PAYMENT BY LETTER OF CREDIT (LC) IN INTERNATIONAL TRADE: DISPUTES ON FRAUD EXCEPTION WITH SPECIAL REFERENCE TO MALAYSIA

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INTRODUCTION

Fraud in international trade is not a new phenomenon. The problem is most rampant in the area involving method of payment especially by letter of credit (LC). The survival of fraud in LC will not only disturb the LC flow but it will end up as a disaster to the whole transaction. Consequently, fraud in LC transaction will frustrate involved parties like buyer, seller as well as banker. It is identified that in LC transaction, fraud is possibly perpetrated by the intentions of fraudulent buyer, seller and financial intermediary. Among these three patterns, fraud committed by seller is the easiest and is common whereas it is unlikely to have fraud arranged by buyer alone to import the goods and disappear. Similarly, it is very rare that a financial intermediary or a bank misappropriates the proceeds. Since banks are dealing with documents, they cannot refuse to pay on compliance of seller’s documents.

The fact that the bank is dealing with documents only, gives an opportunity for fraudsters to utilize this pattern of fraud. What the fraudsters must do is to prove to the bank

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4 For instance, “false documents are presented by the seller to the bank, which comply with LC terms. The confirming bank pays and sends documents to issuing bank. The buyer believes that the cargo has been loaded and on its way to its destination. In many cases, it is only when the vessel is due to arrive at destination port that the buyer discovers that the cargo, as contracted, has not been loaded on board. He has paid put under spurious documents.” Mr P. Mukundan, Director, ICC Commercial Crime Services, Seminar on “Managing International Trade Fraud Risks.” 13 May, 2010, Kuala Lumpur; see also, Ricky, “Strict Compliance and The Fraud Exception: Balancing the Interests of Mercantile Traders in The Modern Law of Documentary Credits,” (2009) Mqjbl vol 5, 137-169, LexisNexis database, retrieved 2 June, 2010at 138; see also, “Problems and Patterns For Letter of Credit,” (1959) HeinOnline, U. Ill. L.F. 162, JSTOR database [http://www.jstor.org/stable/755155] retrieved 19/03/2010, at 186.
5 “However, it is observed that these days of computer generated document, it eased the fraudulent buyer to produce a bill of lading in which appearance of the script is exactly the same as original. The buyer may use this false bill of lading to collect the cargo directly at the port without going to the bank and pay the cargo to get the bill of lading.” Mr Mukundan, n 4.
6 Ibid; see also, Zulkifflee bin Hj Hassan & Anor v. PP [1991] 1 MLJ 240.
7 See, Cane Sugar Trust Co. Ltd. (July, 1991), Sugar Frauds Warning by International Chamber of Commerce. [http://www.almac.co.uk], viewed on 8 April, 2003).
8 Article 5, UCP 600.
that they have a contract which is actually fictitious. Bank will then issue an LC after the customers confirmed that their dealing is credible. When documents are presented to bank against LC, it is not possible for the bank concerned, neither it is required under the UCP, to verify either the genuineness of any such documents including the bill of lading or the signature thereon. The vast number of shipping companies and their agents throughout the world, most of who are empowered to issue bills of lading, make such a check totally impracticable.

**FRAUD EXCEPTION AND THE UCP**

The primary purpose of formulating the UCP is not to provide a set of law in interpreting and deciding nature or substance of fraud in LC. It is intentionally drafted to provide uniformity to govern the application and operations of LC as the payment instrument in trade activity. As the global commerce system has developed into a more complex and becoming more sophisticated, it is essential to ensure smooth transition of movement of goods, services and payment. Money, being the life blood of commerce, is the main reason that the protection needed the most and should not be compromised for whatever reasons. Premised on this principle, UCP is established in a way where fraud exception is strictly narrowed down to only documentary evidence so as not to damage the autonomous nature of LC. Over times, fraud relating to underlying contracts has grown not only in numbers but evolve into more complex nature embedded with the rapid technology growth. The damage caused by fraud originates from the underlying contract has, to certain degree degenerate the trust carried by LC to the extent where it is likely to be refused in an introductory trade relationships. The pressure and trade insecurity faced in commerce is building up the notion of including the underlying contract as part of the fraud exception to mitigate such risks.

