the end.

All this is orthodoxy and, in many ways, is nothing new: since medieval times, bonds have been used to isolate a promise to pay (in legal terms) from the underlying contract giving rise to the debt⁸ and, more recently, bills of exchange have been employed to achieve a similar function, at least when the instrument has reached the hands of a holder for value or holder in due course. Accordingly, it is not the purpose of this paper to question the autonomy doctrine's commercial utility, at least insofar as this relates to documentary letters of credit;⁹ quite the opposite. Nor is it the intention simply to discuss the commercial and legal advantages of the autonomy principle or to analyse in detail the case for or against that principle's various possible exceptions; the former is hopefully self-evident and the latter has already been the object of sufficient academic and judicial attention without this having contributed significantly to clarity in the area. Instead, this working paper's chief aim is to examine the import and nature of autonomy more closely. Accordingly, Part 2 will seek to unpack what it really means to classify a payment instrument as 'autonomous' with a view to determining that notion's juridical nature, in particular whether autonomy simply represents a contractual default rule that the parties are free to choose or ignore as they see fit; or whether this notion possesses some more fundamental normative, or even mandatory, quality. It will be argued that, while autonomy appears to have developed a degree of normativity, it is not a mandatory principle, but rather one that is subject in some degree to party autonomy. On that basis, Part 3 will consider the extent to which the parties can, or should be allowed to, 'tailor' the autonomy principle, whether by excluding that principle entirely, cherry-picking certain of its aspects, or bolstering its application in circumstances where it might otherwise be excluded as result of some exception operating. It will be argued that, whilst parties are free to choose whether they wish the doctrine of autonomy or only certain aspects to govern their dealings, that will be likely to have an impact upon the nature of the resulting instrument, so that it will likely become something entirely different. In light

⁸ *Cavendish Square Holding BV v Makdessi* [2016] AC 1172, [4]-[8]. See also R Goode, 'Abstract Payment Undertakings' in P Cane and J Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press 1991) 213-215.

⁹ The argument will be developed below, however, that the courts and the International Chamber of Commerce have fallen into error in extending the doctrine of autonomy to performance bonds: see further Part 4 below.

of the discussion regarding the nature of the autonomy principle, Part 4 will tackle the issue of whether performance bonds should in principle continue to be treated as autonomous instruments, whether (as suggested academically) they should be placed on a lower point on a supposed scale of autonomy, or whether they are more logically equated with other non-autonomous forms of security. Somewhat controversially, this working paper will advocate the third of these options. Finally, some concluding remarks will be offered.

2 Meaning, nature and scope of autonomy

Autonomy is a much-abused notion. It tends to be bandied about academically and judicially without there being a sufficiently close focus upon what precisely this entails. In some respects, the notion has become over-expansive in its effects (tending to isolate autonomous instruments from general developments in private law, such as unjust enrichment and subrogation principles in respect of a bank's non-documentary rights of recourse) and in other respects under-ambitious and insufficiently assertive (given that all sorts of inroads have nowadays been made into autonomy without that notion appearing to be undermined). Accordingly, it becomes necessary to determine what precisely is meant when one says that a payment instrument or obligation is 'autonomous'. It is submitted that 'autonomy' is a shorthand for the 'bundle of legal consequences' that flow from the judicial characterization of a particular instrument as falling within the class of payment instruments or obligations that the law has determined should be autonomous in nature. Such circular reasoning leads, however, to something of a chicken-and-egg problem: a particular instrument is autonomous because it falls within a particular legal category, yet that category is only legally distinct because it covers only instruments that are considered to be autonomous. The Gordian knot can nevertheless be cut by identifying certain meta-factors that can be used to identify whether a particular transaction falls within one legal category of transaction or another and then determining which of those legal categories require as a matter of commercial necessity to be treated as 'autonomous', which effectively means that it will give rise to certain judicial consequences (to be considered further below). This reasoning structure can be seen in the line of cases that have had to determine whether a particular transaction is a conditional

guarantee (non-autonomous) or a first-demand guarantee/performance bond (traditionally considered to be autonomous).¹⁰ For example, in *Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank of Greece SA*,¹¹ the English Court of Appeal indicated that '[w]here an instrument (i) relates to an underlying transaction between the parties in different jurisdictions, (ii) is issued by a bank, (iii) contains an undertaking to pay "on demand" (with or without the words "first" and/or "written") and (iv) does not contain clauses excluding or limiting the defences available to a guarantor, it will almost always be construed as a demand guarantee'. This is as close to a definition as one can hope to get. One might proffer an equivalent set of meta-factors for the documentary letter of credit to the effect that the instrument is issued by a bank, is designed to facilitate payment in respect of an international sales contract (usually for goods, although it could conceivably cover contracts for services) and is framed in such a way that the obligation to pay arises solely upon strict conformity of presented documents, rather than performance of any related contract.¹² Accordingly, if the instrument displays the characteristics associated with a particular type of payment instrument/obligation, then it ought to be classified as such. Such legal formalism might appear somewhat retrograde, but these meta-factors merely identify the usual characteristics of (rather than provide the rigid definition for) the documentary letter of credit¹³ and may alter over time to reflect prevailing mercantile usage.¹⁴ Moreover, such characterization issues are likely to persist for as long as different types of instrument attract different legal consequences and indeed are still very much alive in the context of differentiating between transactions operating by way of title transfer or those constituting genuine security interests (and, in such cases, there will be need for further differentiation between whether the interest is a mortgage or charge, and in the latter case whether it is fixed or floating).

Assuming that, as suggested above, the notion of autonomy is effectively an umbrella term encompassing the 'bundle of legal consequences' flowing from the legal characterization of a

¹⁰ See n 6 above.

¹¹ *Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank of Greece SA* [2014] 1 Lloyd's Rep 273.

¹² For a suggested list of such meta-factors, see R Goode, 'Abstract Payment Undertakings' in P Cane and J Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press 1991) 223.

¹³ For the distinction between a list of characteristics and a rigid definition, consider (in admittedly very different contexts) *United Dominions Trust Ltd v Kirkwood* [1966] 1 Lloyd's Rep 418; *Ebrahimi v Wesbourne Galleries Ltd* [1973] AC 360.

¹⁴ R Goode, 'Abstract Payment Undertakings' in P Cane and J Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press 1991) 223-224.

particular transaction as falling within the class of transactions that is viewed as autonomous, those consequences fall to be identified. If one takes the documentary letter of credit as being the archetypal autonomous payment undertaking, there are five such consequences that have generally been associated (both judicially and academically) with the characterization of a transaction as such.

2.1 Autonomy and validity

The first possible consequence of classifying an instrument as autonomous is that its formation and legal validity is isolated or 'abstracted' from that of the underlying sale transaction. The mere fact that the underlying transaction is void, voidable, terminated for breach, frustrated or otherwise unenforceable does not, without more, 'infect' the payment undertaking. That said, on the assumption that the autonomous payment undertaking qualifies as a contract,¹⁵ the instrument must be subject to the usual grounds of contractual invalidity (albeit that arguments based upon an absence of agreement,¹⁶ consideration¹⁷ or authority¹⁸ are unlikely to have much scope for operation in this context) and the invalidity of the underlying transaction may provide the *basis* for an independent and freestanding assertion that the autonomous payment undertaking is invalid. For example, in circumstances where, *before* the letter of credit had been issued, the underlying transaction is either void *ab initio* for mistake, frustrated on the basis that it is impossible to source the contractual goods, or avoided for misrepresentation, this may provide the basis for an argument that the letter of credit is also void for a fundamental mistake: this is not an *automatic* result, however, but depends upon whether the payment undertaking is impacted in a *fundamental, distinct and independent* manner.¹⁹ Similarly, even where the issuing of the letter of credit is legal *per se*, its performance may be illegal if payment would further the performance of an underlying

¹⁵ This is certainly the assumption that Lord Diplock makes in *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168.

¹⁶ R Goode, 'Abstract Payment Undertakings' in P Cane and J Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press 1991) 222-226, 235.

¹⁷ *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq* [2017] UKSC 64 [25], [95], [100].

