

# The Autonomy Rules of Documentary Credit in Ethiopia: Is There a Fraud Exception?

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## Abstract

*The 1960 Commercial Code of Ethiopia incorporated the principle of autonomy of documentary credit. The principle requires an absolute separation of the credit from the underlying contract. It imposes an obligation on the bank to honor the credit notwithstanding that there is an allegation or actual fraud in the required documents or the underlying contract. It creates a dilemma that, on one hand, if the principle is strictly applied the system of documentary credit may create undesirable consequences of system-protected fraudsters and abuse of the credit. On the other hand, if it is applied loosely, it would degrade the autonomy of the credit and consequently extend unwarranted protection to unscrupulous parties who, in bad faith, demand enjoinder of payment under the credit for unfounded grounds. This article examined the issue of independence of documentary credit in the Ethiopian legal framework vis-à-vis the trending development of fraud exception rules. The study was conducted based on a qualitative research approach by analyzing laws, documents and data collected through interviews. The study revealed that, unlike the experience of other countries, there is no fraud exception to the autonomy rules of documentary credit in Ethiopia. The author recommended revising the Ethiopian law on documentary credit to incorporate fraud exception rules so as to maintain the equilibrium between ensuring autonomy of the credit and restraining fraudulent activities.*

**Keywords:** Documentary Credits, Principle of Autonomy, Fraud Exception, Commercial Code of Ethiopia, National Bank of Ethiopia, Ethiopia

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underlying contract or the credit agreement he has with the issuing bank. Finally, to avoid confusion and misunderstanding the banks should discourage any attempt to include any undertakings between the applicant and beneficiary or the applicant and the issuing bank as an integral part of the credit.

Besides, the eUCP under its disclaimer specified some independent features of the electronic credits.<sup>50</sup> It holds that electronic credits are independent from information not apparently included in the documents, the identity of their sender and source of the information.<sup>51</sup> Thus, banks responsibility to receive, authenticate and identify electronic documents is limited to what is plainly specified in the records.<sup>52</sup>

However, the UCP600 does not recognize fraud exceptions to the autonomy principle<sup>53</sup> nor does its supplementary rules.<sup>54</sup> It does not incorporate fraud exceptions under its relevant provisions that deal with independent features of documentary credit.<sup>55</sup> The disclaimer incorporated under the rule emphasizes its position on the exclusion of fraud exception from its ambit. The provision is self-explanatory

A bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document, or for the general or particular conditions stipulated in a document or superimposed thereon; nor does it assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods, services or other performance represented by any document, or for the good faith or acts or omissions, solvency, performance or standing of the consignor, the carrier, the forwarder, the consignee or the insurer of the goods or any other person.<sup>56</sup>

Despite the aforementioned provision, it does not mean that the ICC denies a fraud exception. It in deed recognizes fraud exceptions in its different

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<sup>50</sup> eUCP, *supra* note 46, Article e12

<sup>51</sup> eUCP, *supra* note 46, Article e12

<sup>52</sup> eUCP, *supra* note 46, Article e12

<sup>53</sup> The disclaimer incorporated under the Rule states its position on exclusion of fraud exception from its ambit. See The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 ("UCP"), Article 37, [hereinafter UCP600]

<sup>54</sup> Ross and Xiang, *The Development of the Fraud Rule in Letter of Credit Law*, *supra* note 29, p. 700

<sup>55</sup> See UCP600, *supra* note 53, Article 4, 5, 7, 8, 14, 15 and 16

<sup>56</sup> UCP600, *supra* note 53, Article 37

documents such as documents 470/371 and 470/373 and leaves the matter to the national laws and courts. It is because, first, the UCP is about uniform customs and practices. However, there is no uniformity of practices and customs in the area of fraud exception; thus, incorporating such a rule will compromise the universality principle the UCP stands for.<sup>57</sup> Second, the ICC rules, including UCP, are not rules of law in the strict sense. Rather they are rules of best banking practice. The issue of fraud, on the other hand, is a matter of rule of law, thus, it should be tackled by the national laws and the courts of the forum.<sup>58</sup>

## **2.2. National Laws**

In the earlier times, it was only a few countries that have specific statutory rules applicable to documentary credit transactions. However, limitations on the international documentary credit rules and the desire of states to impose public policies urge some jurisdictions to promulgate their own documentary credit rules. In a survey conducted for the International Encyclopedia of Comparative Law, some countries developed specific domestic documentary credit laws.<sup>59</sup>

One of the prominent countries that introduce documentary credit law is the U.S. It addresses the autonomy principle and fraud exception in its court decisions and under the Uniform Commercial Code (hereinafter UCC). In this regard, the case *Maurice O'Meara Co v. National Park Bank* is notable. In this case, the plaintiff entered into a contract of sale of newsprint paper with the Sun-Herald Corporation where the latter opens documentary credit issued by the National Park Bank of New York. However, the bank rejected the payment despite the plaintiff presenting facially complying documents. The plaintiff sued the bank for damages. In its defense, the defendant bank argued the quality of the newsprint is lower than the contracted quality. The Court of Appeals rejected the bank's claim stating that the bank is absolutely

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<sup>57</sup> Ross and Xiang, *The Development of the Fraud Rule in Letter of Credit Law*, *supra* note 29, p. 700

<sup>58</sup> Yanan, *Approaches to Resolving the International Documentary Letters of Credit Fraud Issue*, *supra* note 37, p.68

<sup>59</sup> Among others; Czechoslovakia, Colombia, Guatemalan, Honduras, Lebanon, Syria, German, and Mexico have domestic documentary credit laws. See Hamed, *Documentary Letters of Credit*, *supra* note 1, p. 111.

bound to make the payment under the credit, notwithstanding that there is a breach in the underlying contract.<sup>60</sup>

From the above assertion, the court recognizes the autonomy principle of documentary credit. It argues for an absolute separation of the credit from the underlying contract that a bank does not have a mandate to inquire into evidence indicating fraud. Such a position is, however, changed by the *Sztejn* Case.<sup>61</sup> It is a landmark case in the course of the development of the fraud rule. It has been embodied under statutory laws of the U.S. and shaped the fraud rules across several jurisdictions.<sup>62</sup>

In the *Sztejn* Case, the underlying contract was between Charles Sztejn, an American importer, and Transea Traders Ltd, an Indian exporter. The former opened an irrevocable documentary credit for the payment issued by Schroeder Bank and presented it to the exporter by Chartered Bank of India, provided that that the exporter will deliver the required bristles. Accordingly, the exporter submitted documents that on their face complied with the terms and conditions of the credit to the presenting bank for payment. However, before payment was made, Sztejn had filed a suit against the presenting bank at the New York Court to enjoin the bank from honouring the demand, alleging that the beneficiary shipped worthless and rubbish materials with the intent to stimulate genuine merchandise and defraud the plaintiff. The defendant, in turn, moved to dismiss the complaint on the grounds of lack of cause of action. It alleged that its responsibility is limited to examining the conformity of documents and the documents conform to the requirements of the credit.<sup>63</sup>

The Court examined the elements of fraud and drew a careful rule. First it acknowledged the independent nature of the credit from the underlying transaction. It states the “letter of credit is independent of the primary contract between the buyer and the seller”. The issuing bank agrees to pay upon presentation of documents, not goods.”<sup>64</sup> The Court argued that it would be a most unfortunate interference with business transactions if a bank before honouring drafts drawn upon it was obliged or even allowed to go

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<sup>60</sup> *Maurice O’Meara Co v. National Park Bank*, 239 NY, (1925), para 386

<sup>61</sup> *Sztejn v Henry Schroder Banking Corporation*, 31 N.Y.S (1 July 1941), [hereinafter *Sztejn Case*]

<sup>62</sup> Ross and Xiang, *The Development of the Fraud Rule in Letter of Credit Law*, *supra* note 29, p.676

<sup>63</sup> *Sztejn Case*, *supra* note 61, para 631

<sup>64</sup> *Ibid.*

behind the documents for each and every allegation made by the other party.<sup>65</sup> However, the court did not absolutely close the room for behind scrutiny of the documents if fraud in document or transaction is established. It states the principle of autonomy shall be pierced and the fraud exception rule should be applied if fraud is involved in the transaction. Accordingly, it bluntly rejected the Chartered Bank's motion to dismiss the plaintiff's complaint and ruled for the plaintiff arguing that the exporter was engaged in a scheme to defraud the plaintiff, and that the Chartered Bank is not an innocent holder of the draft for value but merely attempting to procure payment of the draft for the exporter's account.<sup>66</sup>

In the Court's decision three parameters have been used for application of the fraud exception rules. First, payment under documentary credit may be interrupted in a case of fraud in the document or the underlying contract. Second, the payment can be interrupted only when the alleged fraud is proven or established. Third, the payment to the holder of due course or presenter with similar status will not be interrupted despite the existence of an established fraud.<sup>67</sup>

The U.S. also codified the UCC in 1952 to regulate commercial transactions, including documentary credit.<sup>68</sup> It is a well-crafted legislative enactment of contemporary documentary credit practices that combines both technical and legal concepts of documentary credit.<sup>69</sup> Article 5 of the UCC was revised in 1995 and a more comprehensive and advanced regulatory framework is introduced.<sup>70</sup> It is adopted, in a slightly modified form, in almost every state in the U.S.<sup>71</sup>

Article 5 of the UCC, specifically, is designed to regulate the issue of autonomy of the credit and fraud exception along with other issues of documentary credit. Section 5-103 (d) specifies that obligations of the issuing, confirming and advising bank are independent from validity, performance or non-performance of the contracts accompanying the credit.

