



UNIVERSITY OF NAIROBI - FACULTY OF LAW

LLM RESEARCH THESIS

RESEARCH TOPIC

**THE JUDICIAL APPROACH TO INJUNCTIONS AGAINST LETTERS OF CREDIT IN
KENYA; THE FRAUD EXCEPTION RE-EXAMINED**

BY

UMUKULTHUM ALI AHMED DAWOOD

REG. NO: G62/11255/2018

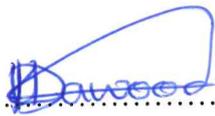
**A RESEARCH THESIS SUBMITTED TO THE UNIVERSITY OF NAIROBI IN PARTIAL
FULFILLMENT OF THE REQUIREMENT FOR MASTERS OF LAWS DEGREE (LLM).**

NOVEMBER

2021

NAIROBI, KENYA

DECLARATION: I, **Umukulthum Ali Ahmed Dawood**, declare that this thesis which I submit in partial fulfillment of the requirement for masters of laws degree (LLM) at the University of Nairobi is my original work and has not previously been submitted for any degree at another University.

Signed  Date **22ND NOVEMBER, 2021**

Supervisor approval

This thesis has been submitted for examination with my approval as the university supervisor



Dr. Kariuki Muigua

22/11/2021

Signed..... Date.....

ACKNOWLEDGEMENT

First I thank the Almighty God. It is only by the good Lord's grace that I was able to successfully complete this research paper.

To my supervisor, Dr. Kariuki Muigua, I am grateful for your wise counsel, guidance, intellectual guidance and patience in the supervision of this thesis. I appreciate that you took time out of your busy schedule to provide direction that enabled me to successfully complete the research paper.

To my parents Ali Ahmed Dawood and Mwanashe Bwanakher for their never-ending support throughout my life, I am eternally grateful for the love, financial and moral support you have provided as I undertook my postgraduate studies and more specifically as I worked on the research paper.

Lastly, my siblings: Mariam, Ahmed, Mohamed, Athman, Hawaa and Fatma, I am thankful for all the support and encouragement you have given me during both good and difficult times.

I pray that the Almighty God bless you all abundantly.

TABLE OF CONTENTS

ACKNOWLEDGEMENT	iii
LIST OF CASES	vi
LIST OF ABBREVIATIONS	viii
1.0 INTRODUCTION TO THE STUDY	1
1.1 CHAPTER ONE.....	4
1.2 Background of Study	4
1.3 Statement of the Problem	10
1.4 Statement of Objectives	11
1.4.1 General objective	12
1.4.2 Specific objectives	12
1.5 Research Questions	12
1.6 Hypothesis	13
1.7 Justification of the Research.....	13
1.8 Theoretical/ Conceptual Framework.....	14
1.8.1 Theories of law informing the study	15
1.9 Research Methodology	25
1.10 Literature Review	26
1.11 Scope and Limitations.....	29
1.12 Description of Chapters.....	30
CHAPTER TWO	31
2.0 Introduction	31
2.1 International Chambers of Commerce and the UCP.....	31
2.2 U. N Convention on Contracts for International Sale of Goods (Vienna CISG1980) and Law of International Trade	34
2.3 Transnational Plane.....	36
2.4 The Domestic Plane	37
2.5 How Uniform Customs and Practice for Documentary Credits applies in Kenya.....	42
2.6 Kenyan cases on injunctions in Letters of Credit	43
2.6.1 The Extraction fraud Exception.....	43
2.6.2 Kenyan Court’s Approach.....	45
2.7 Importance of Guidelines	50
2.8 Conclusion.....	51
CHAPTER THREE.....	52
3.0 Introduction	52

3.1 ENGLAND.....	52
3.2 U.S.A	55
3.3 CHINA.....	61
3.4 Comparison	65
3.5 Conclusion.....	67
CHAPTER FOUR.....	68
4.0 FINDINGS, CONCLUSION AND RECOMMENDATIONS.....	68
4.1 Research Findings.....	68
4.1.1 Research Hypothesis Test	70
4.1.2 Research Objectives Met.....	70
4.2 Conclusion.....	71
4.3 Recommendations.....	72
REFERENCES AND BIBLIOGRAPHY	79

LIST OF CASES

1. *Alternative Power Solutions Ltd. V. Central Electricity Board* (2014) UKPC.
2. *Asbury Park & Ocean Grove Bank v National City Bank of New York* 35 N.Y.S.2d 985 (Sup. Ct. 1942), *aff'd*, 52 N.Y.S.2d 583 (App. Div. 1944) (Mem. Op.).
3. *Bank of Nova Scotia v. Angelica-Whitewear Ltd.*[1987] 1 SCR 59.
4. *Civicon Limited -vs- Kivuwatt Limited* [2013] eKLR.
5. *Czarnikow-Rionda Sugar Trading, Inc. v Standard Bank London, Ltd.*, [1999] 1 All ER 890 (QB, Comm.).
6. *Discount Records Ltd v. Barclays Bank Ltd and another* [1975] 1 Lloyd's Rep. 444
7. *Donholm Rahisi Stores v Barclays Bank of Kenya Ltd & another* [2005] eKLR, Civil Case 156 of 2004.
8. *Dynamics Corp. of America v. Citizens & Southern National Bank* 356 F. Supp. 991 (N.D. Ga. 1973).
9. *Elikem Pharmaceuticals Limited v. Sipri Pharmaceuticals Limited & Another.* [2005] eKLR, Civil Suit 411 of 1999.
10. *Hamzeh Malas & Sons v British Imex Industries Limited* (1958) 2 QB 127.
11. *Howe Richardson Scale Co. Ltd. –Vs- Polimex Cekop*, [1978] 1 LLOYDS Rep. 161
12. *Intraworld Indus. Inc. v. Girard Trust Bank*, 461 Pa. 343, 336 A.2d 316 (1975).
13. *Kenindia Assurance Company Limited –vs- First National Finance Bank Limited* Civil Appeal No. 328 of 2002.
14. *Republic - vs – Commissioner of Customs Services Ex parte Imperial Bank Limited* [2015] eKLR.
15. *R.H. Devanil Limited -vs- Transfuel Enterprises Limited & Another*, [2015] eKLR.
16. *Scope Telematics International Sales Limited v Stoic Company Limited & another* [2017] eKLR, Civil Appeal No 285 of 2015.
17. *Shaffer v. Brooklyn Park Garden Apartments*, 311 Minn. 452, 453 (Minn. 1977).
18. *Sinohydro Corporation Limited v GC Retail Limited & another.* [2016] eKLR, Civil Suit 487 of 2015.
19. *Sztejn v. J. Henry Schroder Banking Corp* 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941).
20. *Taurus Petroleum Limited v. State Oil Marketing Company of the Ministry of Oil* [2017] UKSC 64.

21. *United Bank Ltd. v. Cambridge Sporting Goods Corp.* 41 N.Y.2d 254, 360 N.E.2d 943, 392 N.Y.S.2d 265 (1976).
22. *United City Merchants (Investments) Ltd v Royal Bank of Canada*, [1983] 1 AC 168.
23. *United Trading Corporation S.A. v. Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554.
24. *Urquhart Lindsay And Company Limited vs. Eastern Bank Ltd* 1 KB [1922] 318
25. *Victoria Commercial Bank Ltd v Intra Africa Assurance Co Ltd* [2000] eKLR, Civil Case 1810 of 1999
26. *Wilfred Gitonga t/a Wilken Communications vs Barclays Bank Kenya Ltd*, HCC 1938 OF 1996
27. *Yuegang Agricultural Resources Development Co. v. Japanese Technology of Science Co. ., Zhu ZhongFa Jin ShenZi Di 23-3, Hao Case No. 23-3 (Econ. Div., Zhuhai Interim. People's Ct. 1986).*

LIST OF ABBREVIATIONS

FDI	-	Foreign Direct Investment
GPCL	-	General Principles of the Civil Law
ICC	-	International Chamber of Commerce
ISP 98	-	International Standby Practices
ITL	-	International Trade Law
LC	-	Letters of Credit
SPC	-	Supreme People's Court
UCC	-	Uniform Commercial Code
UCP	-	Uniform Customs and Practice for Documentary Credits
UK	-	United Kingdom
UN	-	United Nations
UNCITRAL	-	United Nations Commission on International Trade Law
URDG	-	Uniform Rules on Demand Guarantees
USA	-	United States of America
USD	-	United States Dollars

1.0 INTRODUCTION TO THE STUDY

Trade is the pulse on which any economy thrives. Trade may be transacted at the domestic and international levels, with distinct transactional instruments or media.

Common documents used in international trade include the Bill of Lading, Sale Invoice and Letter of Credit¹. This study will discuss the use of the Letter of Credit, particularly how it affects the buyer's judicial rights in Kenya.

A Letter of Credit is; -

*A written commitment by the buyer's bank to the seller's bank to pay the agreed amount in the sale contract.*²

Some features of Letters of Credit include: negotiability, transfer and assignment, sight and time drafts and revocability.³ Negotiability means that the beneficiary in a letter of credit is warranted a pay.⁴ Revocability means that the obligation to pay a beneficiary under a letter of credit can be revoked.⁵ Transfer and assignment means that the duty to pay can be imposed to another person.⁶

The significance of the Letters of Credit includes, providing security to transactions which are often highly complex, engage many parties and pose many potential risks. Hence, despite being very ancient and lacking in clear written law, they are trusted as a reliable mode of payment in global trade.

These Letters of Credit facilitate international sale of goods such that where parties that do not readily have funds they may, nevertheless, engage in profitable trade through their banks'

¹ Ajendra Srivastava. "Modern Law of International Trade", Springer Science and Business Media LLC, 2020

² *Black's Law Dictionary*. What Is Letter Of Credit (L/C)? at <https://thelawdictionary.org/letter-of-credit-Letters of Credit/> accessed 20 October 2021

³ <https://bizfluent.com/list-5980966-features-letter-credit.html> accessed 20 February 2021

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

willingness to grant credit. They eliminate the risk of insolvency or lack of creditworthiness with the buyers, which could discourage sellers from committing their goods to trade across national boundaries.

However, notwithstanding the benefits of Letters of Credit as highlighted above, there are several disadvantages and bottlenecks of Letters of Credit such as lack of guarantee of delivery of specified goods, timely delivery, and agreed quality and quantity, together with the many risks associated with it. These factors under the sale of goods may vitiate a contract.

Internationally, a letter of credit is regarded as one of the most secure methods for payment of goods sold under a contract of sale⁷. Many high value commercial agreements depend highly on the certainty provided by standby Letters of Credit to guarantee that a payment obligation will be met⁸. Their greatest benefit seems to be their independence, irrevocability and documentary nature. This ensures that the receiving party does not rely on the counterparty where there is a risk of uncreditworthiness and bankruptcy from that side.

Further, from the bank's or issuer's perspective, the autonomous nature of these Letters of Credit ensure they remain separate from the sale contracts, from any resultant dispute of the underlying sale contract, and that the beneficiary's right to receive payment under the instrument is not interfered with, denoting the independence factor.

Notwithstanding these advantages, some cases have suggested otherwise. In limited cases an element of **extraction fraud (false invoicing)** is enough to provide a restrictive injunctive relief against payment of such Letters of Credit. These circumstances therefore serve as a reminder that a letter of a credit does not always guarantee water tight security of payment and that there may

⁷Trade Finance Global; <https://www.tradefinanceglobal.com/letters-of-credit/ucp-600/> archive.uef.fi (accessed on 2/04/2021).

⁸Ibid.

be circumstances where a bank can legitimately refuse to make payment or can be restricted from making any such payment through injunctive relief obtained from the courts. Particularly in Kenyan courts, a restrictive injunctive relief for aggrieved buyers has been elusive arising from some challenges in the limited interpretation or the lack of it of the technical internationally provided guidelines on the use of letter of credit.

This study therefore seeks to critically analyze the judicial response of such restrictive injunctive relief claims in Kenya, especially from the **buyer's perspective**, with a comparative analysis of English, U.S.A and Chinese legal regimes.

To this end, the study has four chapters; Chapter one which provides for the background of the study, statement of the problem, justification and objective of the study, the research questions, the theories on which this paper is based on, the literature review of books and articles relied upon, the hypothesis, research methodology, scope and limitations of this study and the description of chapters; Chapter Two provides for the legal framework governing Letters of Credit in Kenya with the aim of identifying loopholes in the law on Letters of Credit. Chapter Three gives a comparative study of the Letters of Credit application in England, U.S.A, China and Kenya and what best practices Kenya can borrow in relation to restrictive injunctive reliefs on Letters of Credit, and Chapter Four completes the study with findings, recommendations borrowed from the comparative study and conclusion of the study.

1.1 CHAPTER ONE

1.2 Background of Study

Letters of Credit (also known as Documentary Credits) are very common in international trade, which provide for the financing of international commercial transactions.

Principally, they solve two problems. First, to facilitate trade between parties within different jurisdictions. Many international sales transactions involve a contract of sale where both the buyer and seller are in two different countries and probably neither has met the other before the bargain. The contract of sale may be on 'Cost Insurance Freight' (CIF) or 'Free On Board' (FOB) terms, or any of their respective variations. It is generally presumed that since the buyer and seller may be located in different countries, they hardly know each other.

In this regard, the contract of sale does not by itself provide security for either the buyer or seller. Consequently, the seller will either request for payment in advance before the dispatch of goods, or seek a guarantee that the payment will be completed upon the dispatch of goods. On the other hand, the buyer would want to commit to pay as late as possible after verifying that the goods are dispatched, in a timely manner, and that they are of the right quality and quantity.

The second problem is that of raising credit since both parties are usually reluctant or unwilling to tie up capital while goods are generally on transit. Thus, it calls for the merchants to choose a suitable and reliable method of payment of an international character that will satisfy both parties. The answer is found in a special letter known as Letters of Credit. Under Letters of Credit the buyer agrees to pay the seller using a trusted medium (such as a bank in the seller's country) who remits the price amount to the seller upon the presentation of the particular documents that pertain to the terms of the credit transaction.

Letters of Credit have over time been instrumental in facilitating trade finance dating back to the time of the Phoenicians, Babylonians, Assyrians and Greeks.⁹ Their role crystallized when it became apparent that business between countries could not suffice simply by a handshake. In modern times, Letters of Credits were introduced by the merchant banking system in Europe. Its use begun by a letter from the buyer's bank to the seller's bank promising a guarantee payment to the seller in case the buyer defaulted in payment.

Smoothness in payment facilitates the success of the whole transaction. However, international transaction payments tend to be more complex than domestic ones. The parties situated in different countries where different legal rules might apply also have different interests in the sales transactions. The sellers anticipate that they will get paid for the sold goods upon the release of the goods, whereas the buyers expect before payment that sellers will faithfully ship the goods as stipulated in the sales contract.¹⁰ For this reason, the letter of credit is regarded as one of the most dependable devices of payment.

The justification was that a seller wishing to do business with a distant buyer would be apprehensive about the buyer's credibility and financial ability to pay for the goods sold. The seller would want to reduce the time between shipping those goods and receipt of payment. Finally, he would also desire to steer clear of the buyer's unfamiliar legal system, a system with which the seller is unlikely to be familiar.

To allay these fears, the seller required the buyer to instruct a mutually trusted agent like a bank, to pay out the agreed contract sum in exchange for certain, pre-arranged documents. The bank's pledge to pay under this understanding is what constitutes the letter of credit, which it "opens" in

⁹Wiley, *How to Use Letters of Credit in Financing the Sale of Goods*, 20 Bus.LAW.495, 495 (1965).
www.pierobon.org

¹⁰Van Houtte, Hans (2002), *The law of International Trade*, London: Sweet & Maxwell, 2nd ed., p. 265.

favor of the seller. When the seller issues the bank or issuing agent with the pre-arranged documents, the seller receives the amount owed to him for the dispatched goods. The seller will be swiftly paid whereas the buyer is assured of documents of title to the goods. This bargain works so well that it is widely embraced globally for imports merchandise.¹¹

The law regulating Letters of Credit advanced through the International Chamber of Commerce (ICC). The ICC drafted codified rules that were as a result of norms and business customs. The rules, however, are not derived from a treaty, an intergovernmental organization, or domestic regulators, but is the initiative of a small group of commercial bankers, primarily from large money center banks, working under the ICC's Banking Commission. The Banking Commission is neither a governmental organization nor an intergovernmental organization. It is interesting to note that the practice-based customs and rules eventually found their way as "soft law" into official legal structures through international legal scholarship.

At the centre of the dependability of the letter of credit is the seemingly autonomic or independent nature of the bank's pledge to the beneficiary under the letter of credit. The courts perceive this "independence principle" as concerning three distinct contracts.¹²

First, the customer (buyer) and the beneficiary (seller) agree to exchange money for goods sold under actual or the "underlying" contract. Second, the customer pays a fee to the bank binding to remit the funds owed to the beneficiary¹³. Finally, the beneficiary exchanges the documents, which are valuable and negotiable,¹⁴ with the bank for the sum stated in the letter of credit. Theoretically these contracts are separate and independent, and the issuing bank normally concerns itself with

¹¹ Letters of Credit: Injunction as a Remedy for Fraud in U.C.C. Section 5-114,63MnqN. L. R Ev. 487 (1979).

