Introduction

It has been recognized by international trade countries that a letter of credit is the most frequent method of payment. This payment mechanism is practically utilized where the seller and the buyer are apart and neither knows each other. Dealing with someone whose financial background and sincerity is unknown is of course susceptible to various dangers. Therefore, a letter of credit plays an important role as it gives the parties involved in such businesses a guarantee that all of them will be protected and will receive their rights. \(^{n1}\)

It is interesting to note that payment using a letter of credit is made based on certain documents. The seller will be paid as long as he can produce and comply with all the necessary documents required by the buyer. The bank representing the buyer is obliged to pay the seller and cannot withhold or deny payment until the goods have safely reached the buyer. Whether the goods are in good condition at the time they are received by the buyer is irrelevant. This is based on the rule that all parties using a letter of credit deal with documents and not with goods. \(^{n2}\) The bank will not be involved in the underlying contract between the buyer and the seller and in most cases, the bank does not even have an idea what kind of goods are sold. This is what is known as the autonomy of a letter of credit. The obligation of the bank to pay the seller upon compliance with the documents cannot be interfered with by any arguments between the buyer and the seller. The buyer has no choice except to make payment.

Principle of autonomy and the exception of fraud

The principle of autonomy of letter of credit means the banker's obligation to pay under the credit is separate and independent from the underlying contract of sale. \(^{n3}\) The bank is not concerned with the underlying contract of sale but is only concerned with the documents tendered by the seller. If the bank makes a payment against conforming documents, then it is entitled to be reimbursed by the buyer. \(^{n4}\)

As with other general rules, there are also exceptions to the principle of autonomy in letter of credit. The obligation of the bank to release payment upon compliance with the documents can be nullified in the existence of fraud. But, unlike other exceptions, the courts applied the said exception narrowly. The buyer and the bank bear a heavy burden in having to prove that the seller was involved in fraud in the transaction. It was evidenced by the decisions of the courts that mere suspicion of the existence of fraud will not be entertained. \(^{n5}\) As has been pointed out by Sir John Donaldson MR in Bolivinter Oil v Chase Manhattan Bank: \(^{n6}\)