The Law Applicable to Letters of Credit – why it matters to the trade finance gap problem

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Access to trade finance is key to international trade. A negative legacy from the 2009 global economic crisis has been the emergence of a significant trade finance gap – that means traders, especially small medium sized enterprises, are finding it difficult to access credit support by means of a letter of credit to export or import goods. For example, the Asian Development Bank (ADB) found that the trade finance gap for 2019 had remained at around $1.5 trillion, with nearly 60% of respondents expecting the gap to increase over the next two years.[1] Two years on, worse was yet to come. Following the pandemic, private trade finance provision,[2] a key mechanism being the letter of credit, quickly dried up. As the Organisation for Economic Development (OECD) reported, there was no cushioning from public trade finance provision[3] which did not materialise as quickly or in same volume to plug the worsening gap.[4]

There are several reasons to explain the emergence of this alarming gap.[5] This article will not be revisiting those regulatory, systemic and legal factors but will touch on a matter which, in no small way, constitutes a dampener to the provision and access to private trade finance. It has been reported that around 56% of first tenders under an import letter of credit were

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[1] Asian Development Bank, 'Trade Finance Gaps, Growth and Jobs Survey 2019' <http://dx.doi.org/10.22617/BRF190389-2>.

[2] For a definition of private trade finance, see below at p …

[3] For a definition of public trade finance, see below at p …

[4] OECD Policy Response, 'Trade Finance in the COVID era: Current and future challenges'' (March 2021).

[5] See J Chuah, 'Confronting the Trade Finance Gap: Legal and Policy Considerations' (2021) 4 Int TLR 231.

refused payment because of documentary discrepancies.[6] A number of these disputes over refusal of anomalous payment are likely to be taken to litigation or arbitration.[7] An important attendant issue is thus the matter of choice of law, given the highly internationalised system of documentary credits.

The research question posed in this article is to what extent the provisions of the EU rules on the applicable law of contracts, as contained in the Rome I Regulation, apply to letters of credit and what are the likely the implications for the practical use of letters of credit, globally. It is also to be tested whether and to what degree these provisions reflect and conform to commercial realities. To that end, this article will adopt largely a doctrinal enquiry assessing the scope and interpretations given to those provisions. Where appropriate, a comparison with other systems of private international law applicable to the letter of credit, for example the US Uniform Commercial Code (UCC), would also be undertaken. Section 5 of the UCC makes express provision for the determination of the applicable law of a letter of credit. In contrast, the Rome I Regulation envisages that its general rules would apply – there is no special regime for letters of credit. A study of the English approach would also be relevant, despite the UK's withdrawal from the EU, as the English courts had had occasion to address the matter of applicable law of letters of credit under the Rome[8] regime, the substantive rules[9] of which the UK continues to apply. The overarching paradigm is

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[6] ICC Report on findings of ICC-ADB Register on Trade & Finance (Document 470/1147 (Rev); 21 September 2010) p. 10 <https://iccwbo.org/content/uploads/sites/3/2010/09/ICC-Register-Report_September-2010.pdf>. This is an influential research looking at a sample of 1,033,367 transactions between 2005-2009.

[7] From the size of the sample (see above fn 6), it can only be guessed how many of these rejections would lead to legal disputes.

[8] The Rome Convention on the law applicable to contractual obligations (consolidated version) (Official Journal C 027, 26/01/1998 P. 0034) followed by the Rome I Regulation (Regulation 593/2008 on the Law Applicable to Contractual Obligations)

[9] The UK Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc.) (EU Exit) Regulations 2019 were approved by Parliament in February 2019. Those Regulations state that the UK will continue to apply the rules set out in the Rome I and Rome II EU Regulations. The UK Regulations do make for some minor exceptions because of the UK's change in status following Brexit, for example in the case

essentially this – the matter of efficient and effective use of letters of credit as a form of trade finance is crucial to international trade and development across the world and it should follow thus that a choice of law system should be supportive of such an important international financing tool.

The aspects of the applicable law in respect of tort, delict and restitution claims arising from the use of letters of credit fall outside the scope of this article.[10] The reason, other than space, is the fact that by far letter of credit disputes concern contractual undertakings.

For completeness, it should also be pointed out that the UN Convention on Independent Guarantees and Standby Letters of Credit 1995[11] which does contain a reference to how the applicable law of the guarantee is to be ascertained is unhelpful for conventional letters of credit.[12] That is because an independent guarantee (including a standby letter of credit) seldom entails confirmation, nomination and acceptance by third party banks. A conventional letter of credit is multipartite in its execution and structure, unlike an independent guarantee. As a pure and simple bilateral undertaking, the choice of law question, whether determined by the Rome system or the 1995 UN Convention or indeed most systems of choice of law, is relatively straightforward. Of course, the Convention with its critics in respect of other provisions is not in force in most parts of Europe.[13] Its importance and relevance to conventional letters of credit are thus questionable.