It is noted that the fraud loophole in the UCP is not due the UCP drafters being heedless with regards to the challenge that fraud exception poses for LC. The drafters were fully aware of the negative impact of fraud exception to LC, but rather chose to let the matter be taken care of by the contracting parties and the courts to formulate the relevant rules. Thus, fraud issue in LC is conventionally considered as the proper province of national law and national courts to deal with any injunctive relief on the ground of fraud by the beneficiary.

Indeed, the idea to include the fraud rule in the UCP has been ignored by the new version of UCP 600. The general provisions of Articles 34, 7(c), 8(c) and 12(b) of the

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9 See, article 34, UCP 600.
12 Ibid.
13 Ibid.
14 This Article provides a disclaimer for the bank’s undertaking, that is to check on the content of a document and not its validity; see Commentary on the UCP 600, International Chamber of Commerce, (2007). ICC Commentary
UCP 600 do embrace the fraud issue but only with regards to bankers’ responsibility. These articles explicitly and impliedly restrict banks to examining the data contained in documents and not the validity of the underlying source, content, statements or the acts of any party issuing such documents. It is inferred from those provisions that banks have no responsibility for in any ‘falsification’ of documents. Thus, these general provisions aim to protect bankers from any recourse against fraud by their customers and are not sufficient to solve the problems triggered by fraud in LC transactions.

Hence, the fraud rule in LC transaction once again remains unclear. The UCP 600 does not do anything for the prevention of fraud. In fact, the philosophy of the UCP is to ensure that banks do not have to go beyond checking the documents on their face. It is the only way the documentary credit system can work. The banks take the view that they do not want to get involved in authenticating the trade transaction or getting directly involved in disputes between the buyers and sellers on price, specification or delivery as their function is to facilitate payment on a genuine transaction. If there is fraud, there are other measures to deal with it like the criminal justice system and the criminal statutes in the countries. The current UCP 600 compared to the UCP 500, is more robust in protecting the banks to ensure they are not responsible for false documents or their sufficiency and accuracy.

APPLICATION OF FRAUD EXCEPTION IN LC: APPROACH BY SELECTED COURTS JURISDICTION

Case-law has demonstrated that a conflict always arises in determining the standard of fraud which could prevent the application of the principle of autonomy in LC. Some jurisdictions applied narrow approach whereas other jurisdictions adopted broad approach to permit the application of fraud exception in order to set aside the principle of autonomy in LC. A narrow
approach reflects that only fraud on document can demolish the autonomous nature of LC. For instance, a seller who fraudulently presents documents containing fraud will not be entitled to claim payment and banks in this case are not obliged to pay. On the other hand, a narrow approach disqualifies fraud on the goods as an exception to payment in LC. In other words, if a seller ships fraudulent goods, this will not affect payment under LC. Banks should pay and disputes relating to the fraud on the goods should be resolved between contracting parties. This is considered as a dispute on the underlying sale contract and to be litigated by local law.

A narrow application of fraud exception can be observed in various English cases. In the case of Discount Records Ltd v Barclays Bank Ltd Megary J states:

“...I would be slow to interfere with banker’s irrevocable credits, and not least in the sphere of international banking, unless a sufficiently good cause is shown; for interventions by the court that are too ready or too frequent might gravely impair the reliance which, quite properly, is placed on such credit.”

This indicates that English courts are not willing to get involved with LC affairs unless a strong reason for doing so can be established. Thus, unless “a sufficiently good cause” exists, the court may reserve its interference.

Furthermore, the application of fraud exception in LC is restricted to fraud or material representations that within the beneficiary’s knowledge are untrue. Thus, fraud committed by a third party without knowledge of the beneficiary is not sufficient. In United City Merchant v Royal Bank of Canada, Lord Diplock states:

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

In this case, a loading broker had falsely stated that the goods were put on board the vessel on 15 December 1976 at London when in fact it was a day later, on 16 December 1976, and also not in London but in Felixstowe. The facts proved that the beneficiaries were not aware of the falsehood. The issue that arose was whether or not the obligation to pay can be excused if fraud in document was in fact created by a third party. It was held that the beneficiary in such situation was entitled to be paid since it was established that he was innocent and has no knowledge of such fraud. Otherwise, the beneficiary was not entitled to get payment.

