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A NULLITY EXCEPTION IN LETTER OF CREDIT TRANSACTIONS?

DORA S. S. **NEO***

There has been a difference in opinion between the courts in Singapore and the United Kingdom as to whether there is a nullity exception to the autonomy principle in letter of credit transactions. This article analyses the applicable principles and judicial decisions. It assesses whether the law should include a nullity exception over and above the fraud exception, and the circumstances under which such an exception might apply. The formulation of the nullity exception by the Court of Appeal in Singapore as well as possible future developments are also considered.

I. INTRODUCTION

The existence of a nullity exception in letter of credit transactions was recently discussed by the courts in both Singapore and the United Kingdom. In the United Kingdom, this issue had been left open by the House of Lords in *United City Merchants (Investments) Ltd. v. Royal Bank of Canada*.[1] Some twenty years later, the U.K. Court of Appeal expressed the view in *Montrod Ltd. v. Grundkotter Fleischvertriebs GmbH*.[2] (a case involving a document that, according to the U.K. Court of Appeal in their judgment, was neither a forgery nor a nullity) that the nullity exception was not part of the law. A year after the *Montrod* decision, the Singapore Court of Appeal reached the contrasting conclusion in *Beam Technology (Mfg.) Pte. Ltd. v. Standard Chartered Bank*,[3] where both forgery and nullity were presumed to have been present, that there was a nullity exception in letter of credit transactions.

This article will consider the arguments for and against a nullity exception in letter of credit transactions with a view to assessing whether the law should include such an exception, and in what circumstances this exception might apply. The three cases mentioned in the first paragraph form a useful backdrop for this analysis and are discussed in detail where relevant. Attention is also paid to the formulation of the nullity exception in the *Beam Technology* case and to further developments for the future. Unless the context otherwise indicates, a simple letter of credit is used as a convenient model for discussion, involving three parties—the issuing bank, often referred to just as "the bank", the applicant for the credit (usually the buyer) and the beneficiary (usually the seller).[4]

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* M.A. (Oxon.), LL.M. (Harvard), Associate Professor, National University of Singapore, Visiting Scholar, Harvard Law School (2003-4).

1 [1983] 1 A.C. 168 [*United City Merchants*].

2 [2001] E.W.C.A. Civ. 1954, [2002] 3 All E.R. 697 [*Montrod*].

3 [2003] 1 S.L.R. 597 [*Beam Technology*].

4 Where there is a confirming bank in a letter of credit transaction, its liability to the beneficiary is the same as the issuing bank's liability to the beneficiary. The confirming bank will in turn have a duty to pay

II. Nullity in Context: Another Exception to Autonomy Principle

The principle of autonomy is a fundamental principle that is reflected in judicial decisions[5] and the U.C.P. 500.[6] Together with the doctrine of strict compliance, it makes the letter of credit uniquely useful as a dependable, quick and efficient means of payment in the international sale of goods. In the *United City Merchants* case, Lord Diplock stated:

> The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give the seller an assured right to be paid before he parts with control of the goods that does not permit of any dispute with the buyer as to the performance of the contract being used as a ground for non-payment or reduction or deferment of payment.[7]

The principle of autonomy was designed to support this purpose. It dictates that a letter of credit is independent from the underlying sale contract and that the seller/beneficiary will be paid by the issuing bank as long as he presents documents that conform to the requirements of the credit. This is regardless of any dispute that the seller may have with the buyer, for instance regarding the quality of the goods.[8] The buyer must seek his remedies against the seller separately. The original idea involved in the autonomy principle—that the bank should not look at the underlying sale contract—has evolved into the idea that the bank must confine itself to the face of the documents alone and must not look at any extraneous matters. A reference to the autonomy principle usually encompasses both ideas. The principle of autonomy also ensures that the bank can confidently pay a seller/beneficiary who presents conforming documents, as it will be entitled to claim reimbursement from the buyer/applicant. As long as the bank has exercised proper care in making payment, it can ignore issues in the underlying sale contract, and need not question whether the documents presented were in fact accurate or genuine.[9]

An exception to the autonomy principle applies when there is fraud on the part of the beneficiary, for instance if he has falsified the documents.[10] In such cases, a

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and a right of reimbursement *vis-à-vis* the issuing bank just as the issuing bank has corresponding rights and duties *vis-à-vis* the applicant. The actual payment to the beneficiary is often made by a nominated bank as opposed to directly by the issuing bank, and the nominated bank would have rights and duties *vis-à-vis* the issuing bank, but this does not affect the analysis in this article.

5 For example, see *United City Merchants*, *supra* note 1, *Urquhart, Lindsay & Co. v. Eastern Bank Ltd.* [1922] K.B. 318 and *Malas (Hamzeh) & Sons v. British Imex Industries Ltd.* [1958] 2 Q.B. 127.

6 Uniform Customs and Practice for Documentary Credits (1993 Revision), I.C.C. Publication No. 500. See UCP 500, arts. 3, 4, 9a, 9b, 13a, 14a, and 14b.

7 [1983] 1 A.C. 168 at 183.

8 In *United City Merchants*, Lord Diplock stated: "If, on their face, the documents presented to the confirming bank by the seller conform to the requirements of the credit as notified to him by the confirming bank, the bank is under a contractual obligation to the seller to honour the credit, notwithstanding that the bank has knowledge that the seller at the time of presentation is alleged by the buyer to have, and in fact has already, committed a breach of his contract with the buyer for the sale of goods to which the documents appear on their face to relate, that would have entitled the buyer to treat the contract of sale as rescinded and to reject the goods and refuse to pay the seller the purchase price." *Supra* note 1 at 183.

9 U.C.P. 500, art. 15.

10 In *United City Merchants*, Lord Diplock stated that the fraud exception applied "where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain,

bank need not pay the beneficiary even if the documents conform on their face to the requirements of the credit. This exception is a common law exception that is not covered by the U.C.P. The reason for this exception is the maxim *ex turpi causa non oritur actio*, or "fraud unravels all". A court will not allow its processes to be used to aid a dishonest seller.[11] Although the fraud exception is not without its problems, it will not be considered in this article. The focus will be on situations where the beneficiary is innocent of fraud but the documents are a nullity. In such cases, the fraud exception will not allow a bank to withhold payment against the presentment of conforming documents, as the beneficiary is innocent. It is in this context that discussion of a nullity exception usually takes place: should the law recognise a nullity exception to the autonomy principle over and above the fraud exception that would allow a bank to withhold payment against a facially conforming document that is a nullity? This question will form the central focus of this article. In addition to disputes potentially covered by either the fraud exception or the nullity exception, there is another type of dispute (exemplified by the facts in the *United City Merchants* case[12] and involving a document that, though tainted by third party fraud, does not amount to a nullity) which falls within neither of those exceptions, and this article does not propose to examine whether there should be an exception to the autonomy principle for this type of cases.

III. Judicial Authorities on the Nullity Exception

A. Montrod *in the United Kingdom*

In the United Kingdom, the question whether there was a nullity exception in letter of credit transactions that went beyond the fraud exception was left open by the House of Lords in the *United City Merchants* case in 1982.[13] This question was answered in the negative by the Court of Appeal in the *Montrod* case in 2001.[14] In *Montrod*, the applicant in the letter of credit transaction was a finance company that financed the purchase of frozen pork by the buyer. One of the documents required under the credit was an inspection certificate signed by the applicant. After the documents were presented, the applicant commenced proceedings in court to prevent the bank from paying on the credit on the ground that the certificate of inspection apparently signed by the applicant was a forgery. The inspection certificate had in fact been signed by the seller/beneficiary. This happened because the seller had been wrongly

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expressly or by implication, material representations of fact that to his knowledge are untrue." *Supra* note 1 at 183. This case followed the landmark U.S. case of *Sztejn v. J. Henry Schroeder Banking Corporation* (1941) 31 N.Y. Suppl. (2d.) 631. The autonomy principle and the fraud exception formulated by both these cases were referred to with approval by the Singapore Court of Appeal in *Korea Industry Ltd. v. Andoll Ltd.* [1989] S.L.R. 134.

11 This rationale was referred to by Lord Diplock in *United City Merchants*, *supra* note 1 at 184. It has been stated that a more accurate translation of the Latin maxim, which better reflects the rational of the fraud exception in English law, is "an action does not arise from a base cause". See Jack *et al.*, *Documentary Credits*, 3rd ed. (London: Butterworths, 2001) at 265, footnote 5.

12 [1983] 1 A.C. 168.

13 [1983] 1 A.C. 168.

14 [2002] 3 All E.R. 697.

led to believe (not by the applicant and without his knowledge)[15] that one of the seller's employees should sign the inspection certificate on behalf of the applicant. The Court of Appeal decided that the seller should be paid on the credit, as the fraud exception was based on fraud or knowledge of fraud on the part of the beneficiary, and these were absent on the facts. Although the seller had created the unauthorised inspection certificate, it had done so without fraudulent intent.

The nullity argument advanced by the applicant was as follows:

> If, by the time of full payment . . . , the only reasonable inference is that one (or more) of the documents [. . .] presented under the credit is not what it appears on its face to be, but is a nullity, then the bank is not obliged to make payment under the credit.

Alternatively, the applicant was also willing to advance a narrower proposition where the words "created by the beneficiary and" were inserted within the square brackets in the quotation above. Both versions were rejected by the courts. It was not relevant who had created the document. The point was that it had not been created fraudulently by the beneficiary.

The first instance judge, H.H.J. Raymond Jack Q.C., was of the view that the applicant's proposition was neither supported by authority nor the U.C.P. 500, the terms of which were imported into the credit. He concluded that the nullity exception was not part of English law. The judge observed that the proposition "provides a further complication where simplicity and clarity are needed. There are problems in defining when a document is a nullity. The exception has unfortunate consequences in relation to the rights of third parties."[16] This decision was upheld by the Court of Appeal.

In the Court of Appeal, Potter L.J. (who gave the only judgment, and with whom the other members of the court concurred), was of the view that to allow the nullity argument would clearly be an extension of the fraud exception, and that there were sound policy reasons for not creating a general nullity exception. He stated that in the law relating to letters of credit, precision and certainty were paramount, and "the creation of a general nullity exception, the formulation of which does not seem . . . susceptible of precision, involves making undesirable inroads into the principles of autonomy and negotiability universally recognised in relation to letter of credit transactions." He was also of the view that if a general nullity exception were to be introduced, "it would place banks in a further dilemma as to the necessity to investigate facts, which they are not competent to do and from which the U.C.P. 500 is plainly concerned to exempt them." Further, a nullity exception "would be likely to act unfairly upon beneficiaries participating in a chain of contracts in cases where their good faith is not in question," and such a development would "undermine the system of financing international trade by means of documentary credits."[17]

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[15] The beneficiary was misled by the buyer, who was not the applicant under the credit and did not have the authority of the applicant to make such a statement. The buyer was a third party in the letter of credit transaction.

