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Autonomy Under Pressure: Fraud, Nullity, and Regulatory Compliance in English Documentary Credit Law

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Abstract

The documentary credit has long been regarded as the lifeblood of international commerce, but it is now facing two distinct and growing structural pressures. Within private law, there are institutional blind spots in the provisions on payment exceptions in the framework of English private law. The fraud exception, as construed in *United City Merchants*, leaves banks institutionally exposed to third-party fraud by requiring beneficiary complicity, while the judicial refusal to recognise a nullity exception in *Montrod* compels banks to honour instruments devoid of legal existence. On the financial regulatory front, the rapid expansion of financial crime regulation, represented by economic sanctions and anti-money laundering, requires banks to undertake the obligation to investigate underlying transactions at the precise point when the principle of autonomy strictly limits the obligations of banks to the facial examination of documents. In view of the fragmented and unprincipled manner in which the English judicial practice has responded to this double pressure, this article proposes a two-way reform path. First, regard legal nullities as the front threshold for compliance review, and establish more objective fraud identification standards; secondly, build a structured regulatory intervention framework to ensure that banks cannot abuse sanctions or anti-money laundering reasons, and their refusal decisions must be based on objective evidence and subject to judicial review. This structured approach seeks to restore commercial certainty to cross-border trade finance by reconciling the mandatory obligations of public regulatory compliance with the foundational trust of private commercial instruments.

Keywords: documentary credits, autonomy principle, fraud exception, nullity exception, financial sanctions, anti-money laundering compliance

1. Introduction

Described in the academic and judicial literature as the lifeblood of international commerce,[1] the documentary credit has for over a century served as the principal institutional mechanism for financing cross-border trade. Its legal

[1] *R.D. Harbottle (Mercantile) Ltd. v National Westminster Bank Ltd.* [1978] Q.B. 146.

architecture rests upon two interlocking doctrines. The autonomy principle, confirmed in *Hamzeh Malas & Sons v British Imex Industries Ltd*,[1] insulates the bank's payment obligation from disputes under the underlying sales contract. The strict compliance rule, encapsulated in Viscount Sumner's formulation in *Equitable Trust Co of New York v Dawson Partners Ltd* that "there is no room for documents which are almost the same, or which will do just as well," [2] conditions that obligation on documentary precision. Historically, it is these principles that jointly establish the commercial value of letters of credit, making it a core tool to ensure the certainty of transactions and realise the predictable distribution of risks.

This system is now facing pressure from two very different aspects. The first pressure comes from the field of private law. As the House of Lords held in *United City Merchants*, [3] the fraud exception stipulates that the bank can only dishonour a presentation if the document contains a material misrepresentation submitted by the beneficiary knowing that it exists. The strict requirement of English law for beneficiary complicity renders the system institutionally vulnerable to complex third-party fraud. In addition, as the judgement of the Court of Appeal in *Montrod* showed, the bank was forced to fall into a commercially absurd situation to recognise forged documents in order to maintain formal certainty due to its doctrinal unwillingness to recognise nullity exceptions.[4]

The second pressure is different in nature. The rapid expansion of financial crime regulation, especially the sanctions system implemented under the Sanctions and Anti-Money Laundering Act 2018 and the anti-money laundering obligations arising from the Proceeds of Crime Act 2002, forces banks to investigate the substance of the underlying transaction under the condition that the principle of autonomy limits its investigation to the surface content of the document.[5] English courts dealt with this regulatory disruption in a fragmented and ad hoc manner, revolving sanctions disputes through illegality, frustration, and strict contractual construction, and resolving the issue of AML suspensions through implied clauses that allow delays. This has caused a direct structural contradiction: although the principle of autonomy clearly prohibits banks from investigating basic transactions, modern public law forces them to do so, otherwise they will face serious criminal liability.

While existing academic research has explored these pressures in considerable depth, such investigations have largely been conducted in isolation. Fraud and nullity at the private law level, as well as sanctions and anti-money laundering obligations at the public law level, have attracted in-depth analysis. At present, the academic community has not established a comprehensive analytical framework to combine these two pressures for systematic discussion. Although they are different in nature, they are actually closely connected, jointly triggering a systemic crisis against the principle of autonomy. This article aims to fill this gap. It argues that the current challenges facing the English documentary credit framework stem from two structurally completely different sources, namely the restrictions on private law theory and the structural damage caused by regulatory intervention, and each challenge needs to be treated differently.

The structure of the article is as follows. Chapter II introduces the basic principles of autonomy and strict compliance and discusses the commercial pressures that affect its operation. Chapter III compares and analyses the theoretical response to document fraud in English, American, and Singaporean law. Chapter IV discusses the impact of financial sanctions and AML regulation on banks' payment obligations under English law. In response to the above-mentioned double pressures, Chapter V puts forward a two-way reform path: internally, reshape the nullity exception under the framework of strict compliance principles, and establish objective and transaction-centred fraud review standards; externally, build a structured regulatory framework for illegality, so as to embed public law intervention into a transparent and litigable legal system on the basis of maintaining the autonomy principle.

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1 *Hamzeh Malas & Sons v British Imex Industries Ltd* [1958] 2 Q.B. 127.

2 *Equitable Trust Co of New York v Dawson Partners Ltd.* (1927) 27 Ll. L. Rep. 49 (HL) at 52.

3 *United City Merchants (Investments) Ltd. v Royal Bank of Canada* [1983] 1 A.C. 168 HL at 183.

4 *Montrod Ltd. v Grundkötter Fleischvertriebs GmbH* [2001] EWCA Civ 1954; [2002] 1 W.L.R. 1975.

5 Proceeds of Crime Act 2002, s.335; Sanctions and Anti-Money Laundering Act 2018.

2. The Doctrinal Foundations and Emerging Strains of Documentary Credits

The documentary credit appeared in the 19th century. As a key institutional innovation, it aims to solve the trust deficit between geographically and unfamiliar counterparties. It fills this trust gap through the autonomy principle. This principle establishes a core rule in English law by *Hamzeh Malas* [1], that is, the bank's payment obligations under the documentary credit are completely independent of the basic sales contract and are not subject to the legal restraint of any underlying disputes between the buyer and seller. It separates the bank's documentary credit payment obligations from the basic sales contract, ensuring that the bank only processes documents, not goods.[2]

By insulating the payment mechanism from the breach of contract, the principle of autonomy enforces the structure of "pay now, argue later",[3] which ensures that that the seller can receive the money after receiving the requirements of the document without bearing the risk of delay or renegotiation initiated by the buyer. The irrevocable documentary credit thereby acquires a highly reliable quality in international banking, as courts will not easily interfere with the bank's payment obligations unless there is a "sufficiently grave cause", [4] thus turning the deferred payment instrument into a guarantee that can almost be sure of immediate receipt of the payment. The realisation of this commercial function lies in the certainty and independence of bank payment obligations.

The autonomy principle does not render the bank's payment obligation unconditional in an absolute sense. Imposing such an absolute payment obligation necessitates a robust protective mechanism for banks, which act merely as neutral financial intermediaries. This protection is embodied in the strict compliance rule, which dictates that the bank's duty to pay is strictly contingent upon the presentation of documents that precisely mirror the terms of the credit. In *JH Rayner & Co Ltd v Hambros Bank Ltd*,[5] the Court of Appeal held that a bank was entitled to reject documents where the description of goods in the bill of lading departed from that specified in the credit, notwithstanding that the discrepancy would have been immediately recognisable to any merchant in the relevant trade. MacKinnon LJ affirmed that the bank is not required and indeed not entitled to exercise commercial judgment as to whether a documentary deviation is commercially significant. The strict compliance doctrine ensures that banks are not forced to investigate extraneous commercial facts, thereby solidifying the documentary credit as a rigid cornerstone that historically succeeded in facilitating the secure and rapid flow of global trade.