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<sup>65</sup> *Ibid.*

<sup>66</sup> *Id.*, para 634-35

<sup>67</sup> *Ibid.*

<sup>68</sup> Zsuzsanna, *Documentary Credits in International Commercial Transactions*, *supra* note 12, p. 14

<sup>69</sup> Boris Kozolchik, *Legal Aspects of Letters of Credit and Related Secured Transactions*, *Lawyer of the Americas*, Vol. 11, No. 2/3, (1979), p. 270

<sup>70</sup> Zsuzsanna, *Documentary Credits in International Commercial Transactions*, *supra* note 12, p. 15

<sup>71</sup> Felicity, *The Autonomy Principle and the Fraud Exception*, *supra* note 22, P. 154

The principle is reinforced under Section 5-108 (1) that fortifies the assumption that the obligation of the issuing bank does not extend to performance or otherwise non-performance of the underlying contract or any other contracts accompanying the credit.

The UCC also incorporated fraud exception rules.<sup>72</sup> It specified the fraud exception rule under Section 5-109. The Code tries to approach the fraud issue in a balanced way.<sup>73</sup> It stipulates the fraud exception rule will be applied if "...a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant..." It adopts a "material fraud test"<sup>74</sup> as the standard of fraud.<sup>75</sup> The test necessitates the effect of the fraud should be significant to the participants in the underlying transaction, thus, fraudulent acts which have insubstantial or immaterial effect to the participants in the underlying contract are disregarded.<sup>76</sup>

If martial fraud is established in the transaction, the bank can legitimately dishonor the presentation provided that the person demanding honor is not a protected person in the sense of Section 5-109(a)(1).<sup>77</sup> It is also specified courts can temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons upon fulfillment of the following conditions. First, the person demanding honor is not a protected person mentioned under Section 5-109 (a) (1). Second, on the basis of the information submitted to the court, the applicant is more likely

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<sup>72</sup> Susmitha, *Documentary Credit Law*, *supra* note 21, p. 160.

<sup>73</sup> Zhang Ruiqiao, A Comparative Study of the Fraud Exception Rule of Letters of Credit: Proposed Amendments to the Chinese Credit System, LLM Thesis, McGill University, Montreal, Faculty of Law, (2009), p. 60

<sup>74</sup> According to the official comment on Section 109 material fraud "requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction." See Official Comment to the Revised UCC Article 5-109 In. Douglas G. Baird, Theodore Eisenberg, Thomas H. Jackson (comp), Commercial and Debtor-Creditor Law, Selected Statutes, New York, ((2002) p. 545, [hereinafter Official Comment]

<sup>75</sup> Uniform Commercial Code Revised Article 5, Letter of Credit, (1995), Section 5-109, [hereinafter *Revised UCC*]

<sup>76</sup> Official Comment, *supra* note 74

<sup>77</sup> Section 5-109 (a) of the *Revised UCC*, *supra* note 75, stipulated "negative conditions" that specified lists of four categories of persons who may be immune from application of the fraud rule. These are (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person

than not to succeed under its claim of forgery or material fraud. Third, the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer. Fourth, a party who may be adversely affected by such decision is adequately protected. Fifth, the conditions to entitle a person to the relief under the law of the State have been met.<sup>78</sup>

Despite involvement of material fraud in the transaction, sometimes, it might be difficult to prove existence of fraud having expedited nature of documentary credit transactions. Accordingly, payment in the credit might be honored despite material fraud being committed. To counterbalance this problem the Code devised a system of warranty under Section 5-110. Thus, if the presentation is honored, the beneficiary obliged to warranty absence of forgery or material fraud in the transaction and the drawing does not violate any agreement between the applicant and beneficiary.

The United Kingdom, on the other hand, introduced documentary credit law in the middle of the 19<sup>th</sup> Century. It is recognized as one of the oldest documentary credit laws developed through court cases.<sup>79</sup> It addresses the issue of autonomy of documentary credit and fraud exception in its court cases. In this regard the case *United City Merchant (Investment) Ltd v Royal Bank of Canada* comes in the forefront. In this case the defendant, Royal Bank of Canada, rejected the documents presented and refused to pay on the grounds that the shipment date on the bill of lading is fraudulently antedated.<sup>80</sup> However, the fraud was done by the shipping agents and the beneficiary had no knowledge of it.<sup>81</sup> The plaintiff sued the bank for wrongful dishonor. The case went to the House of Lords. The Court first emphasized the principle of autonomy. It stated, autonomy is the inherent feature of documentary credit and the *raison d'être* that the instrument is developed in the international trade.<sup>82</sup> The Court adds the bank is under

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<sup>78</sup> Revised UCC, supra note 75, Section 5-109 (b)

<sup>79</sup> Frank Roland Hans Mueller, Letters of Credit with Focus on the UCP600 and the Exceptions to the Principle of Autonomy with Emphasis on the "Fraud Rule" Under The Laws of the USA, the UK and the RSA, Mini Thesis, University of the Western Cape, School of Law, (2013), p. 3

<sup>80</sup> The bill of lading showed that shipment had been made on 15th December 1976 (the last date for payment of the credit) when in fact shipment was on 16th December.

<sup>81</sup> *United City Merchants (Investments) Ltd v Royal Bank of Canada*, House of Lords, 1AC 168,183 [1983] (hereinafter *United City Merchants Case*)

<sup>82</sup> *Ibid.*

obligation to honor complying presentations made by the beneficiary, irrespective of a breach in the underlying contract.<sup>83</sup>

After elaborating on the autonomous nature of documentary credit, the Court confirmed that fraud is a well-known exception to the autonomy principle stating:

To this general statement of principle [of independence] 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.<sup>84</sup>

The Court argued that the principle of autonomy is not meant to protect fraudsters. Equally so courts should not allow their process to be used by a dishonest person to carry out a fraud.<sup>85</sup>

Despite its recognition, the English Courts follow a strict approach towards the application of the fraud exception rule.<sup>86</sup> They usually require the cumulative presence of four requirements.<sup>87</sup> First, there should be material misrepresentation. In the aforementioned case, for instance, the court asserted that the fraud rule will be applied if there are “material representations of fact that to his [the beneficiary’s] knowledge are untrue”.<sup>88</sup> In the courts wording misrepresentation should be material to the value of goods under the transaction. This standard has been accepted by subsequent English cases.<sup>89</sup>

Second, the beneficiary should be involved or have knowledge of the fraud.<sup>90</sup> Unlike the experience of the U.S., “the seller’s awareness of the fraud” is an additional criterion for application of the fraud exception in the

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<sup>83</sup> *Ibid.*

<sup>84</sup> *Ibid.*

<sup>85</sup> *Ibid.*

<sup>86</sup> Hamed, *Autonomy Principle and Fraud Exception in Documentary Letters of Credit*, *supra* note 13, p.58

<sup>87</sup> Zsuzsanna, *Documentary Credits in International Commercial Transactions*, *supra* note 12, p.130

<sup>88</sup> *United City Merchants Case*, *supra* note 81

<sup>89</sup> Hamed, *Autonomy Principle and Fraud Exception in Documentary Letters of Credit*, *supra* note 13, p.63

<sup>90</sup> Zsuzsanna, *Documentary Credits in International Commercial Transactions*, *supra* note 12, pp. 131-132