[16] [2001] All E.R. (Comm.) 368 at 381.

[17] [2002] 3 All E.R. 697 at 712, para. 58.

Potter L.J.'s conclusion that there was and should be no general nullity exception based upon the concept of a document being fraudulent in itself or devoid of commercial value[18] would have been much stronger authority if the case had involved a vital document that had been forged and was a nullity. As the certificate of inspection was neither a forgery nor, according to Potter L.J., a nullity, other courts may be able to distinguish the case (as the Singapore Court of Appeal did in *Beam Technology*). Referring to Lord Diplock's judgment in the House of Lords in *United City Merchants*, Potter L.J. said:

> While he left open the position in relation to a forged document where the effect of the forgery was to render the document a 'nullity', there is nothing to suggest that he would have recognised any nullity exception as extending to a document which was not forged (*i.e.* fraudulently produced) but was signed by the creator in honest error as to his authority; not do I consider that such an exception should be recognised.[19]

From this passage, the points of foremost concern to Potter L.J. were that the document in question was not forged but was signed by the creator in honest error as to his authority, and that he was not prepared to recognise a nullity exception as extending to this document that he felt was not a nullity.

B. Beam Technology *in Singapore*

The case of *Beam Technology* was not the first time that a court in Singapore had occasion to discuss the nullity exception,[20] but it was the first time that a definitive decision had to be made on the issue.In that case, a letter of credit was opened to facilitate the sale of electronic components and one of the documents required was a "full set of clean air waybill". When the documents were presented, the confirming bank rejected them on the ground that the air waybill was a forgery because Link Express (S.) Pte. Ltd., the freight forwarders who purportedly issued the air waybill, was a non-existent entity. The seller/beneficiary brought an action against the confirming bank to claim payment under the letter of credit. The hearing before the High Court and the Court of Appeal related to the confirming bank's application under Order 14, r. 12 of the *Rules of Court*[21] for a determination, on

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18 *Ibid.* at 712 at para. 59.

19 *Ibid*. at 712 at para. 56.

20 Prior to the Court of Appeal decision in *Beam Technology*, the nullity exception was discussed in the Singapore High Court in *Mees Pierson N.V. v. Bay Pacific (S.) Pte. Ltd.* [2000] 4 S.L.R. 393 [*Mees Pierson*] and *Lambias (Importers & Exporters) Co. Pte. Ltd. v. Hongkong & Shanghai Banking Corporation* [1993] 2 S.L.R. 751. The judgments in both those cases appeared to favour the existence of some form of a nullity exception, although this point was not necessary for the disposition of the cases before the respective courts.

21 Order 14, r. 12(1): "The Court may, upon the application of a party or of its own motion, determine any question of law or construction of any document arising in any cause or matter where it appears to the Court that (a) such question is suitable for determination without a full trial of the action; and (b) such determination will fully determine (subject only to any possible appeal) the entire cause or matter or any claim or issue therein." Order 14, r. 12(2): "Upon such determination, the Court may dismiss the cause or matter or make such order or judgment as it thinks just." See *Rules of Court* (S. 71/96, 1997 Rev. Ed. Sing.) made under the *Supreme Court of Judicature Act* (Cap. 322, 1999 Rev. Ed. Sing.), s. 80.

a question of law, whether it was entitled to refuse to make payment when the air waybill was a forgery known to the bank. The Court of Appeal recast the question in this way: can a confirming bank, in a case where there is no discrepancy in the documents tendered, nevertheless refuse payment because they have reliably established that a material document is forged? For the purposes of the Order 14 application, it was assumed that the air waybill was a forgery and that the beneficiary was innocent of the forgery, having obtained and tendered the document in good faith.

In *Beam Technology*, the Court of Appeal observed that only two cases had expressly dealt with the issue before them, *United City Merchants* and *Montrod*. The court was of the view that neither of these cases was a direct authority on the question. The House of Lords in *United City Merchants* had left the question of the existence of a nullity exception open. And whilst the U.K. Court of Appeal's decision in *Montrod* might have seemed to be authority to the contrary, the court in *Beam Technology* felt that *Montrod* could be differentiated as the relevant document in that case might not have been a nullity, and the certificate required there was not an essential document but one touching on the question as to the quality of the goods sold.[22] Most significantly for the purposes of this article, the Court of Appeal found that there was a nullity exception to the autonomy principle in letter of credit transactions.[23] Although under the U.C.P. 500 and common law, a bank was not obliged to look beyond the face of the documents, the court felt that this would not extend to the situation where a material document was a forged, null and void document.

The situation in which the Court of Appeal in *Beam Technology* was prepared to recognise a nullity exception is best summarised in the following passage:

> It is our opinion that the negotiating/confirming bank is not obliged to pay if it has established within the seven-day period that a material document required under the credit is forged and null and void and notice of it is given within that period.[24]

Certain requirements can be drawn from this. First, timing is crucial as the decision was directed at the question whether a bank that has not yet paid the beneficiary may withhold payment upon facially conforming documents when it knows that a document is forged and null and void.[25] The *Beam Technology* decision is not directed to questions arising between the beneficiary and the bank after the bank has already paid and wishes to recover the amount from the beneficiary.[26] Next, the bank has to comply with the requirements of the U.C.P. 500 in order to rely on the nullity exception, *i.e.* it has to establish within the seven-day period that the document was null and void, and give notice of refusal to the beneficiary within that period.[27] Further, the offending document must be a material document, and finally, it has to be forged and null and void.

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22 *Supra* note 3 at para. 31.

23 The final decision of the court was to order that there should be further investigation whether the air waybill constituted a forgery and whether it was non-compliant with the terms of the letter of credit.

24 *Supra* note 3 at para. 36.

25 In *Beam Technology*, the bank in question was the confirming bank, but the finding could equally be applied to an issuing bank's obligation to the beneficiary.

26 An example of this type of case is the Singapore High Court decision in *Mees Pierson*, *supra* note 20.

27 U.C.P. 500, arts. 13b and 14d.

Although *Beam Technology* decides the issue between the beneficiary and the confirming bank (and therefore also the issuing bank), the decision will impact the relationship between the confirming or issuing bank and its instructing party. Particularly, the decision is relevant to the question whether a bank that has paid the beneficiary on an apparently conforming document that is in fact forged, null and void is entitled to reimbursement. After the *Beam Technology* decision, a bank in Singapore that knows prior to payment that a material document has been forged and is null and void, and still goes ahead and pays the beneficiary, would probably not be entitled to claim reimbursement.[28] The nullity exception would mean that the bank is neither obliged (*vis-à-vis* the beneficiary) nor entitled (*vis-à-vis* the applicant) to pay the beneficiary upon a document that it knows is forged and a nullity.

The Court of Appeal's clearest reason for finding a nullity exception in *Beam Technology* was the obvious correctness of such a finding, given that a genuine document was what was required. Chao Hick Tin J.A. (who delivered the judgment of the two member court, which also comprised Tan Lee Meng J.) made this striking pronouncement:

> [T]o say that a bank, in the face of a forged null and void document (even though the beneficiary is not privy to that forgery), must still pay on the credit, defies reason and good sense. It amounts to saying that the scheme of things under the U.C.P 500 is only concerned with commas and full stops or some misdescriptions, and that the question as to the genuineness or otherwise of a material document, which was the cause for the issue of the LC, is of no consequence.[29]

The court further stated that implicit in the requirement of a conforming document is the assumption that the document is true and genuine.[30] The conclusion that can be drawn from this is that a forged document that is a nullity cannot be a conforming document. The court also quoted a passage from Ackner L.J.'s judgment in the Court of Appeal in *United City Merchants*, where he pointed out the importance of the documents as security for the bank. Ackner L.J. was of the view that a banker need not be under an obligation to pay upon documents which he knows to be waste paper, as "to hold otherwise would be to deprive the banker of that security for his advances, which is a cardinal feature of the process of financing carried out by means of the credit".[31] Although the court did not comment upon this passage beyond the quotation, it must have formed another basis for their finding that a nullity exception should be recognised.[32] These reasons are analysed later in this article.

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[28] In the case of the fraud exception, it has been established that where the bank did not know about the forgery at the time it made payment to the beneficiary, it did not lose its right to be reimbursed even if the documents later turned out to be false. See the Privy Council decision in *Gian Singh & Co. Ltd. v. Banque de l'Indochine* [1974] 2 All E.R. 754, [1972-1974] S.L.R. 16. However, where the bank knows about the fraud prior to payment, the bank is not entitled to pay the beneficiary. See *Turkiye Is Bankasi A.S. v. Bank of China* [1996] Lloyd's Rep. 611, affirmed [1998] 1 Lloyd's Rep. 251, and *Czarnikow-Rionda v. Standard Bank* [1999] 2 Lloyd's Rep. 187. A similar rule should apply when a bank knows about the nullity prior to making payment.

[29] [2003] 1 S.L.R. 597 at para. 33.

[30] *Ibid.*

[31] *Ibid.* at para. 19.

[32] The Court of Appeal in *Beam Technology* also quoted, albeit without adding its own endorsement, a passage from the decision of Rajendran J. in the Singapore case of *Mees Piersoni*, *supra* note 20, emphasising the same point. See *supra* note 3 at para. 30.

C. Revisiting *United City Merchants*

The English case of *United City Merchants* was not specifically on the nullity exception, but it is relevant to the subject of this article for two important reasons. The first, as noted earlier, is that the existence of a nullity exception was left open as a possibility by the House of Lords. The second is that the decisions of the House of Lords and the Court of Appeal in that case contain policy arguments which, despite being made in a different context, are relevant to the analysis in this article. In particular, the Court of Appeal's judgment contains justifications for broadening the fraud exception that are equally, if not more, powerful when used in support of the nullity exception,[33] and these could be helpful to the current enquiry. The judgments in *United City Merchants* will therefore be revisited for the limited purpose of establishing if the Court of Appeal's statements survive the overruling of their decision by the House of Lords. The actual arguments that are relevant to the nullity exception will be considered in a later section.