¹⁸ *Standard Bank London Ltd v Bank of Tokyo* [1995] Lloyd's Rep 169; *Industrial & Commercial Bank Ltd v Banco Ambrosiano Veneto SpA* [2001] SGHC 120.

¹⁹ R Goode, 'Abstract Payment Undertakings' in P Cane and J Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press 1991) 226-227.

transaction that is unlawful.²⁰ This is not because (as some case law has suggested)²¹ the underlying transaction in some way ‘infects’ the payment undertaking by way of some misguided exception to autonomy, but rather by virtue of applying to the letter of credit directly the principles relating to contracts rendered illegal by virtue of their manner and place of performance. It is even possible for post-issue events relating to the underlying contract to result in the letter of credit’s frustration, provided they reach the high threshold required for that doctrine to apply, although admittedly this will be extremely rare in practice, given the fungible nature of money. Indeed, the possibility of defects in the underlying contractual arrangements providing a potential basis for invalidating a letter of credit was accepted recently by the High Court of Australia in *Simic v New South Wales Land & Housing Corporation*,²² which involved a domestic Australian performance bond issued by the ANZ bank in favour of the stated beneficiary, ‘New South Wales Land and Housing Corporation’ (although the intended beneficiary was in fact ‘New South Wales Land & Housing Department trading as Housing NSW’), in relation to a construction contract with the Australian applicant, Nebax. Unsurprisingly, the ANZ bank subsequently refused payment on the basis that the documents presented misstated the beneficiary’s identity. As the High Court did not consider it possible to resolve the discrepancy in the performance bond by a process of interpretation,²³ the key issue concerned whether, and if so how, the instrument might be rectified to identify the intended beneficiary. A unanimous court concluded that it was possible in principle to rectify a performance bond, albeit that the relevant intentions to be examined for this purpose were those of the applicant and issuing bank, rather than issuing bank and beneficiary.²⁴ This conclusion highlights how matters affecting the associated contracts (in *Simic*, the applicant-issuing bank relationship) can provide material vitiating the expressed consent in the issuing bank-beneficiary relationship. Nor does it matter that *Simic* actually concerned a performance bond rather than a letter of credit, since Gageler, Nettle

²⁰ Ibid, 227, 235.

²¹ See generally *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152; *Mahonia Ltd v JP Morgan Chase Bank* [2003] 2 Lloyd’s Rep 911; *Mahonia Ltd v JP Morgan Chase Bank* [2004] EWHC 1938 (Comm) [1]-[8], [422]-[435].

²² *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47.

²³ Ibid, [7]-[8], [10], [31], [79]-[101].

²⁴ Ibid, [17], [38]-[39], [41], [46], [109].

and Gordon JJ in a joint judgment indicated that ‘in Australia there is no special doctrine of law precluding rectification of a letter of credit on the basis of a common mistake’.²⁵

None of this is, however, entirely unusual or unique to letters of credit, since neither a cheque, bill of exchange nor card or electronic payment is *automatically* invalidated by a defect in the underlying transaction; nor is a guarantee, as an accessory contract, *per se* invalidated by some vitiating factor operating on the principal contract.²⁶ The isolation of the letter of credit’s validity from the underlying agreement is more attributable to the fact that these are factually separate contracts (and there is no general doctrine whereby the invalidity of one contract automatically invalidates an associated transaction) than to the operation of any distinct notion of autonomy.

2.2 Autonomy and interpretation

Assuming that the letter of credit is valid, it has been suggested that the process of construing the instrument’s terms and interpreting what its language requires of the parties (both in terms of the payment obligation and the conditions precedent to payment) is affected by placing the instrument within the class of autonomous transactions. Certainly, in *Simic v New South Wales Land & Housing Corporation*,²⁷ French CJ considered (albeit in the context of a domestic performance bond) that the autonomy principle effectively involved a ‘rule of construction’, since ‘the autonomy principle requires that the obligations of the issuing and accepting bank under the bond not be read as qualified by reference to the terms of the underlying contract’.²⁸ The rest of the High Court of Australia expressed similar views.²⁹ Whilst traditionally contractual interpretation has (subject to defined exceptions) favoured dictionary-bound literalism, recent years have seen the rise of contextual interpretation,

²⁵ Ibid, [118]. Consider further *Tradax Petroleum American Inc v Coral Petroleum Inc*, 878 F 2d 830 (5th Cir, 1989), in which the United States Court of Appeals for the 5th Circuit denied the reformation of a letter of credit on that ground that reformation was unavailable on the facts rather than as a matter of principle.

²⁶ *Associated Japanese Bank (International) Ltd v Credit du Nord SA* [1989] 1 WLR 255, 269.

²⁷ *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47 [7]-[8], [10].

²⁸ In terms of the relationship between the doctrine of strict compliance and the autonomy principle, the High Court of Australia considered that, as the former was a matter of contractual performance and the latter was a matter of construction, the autonomy principle is logically ‘anterior to the principle of strict compliance’: see *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47 [9]-[10], [99].

²⁹ *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47 [31], [77]-[101].

which encourages the courts to examine anything relevant from the contract's 'factual matrix' in the quest for meaning.³⁰ Such an approach would be anathema to autonomous instruments, as it would encourage courts to interpret letters of credit in light of the underlying transaction, thereby threatening their isolationist nature through the backdoor. The English courts have sidestepped this trap by recognizing that interpretation is in practice a 'unitary exercise'³¹ or an 'iterative process'³² that sometimes requires a more literal approach and at other times requires a more contextual approach. Indeed, it has been recognized that a literal approach to interpretation is more likely to be appropriate for those contracts that adopt a standard form to reflect market needs and practices and that are ordinarily relied upon by specific third parties or market participants more generally.³³ Letters of credit are such contracts *par excellence*, since they are issued on standard SWIFT formats to facilitate their transmission from bank to bank and may be relied upon by suppliers (under transferable letters of credit), banks (when making advances on the strength of the credit proceeds) and carriers (when determining the form of the underlying bill of lading).³⁴ Indeed, in *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq*,³⁵ Lord Hodge for the majority (and approving Moore-Bick LJ in the lower court)³⁶ recognized that the generally applicable 'iterative process' of contractual construction would generally require the English courts to adopt a more literal approach to the interpretation of letters of credit. Indeed, such an approach is consistent with authority in the English Court of Appeal³⁷ and High Court of Australia.³⁸ Accordingly, the interpretational isolation of the letter of credit does not necessarily stem from the autonomy principle itself,³⁹ but rather from the courts' wider recognition that the ordinary rules of interpretation should approach certain

³⁰ *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912-913. See also *Prenn v Simmonds* [1971] 1 WLR 1381, 1383-1385; *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989, 997.

³¹ *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900 [21]; *Arnold v Britton* [2015] AC 1619 [77].

³² *Wood v Capita Insurance Services Ltd* [2017] 2 WLR 1095 [10]-[13].

³³ Consider *Re Sigma Finance Corp* [2010] 1 All ER 571.

³⁴ *Homburg Houtimport BV v Agrosin Private Ltd (The Starsin)* [2004] 1 AC 715.

³⁵ *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq* [2017] UKSC 64, [73]-[74].

³⁶ *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq* [2015] EWCA Civ 835, in which Moore-Bick LJ indicated (at [5]) that 'one should be very cautious ... before construing letters of credit by reference to extraneous circumstances' and Briggs LJ (at [60]) made clear that a 'letter of credit effectively excludes recourse to outside assistance'.

³⁷ *Petrosaudi Oil Services (Venezuela) Ltd v Novo Banco SA* [2017] EWCA Civ 9.

³⁸ *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47 [8]-[10].

³⁹ Cf *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47 [7].

types of contract more literally, irrespective of whether those contracts are autonomous in the sense used in relation to letters of credit.