26 [1975] 1 ALL ER 1071, at 1075.
27 Ibid.
29 Ibid, at 68.
Among the rationale for supporting the narrow approach by common law courts are, fraud exception destroys the autonomous nature of LC and will render LC as a secondary device. Therefore, to prevent this negative implication, common law has attached a number of requirements to fraud exception in order to restrict its application. The existence of fraud requires a strong proof and denies a mere allegation or suspicious fraud in order to nullify payment under LC. In addition, fraud must be beneficiary fraud and fraud perpetrated by other parties does not justify a refusal to pay.

On the other hand, the US approach is broader since fraud in the underlying transaction is accepted as an exception and no payment should be honoured. The first case on this point is Sztjen v J Henry Schroder Banking Corporation. In this case, a US buyer contracted to buy a quantity of hog bristles from Transea Traders Ltd in India. The beneficiary allegedly did not ship the hog bristles as contracted for but rather "cowhair, other worthless material and rubbish" with intent to simulate genuine merchandise and defraud the buyer. The buyer brought an action to prevent the issuing bank from paying under the LC. The court disallowed honour of a draft on the LC as the seller had intentionally failed to ship any goods ordered by the buyer.

**LETTER OF CREDIT FRAUD – MALAYSIAN LEGAL PERSPECTIVE**

(i) Legal Framework

As far as Malaysia is concerned, there is no specific local provision with reference to fraud in LC. Contractual issues are governed by the Malaysian Contract Act 1950 (Act 136). Elements such as offer and acceptance are required in order to form a valid contract and all contracts are valid if they are made by the free consent of the parties. Parties’ consent is said to be free if it

32 Ibid, at 486.
33 Bolivinter Oil SA v. Manhanttan Bank [1984] 1 Lloyd’s Rep. 251, Sir Johnson Donaldson M.R “But the evidence must be clear, both as to the fact of fraud and as to the bank’s knowledge. It would certainly not normally sufficient that this rests upon the uncorroborated statement of the customer [buyer], for irreparable damage can be done to a bank’s credit in the relatively brief time [involved]...”; see also Ackner L.J in United Trading Corp SA and Murray Clayton Ltd v. Allied Arab Bank Ltd [1985] 2 Lloyd’s Rep. 554.
35 (1941) 31 NYS 2nd 631, “The principle of independence of the bank’s obligation under the letter of credit should not be extended to protect the unscrupulous seller,” per Shientag J, at 634. Sztjen’s fraud has been codified in Article 5-109 of the UCC. It has been followed by nearly all subsequent LC fraud case in US and has also been cited with approval throughout the common law world, see. Buckley & Gao, “The Development of the Fraud Rule in LC: The Journey So Far and the Road Ahead,” (2002 23 U.Pa J.Int’l Econ. L 663, LexisNexis, retrieved 25 July, 2008..
is not caused by coercion, undue influence, fraud, misrepresentation and mistake. Thus, as far as contractual issues are concerned, fraud is recognised as one of the elements that can make the contract voidable. In other words, contract containing element of fraud is valid until it is set aside by the aggrieved party.

Another important relevant source is the Malaysian Penal Code (Act 574). The Code is the main statute which provides definitions and forms of punishment for crimes committed in Malaysia. Fraud committed in LC is also subjected to the form of punishment provided by this Penal Code. Normally, in Malaysia, fraudsters in cases of LC documentary fraud can be charged under sections 420, section 463 read with 464, section 467, section 468 read with 471, and 474. Among these sections, section 420, 464, 467 and section 471 are among the most frequent sections applied in LC fraud cases since they refer to fraud on “valuable security” where LC is treated as such. Fraudsters “shall be punished with imprisonment for a term which may extend to seven years, and shall also be liable to fine.” In a more serious case, punishment shall be extended to maximum imprisonment of twenty years. Another mandatory longer maximum prison term is consists of a combination of imprisonment for a term of less than one year and not more than ten years with whipping, and fine.