¹²Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 464-65 (2d Cir.1970).

¹³<https://www.nortonrosefulbright.com/en-ke/knowledge/publications/33286e75/letters-of-credit-landlords-and-lenders-rejoice-crystalline-prevails>, 09/08/2021

¹⁴ Lantz In'l Corp. v. Industrial Termotecnica Campana, S.P.A., 358 F. Supp.510 (E.D. Pa. 1973); Discount Records Ltd. v. Barclays Bank Ltd. [1975] 1 All E.R. 1071.

the documents the beneficiary presents that comply with the terms of the letter of credit, but not with the actual performance of the parties' "underlying contract."¹⁵ Promoters of this system have insisted that the issuer's strict obligation to pay upon the presentation of the correct documentation is essential to international trade¹⁶.

The only exception provided for the autonomy principle is the fraud exception, which allows the aggrieved party to seek a restrictive injunctive relief stopping payment even where the documents strictly comply with the Letters of Credit contract. Interestingly, the Uniform Customs and Practice for Documentary Credits (UCP 600), setting rules on issuance and use of Letters of Credit does not provide guidelines to scrutinize fraudulent behavior or documents. The ICC reckons that although the UCP 600 recognizes the fraud issue the varying jurisdictions on the scope of exceptions would leave it up to domestic law and domestic courts acting in good faith to protect the interests of the trading parties.

Nonetheless, the frequency and utility of the restrictive injunctive relief against Letters of Credit in Kenya have not gained prominence, the reason being that its application has been too limiting. Hence, the study explores a comparative study of three different jurisdictions which have established regulations and codes of application that mitigate the vagueness of the current UCP 600 as applied by Kenyan courts. The need for this development in usage arises because Kenya's strategic position as a business hub for the region has seen the volume of international trade in grow substantially. This change has resulted in a direct escalation in the import and export activities of goods in Kenya with heightened transactional activity in Kenya's banking system and its involvement as a primary participant in the competitive international trade. Some of the services

¹⁵ O'Meara Co. v. Nat'l Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925) (bank obligated only to verify that documents presented strictly comply with terms of underlying letter of credit).

¹⁶ *ibid*

provided by the country's banking system are the documentary collection and letter of credit. Together with the benefits that result in the increased volume of the country's export and import, comes equally an increase in the amount of financial risk concerned with doing business in the international market.

Being a common law country, Kenya adopted the common law principles and with it the precedents where courts used the equitable remedy of injunction and propounded its application in a strict or limited manner. The study presupposes that relying solely on soft law (UCP 600) and common law creates a problem of injustice in some instances, due to the rigidity of common law. There is need for some expanded code or guidelines to be developed in order to improve prospects for the equitable remedy of injunction on Letters of Credit. In subsequent discussions the study will highlight some cases decided in Kenyan courts relating to the shortcomings in the strict utility of Letters of Credit under the UCP's common law precedents. The overall effect of the failure to adjudicate on this matter fairly and expeditiously results in a dented business reputation for the country, huge business losses, delayed services and poor quality delivery of goods and services.

The above expectations notwithstanding, the strict conformity to the traditional Letters of Credit requirements that merely relies on release of payment based only on the presentation of documents have left it open to abuse in fraudulent dealings that may be exploited by unscrupulous individuals. The weakness of the strict conformity arrangement is that the bank merely needs to ensure that all documents are in order and fulfill all given Letters of Credit conditions, not wanting to concern itself with the actual operation of the underlying transaction. This predicament leaves the buyer

highly exposed to the inconveniences of change of sale or transactional circumstances¹⁷. Security of all the contracts therein will be compromised.

The disastrous result is the huge economic and time losses that buyers are forced into where they will be compelled to pay the bank for the losses in spite of proof of extraction fraud and misrepresentation by the beneficiaries in the said contracts. Courts appear unjust in these circumstances. Banks, on the other hand, do not benefit by being aloof to the defects in these contracts where they feel that they have no obligation to 'lift the veil' on these transactions to withhold payment to the beneficiary without restrictions from a judicial injunction. Their perceptible indifference dents their reputation as an agent that impedes justice.

This is an unfortunate omission when today's technological advancements provide easier and faster means to verify contracts, the subject matter of contracts, anomalies and misrepresentations in almost real time and bring to the attention of relevant parties the same with a probative value before any institution for dispute arbitration. Global trade interconnectivity offers opportunities for growth in best practices to inform local jurisprudence, where also information is available at the click of a button. There seems no apparent reason for the lack of growth in this area of judicial performance in Kenya. The danger is that these provisions harm and may continue to harm businesses especially in developing countries like Kenya, which involve state to state departments and injure diplomatic relations and further hurt development of trade within these contexts.

The strict independence factor is an incomplete shield as it insinuates that performance under a letter of credit is merely a paper transaction and thus any non-apparent error on the face of the document will not hinder payment. For this reason, some courts in different jurisdictions have

¹⁷<https://www.nortonrosefulbright.com/en-ke/knowledge/publications/33286e75/letters-of-credit-landlords-and-lenders-rejoice-crystalline-prevails>. ir.lawnet.fordham.edu

embraced a more comprehensive examination of the letter of credit's contract and a requirement of a standard of substantial performance on the parties, enabling aggrieved parties to seek redress from courts such as injunctive remedies against the honoring of fraudulent Letters of Credit. Unfortunately, some courts such as Kenyan courts have maintained the standard of strict compliance which requires that prior to honoring of a Letters of Credit, the beneficiary has executed the conditions approved by the customer while shielding the issuer from disagreements not linked to its facilitative function and basically disallows any restrictive injunctive relief success against Letters of Credit. In spite of this allowance by the UCP, there has been no serious attempt by the Kenyan judiciary to introduce contextualized guidelines in Kenyan law to protect these interests.

This rigidity of the court's interpretation of the Letters of Credit in Kenya is what the study proposes to be the main problem that on one hand promotes a fraudulent disposition around Letters of Credit and on the other impedes legal redress.

This study also finds that Kenyan courts ought to initiate creative ways of resolving the rigid application of common law on the fraud exception and successfully grant restrictive injunctive relief orders to traders deserving of the remedy or the discharge of obligations. The supposition is that if clear guidelines are put in place, Kenya will be in a better place to fairly advance the use of Letters of Credit in international trade which the study acknowledges its efficiency and reliability in enhancing international trade.

1.3 Statement of the Problem

The study is investigating possible remedies for litigation claims under Letters of Credit, especially where fraud is involved.

Whereas the Letter of Credit has been approved as reliable, it has not been found foolproof against abuse and fraudulent contractual practices by the parties involved, especially for the purposes of this study, the beneficiary. The strict judicial construing and appliance of the common law in Kenya circumventing the quality of the underlying contract and asserting the independence of the banks has wrought more dissatisfaction than respite to aggrieved buyers as this position seems to strongly favour the seller. A case in point would be if a fictitious contract is submitted to a bank undetected, the bank believing the contract to be credible will issue payment to the beneficiary presenting the documents. The counterparty would then suffer loss in the process and the bank which boasts of an autonomous place in the contract will become victim where the fraudulent party cannot be traced to reimburse the sum amount already and mistakenly released.

1.4 Statement of Objectives

With the foregoing, the study seeks to recreate awareness on the nature of this significant aspect of international trade and proposes a flexible standard of substantial performance to be adopted in Kenya instead of only imposing a strict positive duty on the customer and the issuer leaving performance gaps with the beneficiary. It also petitions for the beneficiary's honest and material compliance with the letter's terms. To reconcile the problem, Kenya needs to strengthen protection clauses in the Letters of Credit, such as to prescribe when acceptance for the buyer may happen in the contract in order before instructing the bank to release payment.

Presently, there are opportunities to remedy the delays, losses and relational bottlenecks that the current common law provisions tolerate by a higher stakeholder participation in modern trade developments. Legal guidelines also provide boundaries within which these transactions may operate and clearly define breaches with clear remedies. The fluidity of soft law exposes parties to market forces beyond their ability to remedy the breaches justly.

1.4.1 General objective

The main objective of the research is to critically examine the applicability and the viability of the current assertion of the independence principle in a restrictive injunctive relief/remedies in Letters of Credit transactions in the face of the changing business contexts in Kenya.

1.4.2 Specific objectives

1. To grow jurisprudence in the area of use of Letters of Credit in Kenya.
2. To establish if the current legal framework in Kenya has granted sufficient guiding principles to the fair, expeditious, and efficient adjudication of ITL disputes based on Letters of Credit
3. To consider best practices in other jurisdictions that Kenya's legal and institutional frameworks might learn from, with regard to the application/grant of a restrictive injunctive relief in cases where goods traded internationally are to be paid for through Letters of Credit.

1.5 Research Questions

The following questions shall be answered:

1. Is the current use of the Letters of Credit the most trustworthy in international trade?
What are some of the hurdles a buyer using Letters of Credit faces?
2. Is the Kenyan judicial authority sufficiently guided in adjudicating fraud related disputes for litigants?

3. What measures must be taken to expand the legal framework and judicial principles to sufficiently guide an effective and just judicial approach in the use of Letters of Credit in Kenya?

1.6 Hypothesis

Currently, Kenyan courts do not or will most likely not grant injunctions in cases concerning Letters of Credit. The rigidity in common law application with lack of well written and defined guidelines permits this inopportune result.

1.7 Justification of the Research

There is currently little jurisprudence on the applicability of Letters of Credit in Kenya coupled with no successful restrictive injunctive relief litigation by buyers in Kenya due to the strict application of only one principle; the autonomy principle in common law. The broader international developments in the interpretation of the Letters of Credit have not been embraced in Kenya. The research is an opportunity to augment efforts of growth and stakeholder participation in this area.

Since the probative requirement in the extraction fraud exception as currently looked at is too narrow and leaves aggrieved parties with little respite should the quality of the underlying contract be compromised, the erosion of confidence in justiciable processes in ITL call for contextualized reforms in Kenya.

It is expected that the reforms will increase investor confidence in the face of growing FDI interests in Kenya and abroad and encourage negotiating institutions like the Kenya Chamber of Commerce and Industry to strike better trade deals with international organizations in a way that is beneficial to the country. It should be noted that Kenya's appetite for Foreign Direct Investment (FDI) under the Kenya Vision 2030's blueprint programme has expanded to spur economic growth and requires

strategic bargaining with international players to enhance Kenya's reputation as a worthy investment destination.

Any commercial agreement cherishes certainty in payment processes and a guarantee that the payment obligation will be performed. Hence, the pointers in this study would be useful in advancing knowledge in this area to inspire positive action towards improving the business environment in Kenya.

1.8 Theoretical/ Conceptual Framework

This implication of this study avails in several ways. The research paper creates awareness about the use of letter of credit, and the attendant litigation risks with international trade in Kenya¹⁸. The low level of professional application of the recently developed international jurisprudence on Letters of Credit in Kenya has adversely affected judicial performance. It is this lack of awareness that has limited the options for litigants seeking a restrictive injunctive relief in Kenya since the result has been the lack of guidelines or the rigid application of the common law. The *status quo* of the rigid application enables extraction fraudsters and appeals for the recommendation of possible reforms in Kenya¹⁹.

Noting that the legal framework in Kenya is not explicit in capturing the complexities of Letters of Credit transactions, the findings in this study strive to expose the knowledge needed to guide decision makers in determining the best interests of traders in the Kenyan business environment context. The knowledge also uncovers gaps in law that need to be addressed.

¹⁸ Arun Kasi, "The Law of Carriage of Goods by Sea", Springer Science and Business Media LLC, 2021

¹⁹ *ibid*

Most importantly, since this is a commercial public interest issue, greater awareness will safeguard potential Letters of Credit applicants by advocating for the judiciary to come up with clear guidelines for granting injunctions in as far as extraction fraud is involved in Letters of Credit.

Lastly, this study anticipates growth in Kenyan literature while building on past research from other jurisdictions. So far, this topic has elicited little research interest in Kenya. Starting with the Letters of Credit, it is imperative to study its nature, understand how it works and then contextualize it in Kenya. Only in this manner can we appreciate the boundaries of injunctions when it comes to Letters of Credit and adopt creative operational methods that accord with international best practices and principles of trade and finance.

1.8.1 Theories of law informing the study

The beginning of this study has elaborated the nature and usage of the Letters of Credit. The theories of law hereafter will try to bring attention to the components of the Letters of Credit that ask for further scrutiny and possible reforms in the judicial performance of Kenya's courts.

Veracity of Subject Matter of Injunctions

Over the years, Injunctions have been granted by courts as an equitable remedy of justice with the intention of protecting the rights of a party to a suit in the subject matter, which rights would otherwise not be protected. The Civil Procedure Rules (2010)²⁰ specify which cases can be considered for the granting of temporary injunctions and lays out the very basis of injunctions in suits where a *prima facie* case has first to be established on a balance of convenience. Applications for grant of injunctions must also be verified that the case being advanced is not frivolous or vexatious. This rule is intended not to harass the defendant in a situation where the suit is frivolous

²⁰Order 40 of the Civil Procedure Act and Rules (2010).

or is an abuse of the court process.²¹ This principle is understandable, save that currently in Kenya the rule in Letters of Credit has served to protect the defendant too much and expose plaintiffs to the consequences of misconduct by the defendant leaving little or no success in legal respite claims for the plaintiffs²². The study contends that the Civil Procedure Rules (2010) should inculcate wider tests of fraud or mechanisms of examining extraction fraud in sale contracts, including those of Letters of Credits.

The legal basis of the letter of credit has been a subject of debate among legal scholars. Some writers have advanced various possibilities that exemplify the legal basis of the letter of credit as obliging a relationship between the agent or issuer and the beneficiary.

The study will rely on the Contract Theory as it ponders the contractual obligations of the parties, and reviews some of its components relevant to the Letters of Credit. Contract is central to Letters of Credit transactions. It will also incorporate Sale of Goods principles interchangeably as the overarching theories that will act as a pointer to the legal basis for reforms in Kenya, and propose what aspects of the Letters of Credit need a proper judicial interpretation. The choice of the contract and guarantee theories was made considering that the Letters of Credit is an integral instrument of an ITL contract. The Letters of Credit is a contractual undertaking between the parties to release payment upon the production of relevant documents of the actual contract. The complexities of this type of contracts have brought to light pertinent features of contract that need to be reviewed under the Letters of Credit. When these features of contract are treated in isolation to the integrity of the transactions, the study has observed that it produces extraction fraud and

²¹Central Bank of Kenya v Uhuru Highway Development Ltd. [2015] 2nd June 2015 (unreported).

²² ibid

later undesirable judicial outcomes, especially for the buyers involved. In the Kenyan context as severally alluded to, there has been no successful restrictive injunctive relief.

a) The Contract Theory

Credibility of contracts

Contracts have been in existence since man's history of transactions. The elements of a contract are the subject, offer and acceptance, meeting of minds, consideration, capacity and legality. Contracts may range from simple agreements which are executed easily, to more sophisticated arrangements that require meticulous execution. In latter years **Kenneth Arrow** expounded research on contract under economic analysis of law²³ pointing out that commercial contracts have huge economic incentives for the performance of the contract.²⁴ The contract theory underscores the relationship between parties who have an intention to mutually agree or not agree to perform certain actions, based on certain incentives through a formal design.²⁵ The contract progresses from notice of intention (Memorandum of Understanding in some cases) to the final agreement where all the terms of contract are expressed.²⁶

It's worthy to note that many contracts begin with a point of asymmetry of information where one party would possess more information than the other and subsequently, a higher bargaining power. The contract framework therefore exhibits one or a combination of factors such as *moral hazard*, *adverse selection* and *signaling*.²⁷ These are the negative factors the study wishes to critique as

²³Explainer: what is contract theory and why it deserved a Nobel Prize, October 11, 2016 5.20pm SAST; <https://theconversation.com/explainer-what-is-contract-theory-and-why-it-deserved-a-nobel-prize-66826>; theconversation.com

²⁴Christina Majaski &Charlene Rhinehart, The Difference Between Letter of Intent and Memorandum of Understanding, Investopedia;<https://www.investopedia.com/ask/answers/042715/what-difference-between-letter-intent-and-memorandum-understanding.asp>. economics.virginia.edu

²⁵ Daniel Liberto, Contract Theory, Investopedia: Business Essentials, Guide to Mergers and Acquisitions Jun 26, 2019; <https://www.investopedia.com/terms/c/contract-theory.asp>

²⁶ ibid

²⁷ ibid

infrequently being the unjust elements of Letters of Credit contract promoting fraudulent behavior calling for judicial reforms in Kenya, especially now when information can be easily ascertained. *Signaling* refers to the act of availing information about oneself to the other party. It is at the point of information sharing that the quality of the contract is determined and affects how the Letters of Credit will be handled. Due to the asymmetry of information, the principal can afford to take a high risk for the incentive knowing that the other party will pay for the economic consequences for failure of performance of any of the contractual terms and may not have to do what is right in the circumstances. This is what **Oliver Hart**²⁸ propounds as the moral hazard where the principal hands over the associated costs to the other contracting party. The study finds that if this aspect is discovered in the contract pertaining to Letters of Credit where the seller took advantage of the buyer and the intermediary bank which had inadequate information and were shortchanged in the process, a sufficient balance of probability should be able to consider that as extraction fraud. In addition to the current judicial standard, if the facts of the case prove a lack of integrity on face value, the merits of the case should consider moving from a rigidly strict position of no proof of intention to a high balance of probability. The current common law standard of proving intention to defraud is too high leading to unsuccessful claims and perpetuates the mischief of extraction fraud or even the judicial reluctance to provide a proper remedy against the extraction fraud proven.