2.3 Autonomy and choice of law

As regards choice of law, the English courts have recognized that a consequence of a letter of credit being autonomous is that the law applicable to the issuing and confirming banks' payment obligations should be determined without reference to the sale contract's applicable law.⁴⁰ The justification for this approach is that it avoids the beneficiary's rights under the letter of credit and the banks' payment obligations being undermined or diluted by the operation of an unanticipated or unconnected legal system and provides the means whereby the credit is insulated from foreign stop orders, freezing injunctions or attachment orders. Whilst this justification makes sense in the context of a confirmed credit (when the beneficiary and confirming bank will usually be based in the same jurisdiction), its operation is potentially less obvious in the context of an unconfirmed credit as the applicable law will usually be the law of the place where the documents are presented to the issuing bank, which may in fact be less favourable or familiar to the credit beneficiary than the law applicable to the underlying sale contract. Moreover, whilst the English courts have developed the doctrine of infection to determine choice of law issues in the context of contractual networks,⁴¹ there has been some inconsistency in its application (or lack of application) in the letter of credit context: according to the UCP 600, the autonomy principle isolates the issuing bank's obligations from 'the contractual relationships existing between banks [and] between the applicant and the issuing bank', as well as the underlying sale contract;⁴² yet the courts have not respected the principle in the former case,⁴³ only the latter.⁴⁴ It would appear, therefore, that the choice of law consequences of autonomy are not a necessary consequence of that

⁴⁰ *Offshore International SA v Banco Central SA* [1977] 1 WLR 399, 401; *Attock Cement Co Ltd v Romanian Bank for Foreign Trade* [1989] 1 WLR 1147, 1158-1159.

⁴¹ *Broken Hill Pty Co Ltd v Xenakis* [1982] 2 Lloyd's Rep 304; *Attock Cement Co Ltd v Romanian Bank for Foreign Trade* [1989] 1 WLR 1147, 1158; *Wahda Bank v Arab Bank plc* [1996] 1 CLC 408, 411. See also *Ilyssia Compania Naviera v Bamaodah* [1985] 1 Lloyd's Rep 107, 112.

⁴² UCP 600, art 4.

⁴³ *Bank of Baroda v Vysya Bank Ltd* [1994] 1 CLC 41, 49; *Bank of Credit and Commerce Hong Kong v Sonali Bank* [1994] CLC 1117, 1184.

⁴⁴ See n 39 above.

notion (since the starting point must be that each contract has its own applicable law), nor one that operates consistently.

2.4 Autonomy and contractual performance

Whatever the letter of credit requires of the parties, the performance of the underlying sale contract does not count as performance under the letter of credit.⁴⁵ Accordingly, the fact that the credit beneficiary/seller has shipped the goods to the credit applicant/buyer is insufficient to trigger the banks' obligations to pay under the letter of credit, since this occurs upon the presentation of conforming documents alone. Similarly, as the letter of credit will require the shipping documents to be presented at the counters of a particular bank,⁴⁶ their presentation to the seller or a related party in accordance with the terms of the underlying contract does not oblige the banks to pay under the credit. It is to this consequence of the autonomy principle that UCP 600 is referring when it indicates that '[b]anks deal with documents and not with goods, services or performance to which the documents may relate'.⁴⁷ In many ways, though, this is simply the consequence of the performance of the underlying contract being *res inter alios acta* and accordingly it may be wondered whether it was necessary to construct a whole new legal edifice to achieve this result. Indeed, the UCP 600 does little more than repeat this truism when it states that '[a] credit by its nature is a separate transaction from the sale or other contract on which it may be based'.⁴⁸ That said, the converse proposition does not necessarily hold true, as performance under the letter of credit (whether presenting conforming documents or paying against them) can constitute performance under the underlying sale contract where these require the same acts (although it is possible, albeit undesirable, for the obligations under the two contracts to diverge). Accordingly, given that the letter of credit clearly stipulates the acts required to trigger payment, it is not clear that the principle of autonomy adds much to the pre-existing *factual* separateness of contractual performance.

⁴⁵ *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq* [2017] UKSC 64 [73].

⁴⁶ UCP 600, art 6.

⁴⁷ *Ibid*, art 5. See also *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47 [85].

⁴⁸ *Ibid*, art 4.

2.5 Autonomy and contractual non-performance/breach

A corollary of the foregoing is that any *failure* of performance in relation to the underlying contract does not affect the beneficiary's right to payment or the issuing or confirming bank's obligation to pay, although (once again) the converse is not necessarily true, since the underlying contract may be breached if the letter of credit fails to produce payment. This suggested consequence of the autonomy principle might be considered to have three distinct aspects.

The first aspect is that, from the credit beneficiary's/seller's perspective, there is no requirement to establish as a precondition to payment that there has been some breach or failure to perform the underlying contract by the credit applicant/buyer, as long as the documents presented strictly comply with the terms of the credit. It is submitted, however, that this consequence is the result of the letter of credit constituting a *primary* payment undertaking (rather than a secondary or default-based undertaking) that may accordingly be enforced without the need for any prior default in payment on the part of the credit applicant/buyer. Accordingly, this feature of letters of credit is not legally attributable to any notion of autonomy.

The second aspect is that it is not generally open to the issuing or confirming bank to revoke the letter of credit unilaterally or to refuse payment (of its own motion) on the basis that the credit beneficiary/seller has failed to perform its obligations pursuant to the underlying sale contract or has otherwise breached that contract. This flows from two specific features of the letter of credit.⁴⁹ The first feature is the irrevocable nature of the undertaking between the banks and credit beneficiary, which was presumed at common law,⁵⁰ and is prescribed under the UCP 600.⁵¹ It is this feature that Rowlatt J was referencing in *Stein v Hambro's Bank of Northern Commerce* when he indicated that '[t]he obligation of the bank is absolute, and is

⁴⁹ It is submitted that each of these features alone suffices to insulate the letter of credit from underlying breaches, since otherwise revocable letters of credit (which admittedly are increasingly rare) would be excluded from the account.

⁵⁰ *Cape Asbestos Co Ltd v Lloyds Bank Ltd* [1921] WN 274.

⁵¹ UCP 600, arts 2-3.

meant to be absolute, that when the documents are presented they have to accept the bill'.⁵² It is accordingly mistaken to ascribe this statement to a distinct autonomy doctrine. The second feature is that *factually* the underlying sale contract is *res inter alios acta* as regards the parties to the letter of credit. There is no general principle of English law that allows one party to justify its non-performance of its contractual undertakings by reference to a breach suffered by another unless the first contract explicitly or implicitly conditions its performance upon the other contract's fulfilment. Certainly, any implication to that effect would be inconsistent with the primary and unconditional nature of the bank's undertaking,⁵³ but it may be wondered what would stop the issuing and confirming banks (acting upon their instructions) from inserting an express condition to this effect into their letter of credit. Indeed, there may be an argument that this is where the autonomy principle has a distinct role, since the UCP 600 stipulates clearly that '[b]anks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit'⁵⁴ and the overriding of an express contractual restriction in a letter of credit cannot really be explained on any contractual, or other private law, basis.⁵⁵ It is submitted, however, that this argument is flawed since, at least as a matter of English law, it is not possible for terms incorporated by reference (such as the UCP) to oust an express contractual provision,⁵⁶ especially when there is an 'irreconcilable inconsistency' between them.⁵⁷ Accordingly, the credit's unconditionality does not appear to be attributable to autonomy.

The third aspect is that the issuing and confirming banks are not entitled to act upon instructions from the credit applicant/buyer not to pay, regardless of whether or not that

⁵² *Stein v Hambro's Bank of Northern Commerce* [1921] Ll L Rep 507. See also *Stein v Hambro's Bank of Northern Commerce* [1921] Ll L Rep 334.

⁵³ *Urquhart Lindsay & Co Ltd v Eastern Bank Ltd* [1922] Ll L Rep 572, 573. For the reluctance to imply terms into a letter of credit, see *Cauxwell Ltd v Lloyds Bank Ltd*, *The Times*, 26 December 1995. See also *Jackson v Royal Bank of Scotland* [2005] 1 Lloyd's Rep 366; *Uzinterimpex JSC v Standard Bank plc* [2007] 2 Lloyd's Rep 187 [155]-[158].

⁵⁴ UCP 600, art 6(a).

⁵⁵ One might try to argue that the invalidation of such a clause might be achieved under the Unfair Contract Terms Act 1977 (or its equivalents in cognate jurisdictions), but, putting aside the fact that the courts have been reluctant to deploy this weapon between sophisticated commercial parties, it is unclear that such a clause is purporting to operate by way of exclusion or limitation rather than as a 'basis' clause.