In *United City Merchants*, the contract provided that the goods had to be shipped on or before 15 December 1976. In breach of this requirement, the goods were shipped on 16 December 1976. However, the loading agents employed by the carrier fraudulently put a false date, 15 December 1976, on the bill of lading and also falsely included an "on board notation" representing that the goods were placed on board the vessel on 15 December 1976. The loading agents did not act on behalf of the seller/beneficiary, who did not know about the fraud. These facts were unchallenged. When the apparently conforming documents were presented, the confirming bank refused to pay. On these facts, the Court of Appeal's decision was that the fraud exception applied to excuse the bank from making payment even though the fraud was that of a third party and not the beneficiary. The Court of Appeal was of the view that the confirming bank was entitled to refuse payment against the documents presented to it because one of the documents presented was fraudulently completed and did not satisfy the terms of the credit. They reached their decision by first analysing the situation relating to a document forged by a third party, and coming to a conclusion that the bank would have been entitled to withhold payment against such a document. As the court found no reason to distinguish between a document forged by a third party and one fraudulently completed by a third party, they applied the same conclusion to the situation were the documents were not forged but fraudulently completed.[34]

The House of Lords disagreed with this conclusion, and said that a bank in such a situation would have to pay as the fraud exception did not extend to fraud to which the beneficiary was not a party. Lord Diplock (with whom the other members of the House of Lords concurred) concluded:

> But even assuming the correctness of the Court of Appeal's premise as respects forgery by a third party of a kind that makes a document a nullity for which at least a rational case can be made out, to say that this leads to a conclusion that fraud by a third party which does not render the document a nullity has the

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[33] In *Beam Technology*, the Court of Appeal said in relation to the question before them: "In short, there is no authority on point, although the views of the Court of Appeal in *United City Merchants* are no doubt highly persuasive." See *supra* note 3 at para. 31.

[34] [1982] Q.B. 208 at 239, 247 and 255.

> same consequence appears to me, with respect, to be a non sequitur, and I am not persuaded by the reasoning in any of the judgments of the Court of Appeal that it is not.[35]

This passage suggests that the House of Lords was merely rejecting the Court of Appeal's conclusion relating to a fraud by a third party that did not render the document a nullity. Their Lordships were open towards the possibility that a limited version (based on nullity) of the conclusion reached by the Court of Appeal might be acceptable, and left open the question whether the bank had to pay when a document presented by the beneficiary was a nullity because, unknown to the beneficiary, it was forged by some third party.[36] Further, the House of Lords did not comment unfavourably upon the reasons that members of the Court of Appeal gave in support of their view relating to documents which had been forged by a third party. Those reasons could still be used to support a narrower proposition than the one rejected by the House of Lords. In some respects, therefore, the views of the U.K. Court of Appeal in *United City Merchants* provide a worthy counterpoint to those of the U.K. Court of Appeal in *Montrod* and, where appropriate, should be given equally weighty consideration.

IV. Should There Be a Nullity Exception?

The reasons against a nullity exception will be considered first, followed by an analysis of why such an exception might be desirable.[37]

A. *Arguments Against a Nullity Exception*

1. *Lack of Authority*

At the time when the cases of *Montrod* and *Beam Technology* came before the courts, a nullity exception was neither supported by judicial authority nor the U.C.P. This lack of authority on both counts was commented upon adversely by the first instance judge in the *Montrod* case.[38] However, the lack of authority under the U.C.P. should not be a constraint to recognising a nullity exception, as it is widely accepted that the U.C.P. is to be supplemented by domestic rules where appropriate. The fraud exception is a common law exception that is not governed by the U.C.P., and a nullity exception could similarly exist independently of the U.C.P. Further, that there is no judicial authority for a nullity exception should not in itself lead a court to conclude that such an exception should not be recognised. The simple reason for the absence of any authority supporting the nullity exception at that time was that the issue had not come up for decision before the courts. There was no direct judicial authority one way or another. The indirect authority that existed in the form of the House of

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35 [1983] 1 A.C. 168 at 188.

36 *Ibid.*

37 In instances where a concrete example might be helpful, the nullity exception as formulated by the Singapore Court of Appeal in *Beam Technology* is used as a convenient model in the analysis.

38 The judge's views were mentioned by Potter L.J. in the Court of Appeal judgment. See [2002] 3 All E.R. 697 at 704, para. 25.

Lords decision in *United City Merchants* left the question open. Far from being an obstacle, the lack of authority presented the court with the classic opportunity to fill the gap and develop the law.

2. *Beneficiary Should Not Be in Worse Position than Holder in Due Course*

In *United City Merchants*, Lord Diplock expressed the view in the House of Lords that even where the documents under a credit were a forgery, the American *Uniform Commercial Code* protected a person who had taken a draft drawn upon the credit in circumstances that would make him a holder in due course. His Lordship added that there was nothing in the *Uniform Commercial Code* to suggest that a seller/beneficiary who was ignorant of the fraud should be in any worse position because he had not negotiated the draft before presentation.[39] In *Montrod*, Potter L.J. referred to Lord Diplock's views and said:

> As I understand it, Lord Diplock was of the view that a seller/beneficiary who was ignorant of forgery by a third party of one of the documents presented, or of the fact that the document contained a representation false to the knowledge of the person who created it, should not be in a worse position than someone who has taken a draft drawn under a letter of credit in circumstances which rendered him a holder in due course.[40]

The point being made here was that a holder in due course would have been entitled to payment despite the fraud, and the beneficiary should be also. It was a point made only summarily by both Lord Diplock in *United City Merchants* and Potter L.J. in *Montrod*, and we do not have the benefit of a developed legal analysis.

The strongest critic of this view appears to be Professor R.M. Goode, who writes, "It is trite law . . . that a holder in due course is in a favoured position and is insulated from defences not available to holders of the bill, let alone to a seller whose documents and draft have been rejected."[41] Contrary views have also been expressed in the courts. For instance, in the Singapore High Court case of *Lambias (Importers & Exporters) v. Hongkong and Shanghai Banking Corporation*, Goh J.C. referred to Lord Diplock's view and said:

> With respect, I do not think that it is right to say that a seller/beneficiary who has not negotiated the draft before presentation should be in the same position as a bona fide holder in due course. I think the short answer to this is that as a party to the underlying contract, he has an additional recourse against the buyer which is not open to a holder in due course.[42]

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39 [1983] 1 A.C. 168 at 187.

40 [2002] 3 All E.R. 697 at 712 at para. 56.

41 Professor Goode also pointed out that the *Uniform Commercial Code*, far from protecting the seller in this situation, provides no fewer than four exceptions to the autonomy principle, including forgery, the presentation of fraudulent documents and "fraud in the transaction". See Goode, *Commercial Law*, 2nd ed. (London: Penguin, 1995) at 1009 [Goode, *Commercial Law*] and Goode, "Abstract Payment Undertakings" in Cane and Stapleton (eds.), *Essays for Patrick Atiyah* (Oxford: Clarendon Press; New York: Oxford University Press, 1991), chap. 9 at 231 [Goode, "Abstract Payment Undertakings"].

42 [1993] 2 S.L.R. 751 at 763. See also the Court of Appeal judgment in *Beam Technology* where Chao J.A. quoted Professor Goode's view that "the beneficiary under a letter of credit is not like a holder in

The idea that a seller/beneficiary in a letter of credit transaction should enjoy the same protected position as a holder in due course when a document has been forged seems to be an insupportable one.

3. *Matching Bank's Duty to Applicant with Bank's Duty to Beneficiary*

An argument put forward by the House of Lords in the *United City Merchant* case was that the bank's duty to the buyer/applicant to honour the credit upon apparently conforming documents (even where they in fact contained inaccuracies or were forged) should, from a commercial point of view, be matched by a corresponding liability to the seller/beneficiary to pay the amount due on the credit upon presentation of apparently conforming documents.[43] This was one of the reasons why the court felt that the seller/beneficiary in *United City Merchants* should be paid by the bank despite the fraud in the documents. However, the first part of the House of Lords' equation is problematic. Neither the U.C.P nor the common law imposes any duty on the bank towards the applicant to pay upon apparently conforming documents. The rules are directed at the duty of the applicant (or the issuing bank) to reimburse the issuing bank (or a nominated bank) if the bank has, despite having exercised all due care, mistakenly paid the beneficiary upon apparently conforming documents which were inaccurate or forged.[44] Their focus is the bank's entitlement to be reimbursed by the applicant, not its duty to the applicant to honour a facially conforming credit. Indeed, it is hard to conceive that the bank would have a duty to the applicant to honour apparently conforming documents even if it knows that these are in fact false or fraudulent, and thereby allow the applicant to be defrauded.[45] Even if the first part of the proposition were correct, the second part would be suspect. Under article 9 of the U.C.P. 500, the issuing bank undertakes to pay on the credit provided that the stipulated documents are presented and the terms and conditions of the credit are complied with. It does not state that conformity on the face of a document is sufficient. It is respectfully suggested that the argument put forward by the House of Lords is not a valid one.[46]

4. *Fairness to Beneficiary*

The issue of fairness to beneficiaries participating in a chain of contracts in cases where their good faith is not in question was also raised by Potter L.J. in *Montrod* as a reason not to recognise a nullity exception. He did not elaborate on how such unfairness might occur. The most likely situation might be where a seller/beneficiary

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due course of a bill of exchange; he is only entitled to be paid if the documents are in order." *Supra* note 3 at para. 35.

43 [1983] 1 A.C. 168 at 184-5.

44 The U.C.P. 500 states that the bank assumes no responsibility for the accuracy, genuineness, falsification or legal effect of any document (art. 15). The bank is entitled to be reimbursed if it pays upon documents which appear on their face to be in compliance with the requirements of the credit: U.C.P. 500, arts. 13a and 14a, *Gian Singh & Co. Ltd. v. Banque de l'Indochine* [1974] 2 All E.R. 754.

45 There is now authority stating that the bank has a duty not to pay in such circumstances. See *Czarnikow-Rionda v. Standard Bank* [1999] 2 Lloyd's Rep. 187.