However, while originally designed to provide legal certainty and safeguard banks acting as neutral intermediaries, strict compliance has generated systemic commercial friction. Global statistics indicate that 65-80% of documentary credit presentations are refused on first examination due to discrepancies.[6] While some discrepancies arise from genuine documentary errors, the persistence of arguable discrepancies also exposes the structural distortion of bank behavior in the modern financial regulatory environment. Such high rejection rates indicate that the doctrine of strict compliance has strayed from its original intent, becoming instead a bargaining chip for banks and buyers. In volatile markets, when a deal becomes unprofitable, applicants may scrutinize documentary presentations for minor discrepancies in order to delay or renegotiate payment. By exploiting the strict compliance rule, they may create a convenient legal loophole to back out of the transaction. In the practice of documentary credits, high refusal rates furnish buyers with unwarranted negotiating leverage, thereby engendering opportunistic rejections. Specifically, certain applicants deliberately exploit discrepancies within a presentation to compel price discounts from beneficiaries as a condition for issuing a waiver.[7] This behavior significantly undermines the commercial

[1] *Hamzeh Malas & Sons v British Imex Industries Ltd.* [1958] 2 Q.B. 127.

[2] International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits* (2007 Revision, ICC Publication No.600) ("UCP 600") arts 4-5.

[3] *Intraco Ltd. v Notis Shipping Corp. of Liberia (The Bhoja Trader)* [1981] 2 Lloyd's Rep. 256 CA at 257 per Donaldson L.J.

[4] *Discount Records Ltd. v Barclays Bank Ltd.* [1975] 1 W.L.R. 315 Ch D at 319 per Megarry J.

[5] *J.H. Rayner & Co. Ltd. v Hambros Bank Ltd.* [1943] K.B. 37 CA at 41 per MacKinnon LJ.

[6] ICC Banking Commission, "Technical advisory briefing no. 3: reducing discrepancy rates under documentary credits" (2022), p. 1.

[7] D. Meynell and P. Taneja. (2024). *A Comprehensive Guide to Documentary Credits: Everything You Need to Know about Letters of Credit*, edited by D. Patel and S. Stevenson. Trade Finance Global & BAFT, p. 27.

reliability of the letter of credit. According to the ICC Global Trade and Finance Survey, only 7% of respondents reported a decrease in spurious discrepancies raised during documentary examination, [1] indicating that arguable discrepancies remain widespread in practice.

Meanwhile, many banking authorities view the increasing regulatory costs driven by sanctions or AML compliance, along with concerns over changing regulatory requirements, as a driver for restricting or terminating business.[2] Whereas the autonomy principle requires banks to confine their examination to the face of the documents, modern regulatory regimes increasingly require them to investigate the underlying transactions. Faced with the prospect of severe regulatory penalties and escalating compliance costs, banks are therefore under growing pressure to move beyond the traditional role of passive document processors and instead assume the position of active factual investigators. As compliance costs associated with sanctions screening and AML due diligence increase, banks may create incentives or utilize the sanctions clause in the contract to rely on formal documentary discrepancies as a defensible basis for refusing or delaying payment.

As banks move from a purely documentary role towards greater scrutiny of the underlying transaction, the traditional doctrines of autonomy and strict compliance in English law are placed under growing pressure. The following chapters examine each category of pressure in turn. Chapter III analyses the internal doctrinal limits of the English fraud and nullity framework — the private law dimension of the problem — by reference to the comparative approaches adopted in the United States and Singapore. Chapter IV then examines the external regulatory pressures introduced by financial sanctions and anti-money laundering legislation, and the structural conflict between those public law regimes and the autonomy principle as a matter of English law.

3. Doctrinal Pressure

This chapter focuses on the internal limits of English law. It argues that the existing doctrinal framework governing fraud fails to adequately address modern commercial realities.

3.1 The Fraud Exception

As discussed in Chapter I, under English law, the parameters of the fraud exception were narrowly defined by Lord Diplock in *United City Merchants (UCM)*, which established that a bank may only dishonour a credit if the documents contain a material misrepresentation of fact that the beneficiary knowingly presents[3]. However, the facts of *UCM* highlight a significant limitation regarding third-party fraud. In that case, a loading broker fraudulently backdated a bill of lading to conceal a late shipment, yet the innocent beneficiary was permitted to enforce payment.[4] The strict requirement of beneficiary's complicity meant that although the confirming bank knows that the shipment date has been falsified before payment, it must be compelled to honour the presentation. [5] Consequently, the English approach paradoxically results in the "immunisation of fraudulently procured documents," leaving the banking system highly vulnerable to sophisticated supply-chain fraud perpetrated by intermediaries.[6]

Although this strict doctrinal stance might appear rigid, it was driven by a deliberate commercial policy. The primary concern of Lord Diplock and his contemporaries, such as Donaldson LJ, was that undue judicial interference with the autonomy principle, such as granting injunctions to restrain payment, would cause a "thrombosis" in international trade, thereby destroying their cash-like liquidity and absolute certainty, which serve as the lifeblood of documentary credits.[7] However, this rationale

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[1] International Chamber of Commerce. (2014). *Rethinking Trade & Finance 2014: An ICC Private Sector Development Perspective*, edited by T. Senechal. ICC Publication No.867E, p. 16.

[2] World Bank. (2015). *The Withdrawal from Correspondent Banking: Where, Why and What to Do about It*. World Bank, p. 31.

[3] *United City Merchants* [1983] 1 A.C. 168.

[4] *United City Merchants* [1983] 1 A.C. 168 at 181-182. See also K. Richards. (2019). Revisiting the fraud exception: a critique of United City Merchants v Royal Bank of Canada forty years on. *L.S.*, *39*, 656, 660.

[5] *United City Merchants* [1983] 1 A.C. 168 at 182, 187-188.

[6] B. Kozolchyk. (1992). The immunization of fraudulently procured letter of credit acceptances. *Brook. L. Rev.*, *58*, 369; R. Hooley. (2002). Fraud and letters of credit: is there a nullity exception? *C.L.J.*, *61*, 279; X. Gao and R.P. Buckley. (2003). A comparative analysis of the standard of fraud required under the fraud rule in letter of credit law. *Duke J. Comp. & Int'l L.*, 13, 293.

[7] For the classic judicial concern regarding the disruption of the autonomy principle, see *Intraco Ltd. v Notis Shipping Corp. of Liberia* (The Bhoja Trader) [1981] 2 Lloyd's Rep. 256 CA at 257 per Donaldson L.J. (warning against causing a "thrombosis" in the commercial bloodstream).

fails to adequately address modern commercial realities. Professor Roy Goode vigorously challenges the *UCM* logic. He pointed out that the seller's basic legal obligation under the basic contract is to provide genuine documents. If the beneficiary is unaware of the third party's forged documents, that does not necessarily give them the legal right to request payment with those documents. As Goode emphasised, there is a fundamental contradiction in Britain's approach. They originally intended to strictly protect the letter of credit mechanism, but ended up protected the forged documents themselves.[1] In essence, as Richard Hooley argued, the rigid protection of the "certainty" of documents by the English judiciary was counterproductive. It actually "undermines the trust that is the foundation of trade".[2] Once the buyer and the bank lose trust in the mechanism's ability to screen forged documents, the mechanism will lose its commercial utility. The deadlock caused by the excessive document-centred English law shows that there is an urgent need to restructure the substantive function of the mechanism; at this point, US judicial practice has already taken the lead in completing the change of concept.

Instead of fully relaxing the principle of autonomy, the US judicial case law provides a practical alternative to address the limitations of English practice. The position of the US is rooted in the landmark case of *Sztejn v J. Henry Schroder Banking Corp*. The case established that the independence principle should not protect a beneficiary of the intentional delivery of "worthless rubbish" instead of the contracted goods.[3] On this basis, the modern US approach has been compiled into Section 5-109 of the Uniform Commercial Code (UCC), which clearly allows injunctive relief for "material fraud".[4] Crucially, the UCC establishes a transaction-focused standard that contrasts with the English strict emphasis on the beneficiary's subjective state of mind. As Gao and Buckley observe, the American standard evaluates the "severity of the effect of the fraud on the transaction rather than the state of mind of the beneficiary."[5] To qualify as material, the wrongdoing must have "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served." This high threshold was firmly established in *Intraworld Industries Inc v Girard Trust Bank* and subsequently adopted by the UCC Official Comments[6]. In addition, UCC § 5-109 explicitly stipulates that the forgery of the required documents is also included, regardless of whether the beneficiary has forged the document or whether it actually knows that the document has been forged.[7] As Richards notes, this statutory formulation expands the scope of intervention to cover third-party counterfeiting, thus making up for the shortcomings of *UCM*.[8] By focusing on whether the honour would "facilitate a material fraud", the UCC shifts the legal paradigm from a pursuit of subjective complicity to a preventive mechanism prioritising objective commercial impact.