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of non-derogable mandatory rules or certain insurance contracts. These exceptions are, however, not relevant to the discussion in question.

[10] For a good coverage of those issues, see A Markstein, 'The Law Applicable to Letters of credit' (2010) Auckland University Law Review 7. Markstein also addresses the matter of how absence of choice in the letter of credit might be addressed. The work proceeded on the basis that the Rome system applied to letters of credit.

[11] With very few ratifications.

[12] See Arts 21 and 22 which essentially provide that an express choice in the guarantee will prevail, whereupon there is no choice of law, the law will be of the state where the guarantor/ issuer has that place of business at which the undertaking was issued. The Convention might be criticised for lack of certainty in that the term 'state'' is used. Where a state has several constituent territorial units with different legal systems (such as federated state (such as Germany or the USA), or a union of several countries (such as the UK)), the convention does not specify explicitly what is meant by 'state''. Article 6 on definitions is silent.

[13] Other than Belarus which ratified it in 2002.

Definitions and workings of the letter of credit

Broadly speaking, trade finance is taken by the international trade communities to mean:

- Short term financing (often not exceeding one year) which is essentially linked to the import and export of goods.
- The financing usually provided by banks, though in some countries, also by state backed export credit agencies, development banks, etc.

Usefully, the Bank of International Settlements provides this description. It stresses that trade finance should serve two purposes:

- To provide working capital tied to and in support of international trade transactions, and/or
- To provide a means to reduce payment risk.[14]

As already alluded to, a very common and important trade finance product offered by the banks is the letter of credit. This is a bank-backed undertaking to pay the exporter simply upon the exporter's tendering of 'conforming' shipping and trade documents. Conforming documents are those required by the bank which show on their face that the underlying contract of sale had been properly performed.[15] The financing bank is not interested in the actual performance of the underlying contract of sale – merely that the shipping and commercial documents required[16] should show on their face satisfactory performance of the trading contract. This is known as the *principle of autonomy*. That principle is endorsed[17] by the Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 (hereafter referred to as 'UCP 600'), a set of harmonised rules developed by the International Chamber of Commerce.[18]

A typical letter of credit arrangement would follow the procedure described below.

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[14] BIS CGFS Papers No 50 January 2014, p 1 <https://www.bis.org/publ/cgfs50.pdf>.

[15] ICC Uniform Customs and Practice for Documentary Credits Publication no 600 (2007), Art 4.

[16] These documents could include the bill of lading, the commercial invoice, the insurance policy or certificate, certificates of quality, certificate of origin, shipping lists, etc.

[17] Article 4, UCP 600.

[18] Although not a law, the UCP 600 has both contractual force (having been conventionally incorporated into letters of credit) and normative force (as reflecting standard international banking procedures and practices).

The documentary credit system was established to overcome those challenges of working capital and risk allocation in international trade.[19] It works like this:

(a) The buyer (applicant) will apply to its bank (issuing bank) to open a letter of credit in the seller's favour. What this means is that the issuing bank undertakes to pay the seller directly and as soon as the seller tenders relevant shipping documents showing that the goods have been shipped to the buyer. The issuing bank's commitment to pay is separate and distinct from that of the buyer so that even if the buyer becomes insolvent, the issuing bank has to pay the seller if the requisite documents are properly tendered by the seller.

(b) The issuing bank will then inform the seller that the letter of credit has been opened in his favour. Usually this is done through a nominated bank in the seller's jurisdiction – the bank doing this is called the advising bank. The letter of credit may also be confirmed by the seller's own bank (a confirming bank) – this is the independent undertaking of the confirming bank to pay against conforming documents. If it pays, it will seek reimbursement from the issuing bank. However, its undertaking is separate from that of the issuing bank – so that if the issuing bank becomes insolvent, the confirming bank must still necessarily pay against conforming documents.

(c) The advice to the seller will specify the documents required (for example, a bill of lading, any insurance document relating to the goods, official certificates, licences, etc), the time for presentment and the expiry date of the letter of credit.

(d) The seller ships the goods and in return is given shipping documents (usually the bill of lading) by the carrier. The seller will then assemble all the documents required under the letter of credit and tender them to the issuing bank or its nominated bank.

(e) If the documents are in order, that is to say, if they are consistent with the terms of the letter of credit, the relevant bank (issuing bank or confirming bank or nominated bank) would pay the seller. This payment, though less common in modern day, *may* take the form of acceptance or negotiation of a bill of exchange.