46 See also Goode, *Commercial Law*, *supra* note 41 at 1008-9 and Goode, "Abstract Payment Undertakings", *supra* note 41 at 230.

is in possession of a facially conforming document passed to him by another seller further down the chain which without his knowledge is forged and a nullity, and as a result, fails to get paid because the nullity exception entitles the issuing bank to refuse to pay on such documents. There would be no question of unfairness if the beneficiary had known about the nullity beforehand as he might have withheld his own payment to his seller up the chain and thereby minimised his losses. Where the beneficiary does not know about the nullity before paying his own seller, this could lead to the "unfairness" referred to by Potter L.J. if the beneficiary is unable to claim under the letter of credit even though he is innocent. Although beneficiaries in a chain of contracts were singled out as a special category by Potter L.J., it would seem that considerations of fairness are not any greater for this type of beneficiary than for a beneficiary in a single sale transaction.[47] The beneficiary spotlighted in this article is an innocent one, whether in a chain or otherwise, and the argument of unfairness can be applied to any innocent beneficiary who failed to get paid through no fault of his own.

Fairness to the seller/beneficiary is an important consideration. However, there are no easy answers to the question of who should bear the loss caused by the nullity. If the seller/beneficiary is allowed to claim on the credit, it will ultimately be the buyer/applicant who has to bear the loss. As between innocent parties, the question of which one should suffer must be decided after balancing the interests of all the parties to the transaction. It will be argued later in this article that the appropriate balance seems to require that the beneficiary, albeit innocent, should bear the loss where a document required under the credit is forged and a nullity.

5. *Certainty and the Dilemma of Banks*

Two other reasons against a nullity exception are that this could lead to lack of certainty and a consequent dilemma faced by banks whether to investigate facts. These were amongst the prime policy reasons put forward by Potter L.J. in *Montrod*, but they are not insurmountable obstacles.

The argument is that a nullity exception would create uncertainty since it is not possible to formulate a general nullity exception with precision, and further, that it would place banks in a dilemma as they have to consider whether to investigate if the facts warrant the application of the exception. However, as the court in *Beam Technology* pointed out, questions of nullity are not that much more difficult to answer than the question whether something is reasonable, an assessment that courts are used to making.[48] The bank's potential dilemma whether to investigate facts might also be exaggerated. It would not be any worse a dilemma than that already faced by banks when there might be fraud on the part of the beneficiary under the fraud exception. Part of the solution to this "dilemma" might be found in Potter L.J.'s judgment in *Montrod* itself. The judge made the point that in the context of the fraud exception, a bank was not expected to make its own enquiries about allegations of fraud brought to

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[47] There could be a difference if good faith or innocence is not looked at in absolute terms, but in the sense of whether the beneficiary was completely divorced from the events and people that created the false document, something which a beneficiary who is a seller in a chain would usually be, but a single beneficiary (albeit innocent) might not.

[48] *Supra* note 3 at para. 36.

its notice. He stated that if a party wished to establish that a demand was fraudulent, it had to place before the bank evidence of clear and obvious fraud.[49] The same rules should surely apply to a nullity exception. Indeed, in *Beam Technology*, where the court recognised a nullity exception, it was stated that a bank would not be expected to make any investigations other than to examine the documents and see that they conform facially to the credit.[50] The nullity exception would merely mean that when a bank is satisfied (because it has come to its notice by whatever means) that a required material document is clearly a nullity, it need not pay even if the documents on their face conform to the credit. In any case, the idea of protecting banks from the dilemma of whether to investigate facts or to pay is not relevant in cases where the bank is not in any dilemma because it is sure that a material document is forged and a nullity and wishes to withhold payment. The lack of a nullity exception in such cases is a hindrance rather than a help.

Banks are already used to some degree of uncertainty due to the application of the fraud exception, and they can respond to the nullity exception in the same way as they do to the fraud exception. However, this does not necessarily mean that such uncertainty is as well justified in the case of nullity as it is in the case of fraud. The application of a nullity exception in addition to the fraud exception could have the negative effect of increasing the instances of uncertainty for banks. The problems of lack of certainty and the potential dilemma of banks might have been overstated by opponents of the nullity exception, but certainty is admittedly the best of the arguments against the nullity exception. The development of the autonomy principle, vital in letter of credit transactions, was motivated by the need for certainty and speed in international sale transactions. Autonomy and certainty should therefore be preserved as far as possible. However, there might be instances where these should, as a matter of policy, be sacrificed when the considerations on the other side are weighty enough. An example is where a beneficiary has committed a fraud on the documents and the fraud exception applies. Whether an exception should also be made in the case of nullity will depend on the strength of the arguments for such an exception, and these will be considered in the next section.

B. *Arguments Supporting a Nullity Exception*

Starting from the premise that the independence and usefulness of letters of credit require as far as possible that the autonomy principle governs, and that facial compliance of documents be sufficient to ensure payment of the beneficiary, any rule that allows a bank to go behind facial compliance should be limited unless good reasons exist. As discussed preciously, the fraud exception is justified by the application of the maxim *ex turpi causa non oritur actio*, with the prime consideration being that the courts will not allow their processes to be used by a dishonest person to carry out a fraud.[51] This justification will not work in relation to a nullity exception as there is no fraud on the part of the beneficiary, and the nullity exception must

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[49] [2002] 3 All E.R. 697 at 712, para. 58.

[50] *Supra* note 3 at para. 34. This is the same as the position under the fraud exception. See *Turkiye Is Bankasi A.S. v. Bank of China* [1996] Lloyd's Rep. 611, affirmed [1998] 1 Lloyd's Rep. 251.

[51] *United City Merchants*, *supra* note 1 at 183-4.

be justified on other grounds. The reasons that support a nullity exception include the non-conformity of null documents, preservation of the bank's security, fairness and appropriate risk allocation, discouragement of forgery, adhering to the bank's mandate and preservation of the understanding between the parties.

1. *Beneficiary's Obligation to Present Conforming Documents*

In order for the beneficiary to be entitled to claim upon the credit, the documents presented must conform to the requirements of the credit. On one level, conformity refers to whether the documents conform on their face to the requirements of the credit. Such facial conformity can be satisfied even where there has been a fraud in relation to the documents. That was why the beneficiary was entitled to payment in a case such as *United City Merchants*. The bill of lading, though fraudulently completed, was a facially conforming document as it reflected the required date of shipment, 15 December 1976. Although facial conformity of the documents is necessary before the seller/beneficiary can claim on the credit, this might not in itself be sufficient to satisfy the requirement of conformity if a document is forged and a nullity.

This is because there is another way to look at conformity, by considering the broader question of whether a document is what is required under the credit. Different variations of this argument have been put forward by academics as well as judges. Professor Goode has argued that "documents which are forged cannot conceivably be treated as conforming documents." He states that a bank may be safe in paying on such forged documents if it has examined them with reasonable care and they appear to be in order, "but to say that the beneficiary has a right to payment against even forged documents if he is not a party to the forgery finds no justification in the terms of the letter of credit or in the provisions of the UCP."[52] Other writers share this view. For instance, Professor Ellinger writes, "The beneficiary is promised payment against a set of documents described in the documentary credit. Can it be seriously argued that the promise is meant to cover false documents?" He further states, "It is disturbing that whilst a document stating the true loading date could have been rejected by the bank in the light of the doctrine of strict compliance, a document in which the loading date was fraudulently misrepresented by its maker constituted a valid tender in the beneficiary's hands."[53]

The Court of Appeal in *Beam Technology* pointed out that implicit in the requirement of a conforming document was the assumption that the document was true and genuine. Although a bank was not required under the U.C.P. 500 to look beyond what appeared on the surface of the documents, the court felt that the question as to the genuineness or otherwise of a material document which was the cause of the issue of the letter of credit had to be of some consequence.[54] In the *United City*

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[52] Goode, *Commercial Law*, *supra* note 41 at 1009. See also Goode, "Abstract Payment Undertakings", *supra* note 41 at 230-1.

[53] Guest (gen. ed.), *Benjamin's Sale of Goods*, 6th ed. (London: Sweet & Maxwell, 2002), chap. 23, paras. 23-140. See also Bridge, *The International Sale of Goods* (New York: Oxford University Press, 1999), para. 6.69.

[54] *Supra* note 3 at para. 33.

Merchants case, Griffiths L.J. in the Court of Appeal was of the view that where the documents were forgeries, the right of the bank to refuse payment rests

> . . . upon the fact that the bank's obligation is to pay upon the presentation of genuine documents in accordance with the requirements of the credit. If the documents presented are fraudulently false, they are not genuine conforming documents and the bank has no obligation to pay.[55]

Similar views were echoed by his brethren in the Court of Appeal.[56]

Although expressed in different ways, the points made by these authorities are that a genuine document is what is required under the credit, a forged document does not meet this requirement despite its apparent conformity, and the beneficiary should not be paid.[57] This argument is persuasive in relation to a forged document, and has even more force in the context of a forged document that is a nullity. The question is whether the beneficiary, in presenting a document that is forged and a nullity, has done all that is required in order to be paid. If the beneficiary has not fulfilled the pre-requisites, the bank's duty to pay does not arise.[58]

2. *Documents as the Bank's Security*

The applicant's creditworthiness is important to the issuing bank, who must look to the applicant for reimbursement after paying on the credit. A bank will strengthen its position by taking security from the applicant for protection in case the applicant is unable to pay. Bills of lading are documents of title and have traditionally formed an ideal security for the bank. Although the development of other forms of transport

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[55] [1982] Q.B. 208 at 254.

[56] Stephenson L.J. stated that "a forged document . . . is not a genuine or valid document entitling the presenter of it to be paid, and if the banker to which it is presented under a letter of credit knows it to be forged he must not pay." *Ibid.* at 239. See also judgment of Ackner L.J., *ibid.* at 247.

[57] This idea was also expressed in *Sztejn v. J. Henry Schroder Banking Corporation*, the U.S. case relied upon as authority for the fraud exception in the United Kingdom. In that case, Shientag J. stated in the Supreme Court of New York: "When an issuer of a letter of credit knows that a document, although correct in form, is, in point of fact, false or illegal, he cannot be called upon to recognise such a document as complying with the terms of a letter of credit." 31 N.Y.S. 2d. 631 (1941), note 1 at 635, 1941 N.Y. Misc. LEXIS 2434. The judge quoted the case of *Old Colony Trust Co. v. Lawyers' Title & Trust Co.* 297 Fed. 152 at 158; *certiorari* denied, 265 U.S. 585 as authority for this principle.