(ii) Modus Operandi

In Malaysia, case-law demonstrates that the similar kind of modus operandi is perpetrated in LC transaction by fraudsters. A trend of fraud by way of fictitious LC can be illustrated by the case of PP v Hang Young Chul & Yayan Sophian. The facts showed that the Defendants, Hang Young Chul, a Korean and Yayan Sophian, an Indonesian had passed off a forged document as an original, that is, a standby LC issued by Bank Rakyat Indonesia (BRI) under the beneficiaries

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39 See also, Section 19 and section 65, Malaysian Contract Act 1950 (Act 136).
40 This Section provides the mandatory maximum term of imprisonment of not less than one (1) year and not more than ten (10) years for cheating and dishonestly inducing delivery of property.
41 This Section defines forgery as the making of a false document with any of the stated intents therein.
42 This Section laid down circumstances where a person is said to make a false documents.
43 This Section deals with an aggravated form or forgery of the documents with maximum punishment of imprisonment term of 20 years.
44 This Section deals with cased where a document is forged with the intent of cheating.
45 This Section required that a forged document was used fraudulently or dishonestly with the knowledge on the part of the person using the document.
46 This Section applies to persons who possesses forged documents with is knowledge of forgery and with an intention to use it.
47 See, Section 468, Malaysian Penal Code (Revised 1997) (Act 574).
48 It is referred as “aggravated form of forgery of the documents.” The punishment for aggravated forms of forgery are provided by Section 466-469; Vohrah & Hamid, The Malaysian Penal Code, Commentaries, Cases and Sample Charges, Printworks Publishing Sdn Bhd, LexisNexis Malaysia, 2006 at 717; Section 467 describes forgery of documents which covers forged of a valuable security, a will, an authority to adopt a son, give authority to any person to make or transfer any valuable security, to receive principle, interest or dividends, to receive or delivery any money, movable property or valuable security, any documents purporting to be an acquaintance or receipt for the delivery of any movable property or valuable security.
49 See, Section 467, Malaysian Penal Code (Revised 1997) (Act 574).
50 See, Section 420, Malaysian Penal Code (Revised 1997) (Act 574).
51 Case No: 42-34-2004 High Court, Kuala Lumpur.
The first defendant was arrested by the police at RHB Bank Office, Malaysia while he was waiting for the RHB Bank officer to consult regarding the LC forms and guidelines. The Defendants were charged under Section 471, 467 read together with section 34 of the Malaysian Penal Code (Act 574) relating to the crimes involving fraudulent documents. It was proved in this case that the Fuzhou Fada Commerce & Trade Company did not apply for any standby LC from China Construction Bank and that they had no account with the said bank. The prosecution had also proved that the Defendants had no connection with BRI and had never submitted any application for standby LC to BRI. However in this case, the Session Court judge decided that the counsel for Defendants had succeeded in establishing a reasonable doubt against the prosecution case that both Defendants were innocent and have no knowledge of the forged documents. Accordingly, both Defendants had been released and acquitted. The prosecution opposed since the charges faced by the Defendants was serious and involved banking documents worth US$200 million. The case was appealed to the High Court. Unfortunately, a notice of appeal was not able to be served to the respondents since they were no longer in Malaysia. They had been confirmed to leave Malaysia once they have been acquitted.

The facts of the case show that there was no clear evidence of actual fraud committed on documents since no loss was suffered by all parties involved. However, from the situation of the case, it can be inferred that there was an attempt to commit fraud by the Defendants. The judge did not consider the fact that the SWIFT could not verify the said standby LC which is could be a ground for establishing that there is a possible fraud committed in the transaction.

Another modus operandi is where fraud is committed by a seller who cheats a buyer and also a bank by way of fraudulent documents. This scenario happened in a recent case, PP v Ibrahim bin Salleh. The accused, Ibrahim, who was a manager of Jalinkom Company Malaysia, had contracted to deliver Malaysian sawn timber to Leowood Company, a Thailand buyer. LC was used as a method of payment where Ibrahim was required to present commercial invoice, bill of lading and packing list to the Bangkok Bank Public Company Limited in order to be paid. Having presented those documents with compliance to Bangkok Bank, Ibrahim was paid upon LC an amount of USD1,215,250.00. Later, it was discovered that the documents contained fraud where the bill of lading was forged and the goods was not delivered. The judge accepted the explanation by an officer from Bangkok Bank that the banks deal with documents only where they have to examine and make sure that the documents are compliant with LC requirement, and the bank had no further obligation to check the physical goods under the sale contract.

