The Law Governing Letters of Credit

ANTHEA MARKSTEIN*

I INTRODUCTION

Letters of credit[1] are frequently used to effect payment in commercial transactions where parties are resident in different jurisdictions.[2] While it seems prudent for parties to give careful consideration to the governing law of these contracts, in reality, letters of credit generally make no provision for a governing law.[3] Furthermore, the Uniform Customs and Practice for Documentary Credits (UCP) released by the International Chamber of Commerce makes no mention of a governing law for the letter of credit contract.[4]

Three main policy considerations underpin the determination of the law governing a letter of credit contract in the absence of choice. The conflict between the first two considerations — promoting legal certainty and ascertaining the governing law that is most closely connected to the contract — characterises much of the debate surrounding the general private international law rules. In the specific context of letters of credit, there is a third policy concern. In attempting to find a governing law in keeping with the commercial expectations of the parties, the courts have endeavoured to apply the same law to all the contracts in the letter of credit transaction (with the exception of the underlying contract).[5] The weight

* BA/LLB(Hons), The University of Auckland, solicitor. The author wishes to thank Chris Hare for his guidance and thorough feedback.

1 Unless otherwise stated, any reference to a letter of credit in this article refers to a bank issued, documentary letter of credit (see Charles Debattista "Performance Bonds and Letters of Credit: A Cracked Mirror Image" [1997] JBL 289 for information on different payment undertakings).

2 For a discussion of the contractual relationships comprising the letter of credit transaction, see Raymond Jack, Ali Malek and David Quest *Jack: Documentary Credits* (4th ed, Tottel Publishing, West Sussex, 2009) at 3–7. See also International Chamber of Commerce *The Uniform Customs and Practice for Documentary Credits* (2007 revision, ICC Services, Paris, 2006) [*UCP 600*], art 2 for further information regarding the relevant banks in a letter of credit transaction.

3 While the underlying contract (generally a contract for the sale of goods) will often provide for a governing law (see James Fawcett, Jonathan Harris and Michael Bridge *International Sale of Goods in the Conflict of Laws* (Oxford University Press, Oxford, 2005) for further discussion), letters of credit are subject to strict autonomy and courts cannot refer to the underlying transaction to determine the governing law of a letter of credit contract (see *Attock Cement Co Ltd v Romanian Bank for Foreign Trade* [1989] 1 WLR 1147 (CA) [*Attock Cement*] at 1159 per Staughton LJ; International Chamber of Commerce *Uniform Customs and Practice for Documentary Credits* (1993 revision, ICC Services, Paris, 1993) [*UCP 500*], art 3; and *UCP 600*, above n 2, art 4 in relation to the autonomy principle).

4 Jack, Malek and Quest, above n 2, at 392. See also Peter Ellinger "The UCP 500: considering a new revision" [2004] LMCLQ 30 at 43. The *UCP 600*, above n 2, still makes no provision for the conflict of laws.

5 *Offshore International SA v Banco Central SA* [1976] 2 Lloyd's Rep (QB) 402 [*Offshore International*] at 404; *The Bank of Baroda v Vysya Bank Ltd* [1994] 2 Lloyd's Rep (WB) 87 [*The Bank of Baroda*] at 93; *Marconi Communications International Ltd v PT Pan Indonesia Bank Ltd TBK* [2005] EWCA Civ 422, [2007] 2 Lloyd's Rep 72 [*Marconi Communications*] at [55].

to be attributed to these policy concerns in the context of various types of letters of credit underlies much of the discussion concerning the appropriate governing law in this article.

This article argues that finding a governing law that provides legal certainty and has a close connection to the contract is vital in determining a governing law in the absence of choice in the letter of credit context. Achieving consistency in the governing law across all the contracts, however, is only important where commercial expectations require this outcome. This article suggests that commercial expectations do not require this outcome in the context of freely negotiable letters of credit,[6] and sets out three alternative methods for determining the governing law of a freely negotiable letter of credit. Finding a consistent method with which to determine the governing law of a letter of credit contract is of particular importance given that it is likely to have implications for tortious and restitutionary claims arising in connection with a letter of credit contract.[7]

II CONTRACTUAL GOVERNING LAW

At common law, the governing law of a contract ('proper law') is determined as at the time the contract was concluded.[8] Where it is impossible to ascertain the parties' intentions with regards to the governing law of the contract either by virtue of an express or implied choice of law, the "objective proper law" of the contract is applied.[9] This is decided by determining "with what country or system of law the contract has the closest connection",[10] without regard to the parties' intentions. In determining the legal system with the closest and most real connection to the contract, the courts will weigh the connecting factors. A particularly weighty factor in these considerations is often the *locus solutionis* of the contract.[11] However, this will not be determinative of the governing law of a contract.