While the US addressed the limitation of third-party by functionally expanding the definition of actionable fraud, Singapore adopted a distinctly different approach. As will be explored in the next section, Singaporean jurisprudence avoids the strict application of the fraud rule by treating third-party forgeries not as an extension of fraud, but as a fundamental failure of documentary compliance.

3.2 The Nullity Exception

While both the English *United City Merchants* doctrine and the American UCC § 5-109 operate strictly within the paradigm of actionable fraud, they expose a significant "structural blind spot" within the traditional letter of credit framework.[9] Neither of these frameworks has adequately addressed the unique legal problem of a completely null legal document tendered by a completely innocent beneficiary. In such scenarios, since the beneficiary has no subjective

[1] R. Goode. (1991). "Abstract payment undertakings" in P. Cane and J. Stapleton (eds), *Essays for Patrick Atiyah*. Oxford: Clarendon Press, p. 230.

[2] Hooley. (2002). Fraud and letters of credit: is there a nullity exception? *C.L.J.*, *61*, 279, 283-284.

[3] *Sztejn v J. Henry Schroder Banking Corp.* 31 N.Y.S. 2d 631 (N.Y. Sup. Ct. 1941) at 633-635.

[4] Uniform Commercial Code (US) § 5-109(b).

[5] Gao and Buckley. (2003). A comparative analysis of the standard of fraud required under the fraud rule in letter of credit law. *Duke J. Comp. & Int'l L.*, *13*, 293, 318.

[6] *Intraworld Industries Inc. v Girard Trust Bank* 336 A. 2d 316 (Pa. 1975) at 324-325; see also U.C.C. s.5-109, Official Comment 1.

[7] UCC § 5-109(a).

[8] Richards. (2019). Revisiting the Fraud Exception: A Critique of *United City Merchants v Royal Bank of Canada* Forty Years On. *L.S.*, 39, 656, 663.

[9] M. Bridge. (2003). Documents and contractual congruence in international trade, in S. Worthington (ed), *Commercial Law and Commercial Practice*. Oxford: Hart Publishing, p. 230.

intention of fraud and has not committed any substantive deception, the traditional fraud exception failed to provide relief. This reveals that fraud and nullity are different legal issues and should not be confused. The fraud exception originated from fraudulent infringement, which primarily focusses on the subjective culpability or dishonesty of the presenter.[1] In contrast, the issue of nullity involves the objective legal effect of the tendered instrument, which is essentially a forged document and has no commercial or legal effect. Compelling a bank to honour a forged document simply because the beneficiary lacks the intention to commit fraud is not merely a minor omission of the fraud rule, but a significant structural deficiency in English law that suggests a definite need for an independent doctrinal response.[2]

Despite the need to address this limitation, the Court of Appeal rejected the creation of a general nullity exception in *Montrod*.[3] The fundamental weakness in Potter LJ's judgment lies not only in its conclusions, but also in its conceptual framing.

The primary point of the controversy is how Potter LJ relied on the UCP to argue that banks are exempt from investigating the genuineness of documents.[4] However, Professor Roy Goode argues that this reasoning is "seriously flawed".[5] He notes it conflates a bank's procedural duty of examination with its substantive contractual liability to honour against genuine documents, effectively treating a fabricated document as a complying presentation.

Compounding this doctrinal error, Potter LJ suggested that a nullity exception would force banks to investigate facts "which they are not competent to do".[6] This justification ignored the key distinction between the legal status of the document and the factual performance of the contract. The fact that a document is legally null does not mean that the bank must inspect the underlying cargo. It only recognises fabricated instruments, such as the forged inspection certificate in *Montrod*, which lack legal effect and fail the threshold of documentary compliance.[7]

This rigid position is further defended on the ground of "sound policy reasons", with Potter asserting that the precision and certainty of the autonomy principle are paramount.[8] Yet, by compelling banks to honour fabricated documents to maintain absolute autonomy, although the formal certainty is retained, the substantive certainty is eroded. As Hooley argues, forcing banks to facilitate payments against fraudulent documents undermines the commercial trust that supports the entire L/C mechanism.[9] In addition, empirical studies on documentary practice challenge this judicial assumption. As described in Chapter II, more than 65% of presentations are rejected on first tender due to discrepancies.[10] This suggests that the system itself operates under the background of a high rate of discrepancy, and banks have long been accustomed to using commercial judgement to handle various defective documents in daily operations. Consequently, accommodating a narrow nullity exception would unlikely cause market disruption, but rather make legal theory consistent with existing commercial practice.

Ultimately, Potter LJ's assertion that nullity is not "susceptible of precision" can be challenged, as courts have long been accustomed to applying more abstract legal standards such as "reasonableness".[11] The English court's refusal to recognise the nullity exception exposed its excessive superstitious formal certainty, thus sacrificing the coherence of jurisprudence and logic. This practice failed to protect the market, leaving the trade finance system institutionally vulnerable.

Unlike the approach taken in *Montrod*, the Court of Appeal of Singapore proposed another assessment method for the nullity problem in

1 L. Lu. (2012). The exceptions in documentary credits in English law. PhD thesis, University of Plymouth, pp. 237-238.

2 Hooley. (2002). Fraud and Letters of Credit: Is There a Nullity Exception? *C.L.J.*, *61*, 279.

3 *Montrod Ltd. v Grundkötter Fleischvertriebs GmbH* [2001] EWCA Civ 1954; [2002] 1 W.L.R. 1975.

4 *Montrod* [2002] 1 W.L.R. 1975.

5 Goode. (1991). Abstract payment undertakings, p. 230.

6 *Montrod* [2002] 1 W.L.R. 1975.

7 Lu. (2012). The exceptions in documentary credits in English law.

8 *Montrod* [2002] 1 W.L.R. 1975.

9 Hooley. (2002). Fraud and Letters of Credit: Is There a Nullity Exception? *C.L.J.*, *61*, 279, 283-284.

10 ICC Banking Commission. (2022). Technical advisory briefing no. 3: reducing discrepancy rates under documentary credits, p. 1.

11 See, e.g. *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 W.L.R. 896 HL, where Lord Hoffmann famously established that commercial contracts must be construed according to what a "reasonable person" having all the background knowledge would have understood.

Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank.[1] In *Beam*, an innocent beneficiary tendered an air waybill that was subsequently discovered to be forged by a fictitious freight forwarder.[2] Rather than applying the strict parameters of the fraud exception, Chao Hick Tin JA resolved this issue by shifting the analytical focus away from the beneficiary's subjective culpability to the objective baseline of documentary compliance. The analytical significance of the Singaporean approach is its recognition of procedural and logical priority: the question of whether a document exists in law logically precedes any inquiry into fraud. As Chao Hick Tin JA held, a document that is a complete fabrication lacks any legal or commercial identity. It is indistinguishable from a "blank piece of paper".[3] Consequently, the tendering of such a document inherently fails to meet the threshold of a "complying presentation" under the UCP. Under this construction, rejecting a forged document does not constitute a breach of the autonomy principle. Instead, the autonomy principle is not engaged because the basic prerequisite for the bank's unconditional payment obligation, that is, the tender of legally existent documents, has not been met.

This model regards third-party forgery as a fundamental deficiency in documentary compliance rather than a sub-category of fraud, so that the fraud exception becomes unnecessary in cases of nullity.[4] It fundamentally shakes the English position, demonstrating that courts can insulate the banking system from paying against fabricated documents without proving that the beneficiary is fraudulent, so as to restore the commercial integrity of the credit mechanism under the premise of strict compliance with the established rules.[5]

The foregoing analysis reveals two distinct but complementary doctrinal failures within the English law framework. According to the interpretation of *United City Merchants*, the scope of application of fraud exception is too narrow to cope with the reality of modern supply chain fraud, leaving the banking system institutionally vulnerable to third-party forgeries that fall outside its strict parameters. The rejection of the nullity exception in *Montrod* compounds this vulnerability. It ignores the fact that fabricated documents are legally null, not just defective payment vouchers, which means that it never satisfies the foundational precondition for payment. Together, these failures reveal that the problem lies not only in the scope of the exceptions but in the understanding of the concept of documentary compliance itself.