52 This Section deals with criminal act for using “fraudulently or dishonestly” the forged documents which the fraudster had reasonably believed and known that the document is forged; see, Vohrah & Hamid, The Malaysian Penal Code, Commentaries, Cases and Sample Charges, Printworks Publishing Sdn Bhd, LexisNexis Malaysia, 2006.
53 This Section laid down punishment with the maximum term of 20 years imprisonment and fine for those who had forged a document as listed down by this Section, see, n. 550, at 163; A false document is defined in Section 470 as, “A false document, made wholly or in part by forgery, is designated “a forged document.” See, Vohrah & Hamid, n 52.
54 This Section provides that if one of several persons who have the same common intention, committed intentionally fraudulent offence, each of them would be liable for the same offence; see, Molly Cheang, Criminal Law of Malaysia, Kuala Lumpur Professional (Law) Books Publishers, (1990), at 219.
prosecution case had successfully established that Ibrahim had committed fraud on documents where he had photocopied an original bill of lading used in his previous LC transaction with another buyer, amended the content and presented to the bank. He also failed to deliver the goods. Accordingly, Ibrahim was charged under section 420 Malaysian Penal Code to have defrauded Bangkok Bank Public Company Limited via Maybank Berhad to believe that all documents presented as genuine with knowledge of the fraudulent fact. He was sentenced to three (3) years imprisonment and 3 times rattan.

In another event, a broker was arrested by the Malaysian Police following a report by the Bank of Tokyo for cheating involving RM100 millions using faked LC. It is reported that the broker, who was one of the several hired brokers of the gang fraudsters, was said to have submitted an LC for USD100 million. The broker was believed to have been paid RM50,000 for his service. The gang would ensure that their runners were not in contact with each other so as to avoid exposing their identities and their fraudulent syndicate. The broker was related to the four women arrested earlier, where three of them were Malaysian and the fourth was a bank employee from Hong Kong. The gang is believed to have directly or indirectly cheated other local banks using fake LCs. It is also reported that a month before this incident, police exposed a gang involved in trying to cheat three local banks of about RM33 million with forged LCs from foreign companies.

In another occurrence, it was reported that a food factory director was charged with cheating a Nigerian out of RM234,000. The defendant allegedly defrauded the victim into believing that he could supply cooking oil worth US$68,737.50 and got the victim to agree with an LC for payment of the equivalent amount to his company’s account. If convicted, the defendant could be jailed for up to 10 years, whipped and fined under Section 420 of the Penal Code.

Precisely, based on the above local cases and incidents, it shows that the existence of fraud in Malaysian LC transaction is not negligible. Furthermore, fraud by way of fictitious LC and documentary fraud seems to be actively perpetrated by fraudsters in Malaysia.

(iii) Standard of Proof

As far as Malaysia is concerned, there are a few Malaysian reported and unreported cases on fraud exception issues.

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56 In addition, the accused was also charged under Section 4(1), Anti-Money Laundering and Anti-Terrorism Financing (AMLATFA) Act 2001, with 3 years imprisonment. Both sentences under Section 420, Penal Code and Section 4(1), AMLATFA 2001 run consecutively.
59 Those cases are gathered from the compilation of cases by the Malaysian Attorney General, police report and newspaper.
The requirement for strong and cogent evidence was applied in the case of \textit{Mohd Jalani Saliman \\& Anor v PP}.\textsuperscript{60} In this case; the sellers had entered into a contract of sale of plywood products with three foreign buyers. The parties agreed that payment for the plywood would be made via LC and the United Malayan Banking Corporation (UMBC) would serve as a negotiating bank. The LC was opened by the buyers and the sellers had presented to UMBC the required documents, namely bill of lading, invoices, certificates of origin and packing lists to claim payment. Those presented documents contained a statement that the plywood was of Malaysian origin, “manufactured by Tropical Veneer Co. Ltd, Kuala Terengganu”\textsuperscript{9} and had been loaded on the designated ship, the MV Sim Lee for shipment. However, the prosecution had succeeded in proving beyond reasonable doubt that the sellers did not purchase the plywood manufactured by Tropical Veneer Co. Ltd, Kuala Terengganu as stated in the certificate of origin. Moreover, the goods were not loaded on the boards the steamer MV Sim Lee as stated in the bill of lading and the packing lists and invoices contained false particulars. Accordingly, the sellers were charged for cheating an offence punishable under section 420 of the Penal Code read with section 34\textsuperscript{61} of the Penal Code.