⁵⁶ *Royal Bank of Scotland plc v Cassa di Risparmio delle Provincie Lombarde* [1992] 1 Bank LR 251.

⁵⁷ *Forestal Mimosa Ltd v Oriental Credit Ltd* [1986] 1 WLR 631; *Credit Industriel et Commercial v China Merchants Bank* [2002] EWHC 973 (Comm); *Korea Exchange Bank v Standard Chartered Bank* [2006] 1 SLR 565.

request is prompted by a breach of the underlying contract. This might also be considered a consequence of the letter of credit's irrevocability, rather than the distinct operation of an autonomy doctrine, but it is clear from the UCP 600 that 'irrevocability' refers more to the inability of the issuing/confirming bank to renege unilaterally from its undertaking once given, rather than to the inability of the credit applicant/buyer to interfere with payment — a 'credit' is defined as 'any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation'.⁵⁸ Given that payment involving most other mechanisms are capable of countermand by the bank's customer (whether cheque,⁵⁹ card payment or (at least theoretically) electronic funds transfers),⁶⁰ the inability of the credit applicant to countermand payment under a letter of credit at all (assuming 'irrevocability' under the UCP 600 has the limited meaning suggested above) must derive from some other source, namely the instrument's autonomous nature. Autonomy, therefore, operates to mediate between the bank's role as principal under the letter of credit and its role as a payment agent for its customer/the credit applicant. Whereas a bank's role as agent will take precedence in other payment systems that have not been characterized as autonomous,⁶¹ the function of autonomy is to suppress the issuing and confirming bank's agency in favour of its undertaking as principal towards the beneficiary. Despite this being one of the clear legal consequences of autonomy, the UCP 600 only addresses the point in a rather tangential manner when it indicates that 'the undertaking of a bank to honour, to negotiate or to fulfill any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationship with the issuing bank ...'.⁶² In fact, this phrase has a further significance, since it indicates that, as well as subordinating the credit applicant's rights as the bank's principal to the credit beneficiary's rights under the letter of credit, autonomy also operates to subordinate the applicant's rights *qua* buyer to the seller's rights *qua* beneficiary. Indeed, it is clear that the existence of a letter of credit as a payment mechanism impacts upon the credit applicant's/buyer's usual remedies

⁵⁸ UCP 600, art 2.

⁵⁹ Bills of Exchange Act 1882, s 75.

⁶⁰ This is even the case for modern electronic funds transfer systems, such as CHAPS and CHIPS, which generally make it extremely difficult (albeit not impossible) for the initiator to reverse or interfere with their payment instruction due to the extremely short time-limits that operate.

⁶¹ Although funds transfers have not generally been considered as autonomous, there have been suggestions to that effect: see R Goode, 'Abstract Payment Undertakings' in P Cane and J Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press 1991) 221-222.

⁶² UCP 600, art 4(a).

under the sale contract: in a straightforward documentary sale (where the financing is not provided by means of a letter of credit), the buyer has independent rights to reject non-conforming documents and non-conforming goods and accordingly to withhold payment on either basis. Moreover, the buyer can also rely upon breaches of the sale contract to abate the price payable by way of set-off. When payment is made by letter of credit, however, the credit applicant's/buyer's usual self-help remedies *under the sale contract* (whether by withholding payment entirely or abating the price payable by means of set-off) are impaired. Whilst the absence of set-off might be explained by the lack of mutuality that arises in a tripartite (or more) relationship, a lack of set-off is not unique to the letter of credit, since it is also not generally possible to reduce or negate the sum payable or paid by setting off compensation for breaches of the underlying contract when payment is made by cheque, bill of exchange, direct debit⁶³ or credit transfer despite these other payment mechanisms never having been characterized as autonomous. Restrictions on set-off must accordingly have some other juridical explanation than autonomy. The same is not necessarily true of the buyer/credit applicant's loss of ability to withhold payment, since this is a necessary consequence of the buyer/credit applicant's inability (discussed immediately above) to revoke its instructions to issue and pay under a letter of credit. Any other conclusion would result in the buyer/credit applicant being able to achieve *directly* against the seller/credit beneficiary what is effectively denied through the intermediation of the issuing bank.⁶⁴ Indeed, in *Hamzeh Malas & Sons v British Imex Industries Ltd*, the English Court of Appeal made it clear that choosing payment by letter of credit by necessity impaired the ability of the buyer/credit applicant to enjoin the seller/credit beneficiary from claiming the price payable by presenting the requisite documents to the relevant bank.⁶⁵ Given that there is no equivalent impairment when other payment mechanisms are used, this position would also appear to flow from the autonomous nature of letters of credit.⁶⁶

⁶³ *Esso Petroleum Company Ltd v Milton* [1997] EWCA Civ 927.

⁶⁴ Contrast the approach in *Themehelp Ltd v West* [1995] 4 All ER 215, 227 with *Deutsche Rückversicherung AG v Walbrook Insurance Co Ltd* [1996] 1 All ER 791, 801.

⁶⁵ *Hamzeh Malas & Sons v British Imex Industries Ltd* [1958] 2 QB 127, although Sellers LJ considered (at 128) that such an injunction might issue 'in a case where there is a fraudulent transaction'.

⁶⁶ Conversely, the letter of credit mechanism (unlike other payment mechanisms such as the bill of exchange or cheque) does not necessarily diminish the beneficiary's/seller's remedial options, since, as well as the beneficiary being able to bring a debt claim for the price when it has presented (or remains willing to present) the shipping documents to the banks under the letter of credit (see *Stein v Hambro's Bank of Northern Commerce* [1921] Ll L Rep 507), it retains the ability to claim its profits on lost sales transactions by way of damages flowing from the banks' failure to pay: see *Standard Chartered Bank v Dorchester LNG*

2.6 The scope of autonomy

The above review of the autonomy doctrine in an English law context has hopefully demonstrated that the *legal* impact of the autonomy principle is really far more modest than is generally suggested both academically and judicially, since many of the letter of credit's advantages are attributable to other juridical devices. In essence, classifying a payment instrument as autonomous is synonymous with saying that there is an irrevocable mandate to pay, which prevents the principal from interfering with payment either indirectly through its agent (the issuing bank) or directly against the payee (the seller/credit beneficiary). As well as explaining the *nature* of the issuing bank's authority or agency (ie it is irrevocable), autonomy (and its insistence on documentary compliance) also explains the *scope* of that authority: the bank is *obliged* to pay against documents that *actually* conform to the terms of the credit, but is *authorized* to pay (and consequently obtain reimbursement) against documents that *apparently comply on their face* to the credit's terms.⁶⁷ By placing autonomy firmly within the applicant-issuing bank relationship (and to the extent necessary to support this view also incidentally within the buyer-seller relationship), rather than within the bank-beneficiary relationship as is traditionally the case, it is submitted that one can provide a more coherent account regarding not only what autonomy achieves *in legal terms*, but also its *legal* limits. Accordingly, rather than explaining the fraud exception by reference to some implied public policy-based limitation upon the bank's *obligation* to pay (which is the current orthodoxy in England following *United City Merchants (Investments) Ltd v Royal Bank of Canada*⁶⁸), that exception could be justified by reference to the notion that where the paying bank is aware of 'fraud' not only does its mandate cease to be irrevocable (so that the credit applicant may enjoin either the bank or the beneficiary, assuming it has sufficiently clear and

(2) *Ltd* [2016] QB 1. The latter is not something that is available when a cheque or bill of exchange fails to produce payment, since damages for failure to honour a cheque are calculated by reference to the instrument's face value (see *Westminster Bank Ltd v Hilton* (1926) 43 TLR 124) and recovery is statutorily limited to the 'amount of the bill' and interest in the case of a bill of exchange (see the Bills of Exchange Act 1882, s 57(1)). Somewhat paradoxically then, the letter of credit can sometimes afford superior protection to the beneficiary in terms of remedies by being *less* isolated from any underlying or related contracts when compared with other forms of payment instrument.

⁶⁷ UCP 600, art 14(a). See also R Goode, 'Abstract Payment Undertakings' in P Cane and J Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press 1991) 229-230.