However, these doctrinal pressures remain within the domain of private law, involving the risk distribution between commercial parties and the internal consistency of the documentary credit mechanism. While the reform proposals discussed in Chapter V later will directly address these failures, it is first necessary to examine the completely different pressures currently facing the English law framework. The modern sanctions regimes and AML obligations impose mandatory public law obligations, which are structurally contrary to the principle of autonomy itself. As will be demonstrated in Chapter IV, these regulatory regimes require banks to investigate transactions that are prohibited from their review by the principle of autonomy. Simply improving the existing doctrine of private law cannot resolve this conflict. Rather, it suggests a definite need for a fundamental reassessment of the relationship between contractual autonomy and public regulatory compliance.

4. Emerging Regulatory Pressures—Sanctions and AML

The second type of pressure is completely different from the former in nature. It directly impacts the objective premise on which the principle of autonomy depends, that is, the payment obligations of the default bank should be fulfilled in a legally neutral regulatory environment. In recent decades, banks operating under documentary credits have found themselves navigating an increasingly complex regulatory environment, in which the obligations imposed by financial sanctions and AML legislation sit in uneasy tension with their contractual duties. In the realm of international trade finance, banks increasingly navigate overlapping and often conflicting obligations. While they remain contractually bound to honour conforming documentary presentations,

1 *Beam Technology (Mfg) Pte Ltd. v Standard Chartered Bank* [2003] 1 S.L.R.(R) 597 SGCA.

2 *Beam Technology* [2003] 1 S.L.R.(R) 597.

3 *Beam Technology* [2003] 1 S.L.R.(R) 597.

4 Hooley. (2002). Fraud and Letters of Credit: Is There a Nullity Exception? *C.L.J.*, *61*, 279.

5 Richards. (2019). Revisiting the fraud exception: a critique of *United City Merchants v Royal Bank of Canada* forty years on. *L.S.*, *39*, 656, 673.

they simultaneously face strict statutory prohibitions. The Office of Financial Sanctions Implementation enforces strict prohibitions under the Sanctions and Anti-Money Laundering Act 2018, which can result in the mere act of payment becoming a criminal offence. In addition, the Proceeds of Crime Act 2002 may compel a confirming bank presented with conforming documents to delay or withhold payment pending regulatory authorization.[1]

This chapter examines the impact of these obligations on banks' duties through the lens of English case law. The central contention is that English law has thus far sought to contain the disruptive potential of these regulatory obligations within existing doctrinal categories, but that the boundaries of that containment are under increasing strain.

4.1 Sanctions as a Defence to Payment: Judicial Treatment

Before proceeding to examine how English courts have responded to sanctions as a defence to payment under letters of credit, it is necessary to establish the doctrinal foundation upon which such a defence might rest. There are two basic approaches: an analogy with the established fraud exception, and the common law illegality defence.

As regards the former, the fraud exception is heavily dependent upon the beneficiary's subjective fraudulent intent and complicity. [2] Financial sanctions, by contrast, typically operate as objective, absolute statutory prohibitions. In the application of sanctions regulations, there is no such subjectivity. If a transaction objectively involves or benefits a sanctioned entity, a financial institution has no choice but to freeze the transaction or refuse payment. [3] This mandatory public law intervention not only directly overrides the private law rules of the UCP 600, but also its application is absolute: whether the beneficiary is subjectively malicious or whether the behaviour is morally reprehensible, the intervention mechanism will be triggered unconditionally.[4]

In contrast, the illegality defence in common law appears to provide a more feasible doctrinal pathway. It is based on the public policy principle of *ex turpi causa non oritur actio*. English courts have gradually developed the "taint" doctrine in the landmark case of *Mahonia Ltd v JP Morgan Chase Bank*. According to the framework of the *Mahonia* case, if a document credit is structurally inseparable from the potential illegal scheme, so that the autonomous payment obligation itself is tainted by the shared illegal purpose, the document credit may be recognised as unenforceable.[5]

However, the decision of the Supreme Court in *Patel v Mirza* has precipitated a fundamental doctrinal shift in English private law, so that the traditional framework of the *Mahonia* case alone is insufficient to solve the tension.[6] The illegality defence is no longer bound by mechanical rules, such as the reliance test, but entails a flexible "trio of considerations", [7] which requires courts to weigh the purpose of the transgressed prohibition, countervailing public policies, and the proportionality of denying the claim. Although the shift of this method to legal theory brings flexibility, academic criticism pointed out that it brings great legal uncertainty to the resolution of commercial disputes.[8]

Applying Lord Toulson's "trio of considerations" in *Patel v Mirza* to the intersection of documentary credits and financial sanctions exposes a profound structural deadlock. In the first stage of the *Patel* inquiry, that is, the underlying purpose of the transgressed prohibition, the provision prohibiting the enforcement is highly reasonable. [9] Modern financial crime regulations, such as the Sanctions and Anti-Money Laundering Act 2018, impose absolute, objective prohibitions designed to isolate targeted entities from the global financial system. Compelling a bank to honour a presentation that contravenes these sanctions would fundamentally frustrate this core public policy, effectively co-opting civil commercial law

[1] Proceeds of Crime Act 2002 s.335.

[2] *United City Merchants* [1983] 1 A.C. 168 at 183.

[3] World Bank Group. (2015). *Withdrawal from Correspondent Banking*, p. 28.

[4] International Chamber of Commerce (ICC) Banking Commission, "Guidance paper on the use of sanctions clauses in trade finance-related instruments subject to ICC rules" (Document 470/1238, 2014), para.1.4.

[5] *Mahonia Ltd v JP Morgan Chase Bank* EWHC 1927 (Comm).

[6] *Patel v Mirza* [2016] UKSC 42; [2017] A.C. 467.

[7] *Patel v Mirza* [2016] UKSC 42; [2017] A.C. 467.

[8] James Goudkamp. (2017). The End of an Era? Illegality in Private Law in the Supreme Court. *LQR*, *133*, 14, 16; James C Fisher (2021). Gray areas in tort: Illegality and authority after Patel v Mirza. *MLR*, *84*, 1, 13.

[9] Patel v Mirza [2016] UKSC 42; [2017] A.C. 467.

into facilitating illicit financial flows and statutory evasion.

However, the second *Patel* consideration necessitates a rigorous weighing of countervailing public policies, and it is here that the tension becomes acute. The autonomy principle and the commercial certainty it underwrites are not merely private contractual rules; they function as macroeconomic public policies in their own right, insulating the bank's payment obligation from underlying factual disputes and preserving the cash-equivalent liquidity upon which global commerce depends.[1] As Paul S Davies observes, public policy must be carefully calibrated to avoid generating commercial uncertainty, a concern amplified here where the strict independence of the credit is the very source of its utility.[2] These competing imperatives do not admit of easy reconciliation.

Under the *Patel* framework, the overarching rationale of preserving the integrity of the legal system, alongside the third specific consideration of proportionality, ultimately militates against the current common law position rather than in favour of it. A framework in which the enforceability of a documentary credit depends upon a multifactorial judicial balancing exercise conducted *ex post facto* is structurally incompatible with the absolute *ex ante* certainty that the autonomy principle is designed to guarantee. The highly discretionary nature of the *Patel* inquiry, which Andrew Burrows defends as a necessary and triumphant mechanism for achieving transparent, proportionate justice,[3] nonetheless generates precisely the commercial unpredictability that the autonomy principle was constructed to prevent. Far from resolving the structural tension, the *Patel* methodology renders it intractable for neutral financial intermediaries.

Compounding the theoretical unpredictability of the *Patel* balancing exercise is the operational reality of trade finance, which imposes a formidable procedural hurdle on neutral intermediaries. In *Group Josi Re v Walbrook Insurance Co Ltd*, Staughton LJ emphasized that, similar to the fraud exception, illegality must be "clearly established", not just doubtful or suspicious.[4] This highly stringent evidentiary threshold proves highly problematic for banks navigating the current regulatory framework. Owing to the opacity of corporate ownership structures and the constantly evolving nature of sanction designation lists, banks are typically only able to establish a "reasonable suspicion" of a sanctions breach at the time of presentation.[5] The doctrinal insistence on definitive proof of illegality, coupled with the strict liability and severe penalties imposed by regulatory bodies for sanctions breaches, places a considerable burden on banks: to pay is to risk criminal prosecution, whereas to withhold payment based on mere suspicion is to invite civil liability for breach of the autonomous contract.[6] Consequently, although the modern common law illegality doctrine rendered analytically fluid by *Patel* and procedurally burdensome by *Group Josi Re*, it fails to provide the absolute ex-ante predictability required to serve as a reliable commercial safe harbour. Deprived of doctrinal certainty, banks and commercial parties have been forced to retreat to private contractual mechanisms. This flight to contractual certainty has primarily manifested in the widespread adoption of express risk-allocation provisions, necessitating a distinct doctrinal analysis of the sanctions clause in documentary credits.