Based on the facts, the sellers have cheated the UMBC by deceiving it into believing that those documents presented together with the LC, namely, the bill of ladings, the invoices, the certificates of origin and the packing lists, were made in order to convince UMBC to believe that the terms of the LC had in fact been complied with and the goods had in fact been laden on the steamer MV Sim Lee. It is proved that, in doing so, the appellant dishonestly induced UMBC into releasing certain sums of monies to the credit of sellers. In this case, the learned judge relied on the provisions of section 415\textsuperscript{62} and section 420, held that to sustain a charge of cheating, there must be deception practiced upon UMBC by the appellants such that UMBC was induced to deliver the money. Accordingly, it was held by the judge, \textit{inter alia}, that it was a first degree of fraud arranged professionally by the appellants.\textsuperscript{63}

Similarly, in \textit{Trengganu Forest Products Sdn Bhd v Cosco Container Lines Company Ltd \\& Anor},\textsuperscript{64} a higher degree of proof was required in applying fraud exception. In this case, plaintiff seller agreed to sell 56 containers of plywood to the buyer and payment was made by LC on compliance of the plaintiff’s documents. The plaintiff submitted, \textit{inter alia}, the bill of lading to the negotiating bank for due payment pursuant to LC. It was subsequently discovered that the cargo was not “shipped on board” on 30.4.1994 as stated in the bill of lading and the cargo was in fact discharged at Hong Kong before being transshipped on to another vessel bound for Xingang Port, China. The dispute was referred to arbitration (between the buyer and the plaintiff seller) before the China International Economic and Trade Arbitration Commission, Beijing (“CIETAC”) in relation to the dispute concerning the contract of sale. The buyer then obtained an injunction to stop the bank from releasing funds pursuant to the LC on the ground that the bill of lading was fraudulent. In view of that, the plaintiff seller was ordered to pay the buyer which incurred loss and expense totalling US$ 276,230.00. Hence, in this case, the plaintiff sought compensation from the defendants for the total sum to US$ 1,446,469.58

\textsuperscript{60}[1997] 5 MLJ 551.  
\textsuperscript{61}This Section determines the liability of a person committing and offence in combination with others.  
\textsuperscript{62}This Section provides that an intention is required to prove the offence.  
\textsuperscript{63}Per Abdul Malik Ishak J, at 153.  
\textsuperscript{64}(2009) MLJU 4.
together with interest and costs, being the loss of the Cargo (US$ 1,170,239.58) and the payments made in connection to the Award (US$ 276,230.00) in relying on the said representations made by the defendants. The defendants admitted that the date on the bill of lading was false but contended that the back-dated of the bill of lading was mutually agreed by the plaintiff to put 30.4.1994 as the shipment date whereas the actual date for the shipment on board for the cargo was 9.5.1994. However, the defendants failed to discharge the onus of proof of the alleged fraud by the plaintiff.

The judge referred to the previous decided cases and established that the person can be liable “if he knowingly and recklessly makes a false statement” which he knows it is not true and with an intention “that other does act upon it and suffers damage.” Thus, in order for the plaintiff to succeed in his claim, it must be proven that the false representations were made with the defendants’ knowledge and the intention that it would be acted upon by the plaintiff. In the present case, it is proved that the defendants were aware that the bill of lading was false and would be relied on by the plaintiff to meet the requirements of the LC in the transaction, so that the plaintiff can submit it to the bank and negotiate the bill. This clearly showed that the plaintiff had suffered damage by acting upon the said false representation. The Court was satisfied that the plaintiff has established beyond reasonable doubt the fact that the defendants were liable to the plaintiff for the tort of deceit in making fraudulent misrepresentations in the bill of lading. Thus, based on above mentioned arguments, the judgment was entered for the plaintiff against the defendants.

