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1. *UNITED CITY MERCHANTS (INVESTMENTS) LTD. APPELLANTS (FIRST PLAINTIFFS) AND GLASS FIBRES AND EQUIPMENTS LTD. APPELLANTS (SECOND PLAINTIFFS) AND ROYAL BANK OF CANADA (INCORPORATED IN CANADA) RESPONDENTS (DEFENDANTS) AND VITROREFUERZOS S.A. FIRST THIRD PARTY AND BANCO CONTINENTAL S.A. SECOND THIRD PARTY [On appeal from UNITED CITY MERCHANTS (INVESTMENTS) LTD. v. ROYAL BANK OF CANADA] [1983] 1 A.C. 168, [1983] 1 A.C. 168*

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United City Merchants (Investments) Ltd and Glass Fibres and Equipments Ltd v Royal Bank of Canada, Vitrorefuerzos SA and Banco Continental SA (incorporated in Canada)

Overview | **[1983] 1 AC 168**, | *[1982] 2 All ER 720*, | *[1982] 2 WLR 1039*, | *[1980-84] LRC (Comm) 15*, | [1982] 2 Lloyd's Rep 1, | [1982] Com LR 142, | *10 LDAB 350*, | 126 Sol Jo 379

UNITED CITY MERCHANTS (INVESTMENTS) LTD. APPELLANTS (FIRST PLAINTIFFS) AND GLASS FIBRES AND EQUIPMENTS LTD. APPELLANTS (SECOND PLAINTIFFS) AND ROYAL BANK OF CANADA (INCORPORATED IN CANADA) RESPONDENTS (DEFENDANTS) AND VITROREFUERZOS S.A. FIRST THIRD PARTY AND BANCO CONTINENTAL S.A. SECOND THIRD PARTY [On appeal from UNITED CITY MERCHANTS (INVESTMENTS) LTD. v. ROYAL BANK OF CANADA] [1983] 1 A.C. 168

[HOUSE OF LORDS]

Lord Diplock, Lord Fraser of Tullybelton, Lord Russell of Killowen, Lord Scarman and Lord Bridge of Harwich

1982 March 16, 17, 18, 22; May 20

Banking — Letter of credit — Bill of lading — False date inserted as date of shipment of goods — Fraud by third party — Innocent plaintiff — Whether banker entitled to refuse payment under letter of credit

International Law — Recognition — Effect — "Exchange contract" — Currency regulations of fellow-member of International Monetary Fund — Agreement between English company and Peruvian company for sale of goods — Price inflated as means of evading Peruvian exchange control — Whether whole letter of credit covering agreement unenforceable as exchange contract — Whether "exchange contract" element severable — Bretton Woods Agreements Order in Council 1946 (S.R. & O. 1946 No. 36), Sch., Pt. I, art. VIII, s. 2 (b)

The second plaintiffs, an English company, sold manufacturing equipment to a Peruvian company and agreed to a scheme to double the price (U.S. $256,043) to enable the Peruvian company to exchange Peruvian currency for the excess amount in breach of Peruvian exchange control regulations. A letter of credit for payments up to U.S. $794,502.20 in London in connection with the transaction was issued in Peru and confirmed by the defendants. The second plaintiffs assigned the rights under the credit to the first plaintiffs. Shipment of the goods was made on December 16, 1976, a day later than the limit specified in the letter of credit, but loading brokers, not acting for the plaintiffs, fraudulently entered the earlier date as the date of shipment on a notation stamped on the bill of lading. The defendants rejected the documents and were sued under the letter of credit.

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Mocatta J. held that, as the plaintiffs were innocent of the brokers' fraud, the defendants were not entitled to reject the documents. But, by a second judgment in the action given for the defendants, he held that the contract of sale and purchase was a disguise for exchanging currencies and therefore that contract and the letter of credit were unenforceable by reason of article VIII, section 2 (*b*), of the Bretton Woods Agreements Order in Council 1946.1 The Court of Appeal dismissed the plaintiffs' appeal on the ground that whilst it was possible to divide the contracts into that part which did not offend against the law of Peru and that part which was a disguised monetary transaction, the plaintiffs could not enforce the former since in the circumstances the defendants were entitled to rely on the broker's fraud as a defence to the claim.

On appeal by the plaintiffs:-

Held, allowing the appeal, (1) that fraud such as to entitle a banker to refuse to pay under a letter of credit notwithstanding the strict general rule requiring payment when the documents were in order on their

face, did not extend to fraud to which the seller or beneficiary was not party, and accordingly, prima facie the defendants should have paid on presentation of the document (post, pp. **183C-D**, **187C-E**, **188 B-D**, **190H - 191B**).

Quaere. The rights of an innocent seller or beneficiary against the confirming bank when a document presented by him was a nullity because unknown to him it had been forged by a third party (post, pp. **188A**, **190H - 191B**).

(2) That the question whether and to what extent a contract was unenforceable under the Bretton Woods Agreements Order in Council 1946 because it was a monetary transaction in disguise was not a question of the construction of the contract, but one of the substance of the transaction to which enforcement of the contract would give effect; that it was the task of the court to penetrate any disguise presented by the language of the contract, to identify any monetary transaction which that language was intended to conceal and to refuse to enforce the contract in so far as it would give effect to the monetary transaction; that there was no difficulty in identifying the monetary transaction that was sought to be concealed by the language used in the documentary credit and the underlying contract of sale, and therefore to the extent that the contracts did not offend exchange control regulations the plaintiffs' claim was enforceable (post, pp. **189F - 190E**, **H - 191B**).

Wilson, Smithett & Cope Ltd. v. Terruzzi [1976] Q.B. 683, C.A. applied.

Decision of the Court of Appeal [1982] Q.B. 208; [1981] 3 W.L.R. 242; [1981] 3 All E.R. 142 reversed.

The following cases are referred to in the opinion of Lord Diplock:

Batra v. Ebrahim (unreported), May 2, 1977; Court of Appeal (Civil Division) Transcript No. 197B of 1977, C.A.

Gian Singh & Co. Ltd. v. Banque de l'Indochine [1974] 1 W.L.R. 1234; [1974] 2 All E.R. 754, P.C.

Owen (Edward) Engineering Ltd. v. Barclays Bank International Ltd. [1978] Q.B. 159; [1977] 3 W.L.R. 764; [1978] 1 All E.R. 976, C.A.

1 Bretton Woods Agreements Order in Council 1946, Sch., Pt. I, art. VIII, s. 2 (*b*): see post, p. 188F.

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Sztejn v. J. Henry Schroder Banking Corporation (1941) 31 N.Y.S. 2d 631.

Wilson, Smithett & Cope Ltd. v. Terruzzi [1976] Q.B. 683; [1975] 2 W.L.R. 1009; [1975] 2 All E.R. 649; [1976] Q.B. 683; [1976] 2 W.L.R. 418; [1976] 1 All E.R. 817, C.A.

The following additional Cases Were Cited in argument:

Alan (W. J.) & Co. Ltd. v. El Nasr Export and Import Co. [1972] 2 Q.B. 189; [1972] 2 W.L.R. 800; [1972] 2 All E.R. 127, C.A.

Dennis (J.) & Co. Ltd. v. Munn [1949] 2 K.B. 327; [1949] 1 All E.R. 616, C.A.

Discount Records Ltd. v. Barclays Bank Ltd. [1975] 1 W.L.R. 315; [1975] 1 All E.R. 1071.

Equitable Trust Co. of New York v. Dawson Partners Ltd. (1926) 27 Ll.L.Rep. 49, H.L.(E.).

Etablissement Esefka International Anstalt v. Central Bank of Nigeria [1979] 1 Lloyd's Rep. 445, C.A.

Finlay (James) & Co. Ltd. v. N.V. Kwik Hoo Tong Handel Maatschappij [1929] 1 K.B. 400, C.A.