As most cases dealing with the governing law of letters of credit

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6 The *UCP 500*, above n 3, art 10(b)(i) refers to freely negotiable letters of credit and the *UCP 600*, above n 2, art 6 refers to freely available letters of credit. This article refers to freely negotiable letters of credit when the letter of credit is available for negotiation at any bank.

7 See Parts IV and V below.

8 *James Miller & Partners Ltd v Whitworth Street Estates (Manchester) Ltd* [1970] AC 583 (HL) [*James Miller*] at 603 per Lord Reid, 606 per Lord Hodson, 611 per Viscount Dilhorne and 615 per Lord Wilberforce.

9 *Compagnie d'Armement Maritime SA v Compagnie Tunisienne de Navigation SA* [1971] AC 572 (HL) at 583 per Lord Reid; *Amin Rasheed Shipping Corp v Kuwait Insurance Co* [1984] AC 50 (HL) at 69 per Lord Wilberforce. As letters of credit rarely specify a governing law, this article sets out the principles relevant to determining the governing law of a contract in the absence of choice.

10 *Compagnie d'Armement Maritime*, above n 9, at 583. See also *Amin Rasheed Shipping*, above n 9, at 69 per Lord Wilberforce and *Bonython v Commonwealth of Australia* [1951] AC 201 (PC) at 219. As the closest connections to a letter of credit are generally the presentation of and payment against documents, it is likely that the law of a particular country will govern the letter of credit.

11 Lawrence Collins and others (eds) *Dicey and Morris on the Conflict of Laws* (11th ed, Stevens & Sons Ltd, London, 1987) vol 2 at 1193 [Collins 11th ed].

are litigated in English courts, the current English law in relation to the governing law of a contract is also relevant. Of particular importance are the European Convention on the Law Applicable to Contractual Obligations (Rome Convention),[12] and the amendment to that convention effected by Regulation (EC) No 593/2008 (Rome I).[13]

Article 4(1) of the Rome Convention establishes that where there is no express or implied choice of law, the governing law ('applicable law') of a contract will be "the law of the country with which it is most closely connected". Article 4(2) outlines the presumptions relevant to determining the law most closely connected to the contract. The starting presumption is that the contract is most closely connected to the place where the party who is to effect "characteristic performance" of the contract has its "habitual residence" or "central administration" at the time the contract is concluded.[14] However, if the contract is entered into in the course of that party's trade or profession, the contract will be deemed to be most closely connected to the country in which that party's principal place of business is situated, or, if performance takes place outside of that party's principal place of business, where the terms of the contract specify that performance is to take place.[15] These presumptions can be displaced, however, under art 4(5), which provides:[16]

> Paragraph 2 shall not apply if the characteristic performance cannot be determined, and the presumptions in paragraphs 2, 3 and 4 shall be disregarded if it appears from the circumstances as a whole that the contract is more closely connected with another country.

The European Court of Justice (ECJ) has recently ruled that "where it is clear from the circumstances as a whole that the contract is more closely connected with a country other than that determined on the basis of one of the criteria set out in Article 4(2) ... it is for the court to disregard those criteria and apply the law of the country with which the contract is most closely connected".[17]

In particular, the ECJ recognised that the objective of art 4(5) was to counterbalance the set of presumptions stemming from the same

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12 Convention on the Law Applicable to Contractual Obligations (opened for signature in Rome on 19 June 1980, entered into force 1 April 1991) [Rome Convention]. The Rome Convention has the force of law in the United Kingdom under The Contracts (Applicable Law) Act 1990 (UK) c 36, ss 2(1) and 2(2). For interpretation of the Rome Convention, see Mario Giuliano and Paul Lagarde *Report on the Rome Convention on the law applicable to contractual obligations* [1980] OJ C282/1 [Giuliano–Lagarde Report], art 4 at [7]. Reference to this report in ascertaining the meaning of the Rome Convention is permitted under the Contracts (Applicable Law) Act 1990 (UK) c 36, s 3(3)(a).

13 Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I) [2008] OJ L 177/6 [Rome I].