Another example of a moral hazard would be bail out promises in international state to state agency transactions or between state agencies and multinational companies which give the seller leeway to offer goods or services at their discretion and not according to the meeting of minds initially anticipated in the contract. Regardless of how the seller may perform, the seller is assured that upon producing the sale instruments, the bank will release payment immediately. What if the goods

²⁸ibid

arrive late, are not of a satisfactory merchantable quality or are of different nature specifications from the agreed terms? The study proposes the imposition of a moral obligation for the seller and their sponsors (if any) to take due diligence in ensuring that the transaction promise is met fully and according to all the parties' expectations or risk having the contract repudiated under the restrictive injunctive relief by the plaintiff.

The Sale of goods Act plainly identifies merchantability quality standards and little can be faulted in this regard, only that it needs to form a crucial substantive base for reforms in Kenya's ITL contracts.

The principal of utmost good faith (*uberimmae fidei*) must be an express and material requirement in a Letters of Credit contract and be certainly what courts begin with to scrutinize the underlying contracts between the parties for the purposes of establishing if extraction fraud was present or not. This would help to expand the scope of fraud and determine restrictive injunctive relief remedies in a more justiciable manner.

With adverse selection, one party withholds full disclosure of information to the other parties. The seller may be aware of certain defects and limitations to a product or service but misrepresent that as a perfect fit for the buyer, which fact the buyer and the bank are alerted of later. ITL contracts have a forward element where the contract will be completed at a later date. The courts should allow some grace period for any discoveries during which defects in the Letters of Credit contracts are raised and investigated. It is disheartening for the customer later to discover inefficiencies within the contract before or during payment to the bank that is obligated to let the consideration pass to the seller without question. It gets worse when the buyer fails to receive legal relief due to the narrow construction of what constitutes fraud.

Unfortunately, despite UCP's rider to leave the interpretation of what fraud entails in domestic jurisdictions, Kenyan courts have not developed their own guidelines and have missed an

opportunity to grow jurisprudence in this area. The revision of contract requirements under Letters of Credit is key in expanding the scope of judicial interpretation for better justice outcomes.

The Offer and Acceptance Theory

Defining point(s) of offer and point(s) of acceptance

In some quarters, the Offer and Acceptance Theory is thought to account for the relationship between the bank and the beneficiary. The bank offers the letter of credit which the seller may accept. The point of acceptance is a matter of debate. **Gutteridge** and **Megrah**²⁹ suggest that acceptance happens when the beneficiary tenders the documents and a draft to the issuing bank, but where the credit is irrevocable a specified duration of time (for example when the documents will be presented) is allowed for the bank to withdraw the offer of credit. The blot here is that the withdrawal quashes the purpose for its issuance.³⁰

Conversely, some writers opine that acceptance could take place earlier. Davis³¹ says that the acceptance may be recognized some time before the documents are tendered, and belatedly at the dispatch of goods. Also in **Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd.**³² Rowlatt J. stated: *“There can be no doubt that upon the plaintiffs' acting upon the undertaking contained in this letter of credit consideration moved from the plaintiffs, which bound the defendants to the irrevocable character of the arrangement between the defendants and the plaintiffs”*. In Davis³³ analysis of this judgement, he is of the view that the court held that the contract was completed when the plaintiffs' "acting upon the undertaking" was done and was a sufficient acceptance of the

²⁹Gutteridge H.C. & Megrah, Maurice, *The Law of Bankers' Commercial Credits*, seventh edition, London 1984.

³⁰Gutteridge p.31.

³¹ Davis A.G., *"The Law Relating to Bankers' Commercial Letters of Credit"* third edition, London 1963 at p. 73.

³²(1922) 1 K.B. 318.

³³ Davis A.G., *"The Law Relating to Bankers' Commercial Letters of Credit"* third edition, London 1963 at p. 74.

defendants' offer. Davis translates "acting upon the undertaking" as the commencement of manufacture.³⁴

Offer and acceptance guidelines are crucial in showing at what point a contract will be completed or may be terminated. The study feels that sufficient time should be given to the customer (buyer) to inspect goods prior to acceptance. The advancement of information technology aids to facilitate this process in a faster manner. As to what regards sufficient time, stakeholder participation may provide guidance as to what would be practical. These guidelines should allow aggrieved parties time to settle any differences in good time, before the Letters of Credit contract has progressed too far and bears costly consequences.

b) The Guarantee Theory

Is Guarantee a contract?

This theory is commonly applied in the United States where bankers' commercial credits are considered contracts the issuing bank guarantees to pay for the price of the goods payable under the actual contract. However this theory has misgivings because³⁵:-

First, the Guarantee Theory presupposes that if the buyer defaults in payment the bank's liability is secondary, while in a commercial letter of credit the bank is expected to pay the due sum regardless of whether the buyer is in default or not.

Secondly, the law of guarantees would deny amendments to the original sale contract in the letter of credit even if all parties are in agreement. Additionally, many laws demand a guarantee to be accompanied by a note or memorandum in writing, indicating the principal debtor and the debt he

³⁴Davis A.G., "The Law Relating to Bankers' Commercial Letters of Credit" third edition, London 1963 at p. 74.

³⁵Eleni Moschouri-Tokmakidou, Commercial Letters of Credit in England and in Greece, Department of Commercial Law, Faculty of Law, The University of Birmingham, at p. 23.

owes, which is not applicable to the Letters of Credit. Finally, the issuing bank can revoke the letter of credit at any time prior to acceptance by the seller. Notwithstanding the foregoing arguments, the study picks out some aspects of a guarantee that exhibit contractual tendencies such as duties of parties, when consideration passes and the completion of contract. There are also consequences for the withdrawal by the bank from performing its obligations under the contract with Letters of Credit. This is a similar relation to a conveyancing transaction where advocates representing various parties would execute the sale contract between their clients and themselves in both contractual and trusteeship terms. The contract entails offer of services which require compensation and the trusteeship when the advocates hold money for their clients pending completion of the sale.

Hence, in the Kenyan context, the guarantee aspect could still be treated as a contract at a primary level (since it may be sued separately if it fails to perform its obligations) and a trust at the secondary level as an intermediary that holds funds to facilitate the transfer of consideration to the seller. In this regard, the bank's relationship with each of the underlying contract's party and its conduct in facilitating this contract would be examined separately based on the issues raised before the court. Such that where any nature of fraud is invoked and the bank was complicit or even unaware, the bank may be held liable or exonerated altogether, respectively.

c) The *Estoppel* or Trustee Theory

Estoppel

In the *Estoppel* or Trustee Theory, after the bank issues an irrevocable letter of credit, it makes a claim that it has received the sale's sum amount from the buyer to match the seller's drafts, and the bank is estopped from refuting that it holds the money on behalf of the seller.³⁶

This theory expounds the principle mentioned in **Pickard v. Sears**.³⁷ "Where one by his words or conduct willfully causes another to believe the existence of a certain state of things and induces him to act on that belief, so as to alter his own previous position, the former is concluded from averring against the latter a different state of things as existing at the same time."

However in **Morgan v. Lariviere**³⁸ the House of Lords opposed the view that the bank's statement of pledge to pay the seller a portion of the contract price amounted holding the money as a trust on behalf of the buyer. They stated, "*In a transaction of that kind there is nothing of equitable assignment, there is nothing on trust; and it appears to me that any banker who had given an undertaking of that kind would be very much surprised to find that it was held that a certain portion of the funds of his customer in his hands had been impressed with a trust, had been equitably assigned, and had, in fact, ceased to be the moneys of the customer.*"³⁹

Practically, the *estoppel* or trustee theory gains little credence since the buyer hardly ever intends to deposit his funds to the bank as credit as this contradicts the core of Letters of Credit. Should the buyer opt to do so anticipating a trust, in fact the bank must communicate to the seller that it holds such moneys in trust and offer a letter of credit for acceptance by the seller.⁴⁰ The study reckons that although the *estoppel* theory may be a major consideration in the Letters of Credit, circumstances may be proved where such an arrangement was indeed made, and also where the

³⁶Eleni Moschouri-Tokmakidou, Commercial Letters of Credit in England and in Greece, Department of Commercial Law, Faculty of Law, The University of Birmingham, at p. 23.

³⁷(1837) 6 A. and E. 469.

³⁸ (1875) L.R. 7H.L. Cas. 423.

³⁹ *ibid*

⁴⁰Walker v. Rostron (1842), 9 M & W 411; Griffin v. Weatherby and Henshaw (1868) L.R. 3Q.B. 135.

bank was made aware of some nature of extraction fraud but went ahead to release payment to the seller. In this case when the customer seeks a restrictive injunctive relief, or the seller claim the unfair withholding of payment by the bank for any unjustifiable reason, the bank would be estopped from denying their obligatory responsibility. Further, would be prudent for the bank that as an agent or sometimes a trustee the bank to look out for the best interests of the parties as its turnover would depend on the success of the underlying contract between the two parties.

The above theories compete to inform the actions and responses between the issuing bank and the beneficiary. The four theories endeavour to show when the duty arises for a bank to pay under Letters of Credit. When going through the comparative analysis of different jurisdictions, the research will illustrate that different jurists in the same region came up with different determinations. The above theories show the legal basis of Letters of Credit.

Commonly running in the above mentioned theories is the need for utmost good faith (*uberrimae fidei*) where all parties are expected to perform the highest standard during contract; make full disclosure as much as possible of any relevant conditions, circumstances and risks to their equals.⁴¹ If material disclosure lacks then the contract may be rendered void and the other parties discharged from their obligations.

The study contends that understanding these theories in their practical aspects would benefit the proposition of the required guidelines for the courts to consider when deciding on matters of letter of credit within Kenyan courts. It proposes the locking in of integrity clauses in the distinct contracts involved under Letters of Credit. For instance, to require that acceptance is deemed so when the buyer is satisfied after inspecting the goods. If a party acts fraudulently, they are estopped

⁴¹Walker v. Rostron (1842), 9 M & W 411; Griffin v. Weatherby and Henshaw (1868) L.R. 3Q.B. 135.

from demanding the corresponding action they normally would receive without any mishaps. The reliability of the autonomy principle can be buttressed by the inclusion of such clauses. The aforementioned observations the study believes, shall provide useful insights that shall also build upon the little jurisprudence in this area, particularly in Kenyan literature.

1.9 Research Methodology

Regrettably, not much has been written in Kenya regarding the judicial approach towards Letters of Credit. This is a Qualitative Research using sample of laws, cases and findings from scholars on the subject. It is also exploratory seeking available data on the various judicial approaches on the use of Letters of credit in Kenyan courts and other jurisdictions. Ultimately, it inquires into which areas in Kenya's judicial and commercial utilization of the Letters of Credit have need for reforms. With limited resources the research could only be undertaken within seven months and has used a lot of references from other scholars in this area.

The methodology in the research is used as follows:

- a. Data Collection: Desktop technique using analyses and observations noted from various jurisprudential and statute materials, commercial literature and reference from scholars in the area of Letters of Credit.
- b. Random sampling of cases on Letters of Credit from jurisdiction of Kenya, US, UK and China
- c. The study of international soft law on the Letters of Credit to inform the reader on how the Letters of Credit is universally governed; the UCP, UCC and UNCITRAL
- d. Recommendations include a multi-pronged approach required in the discussion of possible remedies drawing from the comparative analysis of judicial solutions from other countries.
- e. Ethical: The study has borrowed from other peoples work.

The study has largely used secondary sources of information. Data includes scholarly journals, theses, papers presented at conferences, books, grey literature and library sources. The Desktop data was collected from Kenyan and international case law, the examination of a sample of laws from Kenyan, UK, US and Chinese jurisdictions regarding the use of the letters of credit.

1.10 Literature Review

The objective of the literature review is to depict what has been written on the issue of restrictive injunctive reliefs against Letters of Credit in Kenya and whether Kenya needs a review of its rules on Letters of Credit.

This review presents the extent to which prior studies and research have covered on the topic under study and their respective findings as to the granting of a restrictive injunctive relief against Letters of Credit. In this case, the study finds that there isn't much updated information on Letters of Credit and prefers to use elaborate international literature on the subject to create awareness for the Kenyan context.

Further the review provides information as to any gaps that the study can fill or add to the already existing literature on restrictive injunctive relief on Letters of Credit in Kenya. The research is therefore an additional awareness jurisprudence to spur positive judicial and legislative action towards promoting justice for Letters of Credit related grievances in the allegations of extraction fraud.

Multi-pronged approach to Letters of Credit

Yanan Zhang⁴² undertook a study on approaches to tackling fraud in international Letters of Credit. She viewed the instrument as a critical mode of payment and financial instrument in international trade but fraught with many challenges of fraud. She critiques the two fundamental principles of independence and strict compliance as encumbering the reliable nature of Letters of Credit. Her research is useful in bringing to light types of fraud and proposes innovative ways of dealing with fraud under Letters of Credit. Stating UNCTAD⁴³'s report on international fraud, she highlights four types of fraud as where beneficiary seeks payment for goods which are non-existent using falsified documents, sells goods of inferior quality or lower quantities, sells goods to more than one party, or issues bills of lading to two or more parties. She adds that banks are not safe either as they become targets of fraud, for example in money laundering⁴⁴. Other forms of fraud are forging the amendment letter of credit or confirming Letters of Credit using irrevocable letter of credit⁴⁵. Interestingly, she points out another type of fraud where the buyer and the seller collude to defraud the bank by presenting fictitious papers and upon the bank's paying the seller both traders disappear.⁴⁶ The study notes with interest the vulnerable position in which the bank finds itself considering that the bank has always preferred to remain free from the substantive negotiations between the traders. It impels the bank to be proactive in seeking reforms alongside

⁴²Yanan Zhang, *Approaches to Resolving the International Documentary Letters of Credit Fraud Issue*, Publications of the University of Eastern Finland, Dissertations in Social Sciences and Business Studies; <https://doi.org/10.5278/ojs.njcl.v0i1.3006>;

⁴³The UNCTAD report (2003), prepared by the UNCTAD secretariat, 'A Primer on New Techniques Used by the Sophisticated Financial Fraudsters with Special Reference to Commodity Market Instruments' (UNCTAD/DITC/COM/39), 7 Mar., 2003, p.7, available at http://www.unctad.org/en/docs/ditcom39_en.pdf; epublications.uef.fi

⁴⁴Ellen, Eric (1998), 'Complex letter of credit frauds Put Banks at Risk', DCI (ICC), Winter, Vol. 4, No. 1, p. 1.

⁴⁵Cao, Yuanfang (2006), 'New Trend and Corresponding Solutions to letter of credit Fraud', *Practice in Foreign Economic Relations and Trade*, No. 11, 51, pp. 51-52.

⁴⁶Jin, Saibo (2002), p. 96; see also Li, Xiaoyong (1998), p. 161; Cheng, Zhengyun (1997), p. 150; Wang, Linxia (2006), 'Brief Analysis of Letter of Credit fraud and Prevention', *HLJ Foreign Economic Relations & Trade*, No. 8 (Serial No. 146), 59, pp. 59-60; Li, Jian (2005), 'Study on the Legal Problem of letter of credit fraud in International Trade', *Market Modernisation*, Dec. (1st Issue) (Sum. No. 451), 46.

other institutions in order to protect its credibility and business interests. This point exposes a loophole in the independence principle.

Zhang's proposals combine legal and business perspectives which blend civil and criminal methods with a minimum standard to guide domestic jurisdictions to combat fraud, arbitration and legal rules which identify which party to protect, as well as balance interests of parties.⁴⁷ The study reckons this strategy as a brilliant one for a developing country like Kenya to pursue based on industry behavior patterns and contributions.

Comparative Approach

Paolo S. Grassi⁴⁸ begins by giving a detailed account of how principles regarding the compliance exam, parties' relationship rules work with the documentary transaction. At the centre of his discussion is the role of the banking industry in facilitating documentary Letters of Credit. His main proposition is that the bank has a very integral duty in ensuring compliance with contract terms. He goes ahead to make an international comparison of the doctrinal nuances of the Letters of Credit in different countries by illustrating cases from Germany and Switzerland. It is the study's contention that in light of international developments, Kenya does not need to reinvent the wheel in making reforms for Letters of Credit but can learn what would best work for Kenyan courts.