(f) The confirming bank (where applicable) will then present the documents to the issuing bank for reimbursement. The issuing bank in turn will present the documents to the buyer for payment. The buyer pays and is given the documents. With the documents (especially the bill

[19] Supra fn 14.

of lading), the buyer is able to meet the ship carrying the goods and demand delivery of the goods.[20]

As is immediately obvious the contractual commitment by any of the relevant banks to pay against conforming documents is in some instances autonomous and is not dependent on the original commitment by the issuing bank or indeed the buyer. Secondly, the duty to pay might take place at different countries or electronically. That adds a level of complexity to the process. Thirdly, the duties are often back-to-back – a paying bank is entitled to seek reimbursement from the confirming or issuing banks. Fourthly, the letter of credit is sometimes accompanied by a bill of exchange calling to be paid against or accepted. The bill of exchange, as recognised internationally, is an independent payment vehicle.[21] The net result is that there are in tension possibly four different legal instruments – the underlying international sale contract, the letter of credit, the confirmation of the letter of credit and a bill of exchange. That is the complex commercial backdrop against which this work will set the ensuing discussion on the legal rules addressing the applicable law of the letter of credit.

The Rome I – Applicability to letters of credit

In the EU, matters relating to the choice of law in contracts are largely governed by Regulation 593/2008 on the Law Applicable to Contractual Obligations (Rome I). There is dispute in certain common law jurisdictions as to whether a letter of credit is a contract,

[20] See generally M Furmston and J Chuah, *Commercial Law* (2nd edn, Pearson 2013) Chapter 6.

[21] Article 3(1) of the UN Convention on International Bills of Exchange and International Promissory Notes 1988 for example provides that a bill of exchange is a written instrument which: (a) Contains an unconditional order whereby the drawer directs the drawee to pay a definite sum of money to the payee or to his order (b) is payable on demand or at definite time; and (c) is dated and (d) is signed the drawer. Articles 28-30 provide largely for the autonomy of the bill of exchange, limiting the defences for dishonour strictly.

properly so-called.[22] The matter too has reared its head in civilian systems[23]. In this vein, it is noteworthy that the UCP 600 does not actually refer to the letter of credit as a contract. Article 2 simply asserts that a 'credit' is 'any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation'.

That said, the Rome I Regulation does not seek to adopt an especially legalistic and formalist interpretation of the term 'contractual obligations'. Recital 7 of the Preamble to the Regulation specifically ties the substantive scope and the provisions of Rome I to the Brussels Recast Regulation 1215/2012 on civil and commercial jurisdiction. In the context of the Brussels Recast Regulation and its former guises,[24] it is often stressed that an autonomous reading should be applied to the concept of 'contractual'. Its meaning should thus be uniform across the EU and independent from the national laws of the Member States.[25] The ECJ has consistently ruled that contractual obligations broadly encompass '… legal obligations freely consented to by one person towards another'.[26]

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[22] See B Kozolchyk, 'Legal Aspects of Letters of Credit and Related Secured Transactions' 11 (2/3) Lawyer of the Americas, International Trade Symposium Issue (Summer - Fall, 1979) 265, 272-273, 276. At p 276 the author states unequivocally that *'although the relationship between the issuing and confirming banks and the beneficiary is commonly referred to as 'contractual' there is no contract, in the strict sense of the term, between the beneficiary and the banks.'*). There are understandable reasons for the academic debate – ranging from whether there is consideration for the promise to the genesis of the letter of credit as an instrument akin to a negotiable instrument.

[23] For example, the French Court of Cassation has said, in a decision of January 26, 1926, that a documentary credit is in the nature of a surety transaction, but this decision has never been followed. See [1926] D.P. I 201, note S Hamel; [1926] D.P. I 353, note H Rousseau.

[24] Notably, the Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters and the Brussels I Regulation (44/2001) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

[25] Case C-26/91 *Jakob Handte v Traitements Mécano-chimiques des surfaces SA*).

[26] Ibid; also Case C-334/00, *Tacconi v Wagner*.

The definition given in the UCP,[27] which is internationalist and autonomous in nature, would very much coincide with this broad notion of 'contractual obligations' adopted by the ECJ. It suffices, at this juncture, thus, to say that the Rome I Regulation should extend to the ascertainment of the applicable law of the letter of credit, as between the beneficiary and the issuing/confirming/nominated bank (ie any paying bank). As between the issuing bank and the nominated banks, that is, strictly speaking, not a letter of credit but an agency contract whereby one bank agrees to pay in pursuant to the mandate given by the issuing bank. As between the applicant and the letter of credit, that is essentially a contract for payment services.

There is however another legal hurdle before one could safely conclude that the Rome I Regulation would incontrovertibly apply. Article 1(2)(d) expressly provides for the exclusion, from the scope of the Regulation, 'obligations arising under bills of exchange, cheques and promissory notes and other negotiable instruments to the extent that the obligations under such other negotiable instruments arise out of their negotiable character'. It thus falls to be considered whether a letter of credit is one such instrument. In the Giuliano-Lagarde Report, the official commentary which accompanied the Rome Convention (the regime which preceded the Rome I Regulation) states that it is for the private international law of the forum to determine whether a document is to be characterised as being negotiable. The Rome I Regulation, however, does not have a similar provision, leading to the presumption that such a document would need to be evaluated autonomously.