14 Rome Convention, above n 12, art 4(2).

15 Ibid.

16 Ibid, art 4(5).

17 Case C-133/08 *Intercontainer Interfrigo (ICF) SC v Balkenende Oosthuizen BV and MIC Operations BV* [2009] OJ C282/15 at [64].

article by reconciling the requirements of legal certainty with the necessity of providing for flexibility in determining the law that is most closely connected with the contract in question.[18] The ECJ further noted that art 4(5) must be interpreted to allow courts, in all cases, to disregard the presumptions if the presumptions do not identify the country with which the contract is most closely connected.[19] This approach to art 4 gives courts a wide freedom to determine the law most closely connected to a contract, without any fetter imposed by inflexible presumptions. Given the wide discretion provided by this case law, courts may consider any number of factors in determining whether to apply art 4(5), and are likely to continue to consider characteristics such as geographical connections, commercial expectations of the parties and whether the place of performance differs from the place of business of the person undertaking the characteristic performance of the contract.

On 17 June 2008, the European Parliament and Council amended the Rome Convention to create Rome I. Rome I is applicable to contracts concluded after 17 December 2009.[20] For present purposes, the relevant amendments to art 4 on the governing law in the absence of choice were as follows:[21]

> (1) To the extent that the law applicable to the contract has not been chosen in accordance with Article 3 and without prejudice to Articles 5 to 8, the law governing the contract shall be determined as follows: ...
>
> (b) a contract for the provision of services shall be governed by the law of the country where the service provider has his habitual residence; ...
>
> (3) Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in paragraphs 1 or 2, the law of that other country shall apply.
>
> (4) Where the law applicable cannot be determined pursuant to paragraphs 1 or 2, the contract shall be governed by the law of the country with which it is most closely connected.

In the context of letter of credit contracts, the relevant branch of the bank undertaking performance of the contract will be the starting point for determining the governing law of a contract in the absence of choice. Under Rome I, however, there is a stronger approach to the initial presumption,

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18 Ibid, at [59].

19 Ibid, at [60].

20 Rome I, above n 13, arts 28 and 29.

21 Ibid, art 4. The place of habitual residence for a body corporate or unincorporated is the place of central administration: art 19(1).

whereby it is only when a contract is "manifestly" more closely connected to another country that the provisions in arts 4(1) and 4(2) will be displaced.

In the context of the ECJ's recent decision on the interpretation of art 4(5) of the Rome Convention, it is interesting to note that a similar interpretation appears to be precluded under Rome I. In particular, the ECJ placed particular importance on the fact that the objective of art 4(1) of the Rome Convention was to provide the necessary flexibility to counterbalance the legal certainty provided for under the presumptions in arts 4(2) and 4(4) of the Rome Convention.[22] Given that no such overriding objective is provided for in the text of Rome I, this reasoning will not necessarily apply. Moreover, while the reasoning that it will be for a court to disregard the presumptions where a contract is more closely connected with another country may likewise apply to arts 4(1) and 4(3) of Rome I, any court exercising this discretion will be bound to apply the higher threshold, under which it should only displace the presumptions when the contract is "manifestly" more closely connected to another country.

Importantly in the context of letter of credit transactions, the European Parliament and Council has stated that in making a determination to displace art 4(2), regard should be had as to whether the contract in question has a close relationship with any other contracts.[23] This indicates that the inquiry into the centre of gravity of a contract is not limited to geographical factors, but includes other connecting factors surrounding a contract. Allowing regard to be had to close relationships with other contracts suggests that while the general tide is moving in favour of greater certainty, there is still some room for applying parties' commercial expectations under Rome I.

III APPLICATION OF CONTRACTUAL GOVERNING LAW RULES TO LETTERS OF CREDIT

The Contract between the Applicant and the Issuing Bank

The applicant and the issuing bank are usually resident in the same jurisdiction. If the parties are in separate jurisdictions, however, it is likely that the law of the jurisdiction of the issuing bank will govern.

It has been held that the law with the closest and most real connection to the contract governing the core account relationship between a bank and a customer is "the law of the place where the account is kept".[24] For the purposes of art 4(2) of the Rome Convention, the characteristic performance of the contract is the issuing bank's provision of the core banking facility to the customer, and the governing law will be the law of

22 *Intercontainer Interfrigo*, above n 17, at [59].

23 Ibid, at [20].

24 *Libyan Arab Foreign Bank v Banker's Trust Co* [1989] QB 728 at 746.

the principal place of business of the issuing bank.[25] Treating incidental account services (such as issuing letters of credit) in the same manner as the core account relationship for the purpose of determining the governing law of the bank–customer contract preserves certainty and uniformity for all services carried out in connection with the bank–customer relationship. As the issuing bank would be the service provider, the law of the habitual residence of the issuing bank would also govern under art 4(1)(b) of Rome I.