UK law. In other words, it is only “intentional fraud” that can trigger application of the fraud exception rule. As dealt elsewhere above, existence of material fraud is sufficient enough in the US fraud exception rule. At this point, one can raise a question whether it is necessary to have an additional requirement of “intentional fraud” to apply the fraud exception rule? Literarily, the "intentional fraud" requirement made the application of the fraud rule most complied with the autonomy principle as it narrows down the ground where it can be applied and that it avoids the need to investigate the underlying contract to measure reasonability of the payment. However, the intentional standard is not as commendable as it intends to be. First and foremost, it is too difficult to prove the culpability of the beneficiary, having the complexity of international commerce. Besides, it might imperil the security interest of the paying bank. Paying for a materially fraudulent presentation *per se* may compromise the reimbursement rights of the bank, if the jurisdiction(s) (where the credit is issued or operated) has/have a law that out rightly prohibited any payment based on fraudulent documents. Thus, it would be unreasonable to force the bank to honor the credit at the expense of its security and equally so to require the bank to accept a materially fraudulent presentation only because there is no evidence to establish the fraudulent intent of the beneficiary. Furthermore, it may also cause circulation of fraudulent documents in documentary transactions which is considered as “a cancer in the international trade.”<sup>91</sup>

Third, there should be clear evidence as to the fraud. In a case *Discount Records Ltd v. Barclays Bank*, the plaintiff requested for injunction of the payment under the credit alleging that the beneficiary committed fraud in the credit. The court dismissed the claim stating that the plaintiff failed to adduce clear evidence that shows involvement of material fraud in the transaction.<sup>92</sup>

Lastly, the fraud should be established to the paying bank timely, before the payment is paid to the beneficiary.<sup>93</sup>

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<sup>91</sup> *Standard Chartered Bank v Pakistan National Shipping Corporation and Others*, Queen’s Bench Division(Commercial Court), 1 Lloyd’s Rep, (April 1998), para 684

<sup>92</sup> *Discount Records Ltd v. Barclays Bank*, 1 WLR, (1975), para 320

<sup>93</sup> Zsuzsanna, *Documentary Credits in International Commercial Transactions*, *supra* note 12, p. 132

### 3. The Principle of Autonomy and Fraud Exception in Ethiopia

#### 3.1. The Principle of Autonomy in Ethiopia

In Ethiopia, documentary credit operation was recognized in the banking business since 1905 with the introduction of modern banking upon the establishment of the Abyssinia Bank.<sup>94</sup> Its application in the import and export transactions grew in the 1990s following the country's re-introduction of market led economic policy.<sup>95</sup> Currently, due to escalation of import and export transactions, the documentary credit operation is augmented in Ethiopia.<sup>96</sup>

The laws regulating documentary credit in Ethiopia are a recent phenomenon. The landmark legislation in this regard is the 1960 Commercial Code of Ethiopia (hereinafter the Commercial Code). It introduces regulatory frameworks for documentary credit as provided under Book IV of the code. It allots nine provisions, from Article 959 through 967. Provisions on this section of the Code are verbatim copies of the oldest version of the UCP, the 1951 version.<sup>97</sup> Apart from the Commercial Code, regulatory rules can be found under the 1960 Civil Code of Ethiopia (hereinafter the Civil Code),<sup>98</sup> Banking Business Proclamation No. 592/2008,<sup>99</sup> FDRE Criminal Code<sup>100</sup> and several Directives and Circulars issued by the National Bank of Ethiopia (hereinafter NBE).<sup>101</sup>

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<sup>94</sup> Interview with Mesfin Getachew, Chief Legal Expert, National Bank of Ethiopia, (6 March, 2018)

<sup>95</sup> *Ibid.*

<sup>96</sup> Lubaba Mohammed *et al*, An Assessment of Letter of Credit in Import and Export Case of Commercial Bank of Ethiopia, Senior Essay, St. Mary's University, Faculty of Business, (2014), p. 35, (hereinafter Lubaba *et al.*, *An Assessment of Letter of Credit in Import and Export Case of Commercial Bank of Ethiopia*)

<sup>97</sup> Tilahun *et al*, *Position of the Business Community*, *supra* note 11, p. 79

<sup>98</sup> Civil Code of the Empire of Ethiopia, Proclamation No.165, 19<sup>th</sup> year. No. 1, *Negarit Gazeta*, Extraordinary issue, (1960), Article 1676 and 1678, [hereinafter the Civil Code of Ethiopia]

<sup>99</sup> Banking Business Proclamation, Proclamation No. 592/2008, *Federal Negarit Gazeta*, (2008)

<sup>100</sup> Criminal Code of the Federal Democratic Republic of Ethiopia, Proclamation No. 414/2004, *Federal Negarit Gazeta*, (2004), (hereinafter the FDRE Criminal Code)

<sup>101</sup> See Directive No. FXD/07/1998; FXD/13/2000, National Bank of Ethiopia, Amendment to Directive No. FXD/07/1998, 18 February 2000; FXD/16/2001, National Bank of Ethiopia, Amendment to Directive No. FXD/07/1998, 29 March 2001; FXD/19/2001, National Bank of Ethiopia, Amendment to Directive No. FXD/07/1998, 01 December 2001; FXD/22/2004, National Bank of Ethiopia, Amendment to Directive No. FXD/07/1998, 19 March 2004; FXD/26/2004, National Bank of Ethiopia, Amendment to Directive No. FXD/07/1998, 01 January 2005; FEC/43/97, National Bank of Ethiopia, Exchange Control Directive Regarding Trade Transactions between Ethiopia and Eritrea Directive No. FEC/43/97, 19 December, 1997; FXD/45/2016, National Bank of Ethiopia, Directive on Transparency in Foreign Currency Allocation and Foreign Exchange Management, Directives No. FXD/45/2016 and FXD/46/2017, National Bank of Ethiopia, Directive on Transparency in Foreign

Similar to the experience of the U.S. and UK, the principle of autonomy of documentary credit is enshrined in the Ethiopian legal framework. The Ethiopian Commercial Code under Article 959(2) stipulates “[a] documentary credit is independent of any contract of sale on which it may be based.” The Code isolates the credit from any other accompanying sale contracts and grants the seller an absolute payment right as far as the documents are conforming to the terms and conditions of the credit. Besides, it has the implication that neither the seller nor the bank(s) can challenge payment under the documentary credit by raising fraud in the transaction. The aforementioned provision underlined that documentary credit is independent of what has been agreed between the seller and the buyer under their sale contract. If there is any dispute on the credit or the underlying contract between the seller and the buyer, the premise is ‘pay now, sue later’. Meaning, the buyer should pursue his/her claims, if any, under the underlying contract by a separate suit against the seller and not by withholding all or part of the credit.<sup>102</sup> However, a look at the phrase “...any sale contract...” in the aforementioned provision indicates that the Code isolates the credit only from the sale contract made between the seller and the buyer. As we have seen from Article 4 of the UCP600 and Section 5-103 (d) of the UCC the credit is isolated not only from the sale contract, but also any contract accompanying the credit such as a contract between the buyer and the issuing bank, the issuing bank and the beneficiary or the issuing bank and the correspondent bank.

The principle of autonomy is also reinforced under Article 966 of the Commercial Code. It states “[t]he bank shall not incur any liability where the documents are on their face in conformity with the instructions received. It shall not incur any obligation in relation to the goods which are the subject of the credit opened.” The provision restricts the responsibility of banks only to check the documents, presented by the seller, compliance with the facts stated under the credit. They are not required to check performance in the underlying contract. Any reference whatsoever included in the credit cannot compromise the credit’s autonomy.

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Currency Allocation and Foreign Exchange Management Directives No. FXD/46/2017, 20 March 2017.