Legal Approach

Xiang Gao,⁴⁹ studies the fraud exception rule in the law of Letters of Credit and observes that despite the letter of credit being an ancient international instrument, domestic jurisdictions are still

⁴⁷Yanan Zhang, 5.2. Approaches to Resolving the International Documentary Letters of Credit Fraud Issue; Public examination of a doctoral dissertation in the field of law.

⁴⁸Pace International Law Review, Paolo S. Grassi, Letter of Credit Transactions: The Banks' Position in Determining Documentary Compliance – A Comparative Evaluation under U.S., Swiss and German Law, Volume 7, Issue 1 *Winter 1995* Article 3.

⁴⁹ Xiang Gao, *The Fraud Rule in the Law of Letters of Credit: A Comparative Study*, Global Trade & Finance Series, Kluwer Law International, Published on 21 Jan 2003.

grappling with numerous and serious disputes with respect to it. Dr. Gao widely reviews the fraud rule beyond the confines of the banking law into substantive core legal aspects which ought to inform sound judicial reasoning. He calls for jurists everywhere to expand the judicial scope in this area. His exceptional insights are valuable to all legal practitioners concerned with promoting international trade.

In conclusion, international Letters of Credit litigation may have drawbacks and obstacles and this research is an invitation for decision makers and readers at large to discover the various approaches of handling the Letter of credit. The subject of effective Letters of Credit injunctions by use of well written guidelines is a specific legal problem that has not been well researched on in Kenya. There is profit in borrowing from other legal regimes which have had some success and provide different perspectives in international business. Kenyan courts and policy providers would be keen to note these developments.

1.11 Scope and Limitations

This study limits itself to the application, issuance or rejection of the restrictive injunctive relief for Letters of Credit under extraction fraud allegation claims in Kenyan courts in relation to Letters of Credit payment and whether Kenya has proper guidelines for the same. It investigates this position from the buyer's perspective, which in the Kenyan context now, does not seem to have judicial respite against the beneficiary and the bank intermediary based on the zero success litigation rate.

The limited availability of numerous reference materials on Kenyan judicial performance on the subject matter causes the research to draw heavily from international literature and experiences in the U.K, U.S.A and China. This area of interest has not grown in tandem with modern international developments and the research materials on domestic law references will be limited to what is

currently available in Kenya. The focus of the study is on instances for the grant of injunctions to stop payment to the beneficiary or any offending party in instances of extraction fraud and to determine which other factors can allow the approval of an injunction. It is limited to expounding on the extraction fraud factor.

In this study the main limitation is time as a student. The study was undertaken in less than a year. Financial resources were also limited as the research was not publicly funded.

1.12 Description of Chapters

Chapter 1: It sets the stage for the background of the study, statement of the problem, justification and objective of the study, the research questions, the theories on which this paper is based on, the literature review of books and articles relied upon, the hypothesis, research methodology, scope and limitations of this study and the description of chapters.

Chapter Two: Provides for the legal framework surrounding the Letters of Credit in Kenya with seeking to identify loopholes in the law on Letters of Credit.

Chapter Three: Compares and contrasts the application of Letters of Credit in England, U.S.A, China and Kenya and what best practices Kenya can borrow in relation to the restrictive injunctive reliefs. This chapter is informative on the importance of guidelines in Kenya. The Chapter will also inform the reader whether the hypothesis test was successful, and what the research findings were.

Chapter Four: It will provide the findings, conclusion and recommendations of the study.

CHAPTER TWO

THE LEGAL FRAMEWORK GOVERNING LETTERS OF CREDIT IN KENYA

2.0 Introduction

This chapter will critically examine the legal framework governing Letters of Credit. This is important to trace how Letters of Credit have been litigated and consequently how injunctions apply. In order to understand the relevant legal framework, one may appreciate the role of the International Chamber of Commerce (ICC). This is because customs formed by International merchants and International Agencies also form sources of International Trade Law. The most active is the ICC. After appraising the ICC, the study will examine the Kenyan Constitutional provisions on international trade, national values, dispute resolution, relevant Kenyan statutes and Kenyan cases on injunctions and finally establish why regulation is important.

Role of soft law in ITL and Letters of Credit and Special Group Interests

2.1 International Chambers of Commerce and the UCP

Following the devastation of the First World War in 1919, a small group of entrepreneurs, industrialists, financiers and traders terming themselves "*the merchants of peace*" deliberated upon a transnational organization to protect business interests and enable economic prosperity universally. This was the beginning of ICC⁵⁰ which with time and in a more complex business world has played a pivotal role by designing rules, standards and mechanisms for international trade and business.⁵¹

⁵⁰ICC Albania, The Merchants of Peace <http://icc-albania.org.al/history/> (accessed on 7/2/2019).

⁵¹International Chamber of Commerce, <https://iccwbo.org/about-us/> (accessed on 8/2/2019).

ICC, representing private sector businesses has engaged governments and intergovernmental organizations on a wide variety of activities with the UN and its expert agencies and in 1946 was honoured with the highest consultative level leading to the development of the Uniform Customs and Practice for Documentary Credits (UCP).⁵²

While it is generally thought that the UCP has no legislative force, it is internationally established as a soft law arising from ‘bottom up lawmaking’ where daily and unchoreographed norms and technical practices are translated into legal interpretive, procedural and remedial rules by practitioners to ease their trade operations. These norms grow beyond the group’s range to eventually find their way into ‘hard law’⁵³

Codification of Customs and Self-Regulation

The UCP is a product of The Banking Commission of the ICC’s expertise and experiences which compiles and updates their group norms and practices to accord Letters of Credit with commercial banking practice, yet deter emerging practices which may take away or emasculate bankers’ perceived interests. The Commission’s members continually interpret, reinterpret and refine their rules and even though do not push the Letters of Credit to a strict legal space, its interactions with lawmakers for validity somehow thrusts its domestic and international regulatory efforts into formal law structures.⁵⁴

⁵²Reviewed by Will Kenton, International Chamber Of Commerce - ICC <https://www.investopedia.com/terms/i/international-chamber-of-commerce-icc.asp> Updated Feb 8, 2018 (accessed on 8/2/2019).

⁵³ Janet Kovenlevit, Bottom -Up Lawmaking Through A Pluralist Lens: The ICC Banking Commission And The Transnational Regulation Of Letters of Credit.

⁵⁴ Ibid.

The predictability and consistency of the Letters of Credit makes it a worthy risk for Letters of Credit end-users such as importers and exporters. Banks are therefore supposed to give traders confidence that their payment through the Letters of Credit will be assured with minimal stringent conditions. Feeling that the Letters of Credit is already regulated, acceptable regulation is that which allows freedom to trade in a fair manner that captures market expectations and practices. The Letters of Credit rules are largely self-regulated and do not emanate from a treaty or convention.⁵⁵

The ICC's Banking Commission is neither a governmental organization nor an intergovernmental organization "but a self-professed "private international organization,"⁵⁶ which serves as the global forum and rule-making body for the international trade finance community".⁵⁷ After the 1933 the Uniform Customs and Practice for Documentary Credits (UCP), it reviews the UCP to keep its relevance with progressive banking practice.

The UCP develops the code, standards and practice for the trade finance community permitting parties to a Letters of Credit transaction to incorporate the UCP wholly and envisages being the preferred "law of the Letters of Credit contract."⁵⁸

Having pointed merits of the institutionalization of the UCP, it is worth noting that it suffers the problems of abuse from non-codification of norms. While soft law eases operations, the lack of wider stakeholder participation makes it one sided and limited in representation of interests. In this case, a small group of commercial traders may well overlook societal concerns that are not strictly

⁵⁵ Janet Kovenlevit, Bottom -Up Lawmaking Through A Pluralist Lens: The ICC Banking Commission And The Transnational Regulation of Letters of Credit.

⁵⁶ International Chamber of Commerce, What is ICC? available at http://www.iccwbo.org/home/menu_what_is_icc.asp (accessed on 01/03/2020).

⁵⁷ ICC Commission on Banking Technique and Practice, Priorities, available at <http://www.iccwbo.org/policy/banking/id2424/index.html> (accessed on 01/03/2020).

⁵⁸ Symeon C. Symeonides, Contracts Subject to Non-State Norms, 54 AM. J. COMP. L. 209 (2006).

commercial, such as public interest, rights inequities and inequalities, bargaining power, to name a few. Not all international transactions are purely profit based, for example, national infrastructural projects. These kinds of projects require inquisition of a more substantive nature into contractual obligations that banks ought to consider if grievances are appropriately raised.

Substantive International Trade Issues

2.2 U. N Convention on Contracts for International Sale of Goods (Vienna CISG1980) and Law of International Trade

It provides a framework for the construction and enticement of international trade contracts.

Article 1 of the Convention applies to contracts of sale of goods between parties whose places of business are in different states. Neither the nationality nor civil or commercial character of the parties or of contract is to be taken into consideration in determining the application of the Convention.

These are vital provisions to promote security of international transactions. However, global dynamics are always changing and may pose differing national values and principals and foreign policy rules affecting the transacting parties making dispute resolution complicated and costly. For instance, capitalist and socialist values may determine the substantive issues of a contract differently. International guidelines should also be sensitive to these dynamics. A socialist inclined state which abhors transactions that, say, endanger the environment or contract as a state and direct that parties contracting within its jurisdiction can repudiate offending contracts at will may destabilize contract security, but may call for wider integration of other International Law principles such as sustainable development, and rights protection clauses (including intellectual property rights and some cultural sensitivities such as community rights) in international sale of goods and services. These considerations may need to reflect in modern trade law reviews.

Harmony with International Trade Principles

Harmony in international trade principles would also help to promote smooth dispute resolution. In **Taurus Petroleum Limited v. State Oil Marketing Company of the Ministry of Oil**⁵⁹ relevance was the *situs* of debts due pursuant to Letters of Credit. The Supreme Court unanimously held that the Letters of Credit sum amounts are payable at the debtor's place of residence and not where the sums are due. Lord Neuberger noted that 35 years of mistaken practice in this regard provided some argument for continuing with it, but was not enough⁶⁰.

As regards the construction of the Letters of Credit, the Supreme Court, reached conclusions which are, in many respects diametrically opposed meaning that either approach has its strength but the majority insisted that the UCP's reference was important in giving standards a consistent interpretation.⁶¹

The Banking Commission integrates advisory opinions and policy statements, translating recurring conclusions and themes to complement the UCP, the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP). Exporters and importers commonly refer to the UCP in their Letters of Credit, and hardly will banks deliver international Letters of Credit unless it is expressly under the UCP terms.

The UCP itself is not technically international or domestic law, save for its appearance like the mere “law of the contract,” extremely bare to legal pre-emption. There is apprehension that domestic and global lawmaking could instantly supersede and undermine the UCP's domination and perhaps to protect itself it excludes the matter of documentary fraud and gives banks the wide

⁵⁹[2017] UKSC 64.

⁶⁰Lexology, Dentons, Felicity Ewing, Celia Gardiner, Alexandra Doucas and Alexander Hewitt <https://www.lexology.com/library/detail.aspx?g=5f99cc4b-1650-4e35-b49a-b49afc676ea1>. (accessed on 18/3/2021).

⁶¹*ibid.*

discretion to ignore the duty to verify substantive affairs and stress that Letters of Credit transactions are documentary.⁶²

Then again, the UCP does not answer pertinent questions for circumstances when a document that nonetheless complies with the terms of the L/C but is suspicious to warrant dishonoring by the bank, or the description of extraction fraud and when the bank could raise fraud as shield to payment, and if the bank should willfully overlook extraction fraud. The Commission chooses to be silent on these matters as it fears it may leave members feeling disgruntled and weaken their resolution in decision making. It leaves these controversial matters for domestic and international lawmaking bodies which harmonize local trade law for recognition, ratification and approval of their trade customs. The lawmaking entities gladly welcome the Commission's involvement since the UCP's practice has been ambiguous in the aspects mentioned before.

2.3 Transnational Plane

In order to facilitate smooth flow of international business, The United Nations Commission on International Trade Law (UNCITRAL) utilizes model laws to shape domestic trade law and cascade treaties and conventions on the law relating to international payment systems to the domestic or state level through ratification of the treaties.⁶³

UNCITRAL has forged a close relationship with the Banking Commission whose goals are similar. UNCITRAL fortifies the Banking Commission's regulatory or rule making function by endorsing UCP's usage and growth of documentary credit, further establishing the UCP as hard international law.⁶⁴ Additionally, UNCITRAL's Convention on Independent Guarantees and

⁶²UCP 500, art.9 & 15;

www.springerprofessional.de, UCP 600, arts.5, 7.

⁶³ See <http://www.uncitral.org/uncitral/en/about/origin.html> (accessed on 20/02/2020).

⁶⁴ Yearbook of the United Nations Commission on International Trade Law, 1994, vol. XXV, at 28.

Stand-by Letters of Credit (UNCITRAL Convention),⁶⁵ has adopted the major substance of UCP provisions as well as create international practice standards relating to independent guarantees or stand-by Letters of Credit.

The UNCITRAL Convention also converts some of the UCP provisions from soft to hard international law by incorporating ICC's Uniform Rules on Demand Guarantees (URDG)⁶⁶ and the ISP 98 on the applicability of standby Letters of Credit as standards of international practice.⁶⁷

2.4 The Domestic Plane

Statutes, Legislation and Codes

At the domestic level countries treat the UCP in different ways. Some states create statutes that put all documentary credits under the UCP.⁶⁸ In others the law expressly implements the UCP, or refers to it when it is the preferred law of the documentary credit.⁶⁹ In other cases, the UCP complements domestic statutes.⁷⁰ They may sometimes articulate UCP provisions specifically or generically.⁷¹ For instance, the Chinese Supreme Court received input from Banking Commission representatives to implement a code to administrate letter of credit disputes, to honor parties' obligation to observe international practices, usage and norms and also defer to the UCP as the default law on documentary credit where the law fell short. Kenya does not have a code of practice

⁶⁵ United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, A/Res/50/48 (opened for signature Dec. 11, 1995, entered into force Jan. 1, 2000), available at <http://www.uncitral.org/pdf/english/texts/payments/guarantees/guarantees.pdf>.

⁶⁶ Ahmad Ali Ghouri. "Guaranteeing the guarantee law in Pakistan: the UNCITRAL Convention and the guarantee laws of Pakistan, the UK and the USA", Commonwealth Law Bulletin, 2009

⁶⁷ Ibid.

⁶⁸ Hungary, Decree No. 6/97.

⁶⁹ In particular, this is the case with the United States' Uniform Commercial Code.

⁷⁰ For instance Egypt Law No. 17/1999 (The Uniform Customs and Practice for Documentary Credits by the International Chamber of Commerce shall apply unless the articles of this section contain special provisions).

⁷¹ These laws are uniformly more general and less inclusive than the UCP 500. See generally, Bahrain, Law No. 7/1987.

for Letters of Credit but follows common law practice or the relevant instrument governing the transaction. There is clear need for a framework that will ease the courts' work.

2.4.1 The Constitution of Kenya

Article 2(5) and (6) has regard for the adoption of international law principles into Kenyan law subject to Parliamentary ratification. This article is supported by the Treaties Ratification Act of 2012.⁷² Even so, ratification requires industry input in order to reflect positive gains for the country.

For public policy and institutional rule making regarding international trade, rules cannot be made in isolation from national values and principles under article 10 which provides that:

*10. (1) The national values and principles of governance in this Article bind all State organs, State officers, public officers and all persons whenever any of them—(a) applies or interprets this Constitution; (b) enacts, applies or interprets any law; or (c) makes or implements public policy decisions. (2) The national values and principles of governance include—
(a) patriotism, national unity, sharing and devolution of power, the rule of law, democracy and participation of the people;(b) human dignity, equity, social justice, inclusiveness, equality, human rights, non-discrimination and protection of the marginalised; (c) good governance, integrity, transparency and accountability; and State and religion. National symbols and national days. National values and principles of governance.”*

Accordingly, a rigorous public participation mechanism will be required to arrive at a more balanced law and code of practice to protect local and international business interests and foster the desired economic growth.

2.4.2 Kenyan Statutes

⁷² " Kenya National Commission on Human Rights and Another Attorney General and Others ", International Law Reports, 2021

As mentioned earlier, UCP is currently the most preferred judicially applied guideline in Kenya as concerns the settling of Letters of Credit matters.

In this study, there is additional focus on the role of the Law of Contract rules and Sale of Goods principles. The Banking Act is discussed in the context of an intermediary presently detached from the substantive contractual issues of the trading parties, but integral in ensuring integrity of contract is maintained. The Consumer Protection Act responds to the needs of the buyer who may, where the quality of the sale is compromised suffer the most and requires a more suitable relief than what is provided under the UCP.

2.4.2.1⁷³ Sale of Goods Act, 2009 (2003)

This statute is explicit in detailing the obligations of the seller and buyer and what constitutes a sale and an agreement to sell, which are the structural components of a trade contract. It needs additional references for the use of technological means for detection of and presentation of extraction fraud and evidence based contract frustration references as grounds for voiding or repudiating contracts, to incorporate in Kenyan ITL guidelines.