The Contract between the Issuing Bank and the Correspondent Bank

The governing law of this relationship will depend on the nature of the correspondent bank. In the case of a confirming bank, it has been accepted that the place where the confirming bank adds its confirmation and honours the letter of credit has the closest and most real connection to the contract.[26] This will usually be the place where the confirming bank "carries on its business".[27] In the case of a nominated bank,[28] the law of the nominated bank will have the closest and most real connection to the contract between the nominated bank and the issuing bank from the time the bank accepts the conforming documentation.[29] For the purposes of art 4(2) of the Rome Convention, characteristic performance takes place when a confirming or nominated bank makes payment to the beneficiary, and the law of the place of business of the confirming or nominated bank will govern.[30] This will similarly be the case under Rome I, as under art 4(1)(b) the habitual residence of the service provider — the confirming or nominated bank — will govern the contract.

Where the correspondent bank acts as an advising or collecting bank, the outcome is more ambiguous. At common law, it has been held that the advising bank's performance is in transferring the documentation, rather than making payment to the beneficiary against conforming documents, and, therefore, the law with which the contract has the closest and most real connection is that of the issuing bank.[31]

For the purposes of art 4(2) of the Rome Convention, the issuing bank will not necessarily be undertaking the characteristic performance

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25 *Sierra Leone Telecommunications Co Ltd v Barclays Bank plc* [1998] 2 All ER 820 (QB); *The Bank of Baroda*, above n 5, at 92.

26 *Bank of Credit & Commerce Hong Kong Ltd (in liq) v Sonali Bank* [1995] Lloyd's Rep 227 (QB).

27 *Mizuho Corporate Bank Ltd v Cho Hung Bank* [2004] 4 SLR 67 at [7], citing *Kredietbank NV v Sinotani Pacific PTE Ltd (Agricultural Bank of China, Third Party)* [1999] 3 SLR 288 [*Kredietbank*].

28 The *UCP 600*, above n 2, uses the term "nominated bank" to refer to both the situation where a specific bank is nominated and the situation where the issuing bank makes an offer to the world and the letter of credit is available for negotiation at any bank (a freely negotiable letter of credit). For the purposes of this article, the term "nominated bank" refers to a specific bank at which the letter of credit is available. The term "negotiating bank" refers to the bank at which a letter of credit is negotiated in the case of a freely negotiable letter of credit.

29 *Kredietbank*, above n 27, at [44].

30 *The Bank of Baroda*, above n 5, at 90–91.

31 *Kredietbank*, above n 27; *Sinotani Pacific Pte Ltd v Agricultural Bank of China* [1999] 4 SLR 34 [*Sinotani*] at [23].

of the contract. The Giuliano–Lagarde Report indicates that in the case of a banking contract "the law of the country of the banking establishment with which the transaction is made will normally govern the contract".[32] Furthermore, the advising bank is generally seen as an agent[33] and the law of the agent's place of business will govern an agency contract.[34] If the interpretation in the Giuliano–Lagarde Report is followed, the characteristic performance of the contract between the issuing bank and the advising bank in the case of an unconfirmed letter of credit would be the performance of the advising bank's obligations as the agent. As such, the law of the principal place of business of the advising bank would apply. It is possible, however, that under art 4(5) the contract may be more closely connected with the principal place of business of the issuing bank.

If the relationship is properly characterised as one of agency, the law of the advising bank should likewise apply under Rome I, as it provides the agency service to the issuing bank. It is questionable whether the contract would be considered "manifestly" more closely connected to the law of the issuing bank for the purposes of art 4(3). Reference to other connected contracts, however, may support the application of the law of the issuing bank.[35]

It is therefore a possibility that at present, the contract between the advising bank and the issuing bank will be governed by the law of the advising bank under the Rome Convention or Rome I, but not at common law. It is perhaps possible to move away from the traditional common law approach and apply the law of the advising bank to the contract. The advising bank undertakes the performance obligations under the agency contract and thus, the law of the advising bank is most closely connected to the contract between the advising bank and the issuing bank. This outcome is substantially more consistent with the outcome where a confirming bank or a nominated bank is employed.

The Contracts with the Beneficiary

Potentially, both the issuing bank and the correspondent bank can have individual contracts with the beneficiary. Both these contracts will depend on the employment of a correspondent bank, and the function of that bank, if employed.

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32 Giuliano–Lagarde Report, above n 12, art 4 at [3].

33 Jack, Malek and Quest, above n 2, at 137–138. See also *Bank Melli Iran v Barclays Bank* [1951] 2 Lloyd's Rep 367 (KB). However, this has been contested: *European Asian Bank AG v Punjab & Sind Bank* [1983] 1 WLR 642 (CA); *Credit Agricole Indosuez v Muslim Commercial Bank Ltd* [2000] 1 Lloyd's Rep 275 (CA); contrast this with Alan Ward and Rob Wight "The Advising Bank in Letter of Credit Transactions and the Assumption of Agency" [1993] JIBL 432 (arguing that agency is an incorrect characterisation of the relationship).