⁶⁸ *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168.

compelling evidence of fraud),⁶⁹ but the issuing bank no longer has authority to pay against apparently conforming documents (in light of its knowledge of the true state of affairs)⁷⁰ and indeed owes its customer (the credit applicant) a positive duty to refuse payment, breach of which may make the bank liable in damages.⁷¹ Whilst this agency-based approach to the fraud exception would not diminish the need for either clear evidence of fraud or actual knowledge on the bank's part, it would release English law from the shackles of having to establish documentary fraud as opposed to a broader range of fraudulent activity (indeed a bank would not be *obliged* anyway, albeit it may be *entitled*, to pay against materially fraudulent documents) and would dispense with the need to demonstrate that the beneficiary was privy to the fraud (the precise source of the fraud being irrelevant). Such an approach would also make redundant any need for a nullity exception⁷² (since this would be encompassed within the broader notion of fraud anyway) and would remove any temptation to allow a notion of unconscionability to leech from performance bonds into letters of credit.⁷³ Once properly positioned within our legal taxonomy neither the autonomy principle nor its so-called exceptions should prove legally problematic.

One puzzle, however, remains. If, as argued above, autonomy is simply a proxy for the irrevocability and scope of the issuing bank's agency, it may be wondered why the International Chamber of Commerce through the various iterations of the UCP has found the need to erect what appears to be a whole new edifice to deal with the issue rather than simply relying upon the established and relatively straightforward notion of irrevocability alone. The answer lies in the two commercial functions that the UCP has played and continues to play: one reflective; the other reforming. On the one hand, in its reflective role, the UCP's function is closely tied to the identity and aims of those drafting the UCP: predominantly they are

⁶⁹ *Alternative Power Solution Ltd v Central Electricity Board* [2014] UKPC 31.

⁷⁰ *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd* [1999] 2 Lloyd's Rep 187.

⁷¹ All other forms of payment instrument are conditioned by such a duty as an incident of the banker-customer relationship and there seems to be no reason in principle why it would not also operate between the bank and its customer in relation to the issuing of letters of credit: see *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363; *Lipkin Gorman (a firm) v Karpnale Ltd* [1989] 1 WLR 1340.

⁷² Compare *Montrod Ltd v Grundkötter Fleischvertriebs* [2002] 1 WLR 1975; *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* [2003] 1 SLR 597.

⁷³ Consider *Royal Design Studio Pte Ltd v Chang Development Pte Ltd* [1991] 2 MLJ 229; *Kvaerner Singapore Pte Ltd v UDL Shipping Pte Ltd* [1993] 2 SLR(R) 341; *GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 3 SLR(R) 44; *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352. See also *Boral Formwork and Scaffolding Pty Ltd v Action Makers Ltd* [2003] NSWSC 713.

bankers and traders, rather than lawyers, whose aim is to reflect as far as possible the existing international banking practices, rather than to fit their principles, statements or practices into the straightjacket of existing legal concepts. The prime example of the UCP's reflective aims are the many lengthy provisions dealing with the form of the specific documents that are usually presented under a letter of credit.⁷⁴ Indeed, it is all too often forgotten by practising and academic lawyers alike that the UCP is not a coherent set of 'rules' or even a comprehensively drafted set of contractual terms, but simply a record of an evolving consensus about international banking practices, usages and customs. It is hardly surprising, therefore, that UCP eschews overtly legal or divisive issues (such as principles relating to contractual formation, choice of law, legal remedies or the impact of fraud) and that national courts increasingly seem frustrated by the UCP's elliptical nature.⁷⁵ On the other hand, in its reforming role, the UCP, by purporting to represent an international consensus, does sometimes pursue the ambition of driving forward the harmonization of banking practice by ironing out wrinkles deriving from divergent local banking practices or judicial interpretations — a recent example of the latter being the pre-UCP 600 difficulties surrounding original documents⁷⁶ and deferred payment undertakings.⁷⁷ Given that, as described above, the *legal* impact of autonomy is rather limited, it is submitted that the true commercial and practical significance of that notion lies more in its aspirational, harmonizing and confidence-inspiring effects. In essence, autonomy has been, and remains, a marketing tool. That marketing by the International Chamber of Commerce has been so effective that the notion of autonomy has been almost universally endorsed both commercially and judicially, thereby reassuring parties to international sales that, whatever the particular circumstances of the case, autonomous payment undertakings will not be impeded by some domestic principle of an unfamiliar legal system or by the operations of a foreign (often unforeseen court). This confidence in the unimpeachability of a letter of credit has in turn facilitated third-party financing operations with respect to letters of credit, such as assignments, transfers, back-to-back financing and

⁷⁴ UCP 600, arts 18-28.

⁷⁵ For the increasing examples of courts being requested to imply additional requirements into the UCP regime, see *Fortis Bank SA/NV v Indian Overseas Bank* [2011] EWCA Civ 58; *Grains and Industrial Products Trading Pte Ltd v Bank of India* [2016] 3 SLR 1308; *Deutsche Bank AG v CIMB Bank Berhad* [2017] EWHC 81 (Comm).

⁷⁶ See, for example, *Glencore International AG v Bank of China* [1996] 1 Lloyd's Rep 135; *Kredietbank Antwerp v Midland Bank plc* [1999] 1 All ER (Comm) 801; *Credit Industriel et Commercial v China Merchants Bank* [2002] EWHC 973 (Comm).

⁷⁷ *Banco Santander SA v Banque Paribas* (Unreported, 25 February 2000, EWCA).

factoring. Indeed, one might regard as the litmus test of autonomy's marketing success the fact that letters of credit have been used widely in jurisdictions with less developed payment and banking systems, less stable legal frameworks or less independent judicial, political or economic structures. That said, it may be that the confidence inspired in letters of credit has now peaked, since, although letter of credit use remains widespread in many developing countries, parties are increasingly likely to employ alternative financing mechanisms whether to cope with acute jurisdictional instability (such as countertrade) or to increase efficiency by embracing technological developments that are less dependent on national infrastructure (such as the bank payment obligation). Nevertheless, to focus too much on autonomy's potentially waning commercial significance is to undersell the impact that that notion has had, and continues to have, on trade finance and international trade.

3 Contracting out of (and for) autonomy

Given the meaning of autonomy discussed in the previous section, a further aspect of its juridical nature concerns whether autonomy is a mandatory rule or simply a default rule that the parties are free to abandon if desired. Before considering this theoretical question, it is worth asking first the practical question of whether the parties are likely ever to want to displace the autonomy/irrevocability of the bank's mandate; the response is an affirmative, albeit tentative, one. Support for this being a practical option can be seen from the rapid growth (at the expense of the letter of credit) of trading on open account terms: in circumstances where the balance of commercial power comes down heavily in the buyer's favour, or where the seller is seeking to enter or expand into a highly competitive market, a seller will often have to offer particularly favourable payment and/or credit terms to the buyer. Accordingly, it is not inconceivable that the buyer might instruct its bank to include a provision permitting the buyer/credit applicant to revoke the bank's authority at will or in defined circumstances. Indeed, this is precisely what the English Court of Appeal countenanced (albeit in the context of a performance bond, rather than a letter of credit) in

Sirius International Insurance Corp v FAI General Insurance Co Ltd.⁷⁸ Accordingly, the question arises whether this should be legally permissible.⁷⁹ In general terms, this must be an option open to the parties, since the notion of party autonomy (in a different sense!) requires the courts to respect the express terms of the contract. That said, the instrument would no longer qualify as a letter of credit, since, as indicated above, autonomy (in the sense of irrevocability) is the essence of the letter of credit so that (like Harry Potter and Lord Voldemort) one cannot exist without the other and *vice versa*. Such an instrument would be nothing more than a revocable payment instruction akin to a cheque — although such a creature is certainly possible, it would not benefit from the ‘doctrinal *acquis*’ surrounding documentary letters of credit and other analogous payment instruments (such as on matters pertaining to binding force and performance) and would not be subject to the UCP 600.⁸⁰ It might be objected that party autonomy requires the courts to give effect to the label that the parties attach to their dealings, even if the contract’s provisions effectively hollow its nature out. This is not, however, the case. A similar issue has arisen in the context of classifying fixed and floating charges and in particular, whether a charge should be characterized as a fixed charge simply because the parties have labelled it so, even though the debtor did not exercise any freedom to control the collateral. Whilst the English courts had initially placed the security’s form over its function,⁸¹ such an approach was emphatically rejected by both the Privy Council⁸² and the House of Lords.⁸³ In *Re Spectrum Plus Ltd*, Lord Millett in particular emphasized that there are two steps in any classification process: first, identifying the rights and obligations that the parties have in reality set up amongst themselves or the circumstances in which the parties are operating; and, secondly, using that determination to place the transaction in the appropriate legal category, which will then determine the legal consequences that flow from that particular transaction. In the present case, a number of ‘meta-factors’ were identified as

⁷⁸ *Sirius International Insurance Corp v FAI General Insurance Co Ltd* [2004] Lloyd’s Rep IR 47 (appealed on a different point: [2005] Lloyd’s Rep IR 294).