Hamzeh Malas & Sons v. British Imex Industries Ltd. [1958] 2 Q.B. 127; [1958] 2 W.L.R 100; [1958] 1 All E.R. 262, C.A.

Harbottle (R. D.) (Mercantile) Ltd. v. National Westminster Bank Ltd. [1978] Q.B. 146; [1977] 3 W.L.R. 752; [1977] 2 All E.R. 862.

Howe Richardson Scale Co. Ltd. v. Polimex-Cekop [1978] 1 Lloyd'S Rep. 161, C.A.

Jackson Stansfield & Sons v. Butterworth [1948] 2 All E.R. 558, C.A.

Kwei Tek Chao v. British Traders and Shippers Ltd. [1954] 2 Q.B. 459; [1954] 2 W.L.R. 365; [1954] 1 All E.R. 779; [1954] 3 W.L.R. 496; [1954] 3 All E.R. 165.

Kydon Compania Naviera S.A. v. National Westminster Bank Ltd. (The Lena) [1981] 1 Lloyd's Rep. 68.

Napier v. National Business Agency Ltd. [1951] 2 All E.R. 264, C.A.

Old Colony Trust Co. v. Lawyers' Title & Trust Co. (1924) 297 F. 152.

O'Meara (Maurice) Co. v. National Park Bank of New York (1925) 239 N.Y. 386.

Power Curber International Ltd. v. National Bank of

Kuwait S.A.K. [1981] 1 W.L.R. 1233; [1981] 3 All E.R. 607, C.A.

Ralli Bros. v. Compania Naviera Sota y Aznar [1920] 2 K.B. 287, C.A.

Sharif v. Azad [1967] 1 Q.B. 605; [1966] 3 W.L.R. 1285; [1966] 3 All E.R. 785, C.A.

Société Metallurgique d'Aubrives & Villerupt v. British Bank for Foreign Trade (1922) 11 Ll.L.Rep. 168.

Soproma S.p.A. v. Marine & Animal By-Products Corporation [1966] 1 Lloyd's Rep. 367.

APPEAL from the Court of Appeal.

This was an appeal by the appellants, United City Merchants (Investments) Ltd. (first plaintiffs) and Glass Fibres and Equipments Ltd. (second plaintiffs) from a decision of the Court of Appeal (Stephenson, Ackner and Griffiths L.JJ.) [1982] Q.B. 208given on March 13, 1981, affirming a decision of Mocatta J. given on March 12, 1979, rejecting their claim for U.S. $494,537.59 allegedly due to the appellants under a confirmed irrevocable letter of credit. The credit had been opened by the

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second third party, Banco Continental S.A., a Peruvian bank, and then confirmed at the request of the first third party, Vitrorefuerzos S.A., a Peruvian company ("the buyers") pursuant to the buyers' obligations under a contract made in October/November 1975, for the purchase from the second-named appellants, an English company ("the sellers") of a glass-fibre forming plant on f.o.b. United Kingdom port terms. Thereafter, and on the Peruvian bank's instructions, the credit had been confirmed by the London branch of the respondents, the Royal Bank of Canada (defendants), to the sellers on March 30, 1976. It provided for an advance of 20 per cent. to be drawn down by the sellers, 70 per cent. to be paid on presentation of shipping documents, and 10 per cent. on erection of the plant. The sellers assigned their rights under the credit to the first-named appellants in July 1976.

The facts are stated in the opinion of Lord Diplock.

Alexander Irvine Q.C. and ***Andrew Longmore*** for the appellants. This case is of importance to bankers and international traders because the decision of the Court of Appeal is the first occasion when a court has held that a bank need not honour a letter of credit which appears to be true on its face but which contains a false statement by a third party. The decision of the Court of Appeal goes well beyond any established exceptions to the general rule that a bank must pay. The decision involves a dilemma for banks over a wide range of cases where a bank is expected to pay on a credit when the bank will almost certainly not know that there are circumstances which entitle it not to pay.

The bill of lading contained three misstatements of which the material one is that shipment of the goods was made on December 15, 1976, when in fact it was made on December 16. The question of law on which there is no direct authority except this case is: whether in these circumstances, the bank is obliged to pay out under the letter of credit against apparently conforming documents or whether it is relieved of this obligation (i) because of the misstatement in the bill simpliciter or, (ii) because it was a misstatement fraudulently made, albeit made by someone for whom the beneficiary was not responsible and albeit the beneficiary was unaware of the misstatement at the date of presentation.

Reliance is placed on the following propositions: (1) the operative policy is to encourage the exporter-seller to export by guaranteeing that he is paid. It is the importer-buyer who takes the risk and must sue the seller for damages if he complains of a breach of the contract of sale. (2) The subject matter of the letter of credit contract, that is, the contract between the bank and the seller, is documents, not goods. Goods are the subject matter of the underlying contract of sale between seller and buyer. Thus the bank promises to pay the seller against documents. (3) The reason that this method of financing has arisen is to prevent disputes which arise under the underlying contract of sale between seller and buyer from holding up payment for the goods to the seller-exporter. (4) Thus the letter of credit contract between bank and beneficiary is an autonomous contract whereby the bank assumes a primary liability to pay provided the required documents are tendered. (5) Provided that

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the documents conform the bank can always recover from the customer (the buyer) and it is for the customer-buyer to take up any dispute about the goods with the seller-beneficiary direct. (6) These principles are found expressed in the Uniform Customs and Practice for Documentary Credits 1974. The letter of credit in the present case was made expressly subject to this document. (7) The principles expressed in the Uniform Customs and Practice for Documentary Credits 1974 are expressed in unqualified terms. They do no more than summarise the common law as expressed by Lord Sumner in 1926 in *Equitable Trust Co. of New York v. Dawson Partners Ltd.* (1926) 27 Ll.L.Rep. 49 and applied as late as 1974 in *Gian Singh & Co. Ltd. v. Banque de l'Indochine* [1974] 1 W.L.R. 1234. (8) Until the decision of the Court of Appeal in the present case, the law recognised only two possible exceptions to a bank's obligation to pay the beneficiary under the letter of credit, namely, (i) if the documents were forged and were nullities. Then the condition of the credit that there is a conforming document is not fulfilled. (ii) If the beneficiary was himself dishonest or fraudulent. In

support of the above propositions, reliance is placed on the following authorities: *Hamzeh Malas & Sons v. British Imex Industries Ltd.* [1958] 2 Q.B. 127; *R. D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.* [1978] Q.B. 146, 155G et seq.; *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] Q.B. 159, 169A, 172E, 173A, 174H - 175A; *Power Curber International Ltd. v. National Bank of Kuwait S.A.K*. [1981] 1 W.L.R. 1233, 1238E - 1239B, 1241A-F; and *Gian Singh & Co. Ltd. v. Banque de l'Indochine*7 [1974] 1 W.L.R. 1234. The last case is relevant to the bank-customer relationship and not the bank-seller relationship. The present case is concerned with the width of the exception of the duty of the bank to pay out against apparent conforming documents. Reliance is placed on the judgment of Mocatta J. at first instance [1979] 1 Lloyd's Rep. 267, 278.

As to the judgment of the Court of Appeal, the so called forgery exception is of great importance because in essence the judgment of the Court of Appeal runs together the fraud and forgery exceptions to form a single rationale where there are two rationales. Secondly, it misunderstood the width of the forgery exception which only applies to forgeries which are null and void so that there is no security. The Court of Appeal considered that that exception applied to all third party forgeries and, therefore, it was a short step to hold that the exception applies to false statements for which a third party was responsible. To understand the judgment of the Court of Appeal, it is necessary to consider the English law of forgery. The relevant provision is section 1 (2) of the Forgery Act 1913, as amended by section 35 (1) of the *Criminal Justice Act 1925*. In English criminal law, for a document to be a forgery, the document must not only tell a lie, but also a lie about itself. It is pertinent to analyse the judgment of Ackner L.J. The essential structure of his judgment is as follows: (i) there should be a single rationale for the two exceptions; (ii) the banker is not obliged to pay out against forged documents whether or not the documents are nullities. (iii) Since the banker is not obliged to pay out on a "mere" criminal law forgery, that is, a forgery not causing a nullity, it

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must be the case that the bank is only obliged to pay out against "valid" or "genuine" documents, that is, documents not affected by any fraud of anyone. (iv) Thus a document containing a fraudulent misstatement, albeit the fraud is that of a third party, is not a valid or genuine document: therefore, the banker is not liable to pay out in this case [1982] Q.B. 208, 264F et seq. The essential flaw in this reasoning is that it rests on the false premise that documents which are forged in a criminal law sense are not conforming documents, although the forgery does not cause them to be nullities as a matter of civil law. Griffiths L.J. took the same position as Ackner L.J. [1982] Q.B. 208, 253F - 254D, 255B-D.