<sup>102</sup> Chumah, *The Exceptions to the Principle of Autonomy of Documentary Credits*, *supra* note 36, p. 32

## Introduction

Commerce across national boundaries, sometimes, brings insecurity and uncertainty both to the importer and the exporter.<sup>1</sup> It is primarily due to the long-distance between the contracting parties and lack of information about the solvency of the parties. The problem is exacerbated due to the existence of divergent laws, different business practices and poor communication infrastructures across jurisdictions.<sup>2</sup> Parties in an international business transaction often take special precautions to ensure performance under their contract and protect their respective interests.<sup>3</sup> The exporter wants to avoid delivering goods or services for which he might not be paid. The importer, on the other hand, desires an assurance that the seller will not be paid until there is evidence that the required goods or services will be delivered.<sup>4</sup> Documentary credit along with other payment instruments mitigates the risks for both parties.<sup>5</sup>

Documentary credit provides the most secure modes of payment in international commerce. This security emanates from the legal protection it is accorded.<sup>6</sup> To ensure its effective operation, one of the major governing principles, the principle of autonomy, is developed.<sup>7</sup> It specifies that documentary credit is independent of any contracts accompanying it, including the underlying contract concluded between the buyer and the seller.<sup>8</sup> Thus, the obligations of the corresponding bank are limited in

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<sup>1</sup> Hamed Alavi, Documentary Letters of Credit, Legal Nature and Sources of Law, *Journal of Legal Studies*, Vol. 16, Issue 31, (2016), p. 106, [hereinafter Hamed, *Documentary Letters of Credit*]

<sup>2</sup> Andreas Karl, Letters of Credit and the Doctrine of Strict Compliance, LL.M Thesis, University of Uppsala, School of Law, (2003), pp. 12-13

<sup>3</sup> Daniel C.K. Chow & Thomas J. Schoenbaum, *International Business Transactions, Problems, Cases and Materials*, Aspen Publisher, Austin, (2005), p. 61

<sup>4</sup> *Ibid.*

<sup>5</sup> There are several instruments used to finance international business transactions other than documentary credit. To name a few; documentary credit, cash against document, telegraphic transfer, advance payment, documentary collection and so on. However, in Ethiopia any import and export transaction more than \$5000 should be processed through documentary credit or cash against document. See FXD/07/1998, National Bank of Ethiopia, Directive to Transfer NBE's Foreign Exchange Functions to Commercial Banks Directive No. FXD/07/1998, 18 August 1998

<sup>6</sup> Garth C. Wooler, *Legal and Practice Perspectives on Documentary Credit under the UCP600*, Brisbane, Australia, (2007), p. 45, [hereinafter Garth, *Legal and Practice perspective on Documentary Credit*]

<sup>7</sup> Jacqueline D. Lipton, 'Documentary Credit Law and Practice in the Global Information Age' *Fordham International Law Journal*, Vol. 22, (1990), p. 1979 (hereinafter Jacqueline, *Documentary Credit Law and Practice*)

<sup>8</sup> Rosmawani Che Hashim *et al*, Principle of Autonomy in Letter of Credit: Malaysian Practice, *Iium Law Journal*, Vol. 19 No. 2, (2011), p. 205 (hereinafter Rosmawani *et al*, *Principle of Autonomy in Letter of Credit*)

The issue of autonomy of documentary credit is also addressed under the Ethiopian Federal High Court case, *Ethiopian Grain Trade Enterprise v. Commercial Bank of Ethiopia*.<sup>103</sup> In the case, the plaintiff entered into a contract with Pakistani importer, M/S Patel & Co. or Nominee Grain Center, on 02 May 2008. In the contract they agreed that the plaintiff will deliver 400 Metric Tons of chickpeas to the importer and the importer will open irrevocable documentary credit for a price of \$280,000.00. According to their agreement, the irrevocable documentary credit was issued by the Abn Amro Bank (Pakistan) with a credit No. NLNL1NL08E104142. With the request of the issuing bank, the Commercial Bank of Ethiopia (hereinafter CBE) became an advising bank. Then the plaintiff shipped the required goods to the Djibouti port and tendered the documents to the CBE. The CBE in turn forwarded the documents to the issuing bank. However, the Pakistani importer alleged that it found insects in the imported goods; hence the goods should have a price discount. Besides, the issuing bank rejected the documents by stating that some of the documents did not strictly comply with the terms and conditions of the credit and refused to effect payment upon them. When the plaintiff received such notification, it sued the CBE at the Federal High Court of Ethiopia.

The plaintiff argued contesting the independence of documentary credit that though the issuing bank rejected the complying documents; the defendant (CBE) has the obligation to effect the payment as far as it performs the underlying contract which the documentary credit relays. However, the Court rejected the plaintiff's assertion arguing:

though the plaintiff argued that it performed its obligation to the importer, reside in Pakistan, in compliance with the contractual terms stipulated in the underlying contract, a look at Article 959(2) of the Commercial Code and Article 4(a) of the UCP, documentary credit and the underlying contract are independent of one another. Hence, the plaintiff's mere performance of the underlying contract does not guarantee him to claim the performance of the credit from the defendant.<sup>104</sup>

<sup>103</sup> የኢትዮጵያ አሀል ገንድ ድርጅት vs. የኢትዮጵያ ገንድ ባንክ፣ የፌዴራል ከፍተኛ ፍርድ ቤት፣ ሙ.ቁ. 134400፣ 2006 ዓ.ም

<sup>104</sup> *Ibid.*, translated by the author

In the courts wording, mere performance of the underlying contract does not guarantee the payment under the credit. The principle of autonomy restricts the contracting parties' right to argue based on the underlying contract for claiming an honor or otherwise dishonor of the credit. At this point it is wise to ask whether the principle of autonomy remains intact irrespective of any fraudulent acts of the parties in the credit in the Ethiopian documentary credit law. Thus, the subsequent topic will address the issue of a fraud exception under the Ethiopian documentary credit law

### **3.2. Fraud Exception in Ethiopia**

As discussed above, documentary credits are independent of the underlying contract concluded between the parties and the credit agreement between the issuing bank and the applicant. The credit is disassociated with the actual performance of contracts accompanying it. Thus, when banks measure compliance of documents they restrict themselves to the terms of the credit and the documents presented. This principle no doubt promotes the smooth operation of documentary credit. However, the absolute separation of the credit from the actual performance of the contract might create ample opportunities for fraudsters to abuse the system. That makes fraud one of the major problems facing documentary credit transactions in the world.<sup>105</sup>

Studies show that developing countries are the main targets of documentary fraudsters.<sup>106</sup> At this point, one might ask the volume of fraud experienced in the Ethiopian import and export transactions. Thousands of documentary credits and billions of dollars are transacted in Ethiopia through its banks.<sup>107</sup> However, there is no official record either in the banks or NBE that shows the exact number of documentary credit fraud in Ethiopia. Most of the time fraud in documentary credit is unnoticed by the public. It comes to light only when one of the parties raises a dispute. Bankers and traders do not voluntarily disclose such fraud or like fraud situations as they justify it as protecting customer's information and indeed, some of the fraud cases are

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<sup>105</sup> Yanan, *Approaches to Resolving the International Documentary Letters of Credit Fraud Issue*, *supra* note 37, p. 21

<sup>106</sup> Israel Woldekidan, Introduction and Regulation of Electronic Bill of Lading in Ethiopia: Appraisal of the Legal Environment and Lesson from International Recommendation, LLM Thesis, Bahir Dar University, School of Law, (2018), p. 52 [hereinafter Israel, *Introduction and Regulation of Electronic Bill of Lading in Ethiopia*]

<sup>107</sup> Lubaba *et al*, *An Assessment of Letter of Credit in Import and Export Case of Commercial Bank of Ethiopia*, *supra* note 96, p. 35

interlinked with corruption scandals.<sup>108</sup> However, its existence is undeniable. According to Israel Woldekidan, Ethiopia is one of the countries that face fraud in documentary credit transactions.<sup>109</sup> Common types of fraud experienced in Ethiopia are the issuance of forged bills of lading, insurance policies and commercial invoices.<sup>110</sup> The first instance is falsification of bills of lading while no goods are in fact shipped. In collusion with shipping companies, shippers and insurers forge cargo documents to receive payments in the credit while in fact no goods are actually shipped. The other instance is issuance of commercial invoices, cargo documents and insurance certificates for goods that are actually inferior in terms of their quality and quantity to what the documents have denoted. It also happens that, fraudulently, the same good is sold to two or more persons and the same cargo document is issued twice for the same merchandise.<sup>111</sup>

There are certain cases which have come to the public's attention. In this regard the experience of *Yeju Honey and Honey products Processor PLC (importer)* with the Indian exporter named, *Filtron Limited* is worth mentioning. The parties entered into an agreement in 2013 for machine design, production and installation with the price of €214,180.00 payable through irrevocable documentary credit.<sup>112</sup> However, in breach of the contractual obligation, the exporter delivered incompatible and second-hand machineries while it received the payment by submitting a forged bill of lading and commercial invoice documents. The attempt by the Ethiopian importer to enjoin the payment by requesting the issuing bank, CBE, was fruitless. Consequently, the Ethiopian importer incurred significant losses.<sup>113</sup> In another case, the Addis Fortune unveils a case of fraud in documentary credit. Lubar Industries, a local company, made contractual agreements with an Italian Company, SAFET SPA, for delivery of wire-making machines. Lubar opened documentary credit for the payment. Unfortunately, the SAFET SPA delivered defective products that do not fit the contractual