4.2 The Sanctions Clause in Documentary Credits: Contractual Allocation of Risk

4.2.1 The Practical Background of Banks Inserting Sanctions Clauses

An omission by ICC is that UCP 600 is makes no provision to excuse banks from their payment obligations where honouring a credit would contravene sanctions. As a result of this

[1] Roger J Johns and Mark S Blodgett. (2011). Fairness at the Expense of Commercial Certainty: The International Emergence of Unconscionability and Illegality as Exceptions to the Independence Principle of Letters of Credit and Bank Guarantees. *N Ill U L Rev.*, *31*, 297, 305.

[2] Paul S Davies. (2009). The Illegality Defence and Public Policy. *LQR*, *125*, 556, 560, cited in James C Fisher. (2021). Gray areas in tort: Illegality and authority after *Patel v Mirza*. *MLR*, *84*, 1, 13 fn 104.

[3] Andrew Burrows. (2017). Illegality after *Patel v Mirza*. *CLP*, *70*, 55, 56.

[4] *Group Josi Re v Walbrook Insurance Co. Ltd.* [1996] 1 W.L.R. 1152 CA at 1161 per Staughton L.J.

[5] See generally S. Chong, "Sanctions: between a rock and a hard place" (NUS Centre for Maritime Law Working Paper 24/06, 2024), p. 7 (discussing the practical difficulty of establishing ownership and control through opaque corporate structures) and p. 21 (highlighting the dilemma where banks detect red flags but are required to meet a high evidentiary threshold of 'cogent evidence', forcing them to choose between breaching sanctions or breaching the contract).

[6] C. Lupton. (2022). A critical evaluation of the use of sanctions clauses in letters of credit. *PER/PELJ.*, *25*, 1 at 11-12.

regulatory silence, banks lack a clear legal mechanism to lawfully suspend their payment obligations when confronted with sanctions risks. Consequently, the incorporation of express sanctions clauses has become commonplace in trade finance. The ICC noted the trend that there is a growing tendency among banks to rely on express clauses to exclude liability for sanctions-related non-payment.[1] By incorporating these clauses, banks seek to contractually recalibrate the autonomy principle in response to regulatory demands. This unilateral allocation of risk therefore invites complex judicial scrutiny, requiring courts to determine the validity and scope of such express clauses.

4.2.2 Judicial Review of the Validity of Sanctions Clauses

Owing to the highly stringent evidentiary threshold required to establish the common law illegality defence, English courts have generally tended to avoid relying exclusively on this defence in practice.[2] Judging from recent precedents, English judicial practice has clearly turned to other legal paths, especially focusing on the contractual interpretation and the recognition of sanctions clauses. However, this judicial preference for contract interpretation ultimately fails to solve the fundamental contradiction between the constraints of public law and the obligations of private law, serving instead as a pragmatic compromise.

The decisions in *Mamancochet*[3] and *Lamesa*[4] play a fundamental role in shaping how English courts handle sanctions in commercial disputes. Rather than eroding the autonomy principle by expanding the common law illegality defence, courts increasingly rely on the objective interpretation of express sanctions clauses to manage regulatory risks. *Mamancochet* established a strict approach, holding that sanctions clauses merely suspend payment obligations upon actual, rather than theoretical, exposure to sanctions.[5] The court concluded that the clause functioned solely to suspend the payment obligation until the sanctions risk was resolved, rather than permanently extinguishing the liability.[6] The above case demonstrates a clear reluctance to interpret the sanctions clause as a mechanism for the permanent release of absolute payment obligations. While this strict interpretation appears to protect the autonomy principle against banks' excessive caution, it fails to fully consider the actual situation of modern compliance. Driven by "rational commercial risk management", international banks routinely take pre-emptive risk removal measures before an "actual" statutory breach is formally established to avoid severe regulatory penalties.[7]

In contrast, the judgment in *Lamesa* reflects a more purposeful approach to contractual interpretation, particularly in dealing with the extraterritorial effectiveness of foreign regulatory regimes. The court determined that the phrase "mandatory provision of law" to exempt the liability for non-payment was broad enough to cover the risk of US secondary sanctions.[8] Consequently, this approach shows that even if there is no formal legal prohibition in English law, the court is willing to recognise that such foreign regulatory risks constitute a practical limitation on the performance of obligations. While secondary sanctions are not strictly binding under English law, the court still concluded that the serious implications of losing access to US proxy banks constituted an "effective prohibition" for an international bank.[9] Although this broad interpretation is commercially pragmatic, it undoubtedly introduces doctrinal uncertainty, making the autonomy of the payment obligation progressively susceptible to extraterritorial political changes.

However, the judicial community's tolerance for breach of contract caused by sanctions remains extremely inconsistent. In the case of *Banco San Juan*[10], the High Court decisively rejected a borrower's attempt to suspend his repayment

[1] International Chamber of Commerce, "Addendum to the ICC guidance paper on the use of sanctions clauses" (Document 470/1238, 2020), pp. 1-2.

[2] *Group Josi Re* [1996] 1 W.L.R. 1152 CA at 1164 per Staughton L.J. (holding that illegality, much like fraud, must be clearly established rather than merely doubtful).

[3] *Mamancochet Mining Ltd. v Aegis Managing Agency Ltd.* [2018] EWHC 2643 (Comm); [2018] 2 Lloyd's Rep. 441.

[4] *Lamesa Investments Ltd. v Cynergy Bank Ltd.* [2020] EWCA Civ 821; [2020] 2 Lloyd's Rep. 543.

[5] *Mamancochet* [2018] EWHC 2643 (Comm).

[6] *Mamancochet* [2018] EWHC 2643 (Comm).

[7] K. Marxen. (2018). "Traditional trade finance instruments a high risk? A critical view on current international initiatives and regulatory measures to curb financial crime" in C. Hugo (ed.), *Annual Banking Law Update*. Juta, pp. 177-178.

[8] *Lamesa* [2020] EWCA Civ 821.

[9] *Lamesa* [2020] EWCA Civ 821.

[10] *Banco San Juan Internacional Inc. v Petróleos de Venezuela S.A.* [2020] EWHC 2937 (Comm).

obligations by citing negative clauses related to general sanctions. In distinguishing the facts of this case from the specific contractual mechanism in *Lamesa*, the court reiterated that any attempt to release or suspend a fundamental payment obligation requires clear and unambiguous wording.

This disagreement on the judgements results exposes a fatal flaw. The court primarily focuses on contract interpretation and may therefore fail to establish a cohesive doctrinal framework to reconcile the conflict between the principle of autonomy and the extraterritorial effectiveness of modern public law. The direct consequence of this is that whether the absolute payment obligation can be enforced no longer depends on stable and predictable legal standards, but on excessive dependence on the specific contract wording in the case. Due to the lack of clear judicial guidance, commercial parties are compelled to navigate these systemic risks by drafting increasingly precise contractual clauses to eliminate their own responsibilities.[1] Banks rely entirely on the strict interpretation of customised clauses and may leverage their strong bargaining power to circumvent absolute payment obligations under English law. This practice essentially subordinates the instrument to the internal policies or discretion of financial institutions.[2] Thus, this judicial approach seriously undermines the certainty of trade finance, which the autonomy principle was originally designed to guarantee.[3]

4.3 AML Compliance and the Structural Disruption of Payment Obligations

4.3.1 Payment Delay and the SAR Regime: A Justified Interference or Doctrinal Evasion?

The interaction between documentary credits and AML regulation has led to obvious contradictions between banks' contractual obligations for timely payment and their statutory compliance obligations. According to the consent regime established by section 335 of the UK Proceeds of Crime Act 2002 (POCA), if a financial institution suspects that a transaction involves criminal proceeds, it must submit a suspicious activity report (SAR) to the National Crime Agency (NCA) and obtain "appropriate consent" before the transaction is executed.[4] This statutory obligation compels banks to freeze transactions pending NCA clearance, creating a direct conflict with the absolute and prompt payment obligation inherent in documentary credits, and puts "banks between a rock and a hard place".[5]