As to paragraphs 18, 20 and 25 of the respondents' printed case, they embrace the full width of Mr. Staughton Q.C.'s submissions below. On the doctrine there propounded, whether the buyer or seller loses out is at the discretion of the bank! The respondents are obliged to put their contention as widely as they do because there is no rational ground for holding that a bank is obliged to pay where the inaccuracy is innocent and is the responsibility of a third party but not where the inaccuracy is fraudulent and is the responsibility of a third party. The commercial gravity of the misstatement depends on its nature and effect, not on whether it was innocently or fraudulently made. The security over the goods which the documents confer on the banks is neither more nor less according as any particular misstatement was innocently or fraudulently made.

If banks have a discretion, as the respondents contend, this is a situation that the banking world itself will resile from. It would put the banks in a dilemma, for either it pays out against its customers' wishes, or finds itself involved in litigation between buyer and seller. Subject to the exceptions that the law already recognises, a bank's duty is to pay on the terms set out in the letter of credit itself.

The letter of credit contract is an autonomous contract. As between the Royal Bank of Canada and the seller beneficiary, the bank knew nothing about the situation. This is not an exchange contract, although Stephenson L.J. held expressly that it was. The question, therefore, is whether to enforce the letter of credit contract is to enforce an exchange contract. This involves ascertaining whether this sale contract is a monetary transaction in disguise. In the appellants' submission, the officious bystander would state that here there were two contracts, one a genuine sale contract, the other a monetary contract. To enforce payment for sale of goods is not to enforce the monetary contract contrary to the Bretton Woods Agreement. It is not necessary in answering this question to apply the various tests propounded in the Court of Appeal. The fundamental test is: is this a monetary contract in disguise? Application of this test involves that the court need not consider problems of illegality, severance and so forth.

David Johnson Q.C. and ***Richard Wood*** for the respondents. On the letter of credit issue, the case is of great importance because of the growing incidence of fraud. In a transaction of the present kind, the date of shipment and the accuracy of the bill of lading are vital matters. If the seller does not comply with these requirements, the buyer may reject. How is

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the seller to be paid? Cash against documents - these must be accurate and there must be properly dated bills of lading. This is the practice where the parties have

previously done business together. Otherwise, a letter of credit transaction is entered into. On the wide proposition for which the respondents contend, there is a large element of construction on this question. It is not merely one of policy. The question of construction also arises on their narrow proposition but here it is more a question of policy. To be valid, a bill of lading must be genuine: see *Benjamin's Sale of Goods*, 2nd ed. (1981), para. 1639, p. 873. It is essential to constitute a genuine bill of lading that it bears the correct date: *James Finlay & Co. Ltd. v. N.V. Kwik Hoo Tong Handel Maatschappij [1929] 1 K.B. 400*, 408, 409, 412. The only difference between a bill of lading and a letter of credit is that in the latter case, instead of the buyer, a bank is substituted as payer. Its purpose is to provide a secure payer. But the obligation is the same in both cases. The duty of the bank is no greater than that stated in *Gian Singh & Co. Ltd. v. Banque de l'Indochine* [1974] 1 W.L.R. 1234. Further, any inaccuracy in the bill of lading entitles the bank not to pay on the letter of credit. But it is only things which directly relate to the letter of credit which are material. The appellants' argument entails down grading the obligation to pay under a letter of credit. The bank is only obliged to pay in circumstances where a buyer would be obliged to pay under a bill of lading. The following example shows the fallacy in the appellants' approach. Commercial considerations demand a consistent approach for what is good tender of documents under a c.i.f. or f.o.b. contract. Suppose A agrees to sell to B on c.i.f. terms. A is either the shipper or agrees to sell at a foreign port f.o.b. B buys from A on terms cash against documents. If there is a string contract, some of the contracts will be supported by a letter of credit and others will not and it would be absurd if different standards of liability were to apply to the letter of credit than to the other contracts. It cannot be stressed too strongly that the same standards should apply to all documentation in such a string contract. If somehow the seller is entitled to payment under a bill of lading which the bank knows to be false, a very strange situation arises, for if the appellants be right, the bank is obliged to pay the seller, but the buyer is immediately entitled to repayment.

There is also the matter of insurance. If a buyer purchases on an f.o.b. contract, the buyer will himself insure and the buyer will have to declare the date of shipment and the nature of the goods. The date may be critical if the market is very volatile. The fact that the false date is very close to the true date may nevertheless in the circumstances have considerable financial implications. The appellants' argument, if accepted, would encourage rather than discourage fraud.

On the basis of the necessity for accuracy of the letter of credit and the bill of lading, the difficulties envisaged by the appellants do not arise. The question of accuracy is simply a matter of fact. Article 15 of Uniform Customs and Practice for Documentary Credits (1974) is solely concerned with the construction of the bill of lading or other document. It does not deal with the question where, as here, the document does not accord with the true facts.

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The approach in the *James Finlay & Co. case [1929] 1 K.B. 400*, is reflected in the cases relating to letters of credit: see *Etablissement Esefka International Anstalt v. Central Bank of Nigeria* [1979] 1 Lloyd's Rep. 445, 447, and *Power Curber International Ltd. v. National Bank of Kuwait S.A.K* [1981] 1 W.L.R. 1233, 1243C, *per* Griffiths L.J. The approach in the United States case of *Old Colony Trust Co. v. Lawyers' Title & Trust Co*. (1924) 297 F. 152 reflects the approach in the *James Finlay & Co. case [1929] 1 K.B. 400* and is adopted. See also the strong dissenting judgment of Cardozo J. and Crane J. in *Maurice O'Meara Co. v. National Park Bank of New York* (1925) 239 N.Y. 386, 401. Further, *Sztejn v. J. Henry Schroder Banking Corporation* (1941) 31 N.Y.S. 2d 631, 634, shows that documents have to be genuine before a bank is under an obligation to pay.

On the relationship between a bank and seller on the one hand and bank and buyer on the other, see *Howe Richardson Scale Co. Ltd. v. Polimex-Cekop* [1978] 1 Lloyd's Rep. 161; *Société Metallurgique d'Aubrives & Villerupt v. British Bank for Foreign Trade* (1922) 11 Ll.L.Rep. 168 and *Kydon Compania Naviera S.A. v. National Westminster Bank Ltd. (The Lena)* [1981] 1 Lloyd's Rep. 68.