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<sup>108</sup> Yewondwossen, M., 'The role of National Bank of Ethiopia in foreign currency allocation', *The Ethiopian Herald*, Vol. 6, (2015), p.23

<sup>109</sup> Israel, *Introduction and Regulation of Electronic Bill of Lading in Ethiopia*, *supra* note 106, p. 52

<sup>110</sup> Interview with Melaku Mekonnen, Manager of Legal Service Division at Ethiopian Shipping and Logistics Services Enterprise, (4 April 2018)

<sup>111</sup> *Ibid.*

<sup>112</sup> Interview with Tegegn Zergawu, Former Legal Compliance Expert, Tired Corporate, (8 April 2018)

<sup>113</sup> *Ibid.*

terms. Lubar's action to enjoin the seller's payment under the credit for breach of the underlying contract was futile.<sup>114</sup>

A key informant also mentioned a case that involves fraud in documentary credit. An Ethiopian importer entered into a contract with an Exporter residing in China. They agreed that the exporter would deliver a fiber silk and the importer in return will open an irrevocable documentary credit for the payment. Accordingly, CBE issued documentary credit at the request of the importer. The exporter, however, provided false documents to the bank showing that the required fiber silk was shipped. In fact, it was not the fiber silk, but instead it was crushed stone. The importer's effort to enjoin the payment claiming forgery in the transaction was unsuccessful. Consequently, criminal investigations were made against the Chinese export suspecting fraud in documentary credit. The Ethiopian importer was also under investigation suspecting its participation in the fraud and illegally expatriating foreign currency. However, the case against the importer was closed for lack of sufficient evidence while the case against the exporter continues in collaboration with the Chinese Government.<sup>115</sup>

The Reporter also reported a case of forgery of documentary credit to unduly transfer money. Defendants named *Micheal Maston* and *Aimen Abdela* were charged by the prosecutor for forgery of documentary credit. The defendants allegedly prepared overvalued forged bills of lading and commercial invoices for payment in the credit. With the use of these forged documents they unduly derived 62.3 million birr from CBE.<sup>116</sup> It is also reported that a significant amount of money was fraudulently taken from CBE, Development Bank, Dashen Bank, Abyssinia, Awash and Wegagen banks by opening counterfeit documentary credits for imports that never made it to the country.<sup>117</sup>

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<sup>114</sup> Fasika Tadesse, Central Bank Blacklists Italian Machinery Supplier, *Addis Fortune*, Vol. 20 , No. 1005, (3 August, 2019)

<sup>115</sup> Interview with Sifa Tamrat, Economic Crimes Public Prosecutor, the Federal General Public Prosecutor, (25 December, 2019)

<sup>116</sup> The Reporter, *Two Foreigners Charged with Forex Fraud*, available at <<http://archiveenglish.thereporterethiopia.com/content/two-foreigners-charged-forex-fraud>> last accessed on 19 May, 2018

<sup>117</sup> The Daily Monitor (Addis Ababa), *Ethiopia: About 56 million birr embezzled from banks in the past three years*, available at, <<https://allafrica.com/stories/200004040045.html>> last accessed on 10 January, 2020. The case gives as a lesson that banks can be a victim of fraud in documentary credit transactions. In the given cases, the whole documents were forged, drawn against non-existent import/export transactions.



There are also several cases where the forgery of documents is involved in documentary credit transactions by preparing over invoiced imports and under invoiced exports in order to unduly obtain excessive foreign exchanges and avoid tax liabilities respectively.<sup>118</sup> This problem is noticed by the public authorities of NBE, Ministry of Revenue and the Ministry of Trade. They established a joint task force to verify the actual approved documentary credit and the value of imported items.<sup>119</sup>

As discussed earlier, UCP from its inception in 1929 to its latest version of UCP600 did not incorporate fraud exception rules. It is the perception of the ICC that, the matter should be handled by national laws.<sup>120</sup> Accordingly, several jurisdictions adopted fraud exception rules.<sup>121</sup> Unfortunately, Ethiopia neither enacted fraud exception rules in the form of proclamation, regulation nor directives. Nor does the existing legal framework and court practice address the problem. The Commercial Code incorporates nine provisions only, from Articles 959 to 967, which more or less deal with the principle of independence, the principle of strict compliance, the concept of revocable and irrevocable credit and the respective rights and obligations of the issuing and confirming banks. No provision is incorporated which deals with the issue of fraud exception. Due to this, banks are not willing to enjoin payment even though fraud in the credit is established. They usually justify this because they do not have a statutory mandate and obligation to do so and they do not want to compromise their reputation in international commerce by engaging in such activities.<sup>122</sup> Besides, they argue if banks are required to check whether the documents presented by the beneficiary are forged or not, it will be against the expeditious payment which the nature of commercial transactions and banking business require most.<sup>123</sup>

However, to the contrary, the absence of rules that resolve disputes related to fraud under documentary credit transactions lefts with three undesirable options. The first one is to totally avoid the concept of fraud exception and stick to the independence features of documentary credit as mentioned under

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<sup>118</sup> Eyader Teshome, Legal and Regulatory Issues of Ethiopian Currency (Foreign) Exchange Regime and Transactions, LLM Thesis, Bahir Dar University, School of Law, (2017), p. 97

<sup>119</sup> *Ibid.*

<sup>120</sup> Zsuzsanna, *Documentary Credits in International Commercial Transactions*, *supra* note 12, p. 144

<sup>121</sup> Hamed, *Documentary Letters of Credit*, *supra* note 1, p. 111

<sup>122</sup> Interview with Aster Alemu, Customers Relation Officer of Trade Service, Commercial Bank of Ethiopia, (2 April, 2018)

<sup>123</sup> *Ibid.*

Articles 959 and 960 of the Commercial Code. In the case *Ethiopian Grain Trade Enterprise v. Commercial Bank of Ethiopia* the Court stuck to the independence rule enshrined under Article 959(2) and 4(a) of the Commercial Code and the UCP500 respectively and rejected the arguments, made by the applicant, based on fraud exception.<sup>124</sup> However, this should not be considered as an appropriate choice as it will result in injustice against the innocent party who receives nothing, though the party performed the contractual obligation dully and effectively. It may also create undesirable consequences of system-protected fraudsters and abuse of the credit. The credit will be under the exclusive mercy of the seller that it will be his undue choice to collect his duty honestly by performing the contractual obligations or by simply forging documents.

The other option is to resort to the contract law. Article 1731 of the Civil Code dictates contractual agreements shall be binding on the parties as though they were law. In addition, Article 1745 of the Code requires the seller to perform its obligation(s) in accordance with the contract. In the provisions of the law of sales, enshrined under the Civil Code, the seller is required to guarantee the conformity of the goods as stipulated in the contract. In addition, he should also assure the goods are free from defect.<sup>125</sup> Pursuant to Article 2288 of the Code, the goods shall not be deemed to conform to the contract where the seller delivered to the buyer a thing different from that provided in the contract, or a thing of a different species.

If the seller prepares forged documents for payment while he ships defective goods or ships nothing at all, there comes a breach of the underlying contract. At this juncture, the innocent party can resort to the relevant provisions of the Civil Code to obtain a remedy by invoking a breach of contract. As a result, the party can claim forced performance,<sup>126</sup> purchase in replacement,<sup>127</sup> or cancellation of the contract.<sup>128</sup> Finally, apart from or in addition to other remedies, the buyer has the right to claim compensation for

<sup>124</sup> የኢትዮጵያ አህል ንግድ ደርጅት vs. የኢትዮጵያ ንግድ ባንክ፣ የፌዴራል ጠቅላይ ፍርድ ቤት፣ ሠ.ቁ. 10049፣ 2008 ዓ.ም

<sup>125</sup> The Civil Code of Ethiopia, *supra* note 98, Article 2287

<sup>126</sup> *Id.*, Articles 1771(1), 1790, 2329

<sup>127</sup> *Id.*, Article 2330

<sup>128</sup> *Id.*, Articles 1771(1), 1790 and 2336

damage caused to him by the other party who failed to perform his obligation.<sup>129</sup>

In general, this option focuses on bringing a law suit based on the underlying contract, rather than focus on enjoining the payment in the credit. This option, however, is not appropriate or advisable. Because the concept of fraud exception is required to enjoin payment of the fraudulent seller in the credit before he is actually paid by the bank. In other words, if the fraudulent seller is paid by the authorized bank, despite the fraudulent acts, the issue of fraud exception will be over. It will be very difficult and onerous for the innocent party to bring a suit based on the underlying contract when the parties' are residents in different jurisdictions that are very distant and have different legal systems, languages, political land-scape and other issues. Hence, by no means can it be taken as a substitute for fraud exception rules. It is, rather, the typical way of securing contractual rights. When it is seen in light of the underlying contract accompanied by documentary credit payment, it will have a message of pay now in the documentary credit and sue later based on the underlying contract.