2.4.2.2 Law of Contract 2012 and Law of Contract (Amendment) Act, 2019

The Law of Contract, 2012 is a brief statute but mainly provides principles of contract. It gives plenty of room for freedom of contract to parties who will determine the scope of contract almost unhindered but within the confines of the law. Without proper safeguards, however, the balance of bargaining interests is skewed to favour the stronger party.

The Law of Contract (Amendment) Act, 2019 is an upgraded version of the 2012 law, with more consumer protection insights. For instance, it limits the creditor's rights to attach an asset of the

⁷³ Ajendra Srivastava. "Modern Law of International Trade", Springer Science and Business Media Letters of Credit, 2020

debtor, which is held as a guarantee by a third party. This means that it would be automatic for the creditor (seller) to obtain payment from the bank if the debtor and the bank as the guarantor are not in agreement or are restricted by law.

This proposition has been found to depart from international norm and practice on the same, and the financial markets feel it impracticable to implement. It can somewhat provide a recommendation as a guideline to the proposed changes in judicial approach and Civil Code Procedure rules after considering public participation concerns in a balanced manner.

2.4.2.3 Banking Act

Considering that the history and the backbone of UCP deliberations were made by a group of experienced bankers, the Banking Act is a reflection of the protection of the banking's interests from external factors that would grossly affect its balance sheets. This is not a unique position from any other business venture, only that being mindful of the critical intermediary role the bank plays it behooves the financial sector to facilitate transactions of integrity and as smoothly as possible to increase investor confidence in ITL contracts.

2.4.2.4 Consumer Protection Act, 2014

A recent development in the Kenya law, the Consumer Protection Act is somewhat the equitable guide to transacting businesses in a fair and just manner. Interestingly, it has robust checks on banking transactions, meaning that it creates space for bank clients to exercise some flexibility in the bank's terms of reference in contracts with the bank. The Central Bank of Kenya Act as a fiscal agent to the government and public entities would do well to minimize risk for Kenyan buyers by demanding high quality provision of goods and services prior to the facilitation of payment.

2.4.2.5 Civil Procedure Code Rules

As intimated earlier, these rules are only limited to the procedural technicalities that respect the autonomy principle under common law. Lacking legal substance for expansion into other procedural considerations, it does serve much to serve justice to aggrieved Letters of Credit claimants.

2.4.2.6 Companies Act/Kenya Chamber of Commerce and Industry

The Kenya Chamber of Commerce and Industry is privately instituted under the Companies Act. The Companies Act was reviewed recently to make Kenya an attractive foreign and local business destination with liberal terms on directorship and scope of business. Whereas Kenya has opened up international trading as a regional economic hub, perhaps the Kenya National Chamber of Commerce may have a public component to oversee transnational trade transactions in the public interest, such that it provides a base for dispute resolution that will best favour Kenya's business interests. Some critics find Kenya Investment Authority and Nairobi Investment and Trade Centre as too liberal in allowing foreign entities a higher bargaining power in trade making Kenyan traders and participants vulnerable to over exploitation. KNCC could work consultatively with these kinds of institutions and identify gaps in ITL and give direction for reforms in this area. Leaving KNCC wholly as private may leave ITL transactions where Letters of Credit are involved totally manipulative to the weaker party and some percentage of healthy regulation would be necessary to assure investors of protection should any disputes arise. Alternatively, KCCI can be tasked with designing a self-regulatory system which will check traders' conduct and provide the direction for reforms.

2.4.2.7 Domestic Court Decisions

As the UCP has profoundly impacted domestic statutes and codes, many courts, in Kenya and elsewhere rely on the UCP, and even Banking Commission's interpretive material in deciding Letters of Credit cases.

2.5 How Uniform Customs and Practice for Documentary Credits applies in Kenya

The UCP has wide acceptance worldwide although they are not universally recognized as a source of International Trade Law. The UCP will therefore not be judicially noticed and therefore it requires to be specifically incorporated into the Letters of Credit agreement.

This was reiterated by Justice H.P.G Waweru in the Kenyan case of **Wilfred Gitonga t/a Wilken Communications vs Barclays Bank Kenya Ltd**,⁷⁴

Waweru J held that the UCP has to be integrated into the agreement. He also noted that the UCP appears to have achieved global acceptance. It has the force of law where it is explicitly worded that documentary credit terms are subject to the UCP.

To prove the above statement by the learned judge, Article 1 of the UCP states that: -

"The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 ("UCP") are rules that apply to any documentary credit ("credit") (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules. They are binding on all parties thereto unless expressly modified or excluded by the credit."

⁷⁴HCC 1938 OF 1996.

The learned judge interrogates the subject by asking upon what grounds would the bank refuse to honour a letter of credit and further states that only the relationship between parties on the transaction can determine how the question would be answered.⁷⁵

2.6 Kenyan cases on injunctions in Letters of Credit

The Autonomy Principle

This part of the thesis appraises the situations in which a court proscribes the issuer from issuing the sale sum under Letters of Credit. It introduces Kenyan cases on injunctions in Letters of Credit. Courts have maintained that banks should in no way be obliged to honor these contracts, even where such reference is alluded to in the credit. The general rule follows then that the bank's commitment to honour, to negotiate or to fulfill any other duty under the credit should not be enjoined to the applicant's claims or defences in court due to its relationship with the beneficiary.⁷⁶ Therefore, with the autonomy principle, the bank must pay the beneficiary as long as the documents presented conform to the descriptions of the credit.⁷⁷

2.6.1 The Fraud Exception

The most accepted opposition to the autonomy principle is the fraud exception that permits aggrieved parties to file for injunctive relief in court despite the documents being in strict compliance with the Letters of Credit contract. The UCP 600 does not have guidelines for scrutiny of fraudulent behavior or documents. The ICC defends this position stating that although the UCP 600 recognizes the fraud issue it may be hard to unify the scope of exceptions which can vary across jurisdictions and leaves this type of examination to domestic law and domestic courts acting

⁷⁵ www.kenyalaw.org

⁷⁶ The text of the UCP 600 can be found at: http://www.fd.unl.pt/docentes_docs/ma/mhb_MA_24705.pdf.

⁷⁷ Article 7 of UCP 600.

in good faith to protect the interests of the trading parties.⁷⁸The UCP 600 may be the agreed standard for best banking practices but is not a supervisor on issues such as extraction fraud.⁷⁹ Consequently, the extraction fraud exception is acted upon by courts and lawmaking assemblies.

Even so, the appropriate fraud exception test was discussed in **United Trading Corporation S.A. v. Allied Arab Bank Ltd**⁸⁰ where proof of fraud was debatable but that based on the material circumstances, the only practical deduction is that the beneficiary could not honestly have believed in the validity of its demands and that the bank was aware of that fact.⁸¹ It is not enough for the borrower to claim or suspect fraud from the beneficiary and plead to the court to intervene. The same test was reiterated in **Alternative Power Solutions Ltd. V. Central Electricity Board**

The tension in policy behind the fraud rule was well expressed by Justice Le Dain in the leading Canadian case of **Bank of Nova Scotia v. Angelica-Whitewear Ltd.**⁸² in these terms:

“The potential scope of the fraud exception must not be a means of creating serious uncertainty and lack of confidence in the operation of letter of credit transactions, at the same time the application of the principle of autonomy must not serve to encourage or facilitate fraud in such transactions.” The fraud rule allows an issuer or a court to study the facts that lie on the face of conforming documents and to stop the issuance of credit when fraud is involved.⁸³

⁷⁸Yanan Zhang, Documentary Letters of Credit Fraud exception rules: A comparative study of English law and Chinese law, 30 J. International Banking L. & Reg. 210, 211 (2015) [hereinafter Zhang, Documentary].

⁷⁹ Ibid.

⁸⁰[1985] 2 Lloyd's Rep 554.

⁸¹Ince, Library Sector Insights, Exceptional circumstances required to prevent bank from paying under letter of credit, uploaded on 30.09.2014, <https://www.incegd.com/en/knowledge-bank/exceptional-circumstances-required-to-prevent-bank-from-paying-under-letter-of-credit> (accessed on 14/05/2020).

⁸²[1987] 1 SCR 59.

⁸³ Ross P. Buckley* & Xiang Gao The Development Of The Fraud Rule In Letter Of Credit Law: The Journey So Far And The Road Ahead [https://www.law.upenn.edu/journals/jil/articles/volume23/issue4/BuckleyGao23U.Pa.J.Int'lEcon.L.663\(2002\).pdf](https://www.law.upenn.edu/journals/jil/articles/volume23/issue4/BuckleyGao23U.Pa.J.Int'lEcon.L.663(2002).pdf) (accessed on 17/06/2020).

2.6.2 Kenyan Court's Approach

It is important to appreciate that there is not much jurisprudence in Kenya when it comes to injunctions concerning Letters of Credit. This section demonstrates through case law where the courts considered the issue of injunctions in Letters of Credit.

a. Demonstration of extraction fraud

One of the leading Kenyan cases on the above is **Scope Telematics International Sales Limited v Stoic Company Limited & another**.⁸⁴ Under a contract, the Appellant was to supply 846 units of Mhubs to the 1st Respondent. Mhubs was a technical term which referred to tracking devices used in fleet or vehicle management. For purposes of guaranteeing payments under the contract, the Appellant opened a letter of credit dated August 27, 2014 with the 2nd Respondent as the issuing bank for 4.2 million Kenya shillings. The 2nd Respondent acknowledged receipt of documents from Allied Irish Bank, the advising bank. The documents meant that as per the 1st Respondent's authorization, the 2nd Respondent would pay the Appellant for supplying devices upon receipt of the relevant documents and would pay the amount guaranteed under the letter of credit on its maturity date, February 28, 2015.

The Appellant supplied *M-hubs* to the 1st Respondent but the devices did not meet the required standard in terms of quality and functionality. In response the contract, in terms of device specifications, was varied. After the variation, the supplied devices still failed to meet the required specifications and did not function as expected. A dispute arose close to the maturity date of the letter of credit.

⁸⁴Scope Telematics International Sales Limited v Stoic Company Limited & Co-operative Bank of Kenya [2017] eKLR, Civil Appeal No 285 of 2015.

Some of the issues that were discussed were: -

First, what were the circumstances under which the Court would interfere with an obligation to make payment under a letter of credit? Also, whether it was proper for the High Court to grant orders to restrain payments from being made under a letter of credit given that either fraud or irreparable harm or injustice had not been alleged?

The ICC Uniform Customs and Practice for Documentary Credits (UCP 600)⁸⁵ came into play in this instance. The court defined what a letter of credit entails using the 9th Edition of Black's Law Dictionary, as 'an instrument under which an issuer (usually a bank), at the request of a customer, agrees to honour a draft or other demand for payment made by a third party (the beneficiary) as long as the draft or demand complied with specified conditions, regardless of whether any underlying agreement between the customer and beneficiary was satisfied.' A letter of credit exists separately and distinctly from an underlying contract and it was not dependent or based upon such a contract in any manner.

It was held that a Court could only interfere with a letter of credit where fraud was established and the bank had been notified of the fraud or where encashment of a letter of credit would result in irreparable harm or injustice to one of the parties. In the instance case, no fraud, irreparable harm or injustice was alleged. There was no evidence that if payments were made under the letter of credit, the 1st Respondent would be unable to recover compensation from the Appellant if it

⁸⁵article 4 states that a credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary.

A beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank.

b. An issuing bank should discourage any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, proforma invoice and the like.

succeeded in the arbitration proceedings. No basis was laid to warrant the Court's interference with the 2nd Respondent's obligation to honour the letter of credit upon its maturity on February 28, 2015. In this case, the court declined the grant of injunction based on the three grounds mentioned above. The study appreciates that while the court separated the agreement of credit from the underlying contract, it criticizes this ruling for failing to reproach the Appellant for frustrating the contract. It opines that the merits of the case had to be looked at first and either compel the Appellant to effect specific performance or grant injunctive relief pending the specific performance. This is an example of what the study argues that the beneficiary's conduct should be viewed from a high standard of probability to frustrate or defraud the contract.

b. The Plaintiff has to establish special circumstances to warrant intervention by the Court⁸⁶.

In **Kenindia Assurance Company Limited –vs- First National Finance Bank Limited**,⁸⁷ quoted in **Republic - vs – Commissioner of Customs Services Ex parte Imperial Bank Limited**⁸⁸ the Court of Appeal stated as follows in respect of conditions precedent in Performance Bonds and Letters of Credit;

“As to the fulfillment of the conditions incorporated in the guarantee the statement of the beneficiary shall be taken at its face value unless the contractor can establish that the beneficiary's stand is motivated by fraud, misrepresentation, deliberate suppression of material facts or the like of which would give rise to special equities in favour of the contractor. In absence of such elements

⁸⁶ kenyalaw.org

⁸⁷Civil Appeal No. 328 of 2002.

⁸⁸[2015] eKLR.

the bank guarantee has to be honoured by the bank and the beneficiary cannot be restrained from enforcement.”

In a similar fate, , the High Court in **Civicon Limited -vs- Kivuwatt Limited**⁸⁹ premised its holding on the grounds that fraud had not been pleaded. What was pleaded is unlawful termination of the contract. On the two cases mentioned above, the study is of the opinion that if there is no law providing for other circumstances to be proved except the element of fraud, it becomes impossible for the Plaintiff to prove such and defeats justice for the plaintiffs. The beneficiary’s rights seem unfettered and the court unwilling to find a way to compel any further positive action from the defendant.

Guarantor Not Bound. In a similar vein, the High Court case of **R.H. Devanil Limited -vs- Transfuel Enterprises Limited & Another**,⁹⁰ the Court held that disputes between the parties to the contract should not concern the guarantee who has issued a performance security bond unless there is fraud by one of the parties of which the 2nd defendant had notice. Whereas the court is currently bound by the common law position, the court ought to be aware that the bank intermediary role as a central feature of the underlying contract that can be the only means the aggrieved party can use to seek legal recourse.

d. Obligation to Perform Contract Fully – Irrevocable Letter of Credit

Another case of relevance at this point is **Elikem Pharmaceuticals Limited v. Sipri Pharmaceuticals Limited & Another**.⁹¹ The 1st defendant contacted the plaintiff with a view to the plaintiff supplying consignment of pharmaceutical drugs and medicine to be delivered in Mombasa. The plaintiff, as a precondition to supply those goods requested the 1st defendant to

⁸⁹[2013] eKLR.

⁹⁰[2015] eKLR.

⁹¹[2005] eKLR, Civil Suit 411 of 1999.

obtain, from its bankers an irrevocable letter of credit to its favour for an amount sufficient to cover the purchase.

One of the issues in this case was the effect of granting an irrevocable letter of credit. The learned Judge referred to the case of **Urquhart Lindsay And Company Limited vs. Eastern Bank Ltd**⁹² and more particularly page 322, which stated: “The answer to this is that the defendant undertook to pay the amount of invoice for machine without qualification, the basis of this form of banking facility being that the buyer is taken for the purposes of all questions between himself and his banker or between his banker and the seller to be content to accept the invoice of the seller as correct.”

The holding of that case is as follows: “The credit being irrevocable, the refusal of the defendants to take and pay for the particular bills on presentation of the proper documentation constituted a repudiation of the contract as a whole and that the plaintiffs were entitled to damages so reckoned.” The plaintiff as result of the delayed payment of the amount due on the L.C., issued by the 2nd defendant has made claims for damages under various heads. The question the court needs to consider is whether the defendants are liable and if liable whether the plaintiff has proved its case. As stated earlier, there was no proof of seizure of the container and the court did find that it was the 1st defendant’s responsibility to register the drugs in Kenya. These were the reasons given by the defendants for failing to pay the L.C.

The court has also found that the effect of a L.C. is that the defendants had irrevocably bound themselves to pay the amount thereof. The answer of the court is undoubtedly that the defendants are liable to pay the plaintiff. Again, the study agrees that the court would be expected to follow

⁹²1 KB [1922] 318.

the letter of the law, in this case earlier precedents. However, the rigidity of this approach without scrutinizing the facts on the case from a practical sense makes the rigid law appear unjust and inflexible. If the defendants actions were committed not due to factors of their own, say, they had not been made aware of certain information that would significantly affect their ability to perform the contract satisfactorily, an equitable remedy that would allow the defendant time to complete the agreement terms would be feasible.

2.7 Importance of Guidelines

Rules are an essential part of decision making. They are necessary to ensure consistency, predictability in behavior and to give room for parties to be treated equally and fairly. While there's nothing wrong with using the precedents' principle, there are always situations which demand a certain degree of flexibility because judicial officers with different professional backgrounds may add unique perspectives that enrich the law. If they are to adjudicate commercial interests of businesses, judges have to be flexible enough to respond to their needs.

Guidelines enable judges to reduce biases in the exercise of personal judgment which may mean all the difference between winning or losing a case on injunctions in Letters of Credit. These guidelines will provide the boundaries that allow them to make decisions for the benefit of boosting international trade in Kenya. International traders' satisfaction often leads to loyalty which greatly improves the country's economy and overall profitability.