Reliance is placed on the following propositions: (1) the obligation of the bank to the beneficiary of a letter of credit is different from the duty owed by a bank to its customer, that is, the buyer. (2) The duty owed by the bank to the customer is to use reasonable skill and care to ascertain that the documents are in order on their face. (3) The duty owed by the confirming bank to the issuing bank is the same as in proposition (2) for the relationship is essentially the same as banker and customer. (4) Articles 7, 8 and 9 of the Uniform Customs 1974 deal only with the relationship between the issuing bank and the customer and between confirming bank and issuing bank. (5) As a matter of discretion, the courts will generally refuse an injunction in interlocutory proceedings to restrain payment under a letter of credit because (a) if the bank is bound to pay, it would be wrong to restrain payment. (b) If the bank owes a duty to its customer not in the circumstances to pay, the bank will not be entitled to reimbursement and the customer will not suffer damage. (c) If the situation is unclear or rests on mere allegations the bank is entitled and bound to take its own course and the courts will generallly decline to produce an interlocutory solution. (6) The obligation of a bank to the beneficiary of a letter of credit is to pay if (a) the draft is genuine, and (b) the

documents appear on their face to comply with the credit unless (i) any of the documents is inaccurate in a material particular; or, alternatively (ii) any of the documents is thus inaccurate to the knowledge of the person who made it; or, alternatively, (iii) any of the documents is thus inaccurate to the knowledge of the beneficiary. By "material inaccuracy" is meant an inaccurate statement in respect of any matter which the letters of credit requires to be in the documents. It would thus include, in the present case, the misstatement of the loading port and of the shipment date.

In practice, it is highly unlikely that the bank would reject documents without consulting the buyer at all, especially when the documents appear accurate on their face. The bank would only reject on receiving some approach from the buyer. If the bank has information passed to it which

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makes it suspicious concerning a material matter and the bank passes the information to the buyer and the buyer requests the bank not to pay and the bank pays because the documents on their face appear accurate, the bank is protected. It is of great importance to notice the difference as between the buyer and the bank and the bank's right to pay even though the buyer requests it to refuse payment, and the position between the seller and the bank and the bank's right to refuse payment because the documents are not accurate on their face. Vis-à-vis the seller, the bank is under no absolute obligation to pay. See *Paget's Law of Banking*, 8th ed. (1972), p. 580, which shows that the accuracy and truth of the bill of lading are of concern to the banker because of the bank's security. See also *Paget*, pp. 636, 639, 648, 649.

On the assumption that the misstatement is inaccurate but not fraudulent, the bank is not entitled to reject, but the buyer is: see the *James Finlay & Co. case [1929] 1 K.B. 400*. The mere opening of a letter of credit does not mean that the buyer is not likely to pay the purchase price in any circumstances. Payment by the bank is pro tanto payment of the purchase price. If the bank refuses payment when it should pay, the seller has two rights: (a) he can sue the bank for damages and (b) he can bring proceedings against the buyer under the seller-buyer contract. If the seller wishes to enforce his rights, he has to comply with the seller-buyer contract. On the assumptions made, if the seller takes the documents to the buyer, it is quite plain that the buyer is entitled to reject them on the Finlay doctrine: see *Halsbury's Laws of England*, 3rd ed., vol. 34 (1960), p. 187, para. 321, n. (s).

It is quite wrong to assume because there is a letter of credit in addition to a bill of lading that that transforms the position. The right approach is: is there anything in the letter of credit which entails that the buyer must take less than accurate documents? The answer is in the negative. All that such a transaction is doing is substituting the bank's credit for the buyer's credit.

As regards the respondents' proposition (6) above, looking at the letter of credit, are the bank obliged to pay although there is a fraudulent document, albeit on its face the document is accurate? In such circumstances, there is no such obligation. This is a question of policy. The court examines the intention of the parties. The bank is not engaging to pay against fraudulent documents, whomsoever the fraud is committed by. The nullity test put forward by the appellants is not sustainable. The true test relates to whether the documents are merchantable documents and fraudulent documents do not come into this category.

It is common ground that the Royal Bank of Canada would not have been obliged to pay under the credit had Mr. Baker been the servant or agent of the beneficiary of the credit. The narrow but critical issue is whether the findings of fact that the fraud was that of the servant or agent of a third party, and that the beneficiary was not personally involved, means that the refusal to pay was a breach of contract. Is it the fact of the fraud or the implication of the beneficiary which is critical? The conclusions of the Court of Appeal on this point that it is the former and not the latter, is adopted. In particular, it is submitted that: (i) although Mocatta J. founded his rejection of this defence on the opposite view, the maxim

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ex turpi causa non oritur actio is not the basis, alternatively the sole basis, of the fraud exception. The true nature of the Royal Bank of Canada's obligation was to pay against genuine, valid documents and did not extend to pay against fraudulent documents if the fraud was exclusively that of a third party. (ii) If the beneficiary entrusts the preparation of the documents required by a letter of credit to a third party, and that third party fraudulently produces an inaccurate document, there is no reason why the loss should fall on the bank or its customer (the buyer) rather than the beneficiary. (iii) A bank is not obliged to pay against a bill of lading which has been forged by a third party. There is no reason to distinguish between a forged document and a document which is fraudulent without being a forgery, in this context. (iv) It would be a strange rule of law that obliged the Royal Bank of Canada to refuse payment had the bill of lading honestly stated that the goods had been shipped on December 16 (that is, because the bill would thus then conform with the terms of the credit) but obliged it to pay when the bill fraudulently gave December 15 as the shipment date.

A large number of English and American authorities were considered by the Court of Appeal. But, as all three members of the Court of Appeal concluded, there is no English or American authority directly deciding the point now being considered, since it was never an issue.

It is very important to bear this in mind since dicta in certain cases state the "fraud exception" in terms of the fraud of the beneficiary, commonly the seller, and the buyers placed much reliance upon them: see, for example, *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] Q.B. 159 and *Sztejn v. J. Henry Schroder Banking Corporation* (1941) 31 N.Y.S. 2d 631. But Stephenson L.J. observed [1982] Q.B. 208, 234A, fraud on the part of the beneficiary was all that the court was concerned with in both of those cases; it never directed its mind in either case to the question of the effect of fraud of a third party.

Nor do the Uniform Customs and Practice for Documentary Credits, 1974, which were expressly incorporated into the credit, assist in determining the scope of the fraud exception, since they do not contain any article providing what is to happen as between banker and beneficiary if fraudulent documents are presented. By contrast, the United States Uniform Commercial Code does expressly provide for this situation; the relevant provision (section 5-114 (2)) is set out in the judgment of Stephenson L.J. [1982] Q.B. 208, 236G-237A and the only words referring to a "forged or fraudulent" document are clearly wide enough to cover cases where the fraud is of a party other than the seller-beneficiary. The decision of the Court of Appeal on this issue is, therefore, entirely consistent with that section given that in this case it is accepted by the appellants that they are in no better position than the sellers. For these reasons, the Court of Appeal were right to conclude that the Royal Bank of Canada were not obliged to make payment under the credit because the bill of lading was a fraudulent document.

As to the appellants' submissions, it was said that the approach for which the respondents contend would lead to difficulties and dilemmas for the bank which could entail litigation. It was said that the court only recognised two exceptions up to the present case. But those exceptions all relate to interlocutory proceedings and not as here where fraud has

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been established and found. The niceties of English criminal law do not arise on the respondents' case.

As to the authorities, *Hamzeh Malas & Sons v. British Imex Industries Ltd.* [1958] 2 Q.B. 127 merely emphasises the separate nature of the contract. It is nowhere concerned with the issues raised in the present case, *R. D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.* [1978] Q.B. 146; *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] Q.B. 159 and *Discount Records Ltd. v. Barclays Bank Ltd.* [1975] 1 W.L.R. 315 all relate to the granting of interlocutory relief. In the above cases, the bank was desirous of paying, but the courts held to the contrary. It would, therefore, be surprising that where there is fraud and the bank does not wish to pay, the court in those circumstances should compel it to pay. Neither *Power Curber International Ltd. v. National Bank of Kuwait S.A.K.* [1981] 1 W.L.R. 1233 nor *Gian Singh & Co. Ltd. v. Banque de l'Indochine* [1974] 1 W.L.R. 1234 assist on the present point.

The appellants contend that it is axiomatic that an issuing or confirming bank deals in documents not in goods and that the letter of credit contract is, and must remain, independent of any dispute under the primary contract of sale. It follows, therefore, they contend, that with two possible exceptions, the bank is bound to pay if the documents are in order on their face and entitled to refuse to pay only if the documents do not conform to the requirements of the letter of credit. But the above cases do not support the appellants' proposition.