Apart from the civil remedies, one can seek remedy under the Ethiopian Criminal Law. Article 375 through 390 of the FDRE Criminal Code makes it clear that forging documents with intent to injure the rights or interests of another, or to obtain for himself or to procure for another any undue right or advantage is punishable ranging from simple imprisonment and fine to 25 years rigorous imprisonment, which varies depending on the type of forgeries or counterfeits involved. The Criminal Code, also, outlawed any acts of falsification or alteration of goods.<sup>130</sup> If the person is found guilty, the bank can stop the payment and deny the beneficiary as it would be a fruit of criminal acts.<sup>131</sup> It basically emanates from the underlying principle of justice, "no man shall profit from his wrong."<sup>132</sup> In a criminal case *Public Prosecutor vs. Sergio Demi*, the latter was found guilty for a concurrent crime of use of forged instruments and goods in an export transaction

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<sup>129</sup> *Id*, Articles 1771(2), 1790(1) and 2360

<sup>130</sup> The FDRE Criminal Code, *supra* note 100, Articles 391-395

<sup>131</sup> *Id*, Article 98

<sup>132</sup> John W. Van Doren, Theories of Professors H.L. A. Hart and Ronald Dworkin - A Critique, *Cleveland State Law Review*, Vol. Issue 2, (1980), p. 297

involving documentary credit. The defendant was sentenced for 15 years rigorous imprisonment.<sup>133</sup>

At this juncture, it has to be noted that the criminal remedy is independent of the civil one (fraud exception rule); hence, they should not be taken as a substitute for one another. The parties to the cases, the required standard of proof, the available remedies and the objectives behind the remedies sought are entirely different in civil and criminal cases. Therefore, existence of a criminal remedy in the FDRE Criminal Code should not be taken as an excuse for failure to have fraud exception rules.

In general, resorting to the laws of sale contract or the criminal law cannot sufficiently redress the problems of documentary credit fraud. Thus, Ethiopia needs to enact the fraud exception rule. First, Ethiopia needs to close the existing loopholes. It is known that documentary credit does not concern the underlying contract(s). This, obviously, will create a loophole for fraudsters to abuse the system and receive undue benefits. Enacting a fraud rule will shrink the loopholes under documentary credit and it will, at least, minimize the enormity.

Second, there are public policy reasons for controlling fraud. The government, as a responsible organ to correct and suppress acts which can distort the economy of the country, shall enact laws to halt fraud. No one should benefit from his or her wrong. Therefore, those involved in fraudulent activities should not be incentivized; rather they should be penalized, be it civilly or criminally.

The last, but not the least, reason to enact the fraud exception rule is to maintain the utility of documentary credit. Fraud does not only violate public policy, but it also poses a serious threat against the utility of the credit.<sup>134</sup> The utility of documentary credit highly depends on the fact that it will provide a fair and balanced treatment of the interests for both of the parties.<sup>135</sup> The fraud exception rule is needed to suppress fraudsters, thereby, encouraging others to use documentary credit that in turn will increase its credibility in the import and export transactions of Ethiopia.

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<sup>133</sup> Interview with Sifa Tamrat, Economic Crimes Public Prosecutor, Federal General Public Prosecutor, (25 December, 2019)

<sup>134</sup> Ross and Xiang, *The Development of the Fraud Rule in Letter of Credit Law*, *supra* note 29, p. 666

<sup>135</sup> *Ibid.*

## **Conclusion and Recommendations**

Documentary credit accompanied by one of its governing principles, the principle of autonomy, provides a secure mode of payment in international trade. Similar to the experience of other countries, the principle is enshrined under the Commercial Code of Ethiopia. The principle makes documentary credit independent from any other contracts accompanying it. Thus, payment in the credit is confined to the documents presented and not on the terms specified in the underlying contract or the goods actually shipped. This principle no doubt promotes the smooth operation of documentary credit. However, the absolute separation of the credit from the sale or other contract on which it may be based creates ample opportunities for fraudsters to abuse the system.

Fraud in documentary credit is committed against banks, importers, exporters and the carriers of cargo. Common types of frauds experienced in Ethiopia and the world are falsification of bills of lading, insurance documents and commercial invoices to receive payments in the credit while they ship defective goods or ship nothing at all. It also happens that, the same good is sold to two or more persons and the same cargo documents are issued twice for the same merchandise with the intent to procure undue advantages. However, the international instruments of documentary credit do not recognize fraud exception rules. As stated by the drafters of the instruments, a fraud exception should be regulated by domestic laws. Due to that, countries develop a fraud exception rule. In this regard, the U.S. and the UK are pioneers. However in Ethiopia, the existing laws of the country do not address the problem nor do specific fraud exception rules exist in any form. Thus, the author recommends revision of the existing independent principle of the credit and incorporating a fraud exception rule. Enacting such a rule will help the government to close the loophole, control fraudsters and consequently maintain the utility of the instrument in the country's international transaction.

In crafting such a law, Ethiopia should take a lesson from the experiences of the U.S. and the UK, which have advanced fraud exception rules transplanted across several jurisdictions. Accordingly, the fraud exception rule should be crafted in such a way that ensures equilibrium between autonomy of the credit and fighting fraudulent activities. It should not be too strict to release real fraud nor too loose to destroy the inherent nature of

autonomy of the credit. Thus, application of the fraud exception rule should be upon existence of clear and cogent evidence that shows involvement of material fraud in the transaction. No injunction (provisional or permanent) should be given by a court or a bank for mere suspicions or allegations made by one of the parties. It rather should be satisfied that the evidences submitted are clear and convincing. Besides, the fraudulent act should be significant to the participants in the transaction. Any fraudulent act which has insubstantial or immaterial effect to the participants of the transaction should be disregarded. Moreover, it should ensure that the fraud exception rule will not affect the rights of a holder of due course or a person with similar status. There should be an exception that precludes application of the rule, despite existence of material fraud, against a person who is not involved in the fraud and has given value, in good faith, for the credit. However, sometimes it might be difficult to prove existence of material fraud, despite its involvement in the transaction. To minimize the effects of such an unfortunate situation, the law should require the beneficiary to warrant that there is no forgery in the transaction and the drawing does not violate any agreement between the applicant and the beneficiary.

assuring compliance of the documents submitted and not goods actually shipped to the importer.<sup>9</sup> However, with the growing use of documentary credit in Ethiopia and elsewhere in the world, it has become an area of litigation over the extent of the independence of the credit from the underlying contract especially with regard to fraud. The fraudulent seller may forge documents to receive payment while he sends rubbish items or shipped nothing at all. Thus, the underlying purpose of this article is to identify the extent of recognition of the governing principle of the doctrine of autonomy and the fraud exception in the Ethiopian legal framework in light of the international trend.

In analyzing the subject matter, the author consulted the Uniform Customs and Practices for Documentary Credits 600 (hereinafter UCP600) and the experiences of the U.S. and the UK. The UCP600 is chosen because of its worldwide application in documentary credit transactions.<sup>10</sup>

The experience of the U.S. and the UK are chosen for various reasons. First, even though the Commercial Code of Ethiopia has been predominantly adopted from the European continental legal system, the provisions dealing with documentary credit are directly copied from the 1951 version of the UCP,<sup>11</sup> which is also known to have influenced the documentary credit customs and practices of the U.S. and the UK.<sup>12</sup> Second, the U.S. has advanced statutory and judicial documentary credit rules which are transplanted both to common law and civil jurisdictions, and the UK law somehow follows the U.S. law.<sup>13</sup> Third, considering that they have an

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<sup>9</sup> Lu Lu, *The Exceptions In Documentary Credits In English Law*, PHD Dissertation, The University of Plymouth, Plymouth Law School, Faculty of Business, (2011), p. 34

<sup>10</sup> Svitlana Berezna, *Trade Customs, Usages and Practices: General Value and Application of the UCP600 in Particular Value and Application of the UCP600 in Particular*, Masters Dissertation, Ghent University, (2012), p. 21

<sup>11</sup> Tilahun Teshome *et al.*, *Position of the Business Community on the Revision of the Commercial Code*, Addis Ababa Chamber of Commerce and Sectoral Associations, Addis Abeba, 2008, p. 79, [hereinafter Tilahun *et al.*, *Position of the Business Community*]. The 1951 UCP is neither the first nor the latest version. The first version of the UCP was introduced by the ICC in its 1929 congress held in Amsterdam. Later on, it is followed by several revisions in 1933, 1951, 1962, 1974, 1984, 1994 and finally in 2007.