[58] This was the analysis taken by the judge when *Beam Technology* was before the High Court. Choo J.C. did not feel that there was a need to invoke the nullity exception since the beneficiary had failed to produce the documents required under the credit and was not entitled to be paid. He stated that it was a confirming bank's prerogative to reject any document presented to them on the basis that it was not one of the requisite documents, because of forgery or other reasons. The bank just had to bear the consequences of its judgment and, if necessary, face a suit for wrongful rejection. See [2002] 2 S.L.R. 155 at 162. Choo J.C.'s view that there was no need to invoke the nullity exception involves merely a difference of semantics. The important question in relation to the nullity exception is whether a bank is allowed to go behind a facially conforming document to show that the document is a nullity, and thereby be excused from paying the beneficiary. If it is, then the nullity exception applies. This enquiry could be relevant at the stage where the question is whether the beneficiary was entitled to be paid in the first place (Choo J.C.'s approach), or at the next stage where the question is whether a bank that has a duty to pay the beneficiary can negative this duty. See also Goode, "Abstract Payment Undertakings", *supra* note 41 at 228-33.

documents that are not documents of title might have weakened the traditional security function of the documents under a credit,[59] bills of lading remain widely used and the bank's security in the documents remains important. Since the bank may be relying on the documents under the credit as collateral for any advances that it gives to the applicant (usually by paying the beneficiary under a credit), it is hard to justify a rule that requires the bank to pay the beneficiary when presented with documents that it knows are worthless. This would be unreasonable as worthless documents will provide the bank with no security.[60] Preservation of the bank's security has long been regarded as a relevant factor,[61] and a more reasonable rule from the point of view of the bank would be one that recognises the nullity exception, and gives the beneficiary no right to be paid when the documents are null and without legal effect.

In *United City Merchants*, the bank's interest in the goods was put forward as a justification for the argument that the bank should not have to pay the beneficiary when the documents contained a material misstatement. In the House of Lords, Lord Diplock did not quarrel with this proposition but said that if this argument were right, then the 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." His Lordship was of the view that this would not justify the confirming bank's refusal to honour the credit as the realisable value of the goods concerned was not affected by their having been loaded on 16 December instead of 15 December as indicated in the bill of lading.[62] The argument being made here was that an acceptance of the security justification put forward by the bank would have meant that the misstatement was not material, and this would have led to the very conclusion that the bank was trying to resist, that the beneficiary should be paid. However, this problem does not arise in relation to the nullity exception. First, the nullity exception does not involve the concept of a material misstatement,[63] and second, the value of the goods would in most instances be affected by a material document being a nullity as opposed to merely misdated.

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59 Jack *et al.*, *supra* note 11 at 91 and 325.

60 It has been suggested that banks should not be concerned with the worth of a document, as a document can be worthless even if it is not a nullity. See Jack *et al.*, *supra* note 11 at 270. However, that a document might be worthless even if is not a nullity does not mean that the law should not protect the bank when a document is a nullity and definitely worthless.

61 In *Sztejn v. J. Henry Schroder Banking Corporation*, Shientag J. said: "While the primary factor in the issuance of the letter of credit is the credit standing of the buyer, the security afforded by the merchandise is also taken into account. . . . (T)he bank . . . is vitally interested in assuring itself that there are some goods represented by the documents." 31 N.Y.S. 2d. 631 (1941) at 635. See also *United City Merchants*, *supra* note 1 at 247 (*per* Ackner L.J.) and 254 (*per* Griffiths L.J.), and *Beam Technology*, *supra* note 3, paras. 19 and 30. In Singapore, the importance of this was recognised before *Beam Technology* in *Mees Pierson* where Rajendran J. said, "To require the bank to make payment when the bank knows that the bills of lading are a nullity is to require the bank to knowingly forgo its security. That would be tantamount to requiring the bank to honour the credit on terms less favourable to the bank than envisaged under the credit arrangement." See [2000] 4 S.L.R. 393 at 408.

62 [1983] 1 A.C. 168 at 186.

63 Although the formulation of the nullity exception in *Beam Technology* involved a "material document", this is quite different from the concept of a material misstatement.

3. *Fairness and Allocation of Risk*

In a letter of credit transaction where a document that conforms on its face to the requirements of the credit is in fact forged and a nullity, the failure to recognise a nullity exception would mean that the issuing bank would have to pay the seller/beneficiary, and the loss would ultimately fall upon the buyer/applicant who would have to reimburse the bank. This is the other side of the situation discussed earlier, where the argument was that the application of a nullity exception would be unfair as this would place the loss on the innocent seller/beneficiary. It is by no means clear that it would be fairer to place the loss on the buyer/applicant. The question here is which of two innocent parties should suffer, a question that is never an easy one to answer.

In *United City Merchants*, Stephenson L.J. expressed the following view in the Court of Appeal:

> Banks trust beneficiaries to present honest documents; if beneficiaries go to others (as they have to) for the documents they present, it is important to all concerned that those documents should accord, not merely with the requirements of the credit but with the facts; and if they do not because of the intention of anyone concerned with them to deceive, I see good reason for the choice between two innocent parties putting the loss upon the beneficiary, not the bank or its customer.[64]

This is a persuasive passage that presents a valuable judicial view on the proper allocation of loss between the beneficiary and the applicant, an issue that has received scant judicial attention. As it is the beneficiary who has the obligation to present conforming documents which are genuine and valid, it seems fair that he, and not the applicant, should bear the risk that a document presented might be a nullity. A contrary view has been expressed that it is inherent in documentary credits that along a string of innocent parties, the ultimate buyer bears the risk associated with documents which are apparently conforming but actually worthless. The rule that a bill of lading could be good tender under a C.I.F. contract although the parties were aware that the documents had already been lost was presented in support of this view.[65] One difference between cases under that rule and cases where forged and null documents have been presented under a credit is that the buyer in a legitimate transaction where the goods have been lost due to an incident covered under the insurance policy would have a good insurance claim. A bank or a buyer holding forged and null material documents under a letter of credit might be in a different position.

Another relevant consideration which was articulated in the Singapore case of *Lambias (Importers & Exporters) Co. Pte. Ltd. v. Hongkong & Shanghai Banking Corporation* could be to allocate the risk of loss to "the innocent party who puts the person responsible for the document into a position to do as he has done". This argument could be extended to justify putting the loss on the party most closely

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64 [1982] Q.B. 208 at 234.

65 Jack *et al.*, *supra* note 11 at 270. The case relied upon was *Manbre Saccharine Co. Ltd. v. Corn Products Co. Ltd.* [1919] 1 K.B. 198.

connected with the person making or event leading to the offending document.[66] For instance, on the facts of *Montrod*, the beneficiary was misled by the third party into wrongly believing that it had the authority to sign certificates of quality on behalf of the financiers who had instructed the bank to issue the letters of credit, and therefore it could be argued that the beneficiary should bear the risk that the document was not what was required under the credit.

The idea of allocating the risk of loss to the person who made such loss possible may indirectly be supported by the Court of Appeal decision in *Beam Technology*. In that case, the court had answered the question put before them by deciding that there was a nullity exception in the law. However, that was not the end of the matter as the hearing had been based on certain assumptions (that the air waybill was forged and a nullity) which might not necessarily have been valid. The bank in *Beam Technology* had refused to pay the sellers because Link Express (S.) Pte. Ltd., the freight forwarders who purportedly issued the air waybill, was a non-existent entity. The sellers had not selected the freight forwarders themselves, but had used them as a result of instructions given by the buyer, whom the court presumed had also provided the contact details for this non-existent company. On these facts, the Court of Appeal was of the view that the document might not necessarily have been a nullity or non-conforming as it was issued by the very entity selected by the buyers themselves. An alternative way to support a finding that the bank was liable to pay on the letter of credit in *Beam Technology* and claim reimbursement from the buyer could be to argue that the buyer rather than the seller was the one who should bear the risk of loss as it was the one that had made the creation of the null document possible by pointing the seller to non-existent freight forwarders. On these unusual facts, the idea that fairness usually dictates that the seller should bear the loss of null documents might be justifiably displaced.[67]

4. *Not Condoning Forgery*

Maritime fraud involving false and antedated bills of lading is a serious problem in international trade, and victims often lose huge amounts of money.[68] In the United Kingdom, a judge has referred to this as a "cancer in international trade".[69] With

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[66] [1993] 2 S.L.R. 751 at 763-4. An important question is what the beneficiary must have done before he would be seen as having put the forger into a position to do as he has done. In *Lambias*, where the beneficiary had met the imposter without realising that he was an imposter and brought him to the bank to countersign an inspection certificate, the judge, Goh J.C., seemed prepared to accept this involvement of the beneficiary as sufficient.

[67] Whilst such displacement is justifiable in a case where the applicant has done positive acts that made the forgery possible, it would not be so where the argument is merely that a particular beneficiary is a seller in a string of contracts and therefore has done nothing to make the forgery possible. In the latter situation, the idea that the beneficiary has the responsibility to present conforming documents would still point to the innocent beneficiary as the person who should, in fairness, bear the loss.

[68] See further Demir-Araz, "International trade, maritime fraud and documentary credits" Int. T.L.R. 2002, 8(4) at 128.

[69] In *Standard Chartered Bank v. Pakistan National Shipping Corporation (No. 2)*, Cresswell J. said, "Antedated and false bills of lading are a cancer in international trade. A bill of lading is issued in international trade with the purpose that it should be relied upon by those into whose hands it properly comes—consignees, bankers and endorsees. A bank, which receives a bill of lading signed by or on behalf of a shipowner (as one of the documents presented under a letter of credit), relies upon the veracity

this background, it would seem counterproductive that a beneficiary who presents a document that is forged and a nullity should be allowed to claim on the credit. Indeed, it has been argued that the failure to recognise a nullity exception seems to tolerate the circulation of forged documents in international trade, and that this is undesirable as the proliferation of fraudulent and null documents will undermine the trust that forms the foundation of international trade.[70] The fraud exception already addresses the problem of beneficiaries who commit fraud. A fraudulent beneficiary is not entitled to be paid even if the documents conform to the credit. If the bank knows about such fraud before it has paid on the credit, it can withhold payment. More often, the problem is that the beneficiary gets away with the money because the fraud is not detected before payment. Where the fraud is that of a third party, however, the lack of a nullity exception leaves a gap. Whilst the application of a nullity exception would disadvantage the beneficiary without punishing the third party wrongdoer, it would still be an important development that signals that the law takes the problem of fraud seriously and will not give effect to fraudulent documents. Further, by placing the burden onto the sellers who procure such documents to police those with whom they deal, something that sellers should be in a better position to do than banks or applicants, the law might be able to help slow down the spread of fraud in international sales.