As to Lord Diplock's question: if the bank refused to pay, would the buyer be in default under the seller-buyer contract? The answer is there would be a repudiation: see *W. J. Alan & Co. Ltd. v. El Nasr Export and Import Co*. [1972] 2 Q.B. 189, 220B et seq., *per* Stephenson L.J. This decision is to be preferred to that in *Soproma S.p.A. v. Marine & Animal By-Products Corporation* [1966] 1 Lloyd's Rep. 367. If the buyer in the seller-purchaser contract is promising to pay by the bank, it is to pay against genuine documents. The difference between a document which is a forgery and not a nullity and the document which is a forgery and, therefore. a nullity is a distinction which is not relevant in the present case although it was relevant in *Kwei Tek Chao v. British Traders and Shippers Ltd.* [1954] 2 Q.B. 459.

There is no relevant distinction in the present case between the three judgments of the Court of Appeal. They are here dealing with dishonest documents in a broad way. No such distinction as arises in English criminal law is relevant to the present case, but it is the broad approach which should be adopted, both on authority and for reasons for security. The right approach here is to equate the position under the letter of credit with that under the sale-purchase contract. Any other approach leads to uncertainty. The inaccuracy defence obviates this difficulty.

As to the Bretton Woods Agreement issue, the contract in question was an exchange contract being a monetary contract in disguise and to enforce payment under the letter of credit would be to enforce fulfilment of an exchange contract in the only way ever contemplated. The respondents have always focussed on the underlying contract. The appellants

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contend that there is not one but two underlying contracts and that they are entitled to enforce the contract relating to the machinery. The appellants concede that an exchange contract is within the Bretton Woods Agreement.

As to whether there was one contract or two, it is necessary to consider the facts and on this, reliance is

placed on the judgment of Mocatta J. [1979] 2 Lloyd's Rep. 498, 500, 502. The sellers had two objectives, namely, to buy machinery and to obtain dollars, and this resulted in only one contract. Both in form and in fact there was one underlying contract. The appellants are endeavouring to circumvent the well-known principles which would require consideration of the severance doctrine. If the blue pencil doctrine is to be applied here, the question then arises: is this the kind of case in which the courts should give their assistance in relation to a contract tainted by illegality? The answer should be in the negative. The present case falls within the classic type of case relating to illegality.

In summary, in all the circumstances, there is here one underlying contract. Alternatively, the contract sued upon is one contract and the appellants cannot circumvent the English authorities on severance. This is a contract which does lead to a common law illegality. It is a deliberate flouting of the Peruvian law.

Stephenson L.J. and Ackner L.J. [1982] Q.B. 208, 227, 228E, 242E-G, held that the Bretton Woods Order in Council is an exclusive statement of the requirements of comity in the context of exchange control breaches and that, consequently, common law principles of illegality have no part to play in that context. Griffiths L.J. [1982] Q.B. 208, 252G, held that the principles of common law on which the respondents relied did not in fact assist them on the facts of the present case. In the respondents' submission, the Order does not preclude the operation of common law principles, and they invite the House to differ from the opinions of Stephenson and Ackner L.JJ. on this point.

As to the judgment of Ackner L.J. [1982] Q.B. 208, 242F-G, see *Batra v. Ebrahim* (unreported), May 2, 1977; Court of Appeal (Civil Division) Transcript No. 197B of 1977. As to p. 243 of his judgment. there is a wrong analysis of the present transaction. There was no contract for sale at a definite price at to which a monetary contract was added. The difference between illegality and Bretton Woods is that the former depends entirely on knowledge and intention, whilst Bretton Woods does not. A letter of credit is unitary and completely indivisible. Ackner L.J. based his conclusion on *Ralli Brothers v. Compania Naviera Sota y Aznar [1920] 2 K.B. 287* and the *Building Licence cases*, but these have no relevance here. As to the judgment of Griffiths L.J. [1982] Q.B. 208, 252, there is a reference to *J. Dennis & Co. Ltd. v. Munn* [1949] 2 K.B. 327, but that case was in no wise concerned with enforceability. The same considerations applied to *Jackson Stansfield & Sons v. Butterworth* [1948] 2 All E.R. 558. As to the judgment of Stephenson L.J. [1982] Q.B. 208, 227, see *Napier v. National Business Agency Ltd.* [1951] 2 All E.R. 264, 266, and *Sharif v. Azad* [1967] 1 Q.B. 605, 614E, 619.

In conclusion, the respondents realise that the sellers will suffer a loss, but the transaction was entered into with knowledge of the seller of the

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exchange control position and they should not be allowed to circumvent the provisions of the Bretton Woods Agreement.

Irvine Q.C. was required to reply only on the Bretton Woods Agreement issue.

Their Lordships took time for consideration.

May 20. LORD DIPLOCK . My Lords, this appeal, which is the culmination of protracted litigation, raises two distinct questions of law which it is convenient to deal with separately. The first, which I will call the documentary credit point, relates to the mutual rights and obligations of the confirming bank and the beneficiary under a documentary credit. It is of general importance to all those engaged in the conduct and financing of international trade for it challenges the basic principle of documentary credit operations that banks that are parties to them deal in documents only, not in the goods to which those documents purport to relate. The second question, which I will call the Bretton Woods point, is of less general importance. It turns upon the construction of the Bretton Woods Agreements Order in Council 1946 and its application to the particular facts of the instant case.

All parties to the transaction of sale of goods and its financing which have given rise to the appeal were represented at the original hearings before Mocatta J. The sellers and their own merchant bankers to whom they had transferred the credit as security for advances were the plaintiffs, the confirming bank was the defendant, the buyers and the issuing bank were joined as first and second third-parties respectively. The issuing bank admitted its liability to indemnify the confirming bank for any sums for which the latter as defendant should be held liable to the plaintiffs, and in the later stages of the proceedings, although the confirming bank has remained nominally the respondent, the conduct of the appeals both in the Court of Appeal and in your Lordships' House has been undertaken by counsel for the issuing bank. Your Lordships are, however, only indirectly concerned with the contractual relationship between the buyers and the issuing bank or between the issuing bank and the confirming bank. The documentary credit point depends on the contractual relationship between the sellers (or their transferee) and the confirming bank. The Bretton Woods point is about the effect on that relationship of certain special provisions in an agreement between the sellers and the buyers that was collateral to their contract of sale.

Mocatta J. delivered his judgment in two parts with an interval between them. The facts that are relevant to the documentary credit point are set out in detail in the first part ([1979] 1 Lloyd's Rep. 267): the additional facts that

are relevant to the Bretton Woods point are set out in the second part ([1979] 2 Lloyd's Rep. 498). For the purpose of identifying the questions of law that are dispositive of this appeal it is sufficient to state those facts in summarised form, starting with those that raise the documentary credit point.

A Peruvian company, Vitrorefuerzos S.A. ("the buyers") agreed to buy from the second appellants ("the sellers") plant for the manufacture of glass fibres ("the goods") at a price of $662,086 f.o.b. London for shipment

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to Callao. Payment was to be in London by confirmed irrevocable transferable letter of credit for the invoice price plus freight, payable as to 20 per cent. of the invoice price upon the opening of the credit, as to 70 per cent. of the invoice price and 100 per cent. of the freight on presentation of shipping documents and as to the balance of 10 per cent. of the invoice price on completion of erection of the plant in Peru.

The buyers arranged with their Peruvian bank, Banco Continental S.A. ("the issuing bank") to issue the necessary credit and the issuing bank appointed the respondents, Royal Bank of Canada ("the confirming bank") to advise and confirm upon its own behalf the credit to the sellers. The confirming bank duly notified the sellers on March 30, 1976, of the opening of the confirmed irrevocable transferable letter of credit. So far as concerned the 70 per cent. of the invoice price and 100 per cent. freight there was nothing that was unusual in its terms. It was expressed to be subject to the Uniform Customs and Practice for Documentary Credits (1974 revision) of the International Chamber of Commerce ("the Uniform Customs") and to be available by sight drafts on the issuing bank against delivery inter alia of a full set "on board" bills of lading evidencing receipt for shipment of the goods from London to Callao on or before a date in October 1976, which was subsequently extended to December 15, 1976.