<sup>12</sup> Zsuzsanna Tóth, *Documentary Credits in International Commercial Transactions with Special Focus on the Fraud Rule*, PHD Dissertation, Pázmány Péter Catholic University, Faculty of Law and Political Sciences, (2006), p. 3, [hereinafter Zsuzsanna, *Documentary Credits in International Commercial Transactions*]

<sup>13</sup> Hamed Alavi, *Autonomy Principle and Fraud Exception in Documentary Letters of Credit, a Comparative Study between United States and England*, *ICLR*, Vol. 15, No. 2, (2015), p. 54 [hereinafter Hamed, *Autonomy Principle and Fraud Exception in Documentary Letters of Credit*]

important role in the practice of international trade involving documentary credits, it seems odd to ignore their system of documentary credits.<sup>14</sup>

The paper is divided into four parts. The first part provided a brief overview of the principle of autonomy and fraud exception in documentary credits. The second part is dedicated to appraisal of the autonomy principle and fraud exception in light of selected international experiences. In the third part, the Ethiopia approach to the issue of autonomy of documentary credit and fraud exceptions is explored. The fourth and final part ends up by providing conclusion and recommendations.

### **1. The Principle of Autonomy and Fraud Exception: An Overview**

Documentary credit is an arrangement in which the issuing bank, at the request and in accordance with the instruction of the applicant, undertakes to pay a beneficiary or reimburse the paying bank against the presentation of documents and satisfactory compliance with the terms and conditions stipulated therein.<sup>15</sup> There are at least three contracting parties involved in documentary credit transactions.<sup>16</sup> The first party is the applicant, the buyer in the international trade that instructs the credit to be issued.<sup>17</sup> The second party in the documentary credit transaction is the beneficiary, the seller in whose favor the credit is issued.<sup>18</sup> The third party is an issuing bank where it is usually referred to as the buyer's bank. The bank issues the credit at the instruction of the buyer and undertakes to honor a draft or other demand for payment made by the beneficiary or to his order.<sup>19</sup> At times there may be a fourth party involved in the transaction as the corresponding bank. It is usually referred to as the seller's bank and undertakes to advise and/or honor presentation of the beneficiary.<sup>20</sup>

Depending on the parties' interests, documentary credit can be issued in different forms (having different legal consequences) such as revocable

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<sup>14</sup> *Id.*, p. 47

<sup>15</sup> Jacqueline, *Documentary Credit Law and Practice*, p. 1973, *supra* note 7

<sup>16</sup> Franck Chantayan, Choice of Law Under Revised Article 5 of the Uniform Commercial Code--§ 5-116, *Journal of Civil Rights and Economic Development*, Vol. 14, Issue 2, (1999), p. 201

<sup>17</sup> *Ibid.*

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*



credit, irrevocable credit, transferable credit and acceptance credit.<sup>21</sup> Irrespective of its form, the paying bank's obligation to pay (be it the issuing or the corresponding bank) arises out of the presentation of conforming documents, not on conforming performances in the sale or other contract on which it may be based. The documentary credit transaction is essentially independent of the underlying transaction(s). This characteristic of documentary credits is known as the autonomy principle.<sup>22</sup> The word autonomy originates from a Greek word called "*autonomia*" which means 'independent.'<sup>23</sup> The word in the context of documentary credit has a meaning of the credit being independent of the underlying contract, the payment under the credit is solely dependent on the presentation of complying documents, the role of the bank towards the credit is restricted only to check compliance of the documents to the terms and conditions of the credit and the like.<sup>24</sup>

In earlier times, there was no conflict of the independence of documentary credit as it was customarily accepted by traders and bankers that the main determinant factor for compliance of the contract is the goods or services specified under the contract.<sup>25</sup> Hence, banks were used to check the conformity of the goods or services as stated in the underlying contract.<sup>26</sup> However, the trend cannot go further due to sophistication and complication of trades across national boundaries.<sup>27</sup> Thus, recognition of the principle of autonomy of the credit developed as a matter of desperate choice.

The principle creates distinction between documentary credit and other contracts accompanying it such as the underlying contract between the buyer and the seller, and a credit agreement between the bank and the applicant.<sup>28</sup> The principle makes the obligation of the issuing bank independent from the

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<sup>21</sup> Susmitha P Mallaya, *Documentary Credit Law: An Indian Perspective*, PHD Dissertation, Cochin University of Science and Technology, School of Legal Studies, (2007), p. 13, [hereinafter Susmitha, *Documentary Credit Law*]

<sup>22</sup> Felicity Monteiro, *Documentary Credits: The Autonomy Principle and the Fraud Exception: A Comparative Analysis of Common Law Approaches and Suggestions for New Zealand*, *Auckland University Law Review*, P. 146 [hereinafter Felicity, *The Autonomy Principle and the Fraud Exception*]

<sup>23</sup> Rosmawani *et al*, *Principle of Autonomy in Letter of Credit*, *supra* note 8, p. 205

<sup>24</sup> *Ibid.*

<sup>25</sup> *Ibid.*, see also Harfield, Henry, *The Increasing Domestic Use of the Letter of Credit*, 4 *Uniform Commercial Code Law Journal* (1972), p. 251

<sup>26</sup> *Ibid.*

<sup>27</sup> *Id.*, p. 206

<sup>28</sup> Garth, *Legal and Practice Perspective on Documentary Credit*, *supra* note 6, p. 45

underlying contract.<sup>29</sup> It is considered as the foundation for the smooth operation of documentary credit in today's complicated international transactions by several scholars.<sup>30</sup> Felicity noted that the utility of documentary credit is contingent upon its inherent autonomy from the underlying transactions.<sup>31</sup> It is a foundation for allocating entitlements and liabilities of parties involved in documentary credit transactions.<sup>32</sup> Accordingly, the seller will be paid by the issuing bank provided that the former present complying documents. The issuer, in turn, will be reimbursed by the applicant or it may exercise its right of recourse against the applicant. The applicant does not have a right of recourse against the issuer for breach of the underlying contract by seller. The bank as a paying agent should not be held responsible for inspection of the actual goods or services delivered to the buyer as it would not be feasible and will cause unnecessary delay.<sup>33</sup>

However, the autonomy principle sometimes may cause unfair results as it imposes an obligation on the bank to honor the credit notwithstanding an alleged or actual fraud in the required documents or the underlying contract.<sup>34</sup> The doctrine of autonomy of documentary credit presupposes the beneficiary and the bank to honor their respective obligations with trust, commitment and professional integrity. However, good business conducts are eroded and the old assumption of 'the hand shake settles the deal' proves

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<sup>29</sup> Ross P. Buckley & Xiang Gao, *The Development of the Fraud Rule in Letter of Credit Law: The Journey So Far and the Road Ahead*, *Penn law journals, U. Pa. J. Int'l L.*, Vol. 23, Issue 4, (2002), p.663, [hereinafter Ross and Xiang, *The Development of the Fraud Rule in Letter of Credit Law*]

<sup>30</sup> Roberto refers it as a "cornerstone" principle for documentary credit operations (see Roberto Luis, *The Autonomy Principle of Letters of Credit*, *Mexican Law Review*, Vol. III, No. 1, (2009), p.75, [hereinafter Roberto, *The Autonomy Principle of Letters of Credit*]). Gao and Ross also refers it as a "foundation" for documentary credit operations (see Gao Xiang & Ross P. Buckley, *The Unique Jurisprudence of LCs: Its Origin and Sources*, *San Diego Int'l Law J.*, Vol. 4, No. 9, (2003), p.119). Dolan, in turn, argues the principle of autonomy is the backbone for documentary credit operations (see Dolan J.F, *The Law of Letters of Credit: Commercial and Standby Credits*, 4th Edition, Warren, Gorham & Lamont, USA, (1996), p. 480)

<sup>31</sup> Felicity, *The Autonomy Principle and the Fraud Exception*, *supra* note 22, P. 144

<sup>32</sup> Roberto, *The Autonomy Principle of Letters of Credit*, *supra* note 30, p. 76

<sup>33</sup> Employees of the banks are not experts on the inspection of goods. They do not have the required qualification for inspecting the quality, quantity, content, substance, taste, smell or physical appearance of all types' of goods and services. It is hardly possible and uneconomical for bankers to employ hundreds of thousands of employees who have specialization in every goods and service. Due to this, banks only employ workers who are competent in checking documents' conformity towards the specification of the credit and the relevant regulatory rules.