On the other hand, a mere allegation of fraud was not sufficient to prove the existence of fraud. This can be illustrated by the case of Arab-Malaysian Bank Bhd v Bee Leong Industries Sdn Bhd involving wakālah LC. In this case, the plaintiff bank had issued wakālah LC in favour of the defendant. A dispute arose and the defendant claimed that the plaintiff had failed to acknowledge fraud on documents. Furthermore, the defendant alleged that the plaintiff did not properly carry out his duty to examine all documents presented by the beneficiary and make sure that they are compliant to the credit requirement. In addition, defendant asserted that the plaintiff had failed to make inquiry to the transaction before making payment, eventhough the plaintiff had concrete reasons to believe that the transaction had fraud and forgery elements. The learned judge rejected the defendant’s claim and held that the allegation of fraud was a bare allegation without substance. Furthermore, the court held that the defendant had failed to provide any particulars of how, where and when the plaintiff or its servant or agent was involved in such fraud. In addition, it was highlighted that there is no duty to be imposed upon the plaintiff to ensure that all the documents submitted are genuine. In his condensed judgment, the learned

68 Ibid.
69 [2000] MLJU 82.
71 Ibid.
judge did not clarify the issue of payment made by the plaintiff with or without prior knowledge that documents contained fraud.\footnote{72}

A similar situation can be observed in Sadacharamani a/l Govindasamy v Narayanan a/l Gopala Panniker.\footnote{73} A dispute arose where the plaintiff, based on his suspicion, alleged that the defendant had used the forged application form for the issuance of LC and the issued LC itself was a forged LC. To support his allegation, the plaintiff had merely relied on circumstantial suspicion that the application forms for LC was different from the original one and based on the oral evidence which claimed such issued LC was forged. However, the plaintiff failed to establish a strong evidence to prove his allegation of fraud but only relied on “suspicions, surmises and conjecture” which are not permissible substitute for those facts or inferences.”\footnote{74}

A standard of obvious or clear fraud was again highlighted in the case of Standard Chartered Bank Malaysia Bhd v Duli Yang Maha Mulia Tuanku Ja’afar Ibni Almarhum Tuanku Abdul Rahman, Yang Di Pertuan Besar Negeri Sembilan Darul Khasus.\footnote{75} The general principle is, when LC is issued and confirmed by a bank, the bank must pay on compliance of documents “except where an ‘obvious fraud’ or a ‘clear fraud’ has been brought to the notice of the bank.”\footnote{76} Thus, the existence of fraud must be clear and obvious which comes to the knowledge of the bank entitles the bank to refuse payment in LC transaction.

The analysis from case-law and practice shows that the standard of fraud required by Malaysian courts to invoke fraud exception in LC is a narrow approach as is adopted by UK courts. Fraud exception can only be applied when fraud is committed on documents and not on goods. Furthermore, the existence of fraud needs to be clear and fraud in the underlying transaction does not qualify as LC fraud. In order to succeed in a proceeding involves fraud in LC cases; a rigorous standard of proof that is proof beyond reasonable doubt is needed.\footnote{77} Thus, Malaysian practice is not in line with US courts which recognise fraud on goods to invoke fraud exception in LC transaction.

Secondly, there is evidence to suggest that there are cases of LC fraud of which decisions are questionable since they were not based on the UCP. Obviously, most cases did not

\footnote{72} These loopholes left by the learned judge have in fact been clearly elaborated by English and US cases. See, Sztejn v. Henry Schroder Banking Corporation; Thiagarajar Mills, Ltd. v. Thornton, 47 F. Supp. 2d 918 (W.D.Tenn., 1999), Shientag J, at 634; see also, Society of Lloyd’s bank v. Canadian Imperial Bank of Commerce [1991] 2 Lloyd’s Rep 579, Saville J, at 581. See also, United Trading Corp SA v. Allied Arab Bank Ltd, the court considered both the relevant date for establishing knowledge of fraud and the standard of proof required. Ackner LJ held that the bank’s knowledge must exist prior to the actual payment to the beneficiary and that its knowledge at that date must be proved.\footnote{73} [2007] MLJU 0731.

\footnote{74} Ibid, per Dato’ Tengku Maimun Binti Tuan Mat J; the learned judge had referred to Chee Pok Choy v. Scotch Leasing Sdn Bhd [2001] 4 MLJ 346 and Satish Chandra v. Satish Kantha, Roy AIR 1923 PC 73, per Gopal Sri Ram JCA, at 76.