34 Giuliano–Lagarde Report, above n 12, art 4 at [3].

35 Rome I, above n 13, at [20].

1 Consistent Governing Law

The major policy concern affecting most determinations of the law governing letter of credit contracts is equally relevant to both the governing law at common law, and under the Rome Convention and Rome I.

In *Offshore International SA v Banco Central SA*,[36] Ackner J determined that the law of a New York correspondent bank governed a contract between a beneficiary and a Spanish issuing bank. One of the reasons to apply New York law was that "very great inconvenience would arise, if the law of the issuing bank were to be considered as the proper law".[37] Effectively, Ackner J was avoiding the situation where the law governing the contract between the issuing bank and the correspondent bank differed from the law governing the contract between the correspondent bank and the beneficiary.

In *The Bank of Baroda v Vysya Bank Ltd*,[38] Mance J held that as between the issuing bank and the confirming bank, the governing law was that of the principal place of business of the confirming bank under art 4(2) of the Rome Convention. He went on to consider the governing law of the contract between the beneficiary and the issuing bank, stating:[39]

> In the present case the application of art. 4(2) would lead to an irregular and subjective position where the governing law of a letter of credit would vary according to whether one was looking at the position of the confirming or the issuing bank. It is of great importance to both beneficiaries and banks concerned in the issue and operation of international letters of credit that there should be clarity and simplicity in such matters. Article 4(5) provides the answer.

Potter LJ in *Marconi Communications International Ltd v PT Pan Indonesia Bank Ltd TBK* has also advocated this approach, stating:[40]

> [I]t was and is common ground that under a letter of credit it is desirable that the same system of law should govern the co-existing contracts between (a) the issuing bank and the beneficiary, (b) the confirming bank and the beneficiary, (c) the issuing bank and the confirming bank[.]

The concern about applying the same law to the contracts between the issuing bank and the correspondent bank, the correspondent bank and the beneficiary, and even perhaps the issuing bank and the beneficiary has

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36 *Offshore International*, above n 5.

37 Ibid, at 404.

38 *The Bank of Baroda*, above n 5.

39 Ibid, at 93.

40 *Marconi Communications*, above n 5, at [55].

arguably characterised most of the uncertainties and inconsistencies in determining the law governing the contracts with the beneficiary under a letter of credit. If the basis for this policy concern is indeed the desire to determine the governing law that best accords with the commercial expectations of the parties,[41] the outcome may be defensible to the extent that it does indeed comply with the parties' commercial expectations.[42] However, in cases where the commercial expectations of the parties are not fulfilled by applying the same governing law to all the relevant contracts, it should be possible to dispense with this policy concern.

2 The Contract between the Issuing Bank and the Beneficiary

Where there is no correspondent bank, or the correspondent bank is merely an advising bank, the issuing bank will accept the documents and pay the beneficiary. The law of the issuing bank will have the closest and most real connection to the contract and will govern the contract at common law.[43] Under the Rome Convention, the issuing bank will undertake the characteristic performance for the purposes of art 4(2) by accepting the documents and paying the beneficiary. Furthermore, regardless of the existence of a correspondent bank, the issuing bank is the service provider under art 4(1)(b) of Rome I for the purposes of the contract between the issuing bank and the beneficiary. It is unlikely that there will be another law more closely connected to the contract, thus triggering art 4(5), and even less likely that another law will be "manifestly more closely connected" under art 4(3) of Rome I.

The scenario becomes more complex when a confirming bank or a nominated bank is employed. At common law, a confirming bank's law would govern the contract between the issuing bank and the beneficiary. The confirming bank pays the beneficiary against conforming documentation, and therefore is most closely connected to the contract.[44] Similarly, the law of a nominated bank will displace the law of the issuing bank from the point at which the nominated bank accepts the documentation and agrees to pay the beneficiary.[45]

In contrast, art 4(2) of the Rome Convention indicates that the issuing bank undertakes the characteristic performance of the contract. In practice, however, this has not been the outcome reached by the courts. In *The Bank of Baroda*, to avoid applying different laws to the contract between the issuing bank and the beneficiary and the contract between the correspondent bank and the beneficiary, Mance J applied art 4(5) to find that the law of the confirming bank governed the contract between

41 Richard Fentiman "Commercial Expectations and the Rome Convention" (2002) 61 CLJ 50 at 50–51.

42 See Part II.

43 *Kredietbank*, above n 27, at [24]; *Sinotani*, above n 31, at