<sup>34</sup> Nevin Meral, *The Fraud Exception in Documentary Credits: A Global Analysis*, *Ankara Bar Review*, issue 2, (2012), p. 44, [hereinafter Nevin, *The Fraud Exception in Documentary Credit*]

incompatible in today's business reality.<sup>35</sup> There occurs a frequent fraudulent act in documentary credit transactions.

The issue of fraud in relation to documentary credit transactions today is a universal phenomenon that threatens the credibility and effectiveness of the instrument.<sup>36</sup> Technological advancements that intended to enhance commercial transactions at the same time create an opportunity for fraudsters to easily manipulate the transactions. One writer explains, "L/C [letter of credit] fraud is not only widespread, [but] it is [also a] big business too, and its tentacles have spread throughout the world."<sup>37</sup> It has been reported that insurance companies cost millions of dollars each year due to maritime frauds.<sup>38</sup> Due to its undesirable effects, the learned judge Cresswell J describes it as "a cancer in the international trade."<sup>39</sup>

In the documentary credit, fraud refers to an action of misrepresentation of the truth, false making or concealment of a material fact in the credit or the underlying contract to induce the issuing bank (or confirming bank) to pay them or accept their draft.<sup>40</sup> It includes, but not limited to, the act of fraudulently making, completing, authenticating, issuing or transferring a false document or altering a real one to make the documents conform in their face to the terms and conditions of the credit. It is committed against importers, banks, exporters and the carriers of the cargo.<sup>41</sup> The UNCTAD report shows falsification of bill of lading, delivery of inferior goods, selling the same goods twice and issuing cargo documents twice for the same merchandise are the most frequent kinds of fraudulent activities in documentary credit transactions.<sup>42</sup>

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<sup>35</sup> *Ibid.*

<sup>36</sup> Chumah Amaefule, *The Exceptions to the Principle of Autonomy of Documentary Credits*, PHD Dissertation, University of Birmingham, School of Law, (2011), p.36, [hereinafter Chumah, *The Exceptions to the Principle of Autonomy of Documentary Credits*]

<sup>37</sup> Yanan Zhang, *Approaches to Resolving the International Documentary Letters of Credit Fraud Issue*, PhD Dissertation, University of Eastern Finland, (2015), p.21, [hereinafter Yanan, *Approaches to Resolving the International Documentary Letters of Credit Fraud Issue*]

<sup>38</sup> Tareq Al-Tawil, *Letter of Credit and Sale Contract: Autonomy and Fraud*, *International Trade and Business Law Review*, (2013), p. 183, [hereinafter Tareq, *Letter of Credit and Sale Contract*]

<sup>39</sup> *Standard Chartered Bank v Pakistan National Shipping Corporation and Others*, Queen's Bench Division (Commercial Court), 1 Lloyd's Rep. [April 1998] para. 684

<sup>40</sup> Tareq, *Letter of Credit and Sale Contract*, *supra* note 38, p. 183

<sup>41</sup> *Ibid.*

<sup>42</sup> UNCTAD report, UNCTAD secretariat, 'A Primer on New Techniques Used by the Sophisticated Financial Fraudsters with Special Reference to Commodity Market Instruments'

Prevalence of fraud in documentary credit transactions necessitates the development of an exception where the principle of autonomy can be pierced and fraud exception rules applied to suppress fraudsters and abuse of the credit.<sup>43</sup> As a result, the fraud exception has been established in all common law and many civil law countries.<sup>44</sup> Despite the fact that the fraud rule is recognized in several jurisdictions, it is still controversial over its necessity and the required standard of fraud to apply the rule.<sup>45</sup> Thus, it is important to consult the relevant international instruments and the experience of selected jurisdictions with a view to derive a lesson for Ethiopia.

## 2. The Autonomy Rules of Documentary Credit and Fraud Exception in Selected International Experiences

### 2.1. International Instruments

In the international arena, the International Chamber of Commerce (hereinafter ICC) published the UCP and its supplementary rules such as the Supplement to the Uniform Customs and Practice for Documentary Credit for Electronic Presentation (eUCP)<sup>46</sup> and the International Standard Banking Practice for the Examination of the Documents under Documentary Credits (ISBP)<sup>47</sup> to regulate documentary credit operations. The UCP is a product of the harmonization process of the ICC. It aims to facilitate the international trade and reduce conflicts, thereby, creating uniform documentary credit laws among different jurisdictions.<sup>48</sup>

The latest version of the UCP was adopted in 2007 as UCP600. It brought further improvements in the UCP and widely recognized as a business-

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(UNCTAD/DITC/COM/39), (2003), p. 7, available at

<[http://www.unctad.org/en/docs/ditcom39\\_en.pdf](http://www.unctad.org/en/docs/ditcom39_en.pdf)> last accessed 12 May 2018

<sup>43</sup> Hamed, *Autonomy Principle and Fraud Exception in Documentary Letters of Credit*, *supra* note 13, p.52

<sup>44</sup> *Ibid.*

<sup>45</sup> Nevin, *The Fraud Exception in Documentary Credit*, *supra* note 34, p. 45

<sup>46</sup> The Supplement to the Uniform Customs and Practice for Documentary Credit for Electronic Presentation, Vol.1, (2002), Article e1 [hereinafter eUCP]. The ICC introduced eUCP in 2002 to supplement UCP to accommodate the presentation of electronic records.

<sup>47</sup> It was introduced by the ICC in its meeting at Rome in October 2002 with a view to provide practical explanation for UCP on examination and rejection of documents under day to day Documentary credit operation of bankers. It is helpful for banks, insurance companies, logistic specialists, corporations and freight forwards. It has functions, among other things; explaining terms and conditions of the UCP, specification of elements which are not addressed under the UCP, management of errors in the documents and preparation of insurance documents

<sup>48</sup> Hamed, *Documentary Letters of Credit*, *supra* note 1, p. 111

friendly international documentary credit rule.<sup>49</sup> The rule regulated the autonomy of documentary credit under Article 4 and 5.

Article 4(a) of the rule reads;

[a] credit by its nature is a separate transaction from the sale or other contracts on which it may be based. Banks are in no way concerned with or bound by such contracts, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honor, to negotiate or to fulfill any other obligation under the credit is not subject to claims or defenses by the applicant resulting from its relationships with the issuing bank or the beneficiary.

It isolates the credit from any contract which might exist between the applicant and the issuing bank. Thus, any dispute arising out of such contracts will not affect the credit. Article 5 of the rule further emphasized the effect of the principle on the role of the banks by stating, “[b]anks deal with documents and not with goods, services or performance to which the documents may rely.” The second limb of Article 4(a) of the rule strengthens the principle that the “beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank.”

The rule further sanctions the principle under Article 4(b) by discouraging any attempt to include, as an integral part of the credit, copies of the underlying contract, pro forma invoice and the like.

The rule takes a serious stand on the autonomy of documentary credit. As can be seen from the above provisions it provides detailed regulatory rules for the subject matter at hand. The main idea behind these provisions is making a wall between documentary credit and other contacts between the buyer and the seller or a credit agreement between the applicant and the issuer. It gives a special emphasis on putting a visible demarcation between the underlying contract and documentary credit. It is to make sure that the former should not intercept in the operation of the latter. As a result, banks will deal with documents as per the terms and conditions of the credit. It does not have any responsibility for inspecting the goods or services to which the documents may rely. Nor can the beneficiary avail himself the

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<sup>49</sup> Reduction of unnecessary provisions, clarifications of some sensitive terms under the instrument, exclusion of revocable documentary credit from its ambit, clarification on the scope of examination and rejection of documents by bankers are some of the improvements made under the latest version.