5. *The Bank's Mandate from the Applicant*

In letter of credit transactions, the bank has a contract with the applicant whereby the bank agrees to issue the letter of credit in favour of the beneficiary and to pay the seller/beneficiary the amount of the credit upon presentment of conforming documents. The contract in turn provides that the bank is entitled to claim reimbursement from the applicant. As Ackner L.J. stated in the Court of Appeal in *United City Merchants*:

> The banker's authority or mandate is to pay against genuine documents and that is what the bank has undertaken to do. It is the character of the document, not its origin, that must decide whether or not it is a 'conforming' document, that is a document which complies with the terms of the credit.[71]

On this view, a bank that breaches its mandate and knowingly pays upon apparently conforming documents that are not genuine does so at its own peril as it would not be able to claim reimbursement from its instructing party. The view that the bank has a limited mandate is an attractive one. It would be inexplicable that an applicant should be willing to authorise a bank to pay the beneficiary upon documents that the bank knows are forged and null, thereby allowing itself to be left bearing the losses. The bank should be allowed to withhold payment to the beneficiary so as to stay within the terms of its mandate from the applicant, and applying the nullity exception would achieve this result.

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and authenticity of the bill. Honest commerce requires that those who put bills of lading into circulation do so only where the bill of lading, as far as they know, represents the true facts." See [1998] 1 Lloyd's Rep. 684 at 686.

70 Hooley, "Fraud and letters of credit: is there a nullity exception" [2002] C.L.J. 279 at 281.

71 [1982] Q.B. 208 at 247.

6. *Contractual Analysis: Construing the Contract*

A letter of credit transaction involves at least three relationships, usually more. For the purpose of the current analysis, the three core contracts are between the buyer/applicant and the issuing bank, between the issuing bank and the seller/beneficiary, and between buyer and the seller. Because letters of credit are governed by well established and generally applicable rules, it is easy to forget that as in all contracts, the intention of the parties and the agreement between them should not be ignored.[72] Otherwise, the resultant danger could be that courts might develop the law in a way that is completely divorced from the expectations of the parties when they entered into their contracts.[73]

To evaluate the rights and obligations of each party in the letter of credit transaction, courts have to construe the contracts made by the parties. Express terms must be interpreted, and where necessary, implied terms found. For instance, if the letter of credit issued by the bank in favour of the beneficiary provides that the sale price of the goods is payable against a "full set of clean on board ocean bills of lading" drawn to the order of the issuing bank covering the goods sold, the court will have to interpret these terms to see if a bill of lading that is forged and a nullity falls within the requirements.[74]

The reasonableness of a result is one of the factors that a court will take into account in choosing between different constructions of a contract.[75] In the words of Lord Reid:

> The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention absolutely clear.[76]

Is it reasonable that a bank which is aware that a material document is forged and a nullity should nevertheless be bound to make payment to the beneficiary, and be

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[72] There are standard contracts where terms are implied by law based on considerations other than the intention of the parties, but it is not clear that the contracts in a letter of credit transaction belong in this category. One indicator that the intentions of the parties do actually matter in letters of credit is that the U.C.P. takes effect between parties only if it has been positively incorporated into the contract.

[73] Construction of contracts is a matter of law, and the decision of a judge on the construction of a particular type of contract could be subject to the doctrine of *stare decisis*. See Lewison, *The Interpretation of Contracts*, 2nd ed. (London: Sweet & Maxwell, 1997) at para. 3.05. Once a certain aspect of a defined type of contract has been construed by the courts, this construction would tend to be applied in other similar types of contracts, and this makes it particularly important that the initial construction is a supportable one. From the initial construction by the court, parties have an indication of what to expect if they enter into that type of contract, and if their real intention is not in accordance with an existing judicial construction, they can put different terms into their contract, although this possibility seems more theoretical than real unless there is a uniform change in industry practice.

[74] This article has mentioned two situations where judges have expressed their opinion that a conforming document must be a true and genuine one: once in relation to the requirement that a beneficiary has to present conforming documents in order to be entitled to payment by the bank, and again in the immediately preceding section discussing the bank's mandate from the applicant. These conclusions by the court were probably based on a construction of the relevant contracts but there was no express discussion of this consideration in the judgments.

[75] See generally Lewison, *supra* note 73 at para. 6.13.

[76] See *Schuler (L.) A.G. v. Wickman Machine Tool Sales Ltd.* [1974] A.C. 235 at 251.

entitled to claim reimbursement from the applicant? The answer from the earlier analysis in this article is "no". It would make a mockery of his contractual obligations if the beneficiary can satisfy the obligation to present a particular document by producing a forged document. And since the beneficiary has not fulfilled his obligation to produce genuine documents, it is unreasonable to expect the bank to make payment without any security in the documents, or the applicant to later reimburse the bank for worthless documents. It is hard to imagine that the answer can be otherwise.[77]

Reasonableness is a theme that runs through the autonomy principle and the fraud exception. The principle of autonomy is more prejudicial to the buyer than to the other parties as it could operate to deprive the buyer of the self-help option of withholding payment in cases where the goods are defective. Further, he might have to reimburse a bank that has paid on conforming documents even if they later turn out to be inaccurate or forged. Yet, the principle is a reasonable one. A rational buyer might be willing to make the sacrifices for good reason. For instance, he wants to use a system that provides him with confidence that the goods are shipped before he pays for them. He cannot expect the seller to ship the goods before being paid, as this would defeat the whole commercial purpose for which the system of documentary credits has been developed.[78] The alternative of making the bank liable for inaccuracies and forgeries that do not appear on the face of the documents is not feasible as that would increase the cost of procuring a letter of credit. In any case, the buyer's position is not altogether insupportable as he would have rights to sue the seller in the underlying contract.

Where there is a fraud by the beneficiary in relation to the documents, reasonable considerations continue to apply, and the autonomy principle is displaced by the fraud exception. The buyer, already under a disadvantage because of the autonomy principle generally, will not expect that a seller who has committed a fraud in relation to the documents will still have to be paid. The fraudulent seller will not expect to be paid (even if he might have hoped to be)—it should be clear even to him that the letter of credit is not a license for fraud.[79] Similarly, it is reasonable that a bank that knows of the beneficiary's fraud beforehand and still goes ahead to pay him (when it is not bound to do so) cannot expect to be reimbursed by the buyer, and the buyer would not expect to have to make reimbursement.

The hitherto established rules in letter of credit transactions have been reasonable ones, and the existence of a nullity exception in the law will help keep it that way.

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77 It might just be imaginable that a buyer could agree, in the interests of the smooth functioning of the letter of credit payment system, to bear the risk of third party fraud where this does not render the documents a nullity, and sue the seller for any breach of contract afterwards. But it seems most unlikely that the buyer would extend this agreement to a situation where a material documents is a nullity and definitely completely worthless.

78 This purpose was identified by Lord Diplock in *United City Merchants*, *supra* note 1 at 183.

79 Here, an additional canon of contractual construction is relevant. This is the well established principle that as far as possible, a contract should not be construed to allow one party to take advantage of his own wrong. See Lewison, *supra* note 73 at para. 6.08.

C. *Evaluating the Arguments: Nullity Exception or Not?*

The strongest justification for not allowing a nullity exception is the certainty argument. It has been argued that the better rule should reflect the certainty that an innocent seller who presents facially conforming documents would always be paid, as this would assist the integrity of the system of documentary credits as a means of financing international trade.[80] It is hard to argue with the importance of certainty, which is the lynchpin of the letter of credit system. A bank has to be able to decide quickly and easily whether the beneficiary should be paid, and claim reimbursement for this payment. A beneficiary who has shipped the goods should be able to receive payment under the letter of credit without undue interference or a prolonged enquiry. The proper functioning of the letter of credit system requires that these characteristics be preserved as far as possible. On the other hand, the question must also be asked whether an unwavering adherence to certainty where what is presented is a forged document that is a nullity would adversely affect the law in a broader sense. Most of the arguments for applying a nullity exception are based on basic principles that might affect the integrity of the law if sacrificed. These include holding a beneficiary to his contractual promise to present conforming documents, fairness, protecting the reasonable expectations of the parties, and disapproval of fraud. Integrity of the law and integrity of the letter of credit system might point to two different directions. In any case, it is not clear when considering the "integrity of the system", that autonomy should be so all encompassing. A system based on autonomy was set up to ensure that the seller's right to payment would be independent of the underlying sale contract. But protecting the seller from defences based on the underlying sale contract does not mean that he should also be protected from defences that are related to the documents themselves. Indeed, the U.C.P. 500 provides that in credits all parties deal with documents.[81] A fraud in relation to a document that renders it a nullity must surely be directly linked to the document itself rather than a matter confined to the underlying contract.

Ultimately, it comes down to balancing the considerations of commercial convenience against the arguments based on principle. It is a close call, as both positions are imperfect. All things considered, this writer is of the view that there should be a nullity exception, and that the decision of the Singapore Court of Appeal in *Beam Technology* to this effect is a desirable development.

V. Boundaries of the Nullity Exception?

Beam Technology, the one case that holds that the nullity exception exists, propounds a strict formulation which involves a material document that is forged and a nullity. However, it is also possible to envisage a different formulation that involves fewer parameters.

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[80] Jack *et al.*, *supra* note 11 at 270.

[81] U.C.P. 500, art. 4.

A. *Nullity Without Fraud*

Discussion of a possible nullity exception usually takes place in the context of a forgery perpetrated by a third party, but the events leading to a document being a nullity may not always involve forgery, as the *Montrod* case shows. If the nullity exception is part of the law, should forgery be a necessary element before the exception can apply? Where a required document is a nullity without being forged, it is important to look at the requirements of the credit. If the document that is presented is exactly what is required under the credit, it is arguable that the beneficiary is entitled to payment even if this document is a nullity and without legal effect. In other words, if what is stipulated under the credit can be none other than a null document (for instance because the company that is supposed to issue the document does not exist), there should be no exception to the autonomy principle. On the other hand, where the beneficiary presents a facially conforming document that is not a genuinely conforming document despite the absence of a dishonest intent on the part of the maker (for instance because the maker honestly but mistakenly believed that he had authority to sign the document when in fact he did not), it is arguable that the nullity exception should apply. In this type of case, apart from the argument based on discouragement of fraud, the considerations that favour a nullity exception are equally persuasive in the absence of fraud. If a document is a nullity and does not conform (other than facially) to the requirements of the credit, it should not matter whether this was caused by a mistake or a fraudulent act, and it is likely that a court that is prepared to accept a nullity exception in the law would be prepared to find this exception to be applicable even in the absence of forgery.[82]

B. *Fraud Without Nullity*

The corollary to the question posed in the previous section is the question whether the law should recognise an exception to the autonomy principle whenever there is a fraud, even if this does not lead to a material document being a nullity. Where the fraud is that of the beneficiary, the law is well established by the House of Lords decision in *United City Merchants* and the traditional fraud exception would apply to prevent the beneficiary from claiming against facially conforming documents. Where the beneficiary has not been fraudulent, but there has been third party fraud, the law is equally well established by the House of Lords in the same case. The autonomy principle will apply without exception and the innocent beneficiary must be paid. The court did not have to consider the question of nullity as the false date inserted into the bill of lading did not render it a nullity.

