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

Fraud in international trade is not a new phenomenon. The problem is most rampant in the area involving method of payment especially by letter of credit (LC). The survival of fraud in LC will not only disturb the LC flow but it will end up as a disaster to the whole transaction. Letter of credit (LC) is one of the methods of payment which commonly used in international trade. The obligation of the bank to make payment is independent from the underlying sale contract between buyer and seller. As long as the seller can present the documents which are strictly complying with LC requirements, the bank is obliged to pay except if documents presented by seller are fraudulent. Fraud is recognised as the main exception which destroys LC autonomous nature and terminates the payment obligation under LC.4 Having been recognised as an exception to the principle of autonomy in LC transaction, the situations where fraud exception can be invoked are still perplexing, albeit a number of studies were initiated to clarify this issue.5 This paper aims to clarify fraud issues in LC transaction with special reference to Malaysian scenario. It begins with the general outline of nature and background of LC fraud. Furthermore, discussion focuses on the provisions of fraud exception outlined in the Uniform Custom and Practice for Documentary Credit (UCP) and as discussed in case-law. Due attention is given to the Malaysian scenario relating to fraud in LC which covers legal framework, modus operandi and standard of proof as decided by Malaysian case-law. The finding established that only fraud on documents can set aside the payment obligation under LC. On the other hand, fraud on the goods is irrelevant and only invalidates the sale contract between buyer and seller and does not affect the banks’ obligation to pay under LC contract of payment. The existence of fraud in LC transaction must be proved with strong and cogent evidence whereas suspicion or mere allegations are not qualified to invoke the fraud exception.

Keywords: Letter of credit, principle of autonomy, fraud exception.

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