The question as to whether the letter of credit is a negotiable instrument has emerged in the main because letters of credit are often treated as being irrevocable.[28] Combined with the letter of credit's features of independence and transferability, it is not difficult to see characteristics of negotiability in the letter of credit. Indeed, Article 2 UCP 600 envisages the fact that nominated banks would customarily negotiate the letter of credit – it defines negotiation as 'the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or *documents under a complying presentation*, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which

[27] See above.

[28] Indeed, the UCP 600 proposes that all letters of credit are presumed, unless a contrary intention is articulated, to be irrevocable (Art 3).

reimbursement is due to the nominated bank'.[29]

There are perhaps four arguments as to why such a characterisation of the letter of credit might be inappropriate.

First, the letter of credit is capable of being revocable or irrevocable – unlike, say a promissory note or a bill of exchange which could not be freed from its negotiability character.

Secondly, when negotiability is referred to in the UCP 600, Article 2 refers to two types of negotiability. One relates to the nominated or paying bank simply negotiating against the draft or bill of exchange presented alongside the documents. Two, the paying bank 'buys' the documents presented. In the former, it is not the letter of credit which is being negotiated but the bill of exchange. In the latter, the paying bank does not negotiate against the letter of credit but purchases for value (usually at a discount) the documents relating to the goods. The documents (notably the bill of lading) serve as documents of title relating to the goods. This act of 'negotiation' (purchase of the bill of lading, inter alia) gives the buying bank good title in the goods. It follows thus that in neither case is the letter of credit itself being 'negotiated' in the same way, a bill of exchange or promissory note is.

Thirdly, despite the fact that a letter of credit is predominantly autonomous payment against it can be denied in a number of situations. Where there is fraud or forgery, the bank may refuse to pay.[30]

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[29] Emphasis added.

[30] There is no consistency between countries as to what constitutes the type of fraud which would defeat the letter of credit (see H Harfield, 'Identity Crises in Letter of Credit Law' (1982) 24(2) Arizona Law Review 239). In England and Wales, the position as established by the landmark case of *United City Merchants (Investments) Ltd v Royal Bank of Canada (The American Accord)* [1983] 1 AC 168 is that the fraud must have been perpetrated by the beneficiary, and not some third party, before the defence would be available to the paying bank. The English position is thus a very narrow one. Moreover, as confirmed in NIDCO v Banco Santander [2017] EWCA Civ 27 the English courts would not recognise a defence of unconscionability as being sufficient to prevent payment under the letter of credit. The English position has always been premised on the maxim 'pay first, argue later'. On the other hand, we have seen in some countries where a defence of unconscionability in the underlying sale or commercial transaction would suffice (see for example *Dornell Properties v Renansa* 2011(1) SA 70 (SCA) (South African case on performance bonds in construction) – possibility of a third

Fourthly, in the case of transferable letters of credit, the letter of credit is only transferable subject to the terms of the terms laid down by the issuing bank. The transferability character does not come from the letter of credit instrument itself, unlike a conventional negotiable instrument like, for example a cheque, but from the contractual terms on which the bank had originally issued the letter of credit.

It seems thus that the exclusion for negotiable instruments would not extend to letters of credit. However, it is equally pellucid that instruments or commercial devices with an element of negotiability such as letters of credit and bills of lading are anomalous[31] and do not sit well within a general choice of law regime, such as the Rome I scheme.

Scope of the Rome I provisions as relevant to letters of credit

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exception to the autonomy principle? And in *ALYK (HK) Limited v Caprock Commodities Trading Pty Limited and Anor* [2012] NSWSC 1558 (Australian case on sale of iron ore) recognition of unconscionability and an agreement (including an implied agreement) not to draw down as defences. Also, *Olex Focus Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 (another Australian case). See also *Kvaerner Singapore Pte Ltd v UDL Shipping Pte Ltd* [1993] 2 SLR (R) 341 (Singapore High Court). This enlargement of the scope of defences in letters of credit has not been within criticism – see Byrne, J. E., 'Why Judges Should Keep Their Consciences Out of LC Fraud Issues' (2009) Documentary Credit World 20. In parallel to these judicial pronouncements in the common law world, banks have taken to introducing clauses allowing them to refuse payment on the basis of unconscionability. How this contractual phenomenon will be interpreted and enforced by the courts remains to be seen. (see G Wooler, 'The New "Asplenium Clause"—Unconscionability Unwound?' (2016) Singapore JLS 169). In the civilian context, the maxim *ex turpi causa non oritur actio* is broadly adopted with like the common law world, varying levels of interpretation. See for example early cases such as [1974] Bull Civ IV No 307, at 253 (Cass. civ. com. December 2, 1974); Tribunal Federal de Lausanne (July 7, 1964); 1954] S. Jur. I (Cass. civ. com. March 4, 1954),; [1970] J.C.P. II No 16216 (Cass. civ. com. May 2, 1969); [1980] D. Jur. 488 (Tribunal de Commerce de Paris May 13, 1980); *Singer & Friedlander v Creditanstalt-Bankverein*, 17 Cg 72/80 (Handelsgericht Wien 1980) and commentaries such as Stoufflet, 'Les devoirs de la banque qui reçoit des documents irréguliers' (1965) Revue de la Banque 418; Gannage, Note, Journal du Droit International 95 (1972); also H Harfield, 'Identity Crises in Letter of Credit Law' (1982) 24(2) Arizona Law Review 239, especially the commentary on *Singer & Friedlander v Creditanstalt-Bankverein* (above).