The initial payment of 20 per cent. of the invoice price was duly made by the confirming bank to the sellers. Thereafter, in July 1976 the sellers transferred to their own merchant bankers, the first appellants, their interest under the credit as security for advances; but nothing turns on this so far as either the documentary credit point or the Bretton Woods point is concerned. In dealing with the relevant law on each of these points I shall accordingly treat the sellers as having continued throughout to be the beneficiaries of the confirmed credit.

The goods, which had to be manufactured by the sellers, were ready for shipment by the beginning of December 1976. It was intended by the loading brokers acting on behalf of Prudential Lines Inc. ("the carriers") that they should be shipped on a vessel belonging to the carriers (*American Legend*) due to arrive at Felixstowe on December 10, 1976. (The substitution of Felixstowe for London as the loading port is immaterial. It was acquiesced in by all parties to the transaction.) The arrival of *American Legend* at Felixstowe was cancelled and another vessel, *American Accord*, was substituted by the loading brokers: but its date of arrival was scheduled for December 16, 1976, one day after the latest date of shipment required by the documentary credit. The goods were in fact loaded on *American Accord* on December 16, 1976; but the loading brokers, who also acted as agents for the carriers in issuing bills of lading, issued in the first instance a set of "received for shipment" bills of lading dated December 15, 1976, and handed them over to the sellers in return for payment of the freight. On presentation of the shipping documents to the confirming bank on December 17, that bank raised various objections to their form, of which the only one that is relevant to the documentary credit point was that the bills of lading did not bear any dated "on board" notation. The bills of lading were returned to the carriers' freight brokers who issued a fresh set bearing the notation, which was untrue: "These goods are actually on

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board December 15, 1976. E. H. Munday and Co. (Freight Agents) Ltd. as agents." The amended bills of lading together with the other documents were re-presented to the confirming bank on December 22, 1976, but the confirming bank again refused to pay on the ground that they "had information in their possession which suggested that shipment was not effected as it appears in the bill of lading."

The learned judge after a careful hearing, lasting for no less than 30 days, held that Mr. Baker, the employee of the loading brokers to the carriers who was in charge of the transaction on their behalf, had acted fraudulently in issuing the bills of lading bearing what was to his knowledge a false statement as to the date on which the plant was actually on board *American Accord*. The judge held, however, that neither the sellers (nor their transferee) were parties or privies to any fraud by Mr. Baker; at the time of both presentations of the shipping documents to the confirming bank on December 17 and 22, 1976, they bona fide believed that the plant had in fact been loaded on *American Accord* on or before December 15, 1976, and that the annotation on the re-issued bill of lading, stating the goods to be actually on board at that date, was true.

The additional facts that give rise to the Bretton Woods point may be stated even more concisely. The sellers' original quotation for the sale price of the glass fibre making plant was half the figure that ultimately became the invoice price for the purposes of the documentary credit. The buyers who were desirous of converting Peruvian currency into U.S. dollars available to them in the United States, a transaction which was contrary to Peruvian exchange control regulations, persuaded the

sellers to invoice the plant to them at double the real sale price in U.S. dollars and to agree that they would within 10 days after drawing upon the documentary credit for each of the three instalments of the invoice price remit one half of the amount so drawn to the dollar account in Miami, Florida, of an American corporation controlled by the buyers. This the sellers agreed to do; and of the first instalment of 20 per cent. of the now doubled invoice price of $662,086, which was the only drawing that they succeeded in making under the credit, they transmitted one half, viz. $66,208 to the American corporation in Florida. They would have done the same with one half of the next drawing of 70 per cent. of the invoice price payable against shipping documents if the confirming bank had paid this instalment.

The documentary credit point My Lords, for the proposition upon the documentary credit point, both in the broad form for which counsel for the confirming bank have strenuously argued at all stages of this appeal and in the narrower form or "halfway house" that commended itself to the Court of Appeal, there is no direct authority to be found either in English or Privy Council cases or among the numerous decisions of courts in the United States of America to which reference is made in the judgments of the Court of Appeal in the instant case. So the point falls to be decided by reference to first principles as to the legal nature of the contractual obligations assumed by the various parties to a transaction consisting of an international sale of goods to be financed by means of a confirmed irrevocable documentary credit. It is trite law that there are four autonomous though interconnected contractual

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relationships involved. (1) The underlying contract for the sale of goods, to which the only parties are the buyer and the seller; (2) the contract between the buyer and the issuing bank under which the latter agrees to issue the credit and either itself or through a confirming bank to notify the credit to the seller and to make payments to or to the order of the seller (or to pay, accept or negotiate bills of exchange drawn by the seller) against presentation of stipulated documents; and the buyer agrees to reimburse the issuing bank for payments made under the credit. For such reimbursement the stipulated documents, if they include a document of title such as a bill of lading, constitute a security available to the issuing bank; (3) if payment is to be made through a confirming bank the contract between the issuing bank and the confirming bank authorising and requiring the latter to make such payments and to remit the stipulated documents to the issuing bank when they are received, the issuing bank in turn agreeing to reimburse the confirming bank for payments made under the credit; (4) the contract between the confirming bank and the seller under which the confirming bank undertakes to pay to the seller (or to accept or negotiate without recourse to drawer bills of exchange drawn by him) up to the amount of the credit against presentation of the stipulated documents.

Again, it is trite law that in contract (4), with which alone the instant appeal is directly concerned, the parties to it, the seller and the confirming bank, "deal in documents and not in goods," as article 8 of the Uniform Customs puts it. If, on their face, the documents presented to the confirming bank by the seller conform with the requirements of the credit as notified to him by the confirming bank, that 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 of the conforming documents 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 the 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. The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give to 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 of sale being used as a ground for non-payment or reduction or deferment of payment.

To this general statement of principle as to the contractual obligations of the confirming bank to the seller, there is one established 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. Although there does not appear among the English authorities any case in which this exception has been applied, it is well established in the American cases of which the leading or "landmark" case is *Sztejn v. J. Henry Schroder Banking Corporation* (1941) 31 N.Y.S. 2d 631. This judgment of the New York Court of Appeals was referred to with approval by the English Court of Appeal in *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] Q.B. 159, though this was actually

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a case about a performance bond under which a bank assumes obligations to a buyer analogous to those assumed by a confirming bank to the seller under a documentary credit. The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim ex turpi causa non oritur actio or, if plain English is to be preferred, "fraud unravels all." The courts will not allow their process to be used by a dishonest person to carry out a fraud.

The instant case, however, does not fall within the fraud exception. Mocatta J. found the sellers to have been unaware of the inaccuracy of Mr. Baker's notation of the date at which the goods were actually on board *American Accord*. They believed that it was true and that the goods had actually been loaded on or before December 15, 1976, as required by the documentary credit.

Faced by this finding, the argument for the confirming bank before Mocatta J. was directed to supporting the broad proposition: that a confirming bank is not under any obligation, legally enforceable against it by the seller/beneficiary of a documentary credit, to pay to him the sum stipulated in the credit against presentation of documents, if the documents presented, although conforming on their face with the terms of the credit, nevertheless contain some statement of material fact that is not accurate. This proposition which does not call for knowledge on the part of the seller/beneficiary of the existence of any inaccuracy would embrace the fraud exception and render it superfluous.

My Lords, the more closely this bold proposition is subjected to legal analysis, the more implausible it becomes; to assent to it would, in my view, undermine the whole system of financing international trade by means of documentary credits.