\footnote{75} [2009] 4 MLJ 1.

\footnote{76} Ibid, per Abdul Hamid Mohamad CJ, para 78, at 21. The learned judge has referred to English case of United Trading v. Allied Arab Bank [1985] 2 LLR 554.

discuss the substance issue relating to LC. According to the UCP provisions, reference to those relevant articles and the fundamental principles of LC were very rare.

Thus, obviously, the Malaysian court has ignored the contractual fact of LC in LC fraud case. Legally, the substance of the contract should be scrutinised in detail to establish whether or not the beneficiary or other parties involved in the LC transaction have violated any of the terms and conditions. The UCP on principle governs the operations of the LC primarily but of course not solely. It should serve as “an influential source of LC law.” In other words, before judgment is passed, the counsel should first establish compliance of the provisions by all parties such as banks, the beneficiary and the applicant provided for in the UCP. The same should be done for the issues to be considered by the judge in the trial process. Since the UCP is incorporated in almost all LC transactions and is accepted by traders worldwide, it should be the main consideration in addition to other local statutory provisions for judges in deciding cases regarding LC. The legal treatment to any LC dispute should be similar to defaulters who breached facility agreements in a housing loan or a hire purchase facility where the subject matter of dispute is evidenced by the facility agreement. A facility agreement in this case is a set of terms and conditions which is to be strictly observed by the borrower for the credit facility granted by the banks.

Without discounting the credibility and efficiency of the Malaysian judiciary, it is worrisome that the insufficient knowledge and lack of experience amongst local counsels in matters pertaining to LC will plausibly lead to trial decisions which deprive the rights to justice to the innocent party and give an unjust windfall to fraudsters. Hence, a holistic investigation on matters pertaining to the case guided by the UCP provisions as the primary source of reference is of paramount importance to LC practice. The earlier discussion shows that

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80 “However, this source of law often leads to results that are wrong for international letter of credit practice.” Byrne, Contracting out of Revised UCC Article 5 (Letter of Credit), Loyola of Los Angeles Law Review, Vol.40:297, Fall 2006, via Google <llr.lis.edu/volumes/v40-issue1/docs/Byrne.pdf> viewed on 20 March, 2007 at 305.
81 Article, 4, 5 and Article 14(a), UCP 600.
83 Ibid.
84 Most cases are decided by judges and counsels who have limited knowledge on LC technicality. Normally, the LC experts will be called upon to explain the LC principles and procedure and to add view as experts. This fact was agreed by most of the bankers interviewed by the thesis writer.
85 See, PP v. Hang Young Chul & Yayan Sophian High Court, 42-34-2004 High Court, Kuala Lumpur.
in cases involving either Conventional or Islamic banking systems, the UCP, being the primary guideline for LC was not referred to.

CONCLUSION

Based on the above analysis, it seems that the fraud exception is narrowly applied by Malaysian Courts. This resembles UK exception where only fraud on documents could nullify payment whereas fraud on goods is not recognised as an exception to the principle of autonomy in LC. Accordingly, in a claim of fraud in LC transaction, it is not sufficient to rely on “suspicion however great,”86 or a “mere allegation.”87 The court must be satisfied that the evidence is “strong and cogent,”88 “obvious or clear”89 or “deliberate fraud”90 present in the cases. These reflect a higher degree of proof needed rather than just a mere allegation. Hence, this standard of proof in LC fraud once fulfilled is qualified to set aside the autonomous nature of LC. Therefore, the bank is not obliged to make payment to the fraudulent seller beneficiary.

On the other hand, the law in the US has long recognised the importance of providing fairness in trade by also looking into frauds originating from the underlying contract. This is clearly different with the English law which maintains that the underlying contract should be exempted as fraud exception in order to manifest the autonomous nature of the LC. In this regards, UCP is currently being treated differently by two different litigation systems.

The idea to place a fraud provision in the UCP seems to be good since it will clarify the grey area of fraud in LC. Thus, a clear and precise outline can reduce the problem of determining the standard of fraud and the specific requirement of fraud which can nullify payment under LC.

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