In the case of *Shah v HSBC Private Bank (UK) Ltd*,[6] the High Court reasoned that proceeding without NCA consent would expose the bank to primary criminal liability, thus implying a term into the banking contract that permits the bank to lawfully refuse or delay payment in order to comply with POCA. Although the court defended the bank from criminal liability on the grounds of the delay caused by SAR, it failed to set a clear boundary for such suspensions. By permitting indefinite delays based on mere suspicion, this approach arguably bypasses the strict evidentiary thresholds of the traditional fraud exception, effectively allowing regulatory mechanisms to override contractual certainty. Consequently, the failure to establish clear legal parameters arguably results in a de facto erosion of the beneficiary's absolute right to payment. Rather than formally displacing the autonomy principle, the AML framework effectively subjects it to indefinite suspension. As a result, what is traditionally a secure payment mechanism becomes overly dependent on the opaque administrative procedures of the SAR regime. Given the formalistic nature of documentary credits, subjecting them to such stringent regulatory measures arguably undermines their effectiveness as a reliable tool for international trade.[7]

4.3.2 From Documents to Suspicion: Does AML Undermine Strict Compliance?

[1] See generally S. Chong, "Sanctions: between a rock and a hard place" (NUS Centre for Maritime Law Working Paper 24/06, 2024), pp. 11, 22 (observing that the industry's response to sanctions is expressed through the "contractual allocation of risk", and concluding that ultimately, "the only thing that commercial parties can do is to prepare for the risk with precise drafting").

[2] C. Lupton. (2022). A critical evaluation of the use of sanctions clauses in letters of credit. *PER/PELJ*, 25, 1, 20-21.

[3] R.M. Goode and E. McKendrick. (2010). *Goode on Commercial Law*, 5th edn. London: Penguin, p. 1045.

[4] Proceeds of Crime Act 2002 s.335.

[5] D. Hislop. (2009). Banks, SARS & the customer. *N.L.J.*, *159*, 1.

[6] *Shah v HSBC Private Bank (UK) Ltd.* [2010] EWCA Civ 31; [2010] 3 All E.R. 477.

[7] R.K. Chhina. (2016). Managing money laundering risks in commercial letters of credit: are banks in danger of non-compliance? A case study of the United Kingdom. *J.M.L.C.*, *19*, 158.

As mentioned earlier, Article 5 of the UCP 600 clearly stipulates that banks deal exclusively with documents, rather than with the goods, services, or performance to which those documents may relate.[1] However, the modern AML regulatory framework has a fundamental conflict with the practice of relying solely on document censorship. To effectively detect and prevent Trade-Based Money Laundering (TBML), financial institutions are legally obliged to conduct strict Customer Due Diligence (CDD), "Know Your Customer" (KYC) checks, and ongoing transaction monitoring.[2] Consequently, AML obligations require banks to look beyond documentary examination, which may damage the conceptual foundation of strict compliance.

Despite this structural conflict, the English judiciary has basically not formally reconciled the two regimes. While courts continue to strictly enforce the documentary paradigm in traditional trade finance disputes, they concurrently uphold the banks' statutory duties to suspend transactions based on substantive suspicions of the underlying facts.[3] Consequently, this creates a significant doctrinal tension: the law maintains a strict documentary paradigm, whereas commercial practice operates on a substantive risk-based model. Financial institutions are therefore caught between conflicting obligations, where strict adherence to the private law doctrine of strict compliance arguably exposes them to severe criminal liability under public law.

4.3.3 AML as a Structural Disruption: Risk Transfer and Informal Exception

Faced with the severe threat of primary criminal liability for AML regulatory breaches, financial institutions arguably prioritise regulatory compliance over their private law duties to beneficiaries. Consequently, this regulatory pressure has fostered a trend of "de-risking" and defensive over-compliance within the global trade finance sector.[4] To navigate these intricate regulatory demands, there is a tendency for banks to terminate correspondent banking relationships or close accounts associated with money transfer operators.[5] The practical effect of AML compliance is to quietly transfer risks from banks to commercial counterparties, thus undermining the original function of the documentary credit as an instrument of payment certainty.

It is worth noting that the functional suspension of such payment obligations may undermine the structural integrity of the documentary credit regime. As previously stated, English commercial law, recognises limited exceptions to the principle of autonomy, such as fraud and illegal acts, which require a strict threshold of evidence, that is, there is obvious deception or actual legal prohibitions.[6] In stark contrast, the SAR regime allows banks to indefinitely delay payments based on an "honest suspicion" of illicit activity.[7] This approach arguably circumvents the strict burdens of proof required by traditional private law defences, subjecting the beneficiary to face an indefinite delay without formally invalidating the credit. Consequently, AML compliance has essentially become an unwritten "third exception" to the autonomy principle, but without the doctrinal clarity or legal security that traditional legal exceptions are associated with. Unlike fraud or illegality, which are governed by the strict regulation of common law, this informal exception is excessively subject to opaque administrative procedures and unilateral risk control of financial institutions.

4.4 Synthesis: Three Structural Deficiencies in the Regulatory Framework

Throughout this chapter, it has been demonstrated that both international sanctions and AML regulations pose systemic challenges to the traditional documentary credit regime. Although the two have a common public policy objective of combating financial crime, their legal mechanisms are completely distinct.

Sanctions act in the form of "hard prohibitions", making the performance completely illegal or suspended through clear contractual terms. In contrast, the AML framework is based on "soft suspicion". This approach permits banks to unilaterally suspend transactions until they obtain the approval of the executive branch, even in the absence of definitive proof of illicit activity.

[1] UCP 600, art. 5.

[2] Financial Conduct Authority. (2013). *Banks' control of financial crime risks in trade finance*. Thematic Review TR13/3, pp. 18, 24-25.

[3] See *Shah* [2010] 3 All E.R. 477.

[4] Treasury Committee. (2018). *Economic Crime: Written evidence*. ECR0026, Pt II.

[5] G. Pavlidis. (2023). The dark side of anti-money laundering: mitigating the unintended consequences of FATF standards. *J. Econ. Criminology*, 2, 100040, 3.

[6] *United City Merchants* [1983] 1 A.C. 168; *Mamancochet* [2018] 2 Lloyd's Rep. 441.

[7] *Iraj Parvizi v Barclays Bank Plc.* [2014] EWHC B2 (QB).

However, the two systems not only generate doctrinal tensions, but also create three different structural deficiencies that require systematic rather than fragmented remedial measures.

The first is the erosion of legal certainty. As demonstrated above, English law applies different standards of evidence according to the regulatory regime invoked. The illegality defence in *Group Josi Re* requires "clear confirmation" of the violation of sanctions,[1] and the AML regime tolerates payment only by "honest suspicion".[2] This difference not only produces doctrinal inconsistency but also creates a structural asymmetric legal burden under the two regimes. In the AML context, excessively relaxed thresholds exempt preventive refusals from any substantive scrutiny. In the sanctions context, the strict *Group Josi* standard has created a bilateral liability trap. A bank that pays may face criminal prosecution for violating sanctions, based on reasonable but unconfirmed Banks that suspect and refuse to pay may bear civil liability for violating the obligation to pay independently. Therefore, on the one hand, the current framework has insufficient regulation of the AML discretion, and on the other hand, it exposes banks that act in good faith under the sanction regime to excessive risks and does not provide any legal mechanism to solve this contradiction. This is undoubtedly contrary to the transaction certainty that the autonomy principle aims to guarantee.

The second is the governance gap. As evidenced by the different treatment of sanctions clauses in *Mamancochet*, *Lamesa*, and *Banco San Juan*, English courts have addressed regulatory risk almost entirely through contract interpretation without imposing any minimum procedural requirements on banks exercising their discretion to withhold payment. As a result, the decision to reject the payment is completely subject to non-transparent internal compliance policies, rather than transparent and externally verifiable legal standards.

The third problem is the lack of accountability. English law currently affords banks almost uncensored discretion, allowing them to suspend transactions for regulatory reasons. Meanwhile, the internal compliance procedures of banks have great discretion when making decisions regarding the areas of sanctions and AML without the need for structured judicial review of such decisions.

These three deficiencies together reveal that English law has not resolved the tension between autonomy and regulatory compliance. The problem is not merely one of doctrinal fragmentation, but of structural under-regulation.

5. Reform: A Two-Way Path

The preceding analysis has revealed that the contemporary challenges facing the documentary credit system do not stem from a single doctrinal deficiency, but from the significant roots of two structural differences. On the one hand, as demonstrated in Chapter III, the English legal framework exhibits significant doctrinal limitations, especially in the narrow scope of application of fraud exceptions and the lack of coherent responses to legal nullities. These limitations mainly exist within the framework of private law, specifically with regard to properly defining the payment obligations of banks under the principle of autonomy.