It has, so far as I know, never been disputed that as between confirming bank and issuing bank and as between issuing bank and the buyer the contractual duty of each bank under a confirmed irrevocable credit is to examine with reasonable care all documents presented in order to ascertain that they appear *on their face* to be in accordance with the terms and conditions of the credit, and, if they do so appear, to pay to the seller/ beneficiary by whom the documents have been presented the sum stipulated by the credit, or to accept or negotiate without recourse to drawer drafts drawn by the seller/beneficiary if the credit so provides. It is so stated in the latest edition of the Uniform Customs. It is equally clear law, and is so provided by article 9 of the Uniform Customs, that confirming banks and issuing banks assume no liability or responsibility to one another or to the buyer "for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents." This is well illustrated by the Privy Council case of *Gian Singh & Co. Ltd. v. Banque de l'Indochine* [1974] 1 W.L.R. 1234, where the customer was held liable to reimburse the issuing bank for honouring a documentary credit upon presentation of an apparently conforming document which was an ingenious forgery, a fact that the bank had not been negligent in failing to detect upon examination of the document.

It would be strange from the commercial point of view, although not theoretically impossible in law, if the contractual duty owed by confirming and issuing banks to the buyer to honour the credit on presentation of

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apparently conforming documents despite the fact that they contain inaccuracies or even are forged, were not matched by a corresponding contractual liability of the confirming bank to the seller/beneficiary (in the absence, of course, of any fraud on his part) to pay the sum stipulated in the credit upon presentation of apparently confirming documents. Yet, as is conceded by counsel for the confirming bank in the instant case, if the broad proposition for which he argues is correct, the contractual duties do not match. As respects the confirming bank's contractual duty to the seller to honour the credit, the bank, it is submitted, is only bound to pay upon presentation of documents which not only appear on their face to be in accordance with the terms and conditions of the credit but also do not in fact contain any material statement that is inaccurate. If this submission be correct, the bank's contractual right to refuse to honour the documentary credit cannot, as a matter of legal analysis, depend upon whether *at the time of the refusal* the bank was virtually certain from information obtained by means other than reasonably careful examination of the documents themselves that they contained some material statement that was inaccurate or whether the bank merely suspected this or even had no suspicion that apparently conforming documents contained any inaccuracies at all. If there be any such right of refusal it must depend upon whether the bank, when sued by the seller/beneficiary for breach of its contract to honour the credit, is able to prove that one of the documents did in fact contain what was a material misstatement.

It is conceded that to justify refusal the misstatement must be "material" but this invites the query: "material to what?" The suggested answer to this query was: a misstatement of a fact which if the true fact had been disclosed would have entitled the buyer to reject the goods; date of shipment (as in the instant case) or misdescription of the goods are examples. But this is to destroy the autonomy of the documentary credit which is its raison d'etre; it is to make the seller's right to payment by the confirming bank dependent upon the buyer's rights against the seller under the terms of the contract for the sale of goods, of which the confirming bank will have no knowledge.

Counsel sought to evade the difficulties disclosed by an analysis of the legal consequences of his broad proposition by praying in aid the practical consideration that a bank, desirous as it would be of protecting its reputation in the competitive business of providing documentary credits, would never exercise its right against a seller/beneficiary to refuse to honour the credit except in cases where at the time of the refusal it already was in possession of irrefutable evidence of the inaccuracy in the documents presented. I must confess

that the argument that a seller should be content to rely upon the exercise by banks of business expediency, unbacked by any legal liability, to ensure prompt payment by a foreign buyer does not impress me; but the assumption that underlies reliance upon expediency does not, in my view, itself stand up to legal analysis. Business expediency would not induce the bank to pay the seller/beneficiary against presentation of documents which it was not legally liable to accept as complying with the documentary credit unless, in doing so, it acquired a right legally enforceable against the buyer, to require him to take up the documents himself and reimburse the bank for the amount paid. So any reliance upon

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business expediency to make the system work if the broad proposition contended for by counsel is correct, must involve that as against the buyer, the bank, when presented with apparently conforming documents by the seller, is legally entitled to the option, *exercisable at its own discretion and regardless of any instructions to the contrary from the buyer*, either (1) to take up the documents and pay the credit and claim reimbursement from the buyer, notwithstanding that the bank has been provided with information that makes it virtually certain that the existence of such inaccuracies can be proved, or (2) to reject the documents and to refuse to pay the credit.

The legal justification for the existence of such an independently exercisable option, it is suggested, lies in the bank's own interest in the goods to which the documents relate, as security for the advance made by the bank to the buyer, when it pays the seller under the documentary credit. But if this were so, 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." But this would not justify the confirming bank's refusal to honour the credit in the instant case; the realisable value on arrival at Callao of a glass fibre manufacturing plant made to the specification of the buyers could not be in any way affected by its having been loaded on board a ship at Felixstowe on December 16, instead of December 15, 1976.

My Lords, in rejecting this broad proposition I have dealt with it at greater length than otherwise I would have done, because it formed the main plank of the confirming bank's argument on the documentary credit point before Mocatta J. - who, however, had no hesitation in rejecting it, but found for the confirming bank on the Bretton Woods point. It formed the main ground also in the confirming bank's notice of cross-appeal to the Court of Appeal upon which the confirming bank would seek to uphold the judgment in its favour if the sellers' appeal should succeed upon the Bretton Woods point. It was not until half-way through the actual hearing in the Court of Appeal that the notice of cross-appeal was amended to include a narrower proposition referred to as a "half-way house" which the Court of Appeal accepted as being decisive in the confirming bank's favour. This rendered it unnecessary for that court to rule upon the broad proposition that I have so far been discussing, although Stephenson L.J. indicated obiter that for his part he would have rejected it. In the confirming bank's argument before this House a marked lack of enthusiasm has been shown for reliance on the "half-way house" and the broad proposition has again formed the main ground on which the confirming bank has sought to uphold the actual decision of the Court of Appeal in its favour on the documentary credit point.

The proposition accepted by the Court of Appeal as constituting a complete defence available to the confirming bank on the documentary credit point has been referred to as a "half-way house" because it lies not only half way between the unqualified liability of the confirming bank to honour a documentary credit on presentation of documents which upon reasonably careful examination appear to conform to the terms and conditions of the credit, and what I have referred to as the fraud exception to this unqualified liability which is available to the confirming bank where

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the seller/beneficiary presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his own knowledge are untrue; but it also lies half way between the fraud exception and the broad proposition favoured by the confirming bank with which I have hitherto been dealing. The half-way house is erected upon the narrower proposition that if any of the documents presented under the credit by the seller/beneficiary contain a material misrepresentation of fact that was *false to the knowledge of the person who issued the document* and intended by him to deceive persons into whose hands the document might come, the confirming bank is under no liability to honour the credit, even though, as in the instant case, the persons whom the issuer of the document intended to, and did, deceive included the seller/beneficiary himself.

My Lords, if the broad proposition for which the confirming bank has argued is unacceptable for the reasons that I have already discussed, what rational ground can there be for drawing any distinction between apparently conforming documents that, unknown to the seller, in fact contain a statement of fact that is inaccurate where the inaccuracy was due to inadvertence by the maker of the document, and the like documents where the same inaccuracy had been inserted by the maker of the document with intent to deceive, among others, the seller/beneficiary himself?

Ex hypothesi we are dealing only with a case in which the seller/beneficiary claiming under the credit has been deceived, for if he presented documents to the confirming bank with knowledge that this apparent conformity with the terms and conditions of the credit was due to the fact that the documents told a lie, the seller/beneficiary would himself be a party to the misrepresentation made to the confirming bank by the lie in the documents and the case would come within the fraud exception, as did all the American cases referred to as persuasive authority in the judgments of the Court of Appeal in the instant case.

The American cases refer indifferently to documents that are "forged or fraudulent," as does the Uniform Commercial Code that has been adopted in nearly all states of the United States of America. The Court of Appeal reached their half-way house in the instant case by starting from the premiss that a confirming bank could refuse to pay against a document that it knew to be forged, even though the seller/beneficiary had no knowledge of that fact. From this premiss they reasoned that if forgery by a third party relieves the confirming bank of liability to pay the seller/beneficiary, fraud by a third party ought to have the same consequence.