⁷⁹ A less dramatic form of buyer control, which, albeit at odds with the UCP regime, still persists, involves ‘soft clauses’ in a letter of credit, whereby the documents to be presented in order to secure payment involves one produced by the buyer himself or his agents.

⁸⁰ According to UCP 600, art 1, those default rules only apply to instruments that would be characterized as a ‘documentary credit’, although it is not clear whether that characterization should ultimately be carried out by reference to domestic law concepts or according to some supra-national notion of what constitutes a ‘documentary credit’.

⁸¹ *Siebe Gorman v Barclays Bank Ltd* [1979] 2 Lloyd’s Rep 142; *Re New Bullas Trading Ltd* [1994] 1 BCLC 485.

⁸² *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710.

⁸³ *Re Spectrum Plus Ltd* [2005] 3 WLR 58.

pointing towards an instrument being a letter of credit and the chief consequence of that classification is that the instrument is autonomous. Accordingly, an instrument that describes itself as a non-autonomous letter of credit cannot be anything of the sort simply on the parties' say-so.

One further objection that might be levelled at this suggestion is that it is premised upon the idea that the doctrine of autonomy has somehow transcended the UCP regime and has become something more fundamental than just another provision of the UCP that the parties are free to pick and choose. Certainly, it is true that autonomy nowadays finds its most forceful expression in the UCP 600, which contains 'rules that apply to any documentary credit ... when the text of the credit expressly indicates that it is subject to these rules'⁸⁴ — a provision that is strikingly similar to its predecessor in the UCP 500, which applied 'to all Documentary Credits ... where they are incorporated into the text of the Credit'.⁸⁵ Despite the UCP 600's self-reference as 'rules', which might support an argument as to the mandatory nature of the UCP regime nowadays, it remains clear that the UCP 600 requires express incorporation or disapplication by the parties⁸⁶ (although there may still be the possibility of *automatic* disapplication where there exists an 'irreconcilable inconsistency' between the UCP 600 and the letter of credit).⁸⁷ Nevertheless, it is submitted that the UCP generally, and the autonomy doctrine more specifically,⁸⁸ has arguably attained a more normative status than was originally intended.⁸⁹ In relation to the UCP regime generally, there are examples of the courts referring to its terms as a basis for determining substantive issues in other areas of law, such as the interpretation of bills of lading,⁹⁰ and the United States has always been clear

⁸⁴ UCP 600, art 1.

⁸⁵ UCP 500, art 1.

⁸⁶ UCP 600, art 1.

⁸⁷ *Forestal Mimosa Ltd v Oriental Credit Ltd* [1986] 1 WLR 631; *Credit Industriel et Commercial v China Merchants Bank* [2002] EWHC 973 (Comm); *Korea Exchange Bank v Standard Chartered Bank* [2006] 1 SLR 565.

⁸⁸ FP De Rooy, *Documentary Credits* (Kluwer Law and Taxation Publishers 1994) 16 suggesting that certain principles have risen above the essentially contractual status of the UCP regime, notably the autonomy doctrine. See also R Chhina, "'Unconscionability' as an Exception to the Autonomy Principle: How Well is it Entrenched in Singaporean Jurisprudence?" [2016] LMCLQ 412.

⁸⁹ This paper is drawing a distinction between a mandatory provision, which is incapable of being disapplied irrespective of the circumstances, and a normative provision, which may be expressly disapplied, but not without altering the basis upon which the parties are dealing with one another.

⁹⁰ *Homburg Houtimport BV v Agrosin Private Ltd (The Starsin)* [2004] 1 AC 715; *Jl MacWilliam Co Inc v Mediterranean Shipping Co SA (The Rafaela S)* [2005] 1 Lloyd's Rep 347.

that the relevant provisions of the Uniform Commercial Code must give priority to the UCP regime, despite the latter lacking the force of law. Indeed, there are examples of English courts utilizing the UCP regime to resolve the issues before them, even though the letter of credit in question was not governed by those rules.⁹¹ Even if one were to accept that the UCP as a whole has not achieved a more normative status, there is certainly a compelling argument that core principles, such as autonomy, may have. Certainly, the autonomy principle is considered non-derogable for instruments considered to be letters of credit under the Uniform Commercial Code⁹² and, as the notion appears to pre-date the advent of the UCP regime,⁹³ there seems to be no reason to diminish that principle's status by reference to the subsequent advent of the unified regime. Accordingly, it is submitted that the references to the autonomy principle in the UCP 600 and earlier iterations ought to be neutral in this regard.

The issue of whether autonomy may be excluded by contract gives rise, however, to two other related issues. The first issue concerns whether it is possible to have a 'spectrum' or 'rainbow' of autonomy in that the law (for certain types of instrument) or the parties (for their own commercial purposes) may dispense with only certain aspects of autonomy, rather than disapplying the principle wholesale, with the result that autonomy in effect operates with variable intensity in different circumstances. In that regard, there certainly appear to have been academic suggestions that some instruments may be 'less independent' than others or that the transplant of autonomy from one situation to another 'may well be uncomfortable';⁹⁴ this suggests that autonomy may operate more or less strictly in different circumstances. It is submitted, however, that, on the basis of the above arguments, this suggestion is erroneous. If autonomy effectively relates to the irrevocable nature of the issuing bank's mandate then its application to a particular case is essentially binary: the bank's mandate is either irrevocable or it is not; there are no shades in between. This issue will be considered further below in the context of whether performance bonds should be considered autonomous.

⁹¹ *Siporex Trade SA v Comdel Commodities Ltd* [1986] 2 Lloyd's Rep 428.

⁹² Uniform Commercial Code, s 5-103(d).

⁹³ *Stein v Hambro's Bank of Northern Commerce* [1921] Ll L Rep 507; *Stein v Hambro's Bank of Northern Commerce* [1921] Ll L Rep 334; *Urquhart Lindsay & Co Ltd v Eastern Bank Ltd* [1922] Ll L Rep 572, 573.

⁹⁴ C Debattista, 'Performance Bonds and Letters of Credit: A Cracked Mirror Image' [1997] JBL 289, 301-302.

The second issue concerns whether, contrary to the focus so far, it is possible for a party to contract to bolster the operation of autonomy, rather than to negate its operation. In essence, the issue boils down to whether a party may contract out of the circumstances in which the law considers autonomy no longer to apply or the bank's instructions to be no longer irrevocable. Whilst there would arguably be two objections to this possibility, it is submitted that neither is insurmountable. The first objection might be that parties ought not to be entitled to contract out of the *ex turpi causa* or 'fraud unravels all' principle, if that is indeed the proper basis for the 'fraud exception' as suggested in *United City Merchants (Investments) Ltd v Royal Bank of Canada*.⁹⁵ Indeed, the public policy nature of the *ex turpi causa* principle has recently been emphasized by the United Kingdom Supreme Court in *Patel v Mirza*⁹⁶ and by the criminalization of fraud in the Fraud Act 2006.⁹⁷ It is submitted, however, that this objection ought not to stand, since (as argued above) the fraud exception ought not to be conceptualized as a limitation upon the issuing bank's obligation to pay that is designed to prevent a fraudulent beneficiary making away with his ill-gotten gains, but rather as a short-hand for the circumstances in which an applicant is entitled to revoke the instructions to his bank in order to protect himself from fraud generally, whether by the beneficiary or some other third party.⁹⁸ As the fraud exception involves an implied term in the issuing bank's mandate,⁹⁹ rather than an application of a wider public policy principle, it ought to be susceptible to contractual displacement if the parties so choose. The second possible objection arises out of *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank*,¹⁰⁰ in which the House of Lords made clear that a party is not permitted to contract out of the consequences of his own fraud and that it would be extremely unlikely for a person successfully to contract out of his agent's fraud. It is not clear, however, whether *HIH Casualty* would necessarily preclude a clause in a letter of credit excluding the usual effects of fraud, since the bank would be presenting the relevant clause (on a take-it-or-leave-it basis) with the intention of contracting out of *its counterparty's or a third party's fraud*, rather than the

⁹⁵ *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168.

