

# Autonomy Principle of Letters of Credit: Some Practical Considerations under Bahrain Law

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The assurance to the seller that it is able to deliver goods without exposure to the risk of not being paid, while also protecting the buyer from the risk of paying for goods which they may otherwise not receive, has maintained the role and use of LCs as a fundamental method of payment in international sale and purchase transactions throughout the years. The basic structure of LCs has remained the same despite the continuous intervention of judicial authorities around the world to impose exceptions to their use. This article seeks to highlight that the principle of autonomy as envisaged in the UCP 600 in connection with LCs is being upheld by the courts in Bahrain.

## **The Autonomy Principle**

It is widely recognised that LCs are by and of themselves independent instruments, and are autonomous from the underlying contracts on which they are otherwise based. Under this principle, the issuer of an LC is not concerned with the underlying transactions. The characteristic of independence is embodied in Articles 3 and 4 of the Uniform Customs & Practice for Documentary Credits ('UCP') which was issued by the International Chamber of Commerce and adopted by Bahrain.

In a typical transaction the applicant asks the issuing bank to assume absolute liability to pay the beneficiary under terms and conditions previously negotiated with the beneficiary. Banks, for the purpose of initiating this payment, will deal exclusively with documents and not with goods or services to which the documents may relate. Therefore, the payment by the issuer is based solely on a determination of the conformity of the documents presented by the claiming beneficiary, against the terms and conditions of the LC without reference to the performance of the underlying contractual obligations by the applicant or the beneficiary.

In certain civil law jurisdictions, the underlying transaction is not treated as being entirely unconnected to the LC. The acceptance of the very concepts of autonomy and independence has been problematic because the principle of "cause" is deeply rooted in civil law tradition. Having said that, the courts have by and large adhered to the principle of autonomy when dealing with LCs in Bahrain.

## **The Fraud Exception**

In practice, banks will assume absolute liability to pay the beneficiary based on a valid claim under an LC and such an obligation has encouraged beneficiaries to accept the LC as a method of payment throughout the years. In addition, when courts are asked to award injunctions against a bank to stop payment under an LC, the courts are reluctant to grant such an order restricting payment.

It is a widely adopted principle that the bank shall pay the beneficiary unless the applicant pursues an official claim to stop payment of the proceeds under the LC. Such an injunction is only issued by the courts in very limited scenarios.

While the Bahrain Law of Commerce No. 7 of 1987 does not include any specific exceptions pertaining to LCs, there have been recent examples of Bahraini courts accepting arguments based on fraudulent claims. In a recent judgment of Bahrain Chamber for Dispute Resolution, the judges emphasised clearly that without fraud being present and perpetrated by the beneficiary, there is no legal ground to block the payment under an LC.

### **Interpretation of Bahraini Law**

For many years the position in Bahrain has been that the execution court judges have been applying Articles 306 and 307 of the Commercial and Civil Procedures Law No. 12 of 1971 on occasions where an application for an attachment on the proceeds of an LCs was sought.

Article 307(3) states: "The said court order shall be sought by virtue of a petition which shall state the reasons for the request. In the event referred to in the foregoing Article, the petition shall give a detailed list of the movables sought to be attached. Where the supporting documents are believed by the judge to be insufficient, he shall prior to issuing his order make a summary enquiry into the case."

However, under a recent landmark judgment of the Cassation Court in Bahrain the court has prohibited execution court judges from issuing orders to attach the proceeds of LCs based on Article 306 and 307. The Cassation Court was of the opinion that such a petition is limited to the right of submitting a petition to seize movable items which does not apply to the proceeds of LC.

It may also be difficult for the Court of Urgent Matters in Bahrain to accept that it has jurisdiction over an application for an injunction relating to the payment under an LC. In several cases, the summary judges sitting in the Court of Urgent Matters have been known to dismiss cases and refuse to award such injunctions on the basis that the remedy in question is not available in such court.

The above indicates the alignment of the Bahraini Court's approach with the international approach towards LCs as a mechanism of financing trade.

### **Conclusion**

It is clear from the above, that the courts in Bahrain have embraced the principle of autonomy with only the fraud exception. This is generally in line with international practice and the UCP 600 and further illustrates Bahrain's position as a business friendly destination.

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