I would not wish to be taken as accepting that the premiss as to forged documents is correct, even where the fact that the document is forged deprives it of all legal effect and makes it a nullity, and so worthless to the confirming bank as security for its advances to the buyer. This is certainly not so under the Uniform Commercial Code as against a person who has taken a draft drawn under the credit in circumstances that would make him a holder in due course, and I see no reason why, and there is nothing in the Uniform Commercial Code to suggest that, a seller/beneficiary who is ignorant of the forgery should be in any

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worse position because he has not negotiated the draft before presentation. I would prefer to leave open the question of th rights of an innocent seller/beneficiary against the confirming bank when a document presented by him is a nullity because unknown to him it was forged by some third party; for that question does not arise in the instant case. 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 the holder a right to claim them at their destination, Callao, and was evidence of the terms of the contract under which they were being carried.

But even assuming the correctness of the Court of Appeal's premiss 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 the conclusion that fraud by a third party which does not render the document a nullity has the 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. Upon the documentary credit point I think that Mocatta J. was right in deciding it in favour of the sellers and that the Court of Appeal were wrong in reversing him on this point.

The Bretton Woods point The Bretton Woods point arises out of the agreement between the buyers and the seller collateral to the contract of sale of the goods between the same parties that out of the payments in U.S. dollars received by the sellers under the documentary credit in respect of each instalment of the invoice price of the goods, they would transmit to the account of the buyers in America one half of the U.S. dollars received.

The Bretton Woods Agreements Order in Council 1946, made under the Bretton Woods Agreements Act 1945, gives the force of law in England to article VIII section 2 (b) of the Bretton Woods Agreement, which is in the following terms:

> "Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this agreement shall be unenforceable in the territories of any member …"

My Lords, I accept as correct the narrow interpretation that was placed upon the expression "exchange contracts" in this provision of the Bretton Woods Agreement by the Court of Appeal in *Wilson, Smithett & Cope Ltd. v. Terruzzi* [1976] Q.B. 683. It is confined to contracts to exchange the currency of one country for the currency of another; it does not include contracts entered into in connection with sales of goods which require the conversion by the buyer of one currency into another in order to enable him to pay the purchase price. As was said by Lord Denning M.R. in his judgment in the *Terruzzi* case at p. 714, the court in considering the application of the provision should look at the substance of the contracts and not at the form. It should not enforce a contract that is a mere "monetary transaction in disguise."

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I also accept as accurate what was said by Lord Denning M.R. in a subsequent case, as to the effect that should be given by English courts to the word "unenforceable." The case, *Batra v. Ebrahim*, is unreported, but the relevant passage from Lord Denning's judgment is helpfully cited by Ackner L.J. in his own judgment in the instant case: [1982] Q.B. 208, 241F-242B. If in the course of the hearing of an action the court becomes aware that the contract on which a party is suing is one that this country has accepted an international obligation to treat as unenforceable, the court must take the point itself, even though the defendant has not pleaded it, and must refuse to lend its

aid to enforce the contract. But this does not have the effect of making an exchange contract that is contrary to the exchange control regulations of a member state other than the United Kingdom into a contract that is "illegal" under English law or render acts undertaken in this country in performance of such a contract unlawful. Like a contract of guarantee of which there is no note or memorandum in writing it is unenforceable by the courts and nothing more.

Mocatta J., professing to follow the guidance given in the *Terruzzi case* [1976] Q.B. 683, took the view that the contract of sale between the buyers and the sellers at the inflated invoice price was a monetary transaction in disguise and that despite the autonomous character of the contract between the sellers and the confirming bank under the documentary credit, this too was tarred with the same brush and was a monetary transaction in disguise and therefore one which the court should not enforce. He rejected out of hand what he described as a "rather remarkable submission" that the sellers could recover that half of the invoice price which represented the true sale price of the goods, even if they could not recover that other half of the invoice price which they would receive as trustees for the buyers on trust to transmit it to the buyer's American company in Florida. He held that it was impossible to sever the contract constituted by the documentary credit; it was either enforceable in full or not at all.

In refusing to treat the sellers' claim under the documentary credit for that part of the invoice price that they were to retain for themselves as the sale price of the goods in a different way from that in which he treated their claim to that part of the invoice price which they would receive as trustees for the buyers, I agree with all three members of the Court of Appeal the learned judge fell into error.

I avoid speaking of "severability," for this expression is appropriate where the task upon which the court is engaged is construing the language that the parties have used in a written contract. The question whether and to what extent a contract is unenforceable under the Bretton Woods Agreements Order in Council 1946 because it is a monetary transaction in disguise is not a question of construction of the contract, but a question of the substance of the transaction to which enforcement of the contract will give effect. If the matter were to be determined simply as a question of construction, the contract between the sellers and the confirming bank constituted by the documentary credit fell altogether outside the Bretton Woods Agreement; it was not a contract to exchange one currency for another currency but a contract to pay

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currency for documents which included documents of title to goods. On the contrary, the task on which the court is engaged is to penetrate any disguise presented by the actual words the parties have used, to identify any monetary transaction (in the narrow sense of that expression as used in the *Terruzzi case* [1976] Q.B. 683) which those words were intended to conceal and to refuse to enforce the contract to the extent that to do so would give effect to the monetary transaction.

In the instant case there is no difficulty in identifying the monetary transaction that was sought to be concealed by the actual words used in the documentary credit and in the underlying contract of sale. It was to exchange Peruvian currency provided by the buyers in Peru for U.S. $331,043 to be made available to them in Florida; and to do this was contrary to the exchange control regulations of Peru. Payment under the documentary credit by the confirming bank to the sellers of that half of the invoice price (viz. $331,043) that the sellers would receive as trustees for the buyers on trust to remit it to the account of the buyer's American company in Florida, was an essential part of that monetary transaction and therefore unenforceable; but payment of the other half of the invoice price and of the freight was not; the sellers would receive that part of the payment under the documentary credit on their own behalf and retain it as the genuine purchase price of goods sold by them to the buyers. I agree with the Court of Appeal that there is nothing in the Bretton Woods Agreements Order in Council 1946 that prevents the payment under the documentary credit being enforceable to this extent.

As regards the first instalment of 20 per cent. of the invoice price, this was paid by the confirming bank in full. No enforcement by the court of this payment is needed by the buyers. The confirming bank, if it had known at the time of the monetary transaction by the buyers that was involved, could have successfully resisted payment of one half of that instalment; but even if it was in possession of such knowledge there was nothing in English law to prevent it from voluntarily paying that half too. As regards the third instalment of 10 per cent. of the invoice price, that never fell due within the period of the credit. What is in issue in this appeal is the second instalment of 70 per cent. of the invoice price and 100 per cent. of the freight which, as I have held under the documentary credit point, fell due upon the re-presentation of the documents on December 22, 1976. In my opinion the sellers are entitled to judgment for that part of the second instalment which was not a monetary transaction in disguise; that is to say: 35 per cent. of the invoice price and 100 per cent. of the freight, amounting in all to U.S. $262,807.49, with interest thereon from December 22, 1976.

LORD FRASER OF TULLYBELTON . My Lords, I have had the advantage of.reading in draft the speech of my noble and learned friend Lord Diplock. I agree with it and with the order he proposes.

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LORD RUSSELL OF KILLOWEN . My Lords, I have had the advantage of reading in draft the opinion of my noble and learned friend, Lord Diplock. I agree with it and the order proposed by him.

LORD SCARMAN . My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Diplock. I agree with it and with the order proposed.

LORD BRIDGE OF HARWICH . My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Diplock. I agree with it and with the order he proposed.

Appeal allowed.

Solicitors: Nicholson Graham & Jones; Thomas Cooper & Stibbard.

J. A. G