⁹⁶ *Patel v Mirza* [2016] UKSC 42. According to Lord Toulson, one must consider 'the underlying purpose of the prohibition which has been transgressed', 'any other public policy pointing the other way' and whether the denial of the claim would be a proportionate response to the illegality.

⁹⁷ Fraud Act 2006, s 2.

⁹⁸ See n 70 above.

⁹⁹ *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd* [1999] 2 Lloyd's Rep 187.

¹⁰⁰ *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6.

consequences of its *own* fraud. Indeed, there is a strong argument that, if the buyer/credit applicant and the banks (for whatever commercial reason) are prepared to commit to payment even in the face of fraud, then they only really have themselves to blame if this backfires. Whilst it would admittedly be unusual for the parties to enter into a contract excluding the usual effects of the seller/credit beneficiary's *own* fraud, if the fraud exception were ever expanded (as advocated above) there would certainly be a strong commercial incentive for the seller/credit beneficiary to restrict the impact that a third party's fraud might have upon its ability to seek payment under the letter of credit. Indeed, the validity of a similar clause (restricting a court's ability to restrain a beneficiary from making an unconscionable call under a performance bond) was recently accepted by the Singapore Court of Appeal in *CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd*:¹⁰¹ in many ways, the distinction between an expanded notion of fraud and unconscionability is one without a difference.¹⁰² Nor is it likely that such clauses would be regulated by statutory regimes such as the Unfair Contract Terms Act 1977, given the parties' levels of sophistication.

4 Autonomy and performance bonds

The final issue concerns the reach of the so-called autonomy principle, and in particular whether this principle should be limited to letters of credit or should extend to include such instruments as performance bonds. Certainly, this has been the traditional approach in England.¹⁰³ More recently, in *Simic v New South Wales Land & Housing Corporation*, the High Court of Australia unanimously confirmed that the fundamental twin principles of autonomy and strict compliance made performance bonds (like letters of credit) 'equivalent to cash',¹⁰⁴ although their Honours were reluctant to acknowledge the precise quadrature of the

¹⁰¹ *CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd* [2015] 3 SLR 1041.

¹⁰² Any such clauses would impact upon issues of nullity under an expanded notion of fraud (indeed, the UCP regime has always contained a provision to similar effect), but would not exclude issues of illegality as these impact upon contracts by virtue of overriding public policy.

¹⁰³ *Edward Owen v Barclays Bank International* [1978] 1 Lloyd's Rep 166, 171-172; *Howe-Richardson v Polimpex* [1978] 1 Lloyd's Rep 161, 165; *The Bhoja Trader* [1981] 2 Lloyd's Rep 256, 257.

¹⁰⁴ *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47 [6], [85].

principles applicable to the two forms of instrument.¹⁰⁵ Indeed, this paper submits that the extension of autonomy beyond letters of credit has been something of a wrong turn in the law's development and was probably included in international instruments¹⁰⁶ as part of the marketing initiative considered above. This view is not novel, as there has been some (rather limited) judicial hand-wringing about whether performance bonds are truly autonomous.¹⁰⁷ Those judicial comments arguably provide too flimsy a foundation, however, upon which to build a sustained attack on the traditional position. More promising is the academic assault launched by Debattista upon the autonomous nature of performance bonds,¹⁰⁸ in which he correctly identified that, as performance bonds are effectively default undertakings, performing an essentially security function rather than a primary payment mechanism, their equation with letters of credit is problematic.¹⁰⁹ This is hornbook law. Debattista's argument, however, then moves from this uncontroversial proposition to the intermediate statements that 'the bond is consequently closely linked' to the contract of sale,¹¹⁰ that 'the performance bond is a device pointing towards performance of that contract'¹¹¹ and that '[i]n so far as the bond is a child of any other contract, it is a child of the contract of sale, not of the letter of credit',¹¹² and from these by a final logic leap to the suggestion that an unconditional bond should in some way be treated as more conditional than letters of credit resulting in '[a] greater readiness to grant injunctive relief in our courts, based on a greater emphasis on the word "performance" than on the word "bond"'.¹¹³ It is submitted, however, that this approach appears to conflate the autonomy principle (which was equated above with the notion of irrevocability of instruction) with the primary nature of the payment obligation under a performance bond, which is not dependent upon establishing breach under the sale

¹⁰⁵ In *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47, French CJ (at [5]) considered that '[t]he principles governing the legal effect and operation of performance bonds are *similar* to those applicable to letters of credit' (emphasis added) and Gageler, Nettle and Gordon JJ (at [118]) similarly suggested that the applicable principles are similar, but not necessarily identical.

¹⁰⁶ See n 7 above.

¹⁰⁷ *Potton Homes Ltd v Coleman Contractors Ltd* [1984] 28 Build LR 19, 26-29. See also *Simic v New South Wales Land & Housing Corporation* [2016] HCA 47 [5], [118].

¹⁰⁸ C Debattista, 'Performance Bonds and Letters of Credit: A Cracked Mirror Image' [1997] JBL 289.

¹⁰⁹ *Ibid*, 302-303. Debattista also argues that the absence of security rights over the transport documents (*ibid*, 303-304) and the difficulty of applying documentary fraud in the performance bond context also point in the same direction (*ibid*, 304).

¹¹⁰ *Ibid*, 303.

¹¹¹ *Ibid*.

¹¹² *Ibid*.

¹¹³ *Ibid*, 305.

contract. Questioning the primary and unconditional nature of bonds not only misunderstands the autonomy principle (as described above), but also risks turning them into conditional structures. Accordingly, whilst Debattista is correct to question the equation of performance bonds and letters of credit, he fails to advance a clear solution to the problem that he identifies, other than indicating that courts should be more interventionist and injunctions more readily available.

It is submitted that an appropriate analytical framework for the performance bond and any controls upon unjustified calls can be developed by placing such instruments within the law relating to security rather than the law relating to payment mechanisms.¹¹⁴ It is a fundamental principle that a debtor cannot unilaterally withdraw any security provided to the creditor without the latter's consent, regardless of whether the security is real or personal in nature, provided by the debtor himself (as with a mortgage) or furnished by a third party (as with a guarantee). Accordingly, the edifice of autonomy is unnecessary for performance bonds, as irrevocability (as with all forms of security) is inherent in the structure of the transaction (this is arguably *a fortiori* when a third party furnishes the security in question). Indeed, once performance bonds are placed within the context of other forms of security, the basis upon which one can control abusive calls becomes evident. Indeed, one can trace the origins of such controls to the equitable jurisdiction developed in the 18th Century to grant relief from defeasible bonds.¹¹⁵ As explained recently by the United Kingdom Supreme Court in *Cavendish Square Holding BV v Makdessi*,¹¹⁶ even though defeasible bonds contained an unconditional promise under seal, equity would grant relief by treating 'the real intention of the parties [to a defeasible bond as being] that the bond should stand as security only'. By equating a primary bond with a form of security, equity (and subsequently the common law)¹¹⁷ could restrain the bond's enforcement. A parallel jurisdiction can be seen to have developed in the context of conditional guarantees (which have always been considered

¹¹⁴ The decision in *Sirius International Insurance Corp v FAI General Insurance Co Ltd* [2004] Lloyd's Rep IR 47 (appealed on a different point: [2005] Lloyd's Rep IR 294) highlights how poorly suited the autonomy principle is to the operation of performance bonds.

¹¹⁵ *Peachy v Duke of Somerset* (1720) 1 Str 447, 453; *Sloman v Walter* (1783) 1 Bro CC 418, 419.