On the other hand, as discussed in Chapter IV, the expansion of the public regulatory system, especially in the areas of sanctions and AML, brings a completely different kind of pressure. Unlike doctrinal shortcomings, these regulatory interventions do not only expose gaps in the existing legal structure. On the contrary, they force banks to act and investigate relevant transactions based on suspicion alone, thus posing a major challenge to the fundamental logic of the principle of autonomy. Consequently, this external pressure creates a structural tension, which is difficult to fully solve by doctrinal improvement alone.

In light of this distinction, the reform strategy proposed in this chapter is based on a fundamental structural distinction. The first layer focuses on the doctrinal deficiencies within the structure of private law, which can be resolved through specific doctrinal adjustments. The second layer aims to cope with the external regulatory pressure that increasingly prevails over the principle of autonomy. These discrepancies do not stem from the autonomy principle itself, but because the existing law has failed to establish an institutional framework sufficient to harmonise the regulatory requirements of public law and the payment obligations of private law. Based on the internal

[1] *Group Josi Re* [1996] 1 W.L.R. 1152.

[2] *Parvizi* [2014] EWHC B2 (QB).

and external dimensions, this article puts forward a two-way reform path. The path abandons the rigidity and disorderly compromise on the autonomy principle. To reshape it as the core cornerstone of documentary credit transactions, it is not only necessary to realise the logical self-coherence of internal jurisprudence, but also to obtain reasonable standardisation and protection from external systems.

5.1 Internal Doctrinal Reforms: Resolving the Fraud and Nullity Deficiencies

As described in Chapter III, the English documentary credit framework is currently constrained by the narrow applicability of the fraud exception clause and the lack of remedies for legal nullities. Since these two systemic blind spots stem from fundamentally different legal issues, namely subjective dishonesty and objective legal ineffectiveness of bidding, effective reform must be resolved at their respective doctrinal levels. However, it is crucial that any such intervention must be carefully considered so as not to undermine the principle of autonomy, which is still the cornerstone of business trust in international trade financing. Therefore, the reform proposals put forward in this chapter directly correspond to the previously identified dual vulnerability. This chapter proposes a phased reform strategy. On the one hand, functionally adjust the fraud rules to deal with third-party deception; on the other hand, the nullity exception is independently recognised as a threshold for document compliance. This approach aims to provide a coherent structural response that can not only make up for existing shortcomings but also maintain the integrity of the principle of autonomy.

5.1.1 Reconceptualising the Nullity Exception: A Return to Strict Compliance

The first key reform involves a fundamental reconceptualisation of the nullity problem. It should be noted here that recognising a nullity exception is not an attempt to revise the existing fraud framework or seek to make new exceptions to the autonomy principle. On the contrary, it corrects the mischaracterisation of the "complying presentation" under the UCP by the English judiciary.[1] This doctrinal reframing is significant because it eliminates the primary concern that any new exception would erode the autonomy principle. Under this model, the autonomy principle remains entirely intact, as the legal inquiry is resolved before it is applied.[2]

This reform indicates that English courts should acknowledge that a document which is legally void *ab initio* fails to satisfy the foundational precondition for a bank's payment obligation. Consequently, a fabricated instrument cannot constitute a "complying presentation" within the meaning of the UCP.[3] By locating this reform within the internal boundaries of the strict compliance doctrine, this approach is logically more conservative than expanding the parameters of the fraud exception. It reinforces the premise that a bank pays only against genuine documents, rather than fabricated ones.

By locating this reform within the internal boundaries of the strict compliance doctrine, this approach is logically more conservative than expanding the parameters of the fraud exception. It reinforces the premise that a bank pays only against genuine documents, rather than fabricated ones.[4] Nullity refers exclusively to documents that have no legal effect from the outset, namely, documents that are completely forged or documents issued by unauthorised or non-existent entities. This is conceptually and legally distinct from documents containing factual inaccuracies or formal discrepancies, thus drawing a practical legal boundary.[5] As the Court of Appeal of Singapore demonstrated in *Beam Technology*, adjudicating whether a document is a legal nullity provides a practical judicial template for courts to apply without involvement in relevant contract disputes.[6]

In summary, since this conceptual shift is carried out within the framework of strict compliance with established rules, rather than creating external exceptions, it represents the most feasible reform pathway of English law, with minimal intervention in the existing doctrinal structure.

5.1.2 Recalibrating the Fraud Exception: Towards

[1] Richards. (2019). Revisiting the fraud exception: a critique of *United City Merchants v Royal Bank of Canada* forty years on. *L.S.*, *39*, 656, 672.

[2] *Beam Technology* [2003] 1 S.L.R.(R) 597.

[3] Gao and Buckley. (2003). A comparative analysis of the standard of fraud required under the fraud rule in letter of credit law. *Duke J. Comp. & Int'l L.*, *13*, 293.

[4] *Montrod* [2002] 1 W.L.R. 1975.

[5] Lu. (2012). The exceptions in documentary credits in English law, pp. 240-242.

[6] *Beam Technology* [2003] 1 S.L.R.(R) 597.

a Transaction-Focused Standard

The second necessary reform aims to address the inherent structural deficiencies of the English fraud exception. As established in *United City Merchants*, the current English doctrine adheres to the principle of "actual fraud", placing the evaluation entirely on the subjective intention of the beneficiary. [1] This strict requirement for subjective dishonesty creates a loophole, which allows complex third-party fraud to be unrestrained by this principle, forcing banks to facilitate payments with significant false documents just because the beneficiaries of the vouchers are unaware of the fraud.

In order to make up for this loophole, English law must recalibrate its approach and adopt objective, transaction-centred standards. This reform requires shifting the focus of analysis from the moral responsibility of the beneficiaries to the objective commercial integrity of the transaction itself. Drawing on the provisions of Section 5-109 of the US UCC, if honouring the presentation would objectively "facilitates" a material fraud, the court should be allowed to intervene regardless of whether the beneficiary had subjective knowledge of the wrongdoing.[2] As discussed in Chapter III, the concept of "facilitating" fraud is used to change the legal paradigm from passively pursuing subjective complicity to a prevention mechanism that prioritises objective commercial impact.

Fundamentally, this readjusted standard should be clearly defined. Adopting a transaction-centred approach does not mean extending fraud exceptions to negligence, ordinary contract disputes or simple misrepresentations of fact. To trigger the intervention, the wrongdoing must be so serious that it has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served."[3] It only applies to scenarios where the substance of the transaction has been seriously undermined and the compelling payment no longer has any legitimate commercial purposes.

Finally, in order to maintain the liquidity of the documentary credit mechanism, it is necessary to balance this broader substantive standard with a higher procedural threshold. [4] English courts should strictly apply the standard established in *United Trading Corp SA v Allied Arab Bank Ltd*, requiring the applicant to demonstrate a "strong prima facie case" where the "only realistic inference" is that a material fraud has occurred.[5] By combining the functional, transaction-centred definition of fraud with the high procedural threshold, this approach ensures that judicial intervention remains a strict exception, thus eliminating the loopholes of third-party fraud without compromising the systemic efficiency of the autonomy principle.

5.2 Recalibrating Autonomy Under Regulatory Pressure: A Structured Regulatory Intervention Framework

As described in Chapter IV, regulatory compliance no longer acts as a clearly defined legal exception such as fraud but evolves into an unspecified constraint on the autonomy principle.

These deficiencies do not stem from the autonomy principle itself, but from the lack of any structured legal framework to regulate the connection between public regulatory obligations and private payment obligations. In this field, banks actually have unrestrained discretion and can override documentary credit obligations without satisfying any identifiable thresholds, following any established procedures, and without assuming any substantial judicial accountability. In order to systematically address these three structural deficiencies, this article proposes a structured regulatory intervention framework, which contains three interrelated pillars corresponding to each identified defect.

Pillar 1—Substantive Threshold: Restoring Legal Certainty and Establishing a Safe Harbour

In order to solve the double defect pointed out in Section 4.4, namely under-regulation of AML discretion and the contradictions of bilateral responsibilities inherent in the sanctions regime, the first pillar proposed two complementary reform measures.

[1] *United City Merchants* [1983] 1 A.C. 168.