Although the reasoning of the House of Lords in *United City Merchants* has been criticised, the actual decision of the court that the bank had to pay against the bill of lading showing a false date has been less controversial. One view is that the ruling "might just possibly be sustained on the ground that the insertion of a false date in

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[82] In the *Montrod* case, the argument placed before the Court of Appeal was based on nullity without any mention of forgery, as it was accepted by the parties that the beneficiary who had mistakenly signed the certificate of inspection was not fraudulent. The court, which was not open to the existence of a nullity exception in any case, felt that the absence of fraud prevented the certificate from being a nullity. See note 19 above and accompanying text.

the bill of lading did not prevent it from being what it purported to be".[83] Some of the arguments in favour of the nullity exception could be applied also to the case of fraud in the absence of nullity, for instance, the discouragement of fraud. Or the argument could be made that a document containing a false statement is not a conforming document, although this might be less obvious than the argument that a document that is forged and a nullity cannot be a conforming document. Overall, however, the arguments favouring the nullity exception apply with less force to the situation of fraud without nullity, and if a balancing exercise were undertaken, these might not outweigh the competing considerations of certainty.[84] In any case, *United City Merchants* is a clear and influential decision that has been followed by later courts, including those in Singapore. The question whether there is an exception to the autonomy principle when there is third party fraud in the absence of nullity has long been answered in the negative, and any discussion whether there should be such an exception is likely to be futile at this stage.

VI. Putting Rules into Practice: Nullity, Materiality and the Standard of Proof

The recognition of a nullity exception in any jurisdiction would be a first step. The courts would have to develop legal principles in order to flesh out the basic concepts, and these would have to be put into practice by all those involved in letter of credit transactions.

Where a nullity exception is part of the law, a bank wishing to resist paying the beneficiary should have to show at least that a document required under the credit is a nullity.[85] If a formulation like the one in the *Beam Technology* case is applied, it would also have to show that the document is material and a forgery. Fraud and forgery have been discussed by the courts in relation to the fraud exception, and these should be relatively familiar concepts to the banks. But the concepts of "material document" and "nullity" are undeveloped in letter of credit law, and further guidance from the courts would surely be welcome. The possible answers in relation to the documents involved in the key cases are instructive. In *United City Merchants*, the document in question was a bill of lading with a wrong date of loading. This would have satisfied the materiality requirement since a bill of lading is a vital document. But it would have failed on the nullity requirement. In the House of Lords, Lord Diplock said:

> The bill of lading with the wrong date of loading placed on it by the carrier's agent was far from being a nullity. It was a valid transferable receipt for the goods giving

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[83] Goode, "Abstract Payment Undertakings", *supra* note 41 at 231. In contrast, Professor Ellinger's view is that although the decision may be regarded with sympathy from the point of view of commercial reality, it was conceptually problematic as the beneficiary should not be exonerated from liability for fraudulent statements contained in a document tendered by him to the bank. Guest, *supra* note 53, chap. 23 at paras. 23-140.

[84] In any case, this question is not about the nullity exception properly so called. It involves a debate on whether the fraud exception should be extended apart from nullity, which is beyond the scope of this article.

[85] An example of such minimal formulation is the one put before the court in *Montrod*, where the argument was that the nullity exception should apply when a document presented under the credit is a nullity.

> the holder a right to claim them at their destination . . . and was evidence of the terms of the contract under which they were being carried.[86]

In *Montrod*, the document required under the credit was an inspection certificate signed by the applicant, but what was tendered was an inspection certificate signed by the beneficiary in the honest but mistaken belief that he was authorised to do so on behalf of the applicant. The Court of Appeal in that case implied that even if it were inclined to accept a nullity argument, a document signed by the beneficiary in honest error as to his authority would not be a nullity.[87] However, it is hard to see how the mistakenly signed document could have been other than a nullity, as the applicant, who was the party supposed to issue the inspection certificate, did not authorise the signature of the beneficiary.[88] Nevertheless, the facts in *Montrod* might not have fallen within the test propounded in *Beam Technology* for another reason. As Chao J.A. said in *Beam Technology*, "Perhaps another way of differentiating *Montrod* from the present case is that there the certificate required was not an essential document but one touching on the question as to the quality of the goods sold."[89] Even in a case like *Beam Technology* where the document in question was the set of air waybill, clearly a material document, the question of nullity posed a problem. One might have thought that there could be no clearer example of a document that was a nullity than an air waybill that had been issued by a non-existent company of freight forwarders. Yet, the facts of the case complicated matters as it was the applicant who had nominated the freight forwarders to whom the seller should consign the goods. In such circumstances, the court felt that the document might not have been a nullity and directed that there should be a further enquiry as to whether the document was in fact non-compliant or a forgery.[90]

The three examples in the preceding paragraph illustrate the range of situations that could arise. The Court of Appeal in *Beam Technology* was of the view that it was not possible to define generally when a document is material or a nullity, and that these questions could only be answered on the facts of each case.[91] This is a

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86 [1983] A.C. 168 at 188.

87 In *Montrod*, Potter L.J. said, referring to Lord Diplock's judgment in the House of Lords decision in the *United City Merchants* case: "While he left open the position in relation to a forged document where the effect of the forgery was to render the document a 'nullity', there is nothing to suggest that he would have recognised any nullity exception as extending to a document which was not forged (*i.e.* fraudulently produced) but was signed by the creator in honest error as to his authority; not do I consider that such an exception should be recognised." *Supra* note 2 at 711, para. 56.

88 One possible way to give legal effect to the inspection certificate might be to use an agency analysis to argue that the third party was the applicant's agent, *i.e.* that the applicant was bound by the statement made by the third party authorising the beneficiary to sign the certificate, because the third party had ostensible authority to represent the applicant. However, on the facts as described in the judgment, the conditions for ostensible authority were not discernible.

89 [2003] 1 S.L.R. 597 at para. 31.

90 It would seem to this writer that a document purportedly issued by a non-existent entity would be a nullity. The most pertinent inquiry would be whether the document was infact non-compliant. If a null document was what was required under the credit, the beneficiary should be paid regardless of the nullity.

91 [2003] 1 S.L.R. 597 at para. 36. The court did not have to fully analyse the concept of materiality or nullity as the air waybill was clearly material, and it was assumed to have been forged and a nullity for the purpose of the Order 14 hearing. The case-by-case approach and the summary nature of the proceedings might mean that the Singapore Court of Appeal's bold decision could have a more limited impact than it deserves as a trailblazer for law-makers in other jurisdictions, who could be hesitant to

practical approach that makes the building up of case law (likely to be a slow process because of the special fact situation involved) crucial for the guidance of lawyers.

Taking the meaning of "nullity" as being without legal effect, this could be relatively easy to assess once the facts of any case are known. Starting with the plain meaning of the word, this writer would have thought that the certificate of inspection issued by a person without authority to do so in *Montrod* and the set of air waybill issued by a non-existent entity in *Beam Technology* were both nullities. It is hard to see how either document could have had any legal effect or could have represented that which it purported to represent.[92] However, this conclusion does not accord with the view of the court in *Montrod*, and the view of the court in *Beam Technology* is unclear.[93] This divergence might seem to belie the impression that the issue of nullity is easy to assess. However, the courts' approach to the question of nullity in those cases might have been because they were not focused purely on the meaning of "nullity" but were thinking of the broader issues: the court in *Montrod* was unprepared to deviate from the autonomy principle, and the court in *Beam Technology* was unwilling to adjudicate on a matter which had not been argued before them. If the question of whether a document is a nullity comes up to be decided in future by a court which accepts the nullity exception and is in possession of the full facts of the case, the assessment is likely to be more straightforward.

In *Beam Technology*, Chao J.A. used the word "essential" as a synonym for "material".[94] This accords with the dictionary definition of "material" to mean significant or essential. The question is: material or essential to what? One possible answer could be that the document should be essential to the credit. If so, then any document required under the credit would be material. Yet this might not have been the view of Chao J.A. in *Beam Technology*, as he saw the required certificate of inspection in *Montrod* as "not essential"—in other words, non-material. Elsewhere in his judgment, Chao J.A. also referred in passing to "a material document, which was the cause of issue of the letter of credit",[95] suggesting that his standard of materiality was likely to be very high, since not every document required under the credit might satisfy the requirement of being the "cause of issue of the letter of credit".

Such a strict interpretation of "material" will narrow down the application of the nullity exception to cases where the effect of the nullity will definitely be grave for the applicant or the bank. This is an attractive approach in the sense that it preserves autonomy and certainty as far as fairness will allow. The distinction between non-material documents required under the credit and material ones would also reduce the instances of application of the nullity exception and correspondingly, therefore,

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give up the comfort and certainty of the autonomy principle unless they are presented with an example of an extensively formulated nullity exception whose four corners are clearly visible.

92 If the nullity exception is thought not to be applicable in these cases, this should be due to other reasons and not because the documents had any legal effect in themselves. For instance, an airway bill issued by a non-existent entity is clearly null as an airway bill, but a beneficiary who presents such a document might still be able to claim payment if such a null document was a conforming document under the terms of the credit because it was exactly what was asked for.

93 The court in *Montrod* stated that the certificate of inspection before them was not a nullity, and the court in *Beam Technology* did not make a decision relating to the relevant air waybill as they were not called upon to do so, but did think that there might have been a question whether it was indeed a nullity as was assumed for the purposes of the Order 14 hearing.