[31] The fact that they are autonomous makes them different from other commercial contracts.

It is universally acknowledged that the Rome I Regulation stresses the principle of party autonomy. It provides in Article 3 that the parties' contract shall be governed by their choice of law. The applicable law does not only govern the application the meaning and consequences of the contract but also questions as to the plaintiff's right to sue. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. Clarity of the terms or circumstances is an objective matter.[32] In the context of letters of credit, it is not often the case that they are issued with an applicable law clause or at the very least, a jurisdiction clause. The question as to whether a jurisdiction clause, without an attendant applicable law clause, would be sufficient to infer the implied choice of law under Article 3. In this connection, Recital 12 of the Preamble to Rome I might be useful. Recital 12 reads:

> An agreement between the parties to confer on one or more courts or tribunals of a Member State exclusive jurisdiction to determine disputes under the contract should be one of the factors to be taken into account in determining whether a choice of law has been clearly demonstrated.

This is an improvement to the position under the Rome Convention whereby choice of exclusive jurisdiction did not necessarily mean an alignment with the applicable law question.

A more vexed problem is whether the applicable law clause in the letter of credit binds all parties involved in the payment exercise. As we have noted earlier, the letter of credit is issued by the issuing bank in favour of the beneficiary seller. The choice of law clause in the letter of credit would thus bind them.

However, there are two other bank-beneficiary relationships to consider: between a confirming bank and the beneficiary, and between a nominated paying bank and the beneficiary.

Between Confirming Bank and Beneficiary

A confirmed letter of credit is a separate and autonomous undertaking issued by the

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[32] See, for example, the English Court of Appeal case of *Sapporo Breweries v Lupofresh [2013] EWCA Civ 948* , a case which concerned the application of the Rome Convention. The court refused to find that a CIF UK Port term used in the sale contract was sufficiently clear to evince an intention to choose English law as the applicable law.

confirming bank,[33] albeit usually on a back to back basis mirroring the terms of the original letter of credit. However, it is not inconceivable for this autonomous instrument to adopt its own choice of law provision. There may be good reasons for that. The issuing bank is likely to prefer the law of the place of its principal business to be used as the applicable law of the original letter of credit. That commercial preference may not be shared by the confirming bank. That is especially the case where there is silent confirmation of the letter of credit.[34] In such a case, the beneficiary of the original letter of credit had requested the silent confirmation, without informing the issuing bank and a *separate* agreement is entered into between the confirming bank and the beneficiary.[35] Where there is a separate undertaking, it would follow that a properly incorporated applicable law clause in the confirmation would bind the confirming bank and the beneficiary. Indeed, it is not uncommon for confirming banks to insist on their own choice of law clause in the confirmation.

That, whilst providing some semblance of certainty opens up the problem of conflict of laws in its truest sense. One could find oneself embroiled in several competing applicable laws in

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[33] See Arts 2, 8 UCP 600.

[34] Here the 'confirming' bank adds its confirmation without informing the issuing bank. This is usually done when the beneficiary seeks out additional protection from a bank in his or her own jurisdiction but without wishing to cause offence to the foreign issuing bank or applicant by expressing his or her misgivings about the creditworthiness of the issuing bank to honour the letter of credit. The American Bar Association Task Force describes silent confirmation as, 'A confirmation made without the authority of the issuer is not a true confirmation. While a so-called silent confirmation may itself constitute a new and separate letter of credit, commitment to purchase, guarantee, or other obligation binding on the one making it, *vis-à-vis* the beneficiary, the silent confirmer does not acquire the rights of an issuer on the original credit and is not a confirmer in any sense of the term. The use of the term 'confirmer' . . . should never be construed to imply a reference to a silent confirmer'. (The Task Force on the Study of UCC Article 5, An Examination of UCC Article 5 (Letters of Credit), 45 Bus Law 1521, 1565 (June 1990)).

35 As to the legal problems arising from silent confirmations, see AG Lloyd, 'Sounds of Silence: Emerging Problems of Undisclosed Confirmation' (1990) 56 Brook L Rev 139. For the position of silent confirmations post UCP 600 see J Chuah, *Law of International Trade: Cross Border Commercial Transactions* (6th edn, Sweet & Maxwell, London) para 11-059.

respect of a single payment – the applicable law between the issuing bank and beneficiary, the applicable law between the two banks and the applicable law between the confirmer and the beneficiary could all very well be different.