[2] Uniform Commercial Code (US) § 5-109(a).

[3] For this classic articulation of the materiality threshold, see *Intraworld Industries, Inc v Girard Trust Bank* 336 A 2d 316 (Pa 1975) 324–325; subsequently adopted by the UCC § 5-109, Official Comment 1.

[4] 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)

[5] *United Trading Corp SA v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554 (CA) 561.

The first measure is to elevate the threshold of evidence in AML regimes, requiring substantiated grounds based on objective facts, not just out of honest belief. The feasibility of imposing a stricter threshold is practically demonstrated by the Swiss anti-money laundering framework. Under the Swiss model, financial intermediaries have a mandatory reporting obligation in cases of "actual knowledge of or reasonable grounds to suspect",[1] which is differentiated from "mere suspicion" and requires a higher threshold of suspicion than in the UK.[2] Connecting the English AML threshold with this model will bring it into closer coherence with the *Group Josi* standard applicable to sanctions, thus reducing the doctrinal asymmetry pointed out in Section 4.4.

Moreover, the reformed threshold should operate symmetrically. It should not only constrain regulators to exercise discretion over the law, but also protect those banks that exercise that power responsibly. If the bank withholds or delays payment on objective, reasonable and verifiable regulatory grounds, it should benefit from a qualified safe harbour protection and be exempt from civil liability arising from violation of autonomous payment obligations, provided that the bank has satisfied the minimum procedural requirements stipulated in the second pillar below. This safe harbour mechanism directly solves the inherent bilateral liability trap in the current sanctions framework. The doctrinal basis of such protection is implicit in the English contract law. Drawing on the principle established in *Braganza v BP Shipping Ltd* that the parties exercising the discretion of the contract must act honestly and rationally.[3] Banks invoking sanctions or AML concerns should be required to demonstrate that their refusal or delay is based on reasonably substantiated regulatory risk rather than mere precautionary de-risking. Extending this logic to the context of regulatory will reposition the status of banks in a coherent legal structure, replacing the contradictions caused by the current competitive legal risks with a framework for obtaining corresponding legal protection for compliance behaviour.

Pillar 2—Procedural Safeguards: Closing the Governance Gap

The second pillar aims to address the complete lack of minimum procedural requirements in the exercise of regulatory immunity by banks, that is, the governance gap pointed out in Section 4.4. This article extends the rationality principles established in the *Braganza*,[4] and proposes that if any financial institution withhold or delays payment on the grounds of regulatory, it must satisfy the following three minimum conditions: (a) it must provide the beneficiary with a well-reasoned notification indicating the specific regulatory basis for its decision, rather than simply invoking internal compliance policies; (b) decisions must be made within the prescribed time limit to avoid indefinite administrative suspension of payment obligations; (c) the decision-making process must have obvious objectivity, not only reflecting the internal risk preferences of the institution. These requirements do not increase the burden of investigation contrary to the principle of autonomy. They simply place the exercise of regulatory immunity under the basic standards of transparency and rationality that should be followed by parties exercising contractual discretion in commercial relations as required by the English contract law.

Pillar 3—Structured Reviewability: Remedying the Accountability Deficit

The third pillar aims to address the current lack of effective judicial supervision, which allows banks to suspend payment obligations in the absence of effective external accountability. If financial institutions rely on broad sanctions clauses or AML suspicions to withhold payments, courts should conduct a structured review of such reliance based on the established doctrines of contract interpretation, rather than affording undue deference to internal compliance procedures. This objective judicial posture is perfectly exemplified by the Court of Appeal of Singapore in *Kuvera*.[5] Navigating a highly internationalised trade finance hub, the Singaporean judiciary decisively rejected a bank's reliance on its internal, subjective sanctions policy, demanding instead an objective determination of sanctions violations based on

[1] Federal Act on Combating Money Laundering and Terrorist Financing of 10 October 1997 (Anti-Money Laundering Act, AMLA) SR 955.0, art. 9 para.1quater (Switzerland).

[2] D. Chaikin. (2009). How effective are suspicious transaction reporting systems? *J.M.L.C.*, *12*, 238, 245.

[3] *Braganza v BP Shipping Ltd.* [2015] UKSC 17; [2015] 1 W.L.R. 1661 at [30] per Lady Hale and at [104] per Lord Neuberger.

[4] *Braganza* [2015] UKSC 17; [2015] 1 W.L.R. 1661.

[5] *Kuvera Resources Pte. Ltd. v JPMorgan Chase Bank*, N.A. [2023] SGCA 28.

admissible evidence on a balance of probabilities. English courts could adopt a similar structured review to ensure that the beneficiary's right to payment does not depend on administrative processes that are completely unscrutinized by law.

Taken together, these three pillars are not intended to displace the autonomy principle, but they serve to preserve their core function by embedding regulatory intervention within a transparent, procedurally disciplined, and judicially accountable legal structure. In this sense, the structured regulatory intervention framework seeks to reverse the current trend towards the privatisation of regulatory risk through unstructured banking discretion, and to re-anchor the operation of documentary credits within a coherent and publicly accountable legal standard.

6. Conclusion

The central contention of this article is that the contemporary instability of the English documentary credit framework is not a product of doctrinal obsolescence but of structural misalignment — a failure of the existing legal architecture to account for two categories of pressure that its foundational assumptions were not designed to bear. English law has always regarded these pressures as external interference, which are controlled through the fragmentary extension of existing doctrines, but this article shows that these pressures are actually a constituent challenge to the logic of the principle of autonomy itself. The contradiction of the private law framework is that it cuts off the formal requirements of documents from the logic behind them, that is, documents must have legal authenticity. If the bank is forced to pay an invalid counterfeit bill, it is not defending the principle of autonomy but sacrificing its substantive function of ensuring the security of transactions while maintaining the form of the principle of autonomy. The disadvantage of the regulatory framework is that it lets the compulsory investigation obligation under the public law to override the payment obligation of the private law in the absence of clear guidelines. As a result, the payment of letters of credit no longer depends on the definite legal rights but becomes a product of the bank's internal risk appetite.

The above two problems quietly subvert the original risk distribution mechanism of letters of credit in practice. The basic transaction risk that should have been borne by the applicant, that is, the burden of ensuring document compliance and seeking relief for breach of contract, has now been transferred to the beneficiary. Today, beneficiaries not only face payment interruptions caused by regulatory review at any time, but also this compliance mechanism-based intervention completely lacks the due process guarantee provided by traditional private law exceptions (such as the fraud exceptions discussed in the previous chapter). Letters of credit, which serve as the cornerstone of commercial certainty, has evolved into a conditional commitment in practice. Its reliability depends on variables that are completely beyond the control of the beneficiary or the scope of legal relief, such as institutional compliance culture, the accuracy of the drafting of sanctions clauses, and the opacity of the suspicious activity reporting system. Against this background, the phased reform strategy proposed in Chapter V is premised to strictly distinguish between the two types of pressures, rather than adopting a unified theoretical response to the two. The reform of private law follows the inherent logic of strict compliance and autonomy principles; the proposed regulatory framework introduces a mechanism for structured judicial supervision of banks invoking sanctions and anti-money laundering reasons, drawing on the existing rational constraints in English contract law and the evidence standards developed in comparative jurisdictions.

This article's analysis leads to two directions that require further exploration. At a theoretical level, this article reveals a gap in the existing theoretical research: the current theoretical framework of the letter of credit law has not yet explained how the principle of autonomy should work in a regulatory environment that imposes mandatory investigation obligations on financial institutions, providing a convincing normative explanation.

From a comparative perspective, the comparative analysis of this article found that there is a fruitful but unexplored interaction between transaction-focused fraud standards in the United States and Singapore's compliance-threshold approach to nullity. To what extent to which these two models can be applied to English law, and whether their combination will produce greater theoretical coherence than either single model, represents a specific agenda for future comparative research.

At the institutional level, the fragmentation and differences caused by the judicial community's reliance on the interpretation of specific contract terms, such as the different treatment of sanctions clauses in the English case law discussed above, show the limitations of relying purely on domestic solutions. Instead of making a comprehensive revision of UCP 600, it may be more realistic to develop targeted explanatory guidelines or supplementary rules through institutional mechanisms such as the International Chamber of Commerce Banking Committee. Such clarifications can provide a more coherent and internationally consistent framework for dealing with regulatory restrictions without compromising the flexibility on which the UCP system depends.

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