Whereas it may be impossible to make rules to govern every possible scenario that may occur for dealing with injunctions, different situations will arise where a judge or magistrate may have to

use some initiative to solve a problem but only with guidelines that offer this kind of flexibility they have to follow. Justice must be fair.⁹³

2.8 Conclusion

The present judicial position is that a Kenyan Court can only interfere with a letter of credit and grant injunction where extraction fraud is established and the bank has been notified of the fraud or where encashment of a letter of credit would result in irreparable harm or injustice to one of the parties. This is an impossible feat for many litigants due to lack of guidelines for the courts to follow as the only standard is strict proof of fraud.

Even so, if this position has to remain, this conclusion should be reached within a set of guidelines that will ensure all practical factors have been considered, otherwise the courts should expand the scope of issues for a restrictive injunctive relief, as well as broadly interpret what extraction fraud constitutes. It seems that most practitioners of law are not aware on what to plead before the court and knowing beforehand that a guideline exists might save their client's case.

Most cases can be solved if the judges and magistrates demonstrate they are willing to follow the guidelines even if it requires a slight adjustment, but still within court guidelines. Without rules, chaos would govern, there is no doubt about that. However, Kenyans should work with the courts to establish guidelines with a degree of flexibility for decisions about injunctions.

⁹³ John Rawls, Theory of Justice

CHAPTER THREE

A COMPARATIVE ANALYSIS OF KENYA: ENGLAND, CHINA AND THE USA

3.0 Introduction

To have a better understanding of how guidelines on injunctions will work in the Kenyan context, it is imperative to evaluate their application in jurisdictions that have adopted the injunctive relief.

The principles Kenyan courts can glean are highlighted in italics.

This paper selected USA, England and China because these countries represent the multiplicity of legal systems in the world. England engages the common law system, whereas China the continental civil law system. Furthermore, highlighting USA regulations promotes the understanding of the prevailing international approaches.

3.1 ENGLAND

England is a crucial reference point because London has been a leading commercial and banking centre in the past centuries. English courts have grown a rich global Letters of Credit case law. The exception of fraud rule has been distinguished in a number of court decisions in England but what is outstanding of English courts is the rigorous approach courts have taken. It is interesting to note that England lacks an express code with regard to Letters of Credit fraud exception rules. However, the rules are developed through practice in civil courts.⁹⁴ The remedy of an injunctive relief is the most claimed judicial remedy to fraud in England to prohibit payment under the Letters of Credit.⁹⁵

⁹⁴Yanan Zhang, Approaches to Resolving the International Documentary Letters of Credit Fraud Issue, Publications of the University of Eastern Finland No. 15.

⁹⁵ Ibid.

Both procedure and substance are important concerning the issue of injunction. The first technicality of the injunction is a procedural law matter with strict requirements to be satisfied. The second is proving the fraud issue, a matter of substantive law. English law lacks the definition of “fraud” and has to be decided on a case by case basis but English case law has developed particular Letters of Credit fraud exception rules in judicial practice.⁹⁶

In English law, the early application of the fraud rule was restricted to three conditions at the trial stage. First, fraud has to be clearly established. Suspicion or a mere allegation of fraud is not sufficient. Secondly, the bank is only tasked inspecting the facial compliance of the document, and not to investigate if there is fraud in the underlying transaction. Also, the bank is entitled to get compensation from the customer if the beneficiary’s document was compliant and regardless of the proof of forgery of documents especially if the bank was not aware of the fraud.⁹⁷

Thirdly, the intention of the beneficiary to defraud is also a necessary test for the fraud rule, although it does not only mean that a lack of intention may cause a failure to demonstrate fraud itself. In English law, even if fraud is clearly established it must point directly to the beneficiary and fraud by a third party cannot suffice in the fraud rule⁹⁸.

The case of **Discount Records Ltd v. Barclays Bank Ltd and another**⁹⁹ is a premier case relating to fraud exception in England. The scope and character of fraud exception are dealt with in detail. The court declined the injunction reasoning that firstly, the fraud was merely alleged and secondly, a sufficiently grave cause was not illustrated.¹⁰⁰ The court further considered that the payment of the bank disbursement to the seller did not affect the buyer’s interests and if it did so the buyer

⁹⁶ Ibid.

⁹⁷ Lu, Lu, *The Exceptions in Documentary Credits in English Law*, University of Plymouth 2011.

⁹⁸ Ibid.

⁹⁹ [1975] 1 Lloyd’s Rep. 444.

¹⁰⁰ Ibid, pp. 444-445.

could claim damages from the bank.¹⁰¹ This is a feature of the common law practice and jurisdictions, *where a court would not issue an injunction unless it is an absolute and final remedy, and unless the applicant has no other legal recourse.*

Another case worth mentioning is **Hamzeh Malas & Sons v British Imex Industries Limited**.¹⁰² The plaintiffs, a Jordanian firm contracted to purchase from the defendants, a British firm, and a large quantity of reinforced steel rods to be delivered in two installments. Payment was to be released to the defendants by two confirmed Letters of Credit with the Midland Bank Ltd in London for each installment. The Letters of Credit were duly opened and the first was materialized by the defendants and upon the delivery of the first installment the plaintiffs complained that that installment was defective and sought an injunction to bar the defendants from realizing the second letter of credit. Donovan J. refused the application. The plaintiffs appealed: -

Held, that “*although the court had a wide jurisdiction to grant injunctions, this was not a case in which, in the exercise of its discretion, it ought to do so; an elaborate commercial system had been built up on the footing that a confirmed letter of credit constituted a bargain between the banker and the vendor of the goods, which imposed upon the banker an absolute obligation to pay, irrespective of any dispute there might be between the parties whether or not the goods were up to contract.*”¹⁰³ The court was hesitant to use its wide discretion to grant an injunction where the trade practice compelled the banker to pay on the letter credit apart from any contractual challenges.

The fraud rule is expected to reduce the gap between the documentary credits system and fraudulent behavior though it may not totally hinder possible misdemeanors during its operation.¹⁰⁴

¹⁰¹Ibid, p. 448

¹⁰²(1958) 2 QB 127.

¹⁰³ Jenkins, Sellers and Pearce L.JJ., Hamzeh Malas & Sons V. British Imex Industries Ltd. [1958] 2 Q.B. <http://www.uniset.ca/other/cs3/19582QB127.html> (accessed on 17/07/2020).

¹⁰⁴ Lu, Lu, The Exceptions in Documentary Credits in English Law, University of Plymouth 2011.

Overall, English case law has attempted a consistent and strict approach towards L/C fraud exception rules. Since the late 1970s England has developed guidelines for fraud in Letters of Credit. Not surprisingly, there has been minimal success in restrictive injunctive reliefs as the alleged fraud was not established and the injunction was eventually not granted. Thus, the pursuit of traditional remedies like an injunction as a useful instrument in the fraud rule is doubted.¹⁰⁵

3.2 U.S.A

In the USA, the rule, which is termed as the independent contracts rule, provides for payment of Letters of Credit upon objective documentation criteria, without which the parties might not transact business at all.¹⁰⁶ The independent contracts rule, however, can produce inequitable results when the transaction is tainted by the beneficiary's fraud.¹⁰⁷

Accordingly, an exception to the rule of independent contracts was set out in **Sztejn v. J. Henry Schroder Banking Corp.**¹⁰⁸ In *Sztejn*, the seller-beneficiary deliberately neglected to transport the goods ordered by the buyer-customer. The beneficiary sent goods found as "worthless rubbish," and acquired the documentation entailing the letter of credit and thereafter claimed payment from the issuer. The customer applied for an injunction barring the bank from releasing the payment under the letter (an injunction against honor).

The court granted the injunction and stated that *'where there has been active and intentional fraud in the performance of the beneficiary's duty to the customer, a court may make an exception to the independent contracts rule and enjoin the issuer from making payment despite proper*

¹⁰⁵Yanan Zhang, Approaches to Resolving the International Documentary Letters of Credit Fraud Issue, Publications of the University of Eastern Finland No. 15.

¹⁰⁶ H. Harfield, *Bank Credits and Acceptances* 31-32 (5th ed. 1974).

¹⁰⁷ Stephen P. McLaughlin, Letters of Credit: Exploring the Boundaries of Injunctions Against Honor, *Fordham International Law Journal*, Volume 4, Issue 1, 1980, Article 7.

¹⁰⁸ 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941).

*documentation.*¹⁰⁹The court in this case found a creative way to admonish the unscrupulous behavior of the defendant by demonstrating how a substantive issue in the letter of credit can be dealt with. The intention to defraud was inferred from the defendant's actions. The Sztejn court held that breach of warranty concerning the quality of the merchandise was not sufficient cause to enjoin honor but rather it must be shown that the unscrupulous beneficiary actively and intentionally defrauded the buyer.¹¹⁰ The study is impressed with the court's innovative approach that endeavours to maintain integrity of contract under letter of credit.

In **Shaffer v. Brooklyn Park Garden Apartments**,¹¹¹ an action was brought against Brooklyn Park Garden Apartments, Hork Properties, Inc. and Larry Hork by Shaffer and Donald to enjoin collection following certain Letters of Credit issued by First National Bank of Minneapolis and delivered by plaintiffs. Allegedly the letters had been assigned to the defendant, Wayzata Bank Trust Company. Court ordered the dissolution of the earlier temporary restraining orders against the defendants and the First National Bank. The plaintiffs appealed the said order which was reversed and remanded¹¹². Points of interest include: -

First, Wayzata Bank and Trust Company was not a holder in due course of the Letters of Credit issued by First National Bank of Minneapolis.

Second, drafts, unlike Letters of Credit, are negotiable instruments but Wayzata were not holders of the drafts drawn by defendant Brooklyn Park Garden Apartments because the drafts taken by Wayzata had notice of defenses against them. National Bank had no responsibility for the

¹⁰⁹ 177 Misc. at 720-23, 31 N.Y.S.2d at 632-35.

¹¹⁰ Stephen P. McLaughlin, Letters of Credit: Exploring the Boundaries of Injunctions Against Honor, Fordham International Law Journal, Volume 4, Issue 1, 1980, Article 7.

¹¹¹311 Minn. 452, 453 (Minn. 1977).

¹¹²Case text, Shaffer v. Brooklyn Park Garden Apartments, Supreme Court of Minnesota Jan 14, 1977250 N.W.2d 172 (Minn. 1977), <https://casetext.com/case/shaffer-v-brooklyn-park-garden-apartments> (accessed on 2/07/2020).

performance of the underlying contract between its customer and the beneficiary of a letter of credit issued by First National.¹¹³

Although First National must honor a draft which appears to be regular on its face, it is not required to honor a draft presented by one who is not a holder in due course where there are allegations of fraudulent documentation before payment. A court of appropriate jurisdiction may enjoin honor under these circumstances.¹¹⁴ In the court's words:

*"A temporary injunction should be granted when it appears that a party's rights will be irreparably injured before a trial on the merits or where it is shown that the relief prayed for in the main action will be ineffectual or impossible to grant in the absence of temporary a injunctive relief."*¹¹⁵

In most cases, case law more than statutory law informs the procedure to follow in the grant of injunction against honour. Still, section 5-114 of the Uniform Commercial Code gives the grounds for injunctions against honor.¹¹⁶

The broad import of these sections-empower the court 'to enjoin honour when there is possibility of fraud in the transaction.'¹¹⁷ The court may also evaluate previous case law to establish situations where honor is supposed to be enjoined. New York's (known for numerous Letters of Credit trade and litigation cases) version of the UCC, has included subsection to section 5-102 of the U.C.C.,¹¹⁸ which exempt the application of the *U.C.C.* if the Letters of Credit's terms, trade usage or custom wholly or in part refer to the Uniform Customs and Practice Act (U.C.P.).¹¹⁹

¹¹³ Ibid.

¹¹⁴ Ibid.

¹¹⁵ Case text, *Shaffer v. Brooklyn Park Garden Apartments*, Supreme Court of Minnesota Jan 14, 1977 250 N.W.2d 172 (Minn. 1977), <https://casetext.com/case/shaffer-v-brooklyn-park-garden-apartments> (accessed on 2/07/2020).

¹¹⁶ U.C.C. s. 5-114 (1978 version).

¹¹⁷ Id. S. 5-114(2).

¹¹⁸ T. Quinn, U.C.C. Commentary and Law Digest s. 5-101 [A][1][a] (1978).

¹¹⁹ The U.C.C. is not a federal statute and must be adopted by a state (which may amend any section of the Code) before it has the force of law.

In practice there is a higher reliance on U.C.P, more than U.C.C., as an authority for Letters of Credit, mainly because over time the U.C.P. has taken note of the commercial world's practices and procedures and is not a compilation of legal rules seeking to regulate the Letters of Credit, hence making case law the referral point for cases of injunction against honour.¹²⁰The landmark 1941 *Sztejn* case still remains significant in this regard.

More recently, the **United Bank Ltd. v. Cambridge Sporting Goods Corp.**¹²¹ case was decided in similar manner to the *Sztejn* case. A New York buyer ordered 27,000 leather boxing gloves from a Pakistani seller, the beneficiary of a letter of credit which was issued by the buyer's bank and was payable upon specified documentation. The buyer discovered later that the shipped gloves were unpadding, ripped, badly mildewed and contrary to the buyer's expectations. The Pakistani seller went ahead to produce the specified documents to the bank and sought payment. The court stated that, *although mere breach of warranty was not sufficient to enjoin payment and the line between objections based on the quality of goods and objections based on fraud was sometimes thin, the worthless fragments of leather which the beneficiary shipped evidenced fraud rather than breach of warranty.* Consequently, the court enjoined the bank from honoring its letter.¹²²

Dynamics Corp. of America v. Citizens & Southern National Bank¹²³ is another case in which honor was enjoined and brought out different angle to the rule of fraud. The government of India purchased equipment from Dynamics. Dynamics' bank released a standby letter of credit payable to India acceptable from the issuer of a document signed by the Indian President stating that Dynamics had defaulted on its obligations under the contract. War between India and Pakistan

¹²⁰ Stephen P. McLaughlin, Letters of Credit: Exploring the Boundaries of Injunctions against Honor, Fordham International Law Journal, Volume 4, Issue 1, 1980, Article 7.T. Quinn, U.C.C. Commentary and Law Digest s. 5-101 [A][1][a] (1978).

¹²¹41 N.Y.2d 254, 360 N.E.2d 943, 392 N.Y.S.2d 265 (1976).

¹²² Stephen P. McLaughlin, Letters of Credit: Exploring the Boundaries of Injunctions against Honor, Fordham International Law Journal, Volume 4, Issue 1, 1980, Article 7.

¹²³356 F. Supp. 991 (N.D. Ga. 1973).

broke out attracting an embargo by the United States and India claimed that there was no delivery (and as such, a breach by Dynamics) stopping the issuer with the documents required under the letter.

A bankrupt Dynamics opposed India's claim for payment deeming it fraudulent since the goods had been delivered at the Dynamics' plant as indicated in the contract. The court found this insufficient to enjoin the bank from honoring its letter.

It is arguable whether fraud was in any way evident in the Dynamics case. Dissimilar to the *Sztejn* and the United Bank cases, it does not appear like the beneficiary in Dynamics was blameworthy for grave and intentional fraudulent acts. Interestingly, though, the court pronounced another principle for the fraud exception rule: “It is *the court's statement that the fraud necessary for an injunction against honor need not be intentional. Fraud, according to the Dynamics court, has a broad meaning when the action is in equity and includes "all acts, omissions and concealments which involve a breach of a legal or equitable duty."*”¹²⁴

The broader, "equitable" standard is a disputable thought from the ancient independent contracts rule which permits injunctive relief where the beneficiary's behavior might well be interpreted as substandard performance in the actual transaction. If this interpretation of fraud is quickly embraced by the courts, it may be a device that opens for the litigation of breach of the underlying contract and undermine independence of contracts rule, radically diminishing the reliability and utility of the Letters of Credit in complex commercial transactions.

In **Intraworld Indus. Inc. v. Girard Trust Bank**,¹²⁵ a Pennsylvania court departed from this broad "equitable" standard and spelt out a well-reasoned policy to grant injunctions only in such

¹²⁴ Stephen P. McLaughlin, Letters of Credit: Exploring the Boundaries of Injunctions against Honor, Fordham International Law Journal, Volume 4, Issue 1, 1980, Article 7.

¹²⁵461 Pa. 343, 336 A.2d 316 (1975).

instances where the misconduct (fraud) of the beneficiary has *"so vitiated the entire transaction" that the legitimate purposes of the independence of the issuer's obligation would no longer be served.*" It continued to posit that a court of equity's limited duty is to assure security that the beneficiary is not allowed the unconscionable act and advantage over the situation to get away with the plaintiff's-customer's money.¹²⁶

The Inraworld case identified scenarios that warrant an injunction against honor. The court recognized the independence principle as giving the Letters of Credit transaction certainty and could only interfere to prohibit payment where the beneficiary's behavior in the actual contract is so blameful that to proceed with payment would be unconscionable. It is for the courts then, to single out behavior of the beneficiary that could 'shock the conscience' prior to enjoining honour.¹²⁷

United Bank Ltd. v. Cambridge Sporting Goods Corp. and **Sztejn v. J. Henry Schroder Banking Corp.** illustrate instances of such "conscience-shocking" fraud. From the different approaches proposed by courts, they demonstrate that to protect the integrity of Letters of Credit courts should only enjoin honour upon demonstration that the perpetration of fraud was so reprehensible that to allow payment by the issuer would be unconscientious.