Thus, where back-to-back terms in both the original and confirmed letter of credit is preferred, some confirmations would either simply mirror the applicable law clause in the original letter of credit[36] or leave the matter of applicable law silent.

This raises the knotted issue as to the omission is an implied selection of the applicable law in the originally issued letter of credit or an absence of choice falling to be dealt with by the presumptions in art 4 of the Rome I Regulation. That said, commercially, confirming banks might find it loth to subject its own independent undertaking to the law, usually, of the place where the issuing bank is based and not its own place of business.

It is submitted that in the case of *silent confirmations*, as the separate agreement is clearly not authorised by the issuing bank, that is persuasive evidence that that omission of a choice of law in the silent confirmation is not an implied selection of the applicable law in the original letter of credit.

In the case of *conventional confirmations*, the case is less persuasive. That said, case law, at least from England and Wales, seems to have proceeded on the basis that an omission in the confirmation is an absence of choice.[37] It is probably because Article 3 Rome I Regulation refers to 'clearly demonstrated in the terms or circumstances' and for what it is worth, few judges are sufficiently convinced that an omission is 'clear' demonstration of choice. Moreover, there is the fallback presumptions in Article 4 to rely on.

Between Nominated/Negotiating Bank and Beneficiary

Where the nominated bank is a mere advising bank, it is unlikely to stand in a contractual relationship – its role is confined to that of an intermediary acting for and on behalf of the issuing bank. Indeed, most advising banks will add a standard stipulation like the one below in their communications to the beneficiary:

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[36] It is also commercial practicable for the original letter of credit to say that the letter of credit (containing a choice of law clause) issued by Bank A shall be confirmed by Bank B, thereby closing out the problem of additional choice of law issue for the confirmation. There may be problems around whether there is evidence of consent or agreement to such an implicit incorporation of the applicable law clause, for the confirming bank.

[37] See, for example, *Marconi Communications International Ltd v PT Pan Indonesia Bank Ltd TBK* [2005] EWCA Civ 422.

'This letter is solely an advice of the credit established by the bank and conveys no engagement on our part.'

Where the nominated bank is a bank empowered to negotiate against the bill of exchange accompanying the tender of commercial and shipping documents, or the letter of credit itself, the bank would often pay or negotiate without drawing attention to the applicable law. No formal paperwork is usually issued; the bank will rely on the issuing bank's undertaking to reimburse against any negotiation to make payment. Conventional stipulation in the original letter of credit such as the one below is relied on for authority to pay and be reimbursed:

> 'Instruct to payg/acceptg/negotg bank payment under this credit will be effected by the applicant bank at maturity upon receipt of complying documents at counters of [issuing] bank.'

This situation thus leads to an absence of choice of the applicable law which is to be resolved, where appropriate, by reference to the provisions of Article 4 of Rome I.

The Special Presumptions in Article 4, Rome I Regulation

There are special presumptions in the Rome I Regulation to help ascertain the applicable law of the contract where there is no selection made by the parties. Where a letter of credit might be construed as a contract for services, Article 4(1)(b) is particularly relevant:

> … without prejudice to Articles 5 to 8, the law governing the contract shall be determined as follows: … a contract for the provision of services shall be governed by the law of the country where the service provider has his habitual residence …

Where the letter of credit is not characterised as a contract for services or if it contains obligations which extend beyond the provision of services envisaged by Article 4(1)(b), the contract shall be governed by the law of the country where the party who is required to effect the performance of the contract which is characteristic of the contract has his habitual residence (Article 4(2)). It is however important to stress that the UCP 600 representing international banking norms perceive the letter of credit as a contractual undertaking for the provision of payment services.[38]

[38] Terms used across the UCP 600 and the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP) 2013, ICC Publication No 745 are consistent with the premise that the banks are providing payment, advice, negotiation and documentary collection services.

That being the case, in the absence of an express choice, the applicable law of the letter of credit in the relationship between the issuing bank and beneficiary *simpliciter* shall be presumed to be the law of the country where the issuing bank has its place of central administration. This coincides with the special definition given to 'habitual residence' by Article 19(1).[39]

In the case of the confirming bank, if Articles 4(1)(b) and 19 were to apply, it appears that the applicable law to the relationship between the confirming bank and beneficiary shall presumptively be the law of the place where the confirming bank has its central administration.

This approach however would lead to the letter of credit being subject to two different applicable laws.

An example might be apposite.

Assuming the issuing bank (IB) has its central administration in France and the confirming bank (CB) has its central administration in England. If there is no explicit choice of law and the presumptions in Article 4 Rome I Regulation were to apply, the letter of credit as between the beneficiary and IB would be governed by French law but as between the beneficiary and CB would be subject to English law. Clearly that would contradict the legitimate commercial expectations of not merely the parties, but the wider trade finance market.

