The law of letters of credit and bank guarantees

By Agasha Mugasha
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The stated aim of this book is to present the Australian law of letters of credit and bank guarantees. The primary focus is on the position in Australia, however there is frequent reference to overseas literature and authorities having regard to the international nature of its subject matter.

Like many such topics-specific books, it originated from a postgraduate thesis; in this case, a master of laws dissertation by the author on the topic of standby letters of credit in International transactions, which was submitted to Osgoode Hall Law School of York University, Canada in 1988.

The book contains a detailed analysis of both commercial (documentary) letters of credit, and the newer instruments of standby letters of credit and bank guarantees. The table of contents is detailed and provides a useful guide to the book. The index however is somewhat basic.

The opening chapters provide a good introduction to the history and nature of letters of credit and bank guarantees, and the fundamental principles, including the autonomy principle (also known as the independence principle) namely, that the undertaking of the issuer to the beneficiary is separate from the underlying transaction and from other related contracts.

The legal issues arising from the various relationships of applicant and beneficiary, issuer and applicant, and issuer and beneficiary are each considered in turn. There is passing reference to the impact of the insolvency of the applicant, the issuing bank or the beneficiary.

Of particular interest to practitioners is the in-depth analysis of the availability of injunctive relief against beneficiaries from demanding payment from the issuers of letters of credit and bank guarantees. The commonest reason for seeking to restrain the beneficiary is alleged fraud on its part. There are however other arguable bases to restrain payment which are well considered by the author, including whether on proper construction of the document, the issuer's obligation is subject to the underlying contract.

The authorities in this area focus upon the question of whether the document creates an absolute obligation so that payment under the relevant document is conditional simply upon the presentation of a demand or other document asserting that an event of default or other activating event has occurred, or whether proof is required that the event of default or activating event has actually happened.

Australian courts recognise that a performance bond may give rise to an unconditional obligation not predicated upon proof of breach (see, for example: *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545; *Wood Hall Ltd v Pipeline Authority* (1979) 141 CLR 443).

To the authorities considered in the book may be added the recent decision in *Roehampton Developments Pty Ltd (in liq) v FAI General Insurance Company Limited* [2000] WASC 235 (Unreported, Hasluck J, 26 September 2000) where Hasluck J took into account the commercial purpose of the agreement (as he was entitled to do), when construing a performance bond involving an unconditional undertaking to pay on demand, and applied the presumption in favour of a construction which holds a performance bond to be conditional only upon the making of a properly formulated demand, rather than upon facts. His Honour held that the provisions of the performance bond itself did not rebut such presumption.

The conclusion in *Roehampton Developments* accorded with the reasoning of *Ackner LJ in Esal (Commodities) Ltd v Oriental Ltd* [1985] Lloyd's Rep 546, that if a performance bond of this kind was conditional not upon a properly formulated demand but upon proof of facts, then payment could never safely be made by the bank or institution except on a judgment by a court of competent jurisdiction. Such a result would be wholly inconsistent with the entire object of the transaction, namely, to enable the beneficiary to obtain prompt and certain payment.

Ultimately, each document has to be construed in accordance with its terms, and there can be no blind categorisation of its character or blind assumption of the obligations which it creates (see Hirst J in *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146).

Although the book is a specialised work directed primarily at banking and commercial lawyers, it provides a good starting point for all practitioners who encounter a problem involving letters of credit or bank guarantees. The book is a useful contribution to the legal issues frequently raised by these instruments.

Reviewed by Fabian Gleeson