¹¹⁶ *Cavendish Square Holding BV v Makdessi* [2016] AC 1172 [4]. See also *Protector Endowment Loan and Annuity Co v Grice* (1880) 5 QBD 592, 595.

¹¹⁷ *Ibid*, [6]-[7]. See further B Simpson, 'The Penal Bond with Conditional Defeasance' (1966) 82 LQR 392, 418-419.

‘weaker’ than performance bonds as they are secondary in both form and intendment). In this regard, it was always clear that merely ‘irregular’ conduct on the part of the creditor (usually in respect of the underlying contract or debt) did not discharge the surety under a conditional guarantee, even if that conduct was prejudicial to the surety’s interests.¹¹⁸ Accordingly, the simple fact that a creditor (namely the person calling upon the security) was himself in breach of contract or had committed some other form of ‘irregularity’ was not enough to disable him from enforcing the guarantee.¹¹⁹ In contrast, according to Lord Brougham in *McTaggart v Watson*,¹²⁰ there were circumstances in which a surety might be discharged from its obligations:

... it cannot avail to discharge a surety who has expressly bound himself for a person’s doing certain things unless it can be shown that the party taking the security has, by his conduct, either prevented the things from being done, or connived at their omission, or enabled the person to do what he ought not to have done or leave undone what he ought to have done, and that but for such conduct the omission or commission would not have happened.

Indeed, the modern authority setting out the circumstances when the creditor’s conduct might preclude enforcement of a conditional guarantee is *Bank of India v Trans Continental Commodity Merchants Ltd*,¹²¹ where Bingham J (in a statement subsequently approved by the Court of Appeal) indicated the ‘true principle’ to be:¹²²

... that while a surety is discharged if the creditor acts in bad faith towards him or is guilty of concealment amounting to misrepresentation or causes or connives at the default by the principal debtor in respect of which the guarantee is given or varies the terms of the contract between him and the principal debtor in a way which could prejudice the

¹¹⁸ *Bank of India v Trans Continental Commodity Merchants Ltd* [1982] 1 Lloyd’s Rep 506, affd [1983] 2 Lloyd’s Rep 298, 302; *Marubeni Hong Kong and South China Ltd v The Mongolian Government* [2004] EWHC 472 (Comm) [225].

¹¹⁹ The failure to advance a loan would at most constitute an ‘irregularity’, although if the necessary preconditions have not been satisfied then the creditor will be entitled not to advance the funds at all: see *Anglo Petroleum Ltd v TFB (Mortgages) Ltd* [2003] EWHC 3125 (QB) [50].

¹²⁰ *McTaggart v Watson* (1835) 3 Cl & F 525.

¹²¹ *Bank of India v Trans Continental Commodity Merchants Ltd* [1982] 1 Lloyd’s Rep 506, affd [1983] 2 Lloyd’s Rep 298.

¹²² *Ibid*, 302. See also *Scottish & Newcastle plc v Raguz* [2006] EWHC 821 (Ch) [101]-[102].

interests of the surety, other conduct on the part of the creditor, not having these features, even if irregular, and even if prejudicial to the interests of the surety in a general sense, does not discharge the surety.

For these purposes, the notion of ‘connivance’ has been interpreted as ‘amounting ... almost if not entirely to a fraud on the part of the person and particular officers who were so conducting themselves’¹²³ (or as a ‘fraud on the surety’)¹²⁴ and the notion of ‘concealment’ would appear to refer to deliberate omissions in that regard.¹²⁵ Moreover, the principle in *Trans Continental Commodity Merchants* would appear to be broad enough to include illegal conduct.¹²⁶ Although this jurisdiction has traditionally been restricted to the context of conditional guarantees operating to impose secondary liability,¹²⁷ it is submitted that this could readily be extended to performance bonds in order to provide a more secure framework within which to regulate abusive calls, especially as such instruments, albeit primary in form, are secondary in intent.¹²⁸ Indeed, such a development would simply reflect the steps taken by equity all that time ago in relation to defeasible bonds. In many ways, this is precisely the position that the English and Singaporean courts have been clawing towards, albeit with a sense of real hesitation due to the perception that they were effectively carving out an exception to a principle as fundamental as autonomy and thereby risked undermining the fraud exception to letters of credit by developing a more expansive set of principles for performance bonds. By placing performance bonds within the context of security rights, this sense of doing something untoward effectively disappears and the decisions that have suggested a broader basis for judicial interference with performance bonds become unexceptional. For example, in *TTI Team Telecom International Ltd v Hutchison 3G UK Ltd*,¹²⁹ Judge Thornton QC indicated that injunctive relief might be available in cases of ‘fraud, dishonesty or bad faith in relation to the demand’, including ‘a failure by the beneficiary to provide an essential element of the underlying contract on which the bond depends’, ‘a

¹²³ *Dawson v Lawes* (1854) 13 LJ Ch (NS) 434, 438.

¹²⁴ *Egen v Sachdev* [2003] WL 21353280 (QBD, 14 April 2013, Master Whitaker) [30].

¹²⁵ *Islamic Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV* (Unreported, QBD, 13 February 2002, Tomlinson J).

¹²⁶ *Birkett v Acorn Business Machines Ltd* [1999] EWCA Civ 1866 (16 July 1999, Sedley LJ & Colman J).

¹²⁷ *Egen v Sachdev* [2003] WL 21353280 (QBD, 14 April 2013, Master Whitaker) [26]-[27], [32].

¹²⁸ R Goode, ‘Abstract Payment Undertakings’ in P Cane and J Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press 1991) 220.

¹²⁹ *TTI Team Telecom International Ltd v Hutchison 3G UK Ltd* [2003] 1 All ER (Comm).

misuse by the beneficiary of the guarantee by failing to act in accordance with the purpose for which it was given', 'a total failure of consideration in the underlying contract', a threatened call 'for an unconscionable ulterior motive' or a lack of honest belief that 'the circumstances, such as poor performance, against which a performance bond has been given, actually exists'. Similarly, in *Arab Banking Corporation v Boustead Singapore Ltd*,¹³⁰ the Singapore Court of Appeal has recently confirmed that injunctive relief might be available 'to protect the account party from unfair demands by the beneficiary to have the secured sum in hand in circumstances where there had not yet been a final determination as to whether [the beneficiary] is actually entitled to that sum'. In fact, there are a number of other English¹³¹ and Singaporean decisions to similar effect.¹³² The approach adopted in these modern cases bears a striking similarity to that articulated in *Trans Continental Commodity Merchants*, considered above.

5 Conclusion

This paper has sought to examine the nature of the autonomy principle as applied to letters of credit and to demonstrate that the doctrine has a limited *legal* impact, albeit that it remains *commercially* fundamental. Once the autonomy principle is properly understood, it sheds light upon how the so-called exceptions to that principle ought to be formulated, and indicates how contractual provisions might be used to expand or negate the notion, and why performance bonds represent an unfortunate chapter in the story of autonomy. It is to be hoped that, once autonomy as an edifice is dismantled, letters of credit can be exposed once more to the general principles of private law relating to contractual remedies, subrogation

¹³⁰ *Arab Banking Corporation v Boustead Singapore Ltd* [2016] 3 SLR 557.

¹³¹ See, for example, *GKN Contractors Ltd v Lloyds Bank plc* [1985] 30 BLR 48 (suggesting a broader notion of 'fraud' applicable to performance bonds compared to letters of credit); *Potton Homes Ltd v Coleman Contractors (Overseas) Ltd* (1984) 28 BLR 19 (questioning the application of the autonomy principle to performance bonds and suggesting broader bases for injunctive relief).

¹³² See, for example, *Chartered Electronics Industries Pte Ltd v Development Bank of Singapore* [1999] 4 SLR 655 (adopting a more generous approach to 'fraud' for performance bonds); *Dauphin Offshore Engineering & Trading Pte Ltd v Sultan Al Nahyan* [2000] 1 SLR 657 (applying a lower standard of proof for injunctive relief in the performance bond context and advocating unconscionability as a basis for relief).

and unjust enrichment, as the traditional unhealthy focus on the autonomy doctrine has tended to isolate such instruments from wider external influences.