Indeed, under the English common law, the law of the confirming bank's place of business would govern not only the relationship between the beneficiary and confirming bank but also the contract between the issuing bank and the beneficiary. The reasoning is that as it is the confirming bank which pays the beneficiary, it is that circumstance which is most closely connected to the letter of credit.[40] Such a reasoning is consistent with commercial realities, it is argued.

It is undoubtedly the case that the Rome I Regulation is a scheme of general application and does not seek to make special provisions for letters of credit. It might be argued therefore, when push comes to shove, not ideal in giving force to the specific considerations and commercial interests the users of letters of credit expect.

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[39] Article 19(1) states: 'For the purposes of this Regulation, the habitual residence of companies and other bodies, corporate or unincorporated, shall be the place of central administration.'

[40] *Bank of Baroda v Vysya Bank* [1994] 2 Lloyd's Rep 87.

It is however submitted that there *might* be alternative solutions under the Regulation which meet with the kind of commercial expectations alluded to.

The first is by turning to Article 19(2) instead of Article 19(1). Article 19(2) provides that where the contract is concluded *in the course of the operations of a branch, agency or any other establishment*, the place where the branch, agency or other establishment is located shall be deemed the place of habitual residence.[41] Where the contract provides that performance is the responsibility of the branch, agency or other establishment, the place where the branch, agency or other establishment is located shall be treated as the place of habitual residence. It is neither a linguistic nor practical stretch to suggest that under the letter of credit, as payment or negotiation is the responsibility of confirming or negotiating bank and that bank is an 'agency or other establishment' of the issuing bank, the applicable law of the letter of credit should be determined using the place of business of the confirming or negotiating bank.

The difficulty with this route is Article 19(3). Article19(3) provides that when determining the habitual residence, the relevant point in time is the time of the conclusion of the contract. In the case of a confirmed letter of credit, the time the letter of credit was issued, the identity and location of the confirming bank should be reasonably clear. That is virtually impractical in the case of a letter of credit to be 'negotiated'[42] with *any* bank. At the time the letter of credit is issued, the expectation is that the beneficiary can negotiate the letter of credit at any bank wherever that bank might be located (subject to any correspondent banking networks).

That leaves the other option which is to apply Article 4(4). Given that in such a circumstance, as the route provided by Article 4(1) read in conjunction with art 19 could not work, as prescribed by Article 4(4), the contract shall be governed by the law of the country with which it is most closely connected. The obligation which is key to the letter of credit is the payment or negotiation by a paying bank. Thus, it might be said that the country which is most closely connected to the letter of credit is the place where the paying bank has its place of business or administration.[43] The common law has by and large taken the view that there should be a single, unified applicable the letter of credit regardless of the presence of more than one bank.

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[41] Emphasis added.

[42] For an explanation of what it means by 'negotiation' please see above at p.

[43] See for example Bank of Baroda v Vysya Bank (see fn 40).

It is perhaps useful to refer to a quotation by Potter J. in *Marconi Communications International Ltd v PT Pan Indonesia Bank Ltd TBK*:[44]

> [I]t was and is common ground that under a letter of credit it is desirable that the same system of law should govern the co-existing contracts between (a) the issuing bank and the beneficiary, (b) the confirming bank and the beneficiary, (c) the issuing bank and the confirming bank].

In a UK Supreme Court decision, *Taurus Petroleum Ltd v State Oil Marketing Co*,[45] it was held that in a letter of credit the debt must also be said to be located at the place where the paying bank is located. In that case, the issuing bank was the English branch of a larger French banking group but Article 3 UCP 600 states clearly that each bank will be treated as separate.[46] Hence, it was in England where the branch which issued the letter of credit is based where the debt is also said to be situated. The reference to the UCP 600 is important. It shows how the court took pains to ensure that the decision arrived at is not only consistent with doctrine but also banking practices.

The Article 4(4) option seems clearly more effective but does not provide a unified test for the different EU Member State courts to adjudge how best to determine the country with the closest connection to the letter of credit. In the light of the need to facilitate more accessible trade finance across the single market[47] a more ascertainable and certain applicable law framework is needed.

The US Solution

A useful comparison might be had from the US Uniform Commercial Code (UCC). The UCC has long had special rules for addressing the issue of choice of law for letters of credit. It is

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[44] [2005] EWCA Civ 422.

[45] [2017] UKSC 64.

[46] It is noteworthy that in the US, under s 5-116 UCC it is expressly provided that 'For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.'

[47] And indeed the UK too given the fact that following Brexit the UK had retained the substantive rules of the Rome I Regulation.

probably not fair to over-criticise those special rules given how old[48] they are and how difficult it is to revise them in a federalised legal system such as that in the US. However, it must be stressed that there is now much better clarity of the expectations of merchants using letters of credit and in banking practices. These changes and developments in the use of letters of credit, it is opined, render the private international law provisions in the UCC on letter of credit less than satisfactory.