The courts in the Iranian letter of credit cases tactfully declined the notion of 'prospective fraud' or fraud that the beneficiary might commit. If the US court followed this route to enjoin honour, foreign merchants would be hesitant to request a letter of credit from US banks and injure the banking and business communities.¹²⁸ Where the argument of prospective fraud is raised by a

¹²⁶ Stephen P. McLaughlin, Letters of Credit: Exploring the Boundaries of Injunctions Against Honor, Fordham International Law Journal, Volume 4, Issue 1, 1980, Article 7.

¹²⁷ Ibid.

¹²⁸ Stephen P. McLaughlin, Letters of Credit: Exploring the Boundaries of Injunctions against Honor, Fordham International Law Journal, Volume 4, Issue 1, 1980, Article 7.

litigant, the court may only entertain it if even though the payment to the beneficiary has not yet been released, to do so in the future would amount to being "necessarily fraudulent."¹²⁹

3.3 CHINA

Prior to the 1970s, the People's Republic of China operated from a highly centralized and planned economy. Only in 1978 did China open up its economy. Six years later it addressed its first Letters of Credit dispute in 1986 in the **Yuegang Agricultural Resources Development Co. v. Japanese Technology of Science Co.** case.¹³⁰ The plaintiff, a Chinese buyer, sued the Japanese seller asserting that machines delivered based on the contract were unsatisfactory. The plaintiff sought to freeze a payment owed of ¥216 million, and the court disregarding the Letters of Credit element froze the payment through a stop-payment order. This judgement disappointed many traders for the court had not included international jurisprudence on the fraud exception and simply relied on *China's Civil Procedure Law*. It failed to consider fraud principle of Letters of Credit and it seems courts in China were not familiar with Letters of Credit. Unsurprisingly, the Japanese seller and paying bank, citing the autonomy principle, heavily condemned the unseemly halting of the payment.¹³¹

Gradually, the frequent stop-payment orders issued by Chinese courts drew heavy local and international criticism from Chinese banks due to court interference which harmed the healthy operation of Letters of Credit transactions and dented the reputation of China's emerging banking industry.¹³² At the time, the only guide dealing with Letters of Credit fraud was the General

¹²⁹ Ibid

¹³⁰ Yuegang Agric. Res. Dev. Co. v. Japanese Tech. of Science Co., Zhu ZhongFa Jin ShenZi Di 23-3, Hao Case No. 23-3 (Econ. Div., Zhuhai Interm. People's Ct. 1986).

¹³¹ Yeming Ding, Bruno Zeller, The fraud exception in Letters of Credit – the Chinese approach, International Review of Law, University of Western Australia Law School, Perth, Australia, Submitted on 18 May 2016.

¹³² See Edward E. Lehman & John Lee, Adjudicating letter of credit-related cases: the Provisions on Several Issues Concerning the Trial of Letter of Credit Disputes, China's first letter of credit-related law, has attracted widespread attention in the banking sector and judicial circles, 20 CHINA L. & PRAC. 23 (Sept. 2006), <http://ezfind.technion.ac.il/vufind/EdsRecord/edsggo,edsgcl.153186283>.

Principles of the Civil Law (GPCL)¹³³ of the People's Republic of China and Contract Law.¹³⁴ The magnitude of the crisis led the Higher People's Courts to engage the Supreme People's Court to design much-needed direction and guidelines on Letters of Credit-related cases.

On 12th June 1989, the Supreme People's Court¹³⁵ launched the "Summary of the National Forum on the Adjudication of Economic Cases relating to Foreigners and People from Hong Kong and Macao in the Coastal Region."¹³⁶ It broadcast the fraud rules in Paragraph (4) (ii), "Regarding the Freezing of Payment of a Letter of Credit,"¹³⁷ it stipulated that on a general note, payment of a letter of credit should not merely be frozen over a dispute on the foreign related sales contract and injure the reputation of the Chinese banks involved. It stated:

*"In view of the practice at home and abroad, if sufficient evidence shows that the seller is using the underlying contract to defraud the buyer, and the Chinese bank has not paid within a reasonable time, a people's court may freeze the payment of the letter of credit upon the request of the buyer."*¹³⁸

Conversely, if the draft has been presented and the bank has accepted credit and issues the same, the obligation of the Chinese bank becomes unconditional under the law of negotiable instruments. The people's court when taking such measures should move with caution, and first contact the Chinese bank then seek advice from higher courts when necessary. It should follow the same steps

¹³³ Zhang, Ruiqiao. "Study of the fraud exception rule in Letters of Credit in China and proposed amendments to the Chinese credit system", International Journal of Private Law, 2014.

¹³⁴ Yanan Zhang, Evaluation of documentary letter of credit fraud exception rules in China, 29 J. International Banking L. & Reg. 103, 103 (2014) [hereinafter Zhang, Evaluation].

¹³⁵ Zaid Aladwan. "The implementation of the fraud exception rule: a comparative study", Journal of Financial Crime, 2020

¹³⁶ [Announcement from the Supreme People's Court concerning the National Forum on the Adjudication of Economic Cases Relating to Foreigners and People from Hong Kong and Macao in the Coastal Region, Fa (Jing) Fa No.12 (Sup. People's Ct. 1989)], <http://law.lawtime.cn/d556800561894.html> [hereinafter, Announcement].

¹³⁷ Zhang Ruiqiao, A Comparative Study of the Fraud Exception Rule of Letters of Credit: Proposed Amendments to the Chinese Credit System 86-87 (LL.M. Thesis, McGill University, ProQuest Dissertations Pub., Nov. 2009).

upon receipt of an application from a Chinese foreign arbitration agency concerning the freezing of the payment of a letter of credit.¹³⁹

The 1989 improved guidelines reflected international principles and jurisprudence captured in the 2006 UCP 600 albeit having a weaker legal effect having been a conference pronouncement and not a judicial interpretation.¹⁴⁰ Here, two basic rules were laid out as earlier mentioned. First, that a court can only interfere with a payment if sufficient evidence of fraud is shown, and second, that a court cannot interfere with the payment if the bank has already accepted the draft.¹⁴¹ Even with the clear articles, they lacked a binding effect and their application became a challenge up to 15 years later. This was a great accomplishment, though, which was instrumental in establishing subsequent guidelines in 2005. The first set of guidelines in 2005 SPC Provisions dealing with fraud evidently factored international customary rules and jurisprudence from other jurisdictions.¹⁴² Customized also with fundamental principles they were specifically designed to suit the Chinese legal system with input from local banks and courts.¹⁴³ The 2005 SPC has four parts consisting rules on establishment of fraud, immunity from the fraud exception, the stop-payment order and remedy of the stop-order payment in five articles in sections 8, 9, 10, 11, and 12.¹⁴⁴

¹³⁹[Announcement from the Supreme People's Court concerning the National Forum on the Adjudication of Economic Cases Relating to Foreigners and People from Hong Kong and Macau in the Coastal Region, Fa (Jing) Fa No.12 (Sup. People's Ct. 1989)], <http://law.lawtime.cn/d556800561894.html> [hereinafter, Announcement].

¹⁴⁰Yeming Ding, Bruno Zeller, The fraud exception in Letters of Credit – the Chinese approach, *International Review of Law*, University of Western Australia Law School, Perth, Australia, Submitted on 18 May 2016.

¹⁴¹ Xiang Gao, The Fraud Rule in Law of Letters of Credit in the P.R.C., 41 *The International Lawyer* 1067, 1068 (2007) at 1074.

¹⁴²Yeming Ding, Bruno Zeller, The fraud exception in Letters of Credit – the Chinese approach, *International Review of Law*, University of Western Australia Law School, Perth, Australia, Submitted on 18 May 2016.

¹⁴³ China Court, Review of the Provisions of the SPC on Some Issues in the Adjudication of L/C Cases (09 Dec. 2005)], <http://www.chinacourt.org/article/detail/2005/12/id/189405.shtml>, [hereinafter, China Court, Review].

¹⁴⁴Provisions of the Supreme People's Court on Some Issues Concerning the Trial of Cases of Disputes over Letter of Credit, Fa Shi No. 13 (Sup. People's Ct. 2005)], http://www.gov.cn/ziliao/flfg/2005-12/09/content_122712.htm. The SPC adopted the provisions as a judicial interpretation rather than as legislation, which plays a significant role in judicial practices.

The establishment of fraud: Articles 8 and 9

Article 8 is an articulation of situations which constitute the Letters of Credit fraud as follows:

- i. “the beneficiary has forged or incorporated false contents in any of the presented documents;
- ii. the beneficiary, in bad faith, delivers no goods or delivers goods of no value;
- iii. the beneficiary, in conspiracy with the applicant or any third party (parties), presents documents while no real underlying transactions exist;
- iv. other circumstances where fraud under Letters of Credit may be found.”

Of special interest is that it still does not define Letters of Credit fraud but makes a list of where Letters of Credit fraud exists. It centres on the beneficiary. It is a blend of procedural and substantive exceptions.

Where the existence of fraud is concluded, the People’s Court shall order the suspension or termination of the payment under the Letters of Credit save in any of the following conditions:

- i. “A party nominated or authorized by the issuing bank has made payment in good faith according to the issuing bank’s instructions;
- ii. The issuing bank or a party nominated or authorized by it has accepted the draft under the Letters of Credit in good faith;
- iii. The confirming bank has paid in good faith;
- iv. The negotiating bank has negotiated in good faith.”

3.4 Comparison

This part of the thesis is by no means comprehensive, but in highlighting comparative features it helps to promote understanding of the prevailing international approaches. Even so, there is no uniform application of the fraud exception as various standards are used.

Generally, as has been observed, English courts narrowly construe the fraud exception for Letters of Credit transactions and would be very reluctant to grant injunctions¹⁴⁵ not wanting to compromise the Autonomy Principle. For instance, in **Czarnikow-Rionda Sugar Trading, Inc. v Standard Bank London, Ltd.**¹⁴⁶ Rix J. held the plaintiff's claim could not sustain an injunction because prior to the payment the advising banks were not notified of the fraud. Two types of fraud are appreciated under English law, and thus two possible exceptions that stop the banks' obligation to pay cited in **United City Merchants (Investments) Ltd v Royal Bank of Canada** as "*Firstly, if the documents were forged and were nullities, then, the condition of the credit that there is a conforming document is not fulfilled; and secondly, if the beneficiary was himself dishonest or fraudulent.*"¹⁴⁷

On the other hand, the United States method seems more flexible. The position on intentional fraud was first recognized in **Sztejn v J. Henry Schroder Banking Corporation.**¹⁴⁸ However, **Asbury Park & Ocean Grove Bank v National City Bank of New York**¹⁴⁹ moved from the ruling in *Sztejn* and took into account egregious fraud. This standard becomes a high ceiling to prove fraud, requiring a comprehensible proof of extraction fraud and not just a mere allegation.¹⁵⁰ Additionally, the paying bank must be notified of extraction fraud before the draft of payment is produced.

¹⁴⁵Nevin Meral, The Fraud Exception in Documentary Credit: A Global Analysis, 2 Ankara B. Rev. 45, 59 (2012).

¹⁴⁶[1999] 1 All ER 890 (QB, Comm.).

¹⁴⁷[1983] 1 AC 168, 172 (Ct. App., Civ. Div.).

¹⁴⁸*Sztejn v J. Henry Schroder Banking Corp.*, 31 N.Y.S.2d 631 (Sup.Ct. 1941).

¹⁴⁹35 N.Y.S.2d 985 (Sup. Ct. 1942), *aff'd*, 52 N.Y.S.2d 583 (App. Div. 1944) (Mem. Op.).

¹⁵⁰See *Discount Records Ltd. v. Barclays Bank Ltd.* [1975] 1 WLR 315, 319 (Ch), where this view was confirmed.

Practically, the U.S. and English courts are not as far apart at a cursory glance, but they are not *ad idem* either.

A critical view is that there is apparent significant connection between the English law and the Chinese provisions fraud exception rules in articles 8(I) and 8(III). Despite criticism, Zhang¹⁵¹ hailed the court's pronouncement in **United City Merchants (Investments) Ltd v Royal Bank of Canada** (The American Accord)¹⁵² as an excellent elucidation of the English position on the Letters of Credit fraud exception¹⁵³. Zhang accepts that evaluating whether alleged third-party fraud constitutes Letters of Credit fraud in **United City Merchants** case requires commercial custom's logical arguments.

Two issues therefore arise: first, the beneficiary is aware of the fraud, and second, if the magnitude of the fraud is substantial¹⁵⁴ as captured in the Chinese provisions. Article 8(III) mentions that where the beneficiary submits false documents with the collusion of a third party. And further, article 11(III) and article 9 anticipated the issuing of an injunction against payment when severe loss may be occasioned by the fraud. Questionably, there is no allowance for suspending the payment in these occurrences.

In review, the same conclusion can be reached by applying either English jurisprudence or the Chinese provisions. Both court systems prefer a high threshold which makes it difficult to obtain stop payment order. Notably, following Chinese jurisprudence obliges caution as article 8(IV) gives the courts some discretion.

¹⁵¹Yanan Zhang, Evaluation of documentary letter of credit fraud exception rules in China, 29 J. International Banking L. & Reg. 103, 103 (2014) at 105.

¹⁵²United City Merchants, [1983] 1 AC 168.

¹⁵³Yanan Zhang, Evaluation of documentary letter of credit fraud exception rules in China, 29 J. International Banking L. & Reg. 103, 103 (2014) at 104. qspace.qu.edu.qa, See, e.g., Roy Goode, Chapter 9: Abstract Payment Undertakings, in Essays for Patrick Atiyah 229-31 (Peter Cane & Jane Stapleton eds., 1991).

¹⁵⁴Yanan Zhang, Evaluation of documentary letter of credit fraud exception rules in China, 29 J. International Banking L. & Reg. 103, 103 (2014) at 105.

3.5 Conclusion

The conclusion of this section finds that keeping a high threshold for Letters of Credit fraud helps to maintain the stability and certainty in Letters of Credit transactions, yet it is important to investigate the claims on a merits basis.¹⁵⁵ In all the three jurisdictions looked at, the principal role of the Letters Of Credit system remains the facilitation of payment. The strict approach is commendable yet it needs to be complemented by a broader equitable approach that ensures fair justice by litigants in order to sustain a reliable Letters of Credit system and achieve the smooth operation of international trade financing in Kenya.

¹⁵⁵Yanan Zhang, Evaluation of documentary letter of credit fraud exception rules in China, 29 J. International Banking L. & Reg. 103, 103 (2014) [hereinafter Zhang, Evaluation] at 120.

CHAPTER FOUR

4.0 FINDINGS, CONCLUSION AND RECOMMENDATIONS

The study makes the findings as mentioned here below.

4.1 Research Findings

Kenya like some jurisdictions does not have fastidious laws on Letters of Credit. There are, however, internationally recognized guidelines on the use of Letters of Credit such as UCP, ISBP, UCC and UNCITRAL codes which seek to harmonize and unify Letters of Credit practice in international trade. These are largely self-regulatory mechanisms but seem to have force of law in case law.

The autonomy principle under Letters of Credit is heavily protected globally in order to give security to international trading. It may only be reconsidered in the case of fraud. However, due to the strict interpretation of 'fraud' there have been few successful injunctive reliefs granted to litigants.

Consequently, there have been efforts to widen the scope that allows for an injunctive relief to be granted which has grown the jurisprudence on and the applicability of the broader interpretation of the fraud exception and other reasons for its grant. Comparative arguments include examining the behavior of the beneficiary and treating breach of warranty in the underlying contract as being negligently fraudulent. China's domestic code, though criticized, makes intervention for a 'stop order for payment' where fraudulent behavior by the beneficiary is reported and the bank was yet to receive a draft of the documents authorizing it to make the payment.

The research has also found that Kenya's judicial approach in determining disputes concerning Letters of Credit has strictly followed the common law approach of strict proof of extraction fraud

and has not explored the scrutiny of contractual terms, and treats Letters of Credit as binding in isolation of parties' conduct, with a heavy reliance on soft law practices. There is no law to stop a bank from releasing payment to seller except a restrictive injunctive relief by court. To a large extent jurisprudence in this area has not developed in tandem with modern international interpretations. There is need to challenge the binding nature of such contracts based on merit.

The result has been no successful litigation by aggrieved buyers due to the rigidity of precedent-based old common law application. The regrettable end by this omission has been numerous losses for the aggrieved parties. Undesirable trade malpractices such as extraction fraud and deliberate misrepresentation in goods and services have continued unabated in Kenya. The existing position favours the beneficiary or the seller the most.

