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INTERNATIONAL BUSINESS TRANSACTIONS: LETTERS OF CREDIT & STANDBY LETTERS OF CREDIT JURISPRUDENCE

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**Commentary on how the following cases:
Voest-Alpine; Mid-America Tire and Archer
Daniels have impacted individually and
cumulatively on Letters of Credit & Standby
Letters of Credit Jurisprudence**



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Voest-Alpine

The case in *Voest-Alpine*¹ highlights the significance of the strict compliance on a commercial letter of credit transaction (“**LOC**”) and the fundamental principles of independence. Voest–Alpine experienced many hurdles in complying with the strict documentary compliance that was required by the confirming banks, to facilitate payment. When the presented documents did not conform exactly to those required by the letter of credit, this created a problem — where Voest–Alpine was at risk of losing their payment for a minor typographical error in their submitted documentation.

The *Uniform Customs and Practice for Documentary Credits* (“**UCP**”) 500 and the *Uniform Commercial Code* (“**UCC**”) govern commercial letters of credit. Although, the court did state the banks have certain standards when it comes to interpreting and upholding strict compliance, but this standard is hardly the same as other banking institutions. Moreover, the court did recognise the strict compliance under UCP 500; however, the court indicated that the UCP does not provide guidance in addressing document inconsistencies or documentary discrepancies that banks would otherwise justify that the documents do not comply with the terms and conditions of the letter of credit.

The issue for the court was whether the restrictive approach, known as the mirror image compliance is “problematic” whereby banks can reject presenting documents that common sense approach would otherwise find in compliance. The banks on the other hand argued that this goes against the principles of strict compliance and may mislead the bank to its own detriment. The court rejected this view and, emphasised heavily that the issuing bank should

¹ *Voest-Alpine Trading USA Corp v Bank of China*, 167 F Supp 2d 940 (SD, 2000).



examine the whole of the documentation relating to the specific transaction on its face, and that the mirror image compliance is difficult to achieve. The noted common sense case-by-case approach would establish a link to one another and allow minor errors in the documentation. On the other hand, such approach would require the bank to evaluate risks that could undermine the principles of independence of sales contracts. Ultimately, this may have a detriment impact on the international trade market, which may erode the commercial letter of credit transaction.

Mid-America Tire

The *Mid-America Tire*² case concerned the payment of a letter of credit LOC on the basis of apparent fraud in the underlying contract. In this particular case, the LOC is governed by UCP 500, which does not contain any rule in connection with beneficiary's fraudulent conduct in the transaction.

Note that the fundamental principles of independence is the very essence of the LOC, where contracts are treated completely separate in the underlying transaction. The court determined that there is no adequate remedy at law to recover damages for fraud claim, and for the appellants to recover damages; this would be difficult to estimate because of the sheer quantity, market conditions and cost price differential. Therefore, the court established that it was required to examine the LOC in more detail to address the issue of fraud and, in order to protect the appellants, the court would grant an injunctive. Arguably, this goes against the spirit of the independence principle. It is likely that the decision is a direct challenge and undermines the credibility of the independence principle.

It may be argued that if the appellants required guaranteed protection for this transaction, they could have sought "a countersigned document to be presented for payment."³ And "by necessitating a countersigned document, Mid-America or Jenco could have reserved the power in one of their corporate officers to be the final barrier against the bad-faith shipment of

² *Mid-America Tire, Inc. v. PTZ Trading Ltd.*, 95 Ohio St.3d 367, 2002.

³ Rocco D'ascenzo, "The supreme court of Ohio's decision in *Mid-America Tire, inc. v. ptz trading ltd.*, and the weakening of the independence principle."



the unwanted tires.”⁴ Another option is inserting an arbitration clause in between the contracting parties.⁵

This decision may potentially affect the sanctity of the “independence principle in the LOC and confuse the jurisprudence of the fraud exception.”⁶

Archer Daniels

The case in *Archer Daniels Midland*⁷ dealt with standby letter of credit (“**SLOC**”). This is another case that the fraud exception to the independence principle applies in circumstances where there is intentional fraud. The exception to the independence principle is codified in the New York Uniform Commercial Code (“**NYUCC**”), which provides that “an issuing bank may refuse to honor documents which ‘appear on [their face] strictly to comply with the terms and conditions of the letter of credit.’”⁸

In this case, the court held that Trade Bank of Iraq (“**TBI**”) was conducting a fraudulent draw in SLOC issued by JP Morgan Bank, N.A. for an account of the plaintiff. Under the rules of the NYUCC, the court was permitted to restrain JP Morgan Bank, N.A from honouring a payment request by the TBI⁹ and granted an injunction in favour of Archer Daniels Midland Co.

⁴ Ibid.

⁵ Ibid.

⁶ Ralph H Folsom et al, *International Business Transactions: A Problem Oriented Coursebook* (West/Thomson Reuters, 11th ed, 2012) 328.

⁷ SD WL 2011.

Ralph H Folsom et al, *International Business Transactions: A Problem Oriented Coursebook* (West/Thomson Reuters, 11th ed, 2012) 328.

⁸ Ralph H Folsom et al, *International Business Transactions: A Problem Oriented Coursebook* (West/Thomson Reuters, 11th ed, 2012) 328.

⁹ Ibid.



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Peterburg Oppenländer is national law firm headquartered in Sydney city providing quality and innovative legal services and business solutions to individuals and corporations in a changing world.

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