The starting premise is that the UCC envisages that all letters of credit should be adhere to the UCP rules as far as possible and contractual permissible. The rationale is that the UCP Rules provide for the resolution of disputes of substantive rights and duties.[49] Where recourse must be had to substantive law, § 5-116(a) UCC provides that 'the liability of an issuer, nominated person or adviser for action or omission is governed by the law of the jurisdiction chosen by [the] agreement …'.

This is to some extent similar to Article 3 and tries to give effect to party autonomy in selecting the applicable law. It is, as expected of then federal legislation attempting to harmonise the laws of the many different states, silent as to how the provision might be interpreted. Unlike Article 3, there is no wording dealing with implied selection or what selection actually means. It is also problematic in that it does not recognise the commercial need for there to be a single unified applicable law. The net result with adhering to § 5-116(a) UCC especially in a cross-country context, as is the case outside the US, is that there could well be several applicable laws for a single letter of credit instrument.

In the case where § 5-116(a) UCC does not apply,[50] § 5-116(b) UCC provides that the liability of the nominated person, issuer and adviser for action or omission shall be governed by the law of the jurisdiction in which the person is located. This presumption, similarly, potentially leads to different applicable laws for different parties in the same letter of credit arrangement.

Conclusion

Across this article is the refrain that meeting commercial interests and legitimate expectation contributes significantly to reducing the trade finance gap problem. In order to promote better

[48] First published in 1952.

[49] RJ Gewolb, 'The Law Applicable to International Letters of Credit' (1966) 11 Vill L Rev 742.

[50] As argued it is not entirely clear when it would not apply.

access to trade finance, the rules on the applicable law of letters of credit should therefore reflect those commercial realities and interests.

It has been demonstrated that whilst the Rome I Regulation might be distended to provide for solutions to the problem of choice of law in letters of credit, it is not entirely satisfactory for the reasons expounded above. There are possible solutions where no express choice has been made or where there are conflicting applicable laws chosen in the letter of credit, the inter-bank correspondent contract and the confirmation.

One is for the International Chamber of Commerce to take a lead in their future revision of the UCP regime to provide for an express provision dealing with choice of law. Such an express provision might thus be deemed a choice of law term to be incorporated or at least implied for the purposes of determining the chosen applicable law under Article 3, Rome I Regulation. Perhaps, a provision stating to the effect that the applicable law should be the same for all co-existing contracts represented by the letter of credit should be introduced to the UCP.[51] The advantage with this solution is undoubtedly its global reach. The UCP rules are so well established and attract such wide international recognition, respect and reception that such a provision could succeed in providing certainty in a matter which has plagued for long[52] so many courts and tribunals. For states concerned at any perceived loss of judicial control of matters of private international law, this solution is ultimately a contractual one and therefore subject the state's application of their public policy exception.

The second is a legislative solution, namely, to amend the Rome I Regulation to spell out the exclusion of letters of credit from its governance. As it stands, the Rome I Regulation already does not apply to negotiable instruments. As the Giuliano-Lagarde Report[53] points out, 'the provisions of the [Rome] Convention were not suited to the regulation of obligations of this kind. Their inclusion would have involved rather complicated special rules.'[54]

Although the Report does go on to state that

> If a document, though the obligation under it is transferable, is not regarded as a negotiable instrument, it falls outside the exclusion. This has the effect that such

[51] As reflected in the quotation from Potter J (see fn above).

[52] Academic commentaries available to the author on the problem of applicable law date all the way back to the 1920s.

[53] Official Journal C 282 , 31/10/1980

[54] Para 4, commentary on Art 1.

> documents as bills of lading, similar documents issued in connection with transport contracts, and bonds, debentures, guarantees, letters of indemnity, certificates of deposit, warrants and warehouse receipts are only excluded by subparagraph (c) if, they can be regarded as negotiable instruments ; and even then the exclusion only applies with regard to obligations arising out of their negotiable character.[55]

Letters of credit are not expressly cited and none of the examples given has an autonomous nature. It is argued that given letter of credit use is regularly accompanied by bills of exchange, are autonomous and have a negotiable character,[56] either the Rome I system should not apply to letters of credit or special rules in the Rome I Regulation should be provided for. The latter option is the author's preference – a solution akin to the special rules established for carriage, consumer, employment and insurance contracts. The former, by passing the matter back the national systems, triggers the use of domestic private international law principles causing in turn problems with legal characterisation challenges for the national courts.

This article has attempted to look to solutions which would avoid the need for litigation, especially costly litigation not about the substantive rights and obligations, but over what law to apply to the letter of credit. As one commentator said, it is, after all, the absence of litigation in the letter of credit field that has permitted the incredible flexibility and popularity of credits.[57] It is hoped that the article has gone sufficient distance at delineating a few possible solutions.

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[55] Ibid.

[56] See above (at …) for a critique of the term negotiability in the context of letters of credit.

[57] Gewolb (fn 49) 770.