94 See text accompanying note 89, above.

95 *Supra* note 3 at para. 33.

the instances of uncertainty caused by a departure from the autonomy principle. Yet ironically, this approach could itself cause more uncertainty as it would require a fine distinction to be made between material and non-material documents. Further, the conceptual distinction between required documents that are material and those that are not might be awkward. This distinction might mean, for example, that of the various documents required under the credit, a bill of lading has to be genuine and legally effective in order to satisfy the requirements of the credit, whereas a certificate of inspection does not. It is possible to justify this difference in treatment by pointing to the varying importance of each of the required documents to the parties. However, as it was the parties who stipulated the documentary requirements to begin with, it is arguable that every required document is important to them, and distinguishing amongst such documents would involve substituting the court's judgment for that of the parties. Taking the example of the certificate of inspection in *Montrod*, if this had not been presented, or if a nonconforming version of a document purporting to be such a document had been presented, the bank would have been entitled to reject the document under the normal rules of non-compliance with the documentary requirements. This would seem to indicate that such a document, and indeed any document which is required under the credit, should be considered to be "material" for the purposes of the nullity exception. Such an approach could be more consistent with the reasons discussed earlier in this article for supporting the application of a nullity exception in the first place, for instance the obligation of the beneficiary to present conforming documents, or the desirability of adhering to the expectations of the parties.[96]

Other relevant questions relate to the standard of proof required before the nullity exception can apply. This question could arise in different contexts.[97] An example would be where the bank has refused to pay the beneficiary on the basis of the nullity exception. When the beneficiary sues the bank, the ordinary civil standard of proof will be applied at the trial to decide whether the requirements for the nullity exception

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[96] The finely-tuned approach implied by the Singapore Court of Appeal in *Beam Technology* is appealing in terms of the tailor-made results that it can facilitate in terms of fairness, and it is with reluctance that this writer feels bound on principle to suggest that the alternative of treating every required document under the credit as "material" could be a more certain and consistent approach. One example of a situation where the *Beam Technology* approach could be superior can be illustrated on the facts of the *Montrod* case. In *Montrod*, although the credit required a certificate of inspection signed by the applicant, the applicant was, unknown to the beneficiary, not interested in inspecting the documents but wanted to use the certificate as a control mechanism to ensure that the credit was not operable by the beneficiary until the applicant was put in funds by their borrower, the buyer. Assuming that the document in the *Montrod* case was a nullity (as is this writer's view), the broader approach of treating all required documents as "material" would have allowed the applicant to win the case under the nullity exception, whereas the finely-tuned approach of *Beam Technology* would have prevented the applicant from winning as the court did not regard a certificate of inspection as a material document. Although the court in *Beam Technology* seemed to be speaking about the materiality of an inspection certificate in general terms, there would seem to be additional reason on the facts of *Montrod* to use the *Beam Technology* approach to conclude that the particular inspection certificate in *Montrod* was not a material document, and that the beneficiary had to be paid, a result that could not have been facilitated by the broader approach. On the other hand, it could be argued (in support of the broader approach) that the motivation of the parties in requiring a document is irrelevant, as long as it was important to them in some way.

[97] In *Beam Technology*, the question put before the court was on the basis that the air waybill was a forgery known to the bank, and questions relating to the standard of knowledge and proof did not have to be answered.

have been satisfied. If, instead, the bank has paid the beneficiary despite knowing facts that would have entitled it to withhold payment under the nullity exception, the applicant might assert that the bank has breached its duty as it had knowledge of the nullity and should not have paid. The question would then be a different one based on matters such as whether knowledge of the bank is shown and evidence of the nullity was clear. A third standard that could be relevant is the standard that the courts would apply to decide whether a case has been made out that would persuade them to issue an injunction to stop a bank from paying on a credit that falls within the nullity exception. The standard of proof required in these various situations are relevant also to the fraud exception, and a body of law has developed that will be helpful in nullity exception cases.[98]

In most transactions, the principle of autonomy will govern. It is only in a small number of cases that the nullity exception might apply. From the analysis made previously, certain propositions can be stated. Where the facts establishing the nullity exception are clearly present, the bank can confidently withhold payment. When the bank is not sure, it is entitled to pay the beneficiary and claim reimbursement from the applicant. It does not need to investigate facts, and it only has a duty to withhold payment when it knows, by whatever means, that the facts necessary for the application of the nullity exception are present. A bank might nevertheless feel insecure about going ahead and making payment if it merely has a suspicion that there are facts sufficient for the nullity exception to apply. It might be unsure at what point its awareness of a possible problem with the documents will be judged by the courts *ex post facto* to have crossed the line to become knowledge which triggered its duty not to pay. In such cases, as in similar fraud exception cases, the practical solution could be the involvement of the applicant in seeking an injunction from a court to stop payment by the bank, and for the bank to act accordingly depending on whether a court order is procured. This protects the bank from both the applicant and the beneficiary. Whilst the potential effect of this practice could be to reduce the speed and efficacy of using letters of credit in a small number of cases, it is likely to have less negative impact than might be feared. From the fraud exception cases, the standard of proof that will be required by the courts is likely to be very high. If the courts continue to send clear signals to this effect, the practical result over time could be to alleviate the bank's uncertainty whether to pay. The courts' attitude would make it unlikely that they would fault a bank *ex post facto* for making payment in a case where it was not clear to the bank that a material document was a nullity. This might also curb the applicant's tendency to apply for an injunction to prevent payment unless he has a very good case since the letter of credit cases involving fraud show that an injunction is extremely difficult to obtain.[99] It seems likely that the recognition of a nullity exception, which will allow principle to take precedence over expediency, will not prejudice the speed and efficacy of letter of credit transactions to an unacceptable degree.

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[98] For a discussion of corresponding issues in relation to the fraud exception, see King, *Gutteridge and Megrah's Law of Bankers' Commercial Credits*, 8th ed. (London: Europa Publications Ltd., 2001) at 65-72, 167-75.

[99] See particularly *Czarnikow-Rionda v. Standard Bank* [1999] 2 Lloyd's Rep. 187.

VII. Future Development: Beneficiary Fault?

To justify an exception to the principle of autonomy, the fraud exception focuses on the actions of the beneficiary, whilst the nullity exception looks at the effect that a forgery or other act may have on a document required under the credit. There is some indication that some courts may in future look at other actions of the beneficiary apart from fraud in order to assess whether there should be an exception to the autonomy principle in any particular case. Although the Court of Appeal in the *Montrod* case rejected the nullity exception, they left open the possibility of focusing on the acts of the beneficiary and in an appropriate case, penalising him for conduct in connection with the creation and/or presentation of a document forged by a third party, even if such conduct did not amount to fraud. In support of this possibility, Potter L.J. referred to a statement in the High Court judgment of Mocatta J. in the *United City Merchant* case (where the judge mentioned the relevance of "unscrupulous behaviour" on the part of the seller), and also quoted the judgment of the Singapore High Court in *Lambias (Importers and Exporters) Co. Pte. Ltd. v. Hongkong & Shanghai Banking Corp*.[100] His Lordship found the argument attractive, but did not decide on its correctness as it was not relevant to the facts of the case. In the relevant part of the *Lambias* case, Goh J.C. said:

> The law cannot condone actions which, although not amounting to fraud per se, are of such recklessness and haste that the documents produced as a result are clearly not in conformity with the requirements of the credit. The plaintiffs in the present case are not guilty of fraud, but they were unknowingly responsible for having aided in the perpetration of the fraud. In such a case, where the fraud was discovered even before all other documents were tendered, I think it is right and proper that the plaintiffs should not be permitted to claim under the letter of credit.[101]

However, the court in *Lambias* did not have to rely on this principle as they found that the documents did not conform to the requirements of the credit, and that alone was sufficient to excuse the bank from paying. The decision of the Court of Appeal in *Beam Technology* may also support the relevance of beneficiary fault not amounting to fraud, as the court there thought it might be significant that the buyers had been the ones who had selected the non-existent freight forwarders who purportedly issued the air waybill.

The degree of fault required on the part of the beneficiary before his right to payment might be curtailed is an issue that will have to be developed if this exception is to be recognised. In *Lambias*, the beneficiary had unknowingly allowed a quality and weight inspection certificate which they had issued to be countersigned by an imposter, and the judge seemed prepared to accept this involvement of the beneficiary as sufficient. This indicates that the ideas of "responsibility" and "aid" envisaged by the court in *Lambias* might have been very broad, and might not necessarily have involved moral turpitude on the part of the beneficiary, nor the "unscrupulous behaviour" mentioned by Mocatta J. in *United City Merchants*.

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[100] [2002] 3 All E.R. 697 at 713, para. 59.
[101] [1993] 2 S.L.R. 751 at 765.

The idea of beneficiary responsibility not amounting to fraud is one that might be further developed and applied in the future. In particular, the proposition that a non-fraudulent beneficiary might fail to obtain payment upon tender of facially conforming documents if he had acted recklessly, in haste or is somehow at fault could be used to ameliorate the harshness of a refusal to recognise the nullity exception in jurisdictions where such exception might not be part of the law. However, some skepticism has been expressed as to whether an acceptance of this proposition would better avoid the pitfalls that those against the nullity exception are seeking to avoid.[102]

VIII. Conclusion

The letter of credit is a brilliant device, and the rules for its operation are by and large neatly designed to provide as much protection as possible to each party whilst incorporating the autonomy principle to ensure certainty and speed. However, the law must properly manage the tension between the smooth, speedy operation of the letter of credit system on the one hand and on the other, maintaining a balance in the interests of the parties and preserving the integrity of the law. This is necessary so that letters of credit can serve their primary function without sacrificing the justice, fair play and sensibility that underlies the common law. In the clash between the autonomy of credits and the fraud exception, the fraud exception triumphed. An assessment of the competing factors suggests that in the clash between the nullity exception and the autonomy of credits, the nullity exception should similarly triumph.

Although the U.K. Court of Appeal's view in *Montrod* was that the nullity exception was not part of the law in the United Kingdom, it is arguable that the court found the bank liable to pay the beneficiary only because they were of the view that the facts of the case lacked the essential ingredients necessary for the nullity exception to apply. Further, the policy reasons advanced by the U.K. Court of Appeal in *Montrod* against the nullity exception should be balanced against the contrary arguments advanced by the U.K. Court of Appeal in *United City Merchants* which survive the House of Lords decision in that case. It might therefore be open for a United Kingdom court faced with different facts to distinguish the *Montrod* decision and consider the nullity exception afresh. Should they be prepared to do this, the Singapore Court of Appeal decision in *Beam Technology*, which recognised the nullity exception, could be helpful in illustrating one formulation of the principle. It must be accepted, however, that there is no perfect formulation of the nullity exception. The competing considerations discussed in this article are such that some trade off is inevitable when expediency makes way for principle. It would be up to the courts of the relevant jurisdiction, after having decided to apply a nullity exception as a matter of policy, to decide on where to draw the line.

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[102] Hooley, "Fraud and letters of credit: is there a nullity exception" [2002] C.L.J. 279 at 281.