Then again, the Judiciary is not solely responsible for this situation when the law making institutions have been silent on this matter. The role of the Judiciary is to interpret laws in existence or suggest which areas of law need improvement. Nonetheless, little growth of judicial jurisprudence in this area could easily contribute to apathy or low contribution from legislative processes that could attempt to cure the defects in the current ITL that concerns the administration of Letters of Credit.

It is not clear that where court litigation has failed, how arbitration has tried to mitigate the losses in a significant way. The judiciary ought to be more aggressive in prompting growth in trade jurisprudence for relevant application in court decisions.

The reputation of banks as a detached intermediary does not seem to promote investor confidence where it is perceived as complicit in encouraging the status quo in justice gaps, and the bank is embraced as a necessary evil. To enhance justice concerning Letters of Credit matters, banks are

invited to increase confidence in international transactions by increasing their due diligence where impediments to successful contractual performance are likely to arise.

The role of technology in verifying credibility of transactions is not being utilized to its highest potential to minimize the failure rate of claims under Letters of Credit; whether on the determination of the quality of contract, jurisdictional matters, or in dispute resolution and law making processes in this area. This benefit ought to be exploited more.

International Trade Law principles ought to grow corresponding with other International Law developments such as globalization, regard for rights based approaches, and environmental protection for inclusive trade practices.

4.1.1 Research Hypothesis Test

The hypothesis test was done by researching Kenyan case law outcomes to discern the laws used and how they impacted the restrictive injunctive relief claims. From the published court cases, no injunctive relief has been granted as the courts argued that no intention of fraud had been proved or that the plaintiff could not prove they would suffer irreparable damage if the letter of credit was honored by the bank. Without any other form of departure from only these two narrow conditions, it is impossible for the plaintiffs to claim any other grounds for an injunctive relief, or fully satisfy these conditions.

The hypothesis has been tested to prove that the current judicial and legal approach in Kenya solely relying upon common law autonomy principle for Letters of Credit claims cannot successfully provide a restrictive injunctive relief to a claimant.

4.1.2 Research Objectives Met

Research objectives have been met which included stating the definition and the usage of the letter of credit, the theoretical and legal questions surrounding the Letters of Credit, the comparative

analysis internationally, and case law difficulties in the Kenyan context which is not in tandem with the broader international development. Further, the research has added to the literature contribution into Letters of Credit jurisprudence in Kenya with an analysis of the current judicial approach demonstrating the need for improved legal and judicial guidelines in providing a fair and effective legal relief to claimants (especially the aggrieved buyer).

4.2 Conclusion

From the foregoing, it is evident that Letters of Credit play a crucial role in international trade and are the lifeblood of international commerce. The UCP 600 is the uniform standard for best banking practices but does not contain any articles providing guidelines for examining fraudulent behavior or documents. It leaves room for domestic enhancement of the principles which secure the use of the Letters of Credit, an opportunity that Kenyan courts are yet to exploit.

Assessing the comparative analysis, although the UCP recognizes the fraud issue, Kenya can embrace the scope of exceptions varying across jurisdictions and hence, domestic law and domestic courts should act in good faith and endeavor to protect the interests of the trading parties. For instance, if the goods or services are not provided, or fail to meet the merchantability test, based on the merits of the case a party should be allowed an injunctive relief for the seller to correct the remedy. Where the contractual terms are breached to the root of the contract, the contract should be repudiated and the seller refunds any payments made. The guidelines should compel the guarantor Bank to be a party to these proceedings where possible.

The Kenyan courts are likely to get better results in litigating Letters of Credit matters where they develop a set of guidelines that aid the judges, magistrates and advocates in the procedures to be followed from the time the issuer of a Letter of Credit is desirous to request the bank to stop payment.

Staring at the weakness of common law, it is important to note that England which uses common law only has a very low success rate when it comes to injunctions just like Kenya. It is also noteworthy that USA and China, countries that use codes and guidelines have good success rates in litigating Letters of Credit transactions and obtaining injunctions. Thus, it is important to have guidelines as well as case law to help in determination of matters concerning Letters of Credit Injunctions as common law is not enough.

4.3 Recommendations

This paper suggests the following recommendations: -

From the comparative analysis, there are principles Kenya can borrow from to incorporate into the judicial guidelines.

At the institutional level, first, the following have a part to play.

a. Supreme Court

Short term

The Supreme Court should come up with guidelines for courts to follow in order to ascertain whether an injunction should be granted to stop payment on Letters of Credit. The guidelines should make it clear that a Court can interfere with a letter of credit where fraud has been specifically pleaded and where extraction fraud is established and the bank had been notified of the fraud; or where encashment of a letter of credit would result in irreparable harm considering the nature of the contract on a merits based system; or where encashment of a letter of credit would result to great injustice to one of the parties. The party seeking the injunction should show that the demand on the credit, bond or guarantee was fraudulent and the bank knew it to be fraudulent after being notified of the same by either of the parties. Although this study focuses on the plight of the buyer, it also acknowledges that in some instances a seller may suffer loss where the buyer may

act fraudulently and refuse to give instructions for the payment to be released. The bank may also be defrauded by the seller and the buyer, therefore, rules formulated should be able to protect each party.

There also may be need to classify trade extraction fraud as criminal in order to minimize acceptance of fraud.¹⁵⁶

Medium term

Secondly, drafters should consider a treatment of Letters of Credit that is useful and one that will attract all concerned parties. The guidelines must address the current scenario of international trade. Importers, exporters and intermediaries must be assured that the solutions proposed are viable. Clear guidelines will boost investor confidence and give a semblance of certainty to litigation.

Long term

Thirdly, there would be need to review Letters of Credit and ITL contracts to include provisions that give the buyer discretion to reject goods if they are not of agreed merchantable quality or timely delivery which could have been avoided, drafters should proceed cautiously considering proper safeguards taking into account international customary rules and international jurisprudence concerning Letters of Credit. They should direct special attention toward examining the fundamental principles that have been widely adopted by many other jurisdictions. Additionally, whereas these rules conceptually and operationally should adopt methods that are consistent with and accord international best practices and principles, they should suit the Kenyan legal system augmented with suggestions from local banks and courts. For instance, we can borrow the Chinese regulations which are borrowed from different jurisdictions and tailor them to suit our

¹⁵⁶Yanan Zhang, entitled Approaches to Resolving International Documentary Letters of Credit Fraud Issue; <http://www.uef.fi/vaitoskuvat>

needs whilst also noting trade concerns that are unique to our African trade environment. It is worthy to note that Kenya is not limited and can still set new international standards if local industry players come up with more efficient and practical ways of handling Letters of Credit.

The introduction of new and viable concepts for granting injunctions in Letters of Credit that meet the requirements of Kenya's trade and finance will enhance efficacy of Letters of Credit and strengthen its position in international trade.

b. Kenya Law Reform Commission

Immediate Short Term

KLRC shall work with the Rules Committee established under the Civil Procedure Rules of Kenya and take the lead in implementing the above recommendations into court practice. This is due to the fact that it largely involves litigation in civil courts.

Medium Term

The Chief Justice, the Kenya Law Reform Commission, Kenya Bankers Association and the Kenya Chamber of Commerce should work together to formulate guidelines for inclusion in the Civil Procedure Code. Money laundering and other international crimes should be factored as additional inclusions in the anti-extraction fraud rules under ITL.

KLRC may also contextualize the international elements of soft law and international best practices working with Parliament to ratify needed legal instruments and review current practices to going tandem with present and future trade developments.

Long term

Pertinent rules arising from the norms can form the basis for subsidiary amendments to the Companies Act, Law of Contract, Sale of Goods Act and any other statutes incidental to international trade transactions to promote integrity in contracts. Court adjudication processes should promote balance in bargaining power between parties; consider contract principles on the basis of merit if there are significant errors on the face of the transaction.

c. The Kenya Chamber of Commerce

Short, Medium and Long Term

KCCI should design a self-regulatory mechanism to check traders' conduct and use the same to inform legislative processes. The country's best interests should be a key factor in regulating ITL practices which include the letter of credit. Ultimately, there should be a higher litigation success in courts with the scope of complaints widened. KCCI can also enhance the Economic pillar of the Vision 2030 secretariat by its input.

d. Arbitration tribunals

Immediate Short and Medium Term

The tribunals should be allowed some leeway for more equitable outcomes where courts are bound by strict rules. In the meantime, Alternative Dispute Resolution mechanisms can be employed to resolve matters of specific performance where possible. Consequently, the Banking Act and the Central Bank of Kenya (CBK) Act should reflect these developments. Internationally, the DOCDEX rules and mediation sort out questions about the independence principle of arbitration agreement, interim measures, arbitrability of extraction fraud and stricter punitive damages and

enforcement of arbitral awards which require to be backed by legal sanctions to be more effective.¹⁵⁷

e. Kenya School of Law, Council for Legal Education and institutions of higher learning

Short Term, Medium and Long Term

They should conduct Continuous education with judicial staff and legal practitioners under Continuous Legal Education (CLE) programmes within legal circles would also do well to inform them on global commercial law developments. The Academia would assist in keeping research momentum up and provide useful insights for the industry to customize and improve the business environment.

f. The Banking sector

Medium and Long Term

On its own volition would help to minimize losses arising from court injunctions and cancellation of contracts if it takes a proactive role to scrutinize the nature of the contracts involved. Fraud detection units should scrutinize more than internal extraction fraud but lift the veil over external activities including classifying international crimes as under the ambit of fraud. If sufficient evidence shows illegalities requiring inquisition into lifting of the corporate veil and *ultra vires* actions or substantive matters of contract are flouted (public interest, environmental degradation, fraud, corruption and Chapter Six violations of Integrity in the Constitution of Kenya), it may choose to raise the concerns with the parties involved. This part of professional diligence can fit in the existing mechanism of Know Your Customer (KYC) guidelines as provided by the Central

¹⁵⁷Yanan Zhang, Approaches to Resolving International Documentary Letters of Credit Fraud Issue; <http://www.uef.fi/vaitoskuvat>. www.wgtn.ac.nz, "Asian Yearbook of International Law, Volume 3 (1993)", Brill, 1995.

Bank of Kenya. **The Treasury** shall be a financial facilitator for CBK to implement these raft of reforms to enable it to supervise the macro and micro finance elements.

g. The Capital Markets Authority

Medium and Long Term

To promote investment worthiness of Kenya, may also provide for listed companies' operational guidelines capturing the same developments, particularly in regulating against companies involved in domestic and transnational crimes.

h. The Ministry of ICT

Short and Medium Term

Digitization of ITL documents with strict security protocols would reduce occasions of forged documents and ensure real time inspection of Letters of Credits, contracts, bills of lading and other ITL instruments as well as allow for goods on transit to be monitored and inspected.

i. The Kenya Revenue Authority

Immediate Short and Medium Term

KRA can do more than look for tax evaders with shipping or cargo consignments and help to verify the quality and quantity of goods in the documentation provided by traders.¹⁵⁸

Some features of Letters of Credit include: negotiability, transfer and assignment, sight and time drafts and revocability.¹⁵⁹ Negotiability means that the beneficiary in a letter of credit is warranted

¹⁵⁸Zhang, Yanan. (2012). Documentary letter of credit fraud risk management. Journal of Financial Crime. 19. 10.1108/13590791211266340, www.econstor.eu ; also In Al Maren, Ismail and Nor, Risks And Remedy In Islamic And Conventional Letter Of Credit: Jordanian Practice e-journal.metrouniv.ac.id (2020);https://www.researchgate.net/publication/263462735_Documentary_letter_of_credit_fraud_risk_management www.emerald.com

¹⁵⁹<https://bizfluent.com/list-5980966-features-letter-credit.html> (accessed on 20/02/2021)

a pay.¹⁶⁰ Revocability means that the obligation to pay a beneficiary under a letter of credit can be revoked.¹⁶¹ Transfer and assignment means that the duty to pay can be imposed to another person

This list of institutions is not exhaustive but indicates how an inclusive participation can enrich decision making on ITL matters at the domestic level. Overall, if all the stakeholders come in handy to address this issue soonest a clear and helpful map will be most desirable. The overall result would be improved security for buyers, freedom to contract and investor confidence.

¹⁶⁰ Ibid.

¹⁶¹ Ibid.

REFERENCES AND BIBLIOGRAPHY

JOURNALS, ARTICLES & SCHOLARLY WRITINGS

1. Berman P, 'Global Legal Pluralism',(2007). 80S.Cal. Rev.1155
2. D. Held and A. McGrew, *World Orders, Normative Choices: Introduction*, in D. Held and A. McGrew (eds), *The Global Transformations Reader: An Introduction to the Globalization Debate*, Polity Press, 2003.
3. E. Moschouri-Tokmakidou, *Commercial Letters of Credit in England and in Greece*, Department of Commercial Law, Faculty of Law, The University of Birmingham.
4. Gunther Teubner, "Global Bukowina:"Legal Pluralism in the World Society, in *Global law without a State* at 128, 133, 146.
5. J. Kovenlevit, *Bottom -Up Lawmaking Through A Pluralist Lens: The ICC Banking Commission And The Transnational Regulation of Letters of Credit*.
6. J.White& R. Summers, *Handbook of the law under the commercial code* at page 9-18 (2d ed. 1980).
7. *Letters of Credit: Current Theories and Usages*, 39 LA.L.REV. 581, 581-85, 609 (1979).
8. *Letters of Credit: Injunction as a Remedy for Fraud in U.C.C. Section 5-114*,63MnqN. L. REv. 487 (1979).
9. Lu Lu, 'The Exceptions in Documentary Credits in English Law',(2011)Plymouth Law School Faculty of Business Published on January.
10. N. Luhmann, *Law as a Social System*, cit.
11. Grassi P, 'Letter of Credit Transactions: The Banks' Position in Determining Documentary Compliance – A Comparative Evaluation under U.S., Swiss and German Law' 1995, 7 (1), *Pace International Law Review* ;
12. Linarelli J, 'Analytical Jurisprudence and the Concept of Commercial Law' (2009) *PennState Law Review* 114;
13. McLaughlin S, *Letters of Credit: 'Exploring the Boundaries of Injunctions Against Honor'*, (1980) 4 (1) *Fordham International Law Journal*,
14. T. Quinn, *U.C.C. Commentary and Law Digest s. 5-101 [A][1][a]* (1978).
15. Nagel T, 'The Problem of Global Justice',(2005). 33Phil. & Pub. Affairs 113

16. Wiley, 'How to Use Letters of Credit in Financing the Sale of Goods', (1965).20 Bus. LAW. 495,
17. ZhangY, *Approaches to Resolving the International Documentary Letters of Credit Fraud Issue*, Publications of the University of Eastern Finland, Dissertations in Social Sciences and Business Studies.
18. Zhang Y, 'Documentary Letters of Credit Fraud exception rules: A comparative study of English law and Chinese law',(2015) 30 J. International Banking L. & Reg. 210;
19. Zhang Y, 'Evaluation of documentary letter of credit fraud exception rules in China',(2014) 29 J. International Banking L. & Reg.103.
20. Ding Y, Zeller B, The fraud exception in Letters of Credit – the Chinese approach, International Review of Law, University of Western Australia Law School, Perth, Australia. Submitted on 18 May 2016.
21. Ruiqiao Z, 'A Comparative Study of the Fraud Exception Rule of Letters of Credit: Proposed Amendments to the Chinese Credit System' (LL.M. Thesis, McGill University, 2009).
22. Ahmad Ali Ghouri. "Guaranteeing the guarantee law in Pakistan: the UNCITRAL Convention and the guarantee laws of Pakistan, the UK and the USA", Commonwealth Law Bulletin, 2009
23. Sang Man Kim. "Payment Methods
24. Arun Kasi "The Law of Carriage of Goods by Sea", Springer Science and Business Media, Letters of Credit, 2021
25. Zaid Aladwan. "The implementation of the fraud exception rule: a comparative study", Journal of Financial Crime, 2020
26. Zhang, Ruiqiao. "Study of the fraud exception rule in Letters of Credit in China and proposed amendments to the Chinese credit system", International Journal of Private Law, 2014

TEXTS

1. The text of the UCP 600.

BOOKS

2. Guest T, *Benjamin's Sale of Goods* 5thEdn. (1997).

3. Hans V *The law of International Trade*, London: 2ndedSweet & Maxwell,(2002).

INTERNET SOURCES

1. ICC Albania, The Merchants of Peace<<http://icc-albania.org.al/history/>>(accessed on 7/2/2019).
2. International Chamber of Commerce,<<https://iccwbo.org/about-us/>>(accessed on 8/2/2019).
3. United Nations, Trade Facilitation Implementation Guide, Letters of Credit <<http://tfig.unece.org/contents/letters-of-credit.htm>> (accessed on 15/2/2019).
4. Reviewed by Will Kenton International Chamber Of Commerce - ICC <<https://www.investopedia.com/terms/i/international-chamber-of-commerce-icc.asp>>Updated Feb 8, 2018.
5. " Kenya National Commission on Human Rights and Another Attorney General and Others ", International Law Reports, 2021
6. "Asian Yearbook of International Law, Volume 3 (1993)", Brill, 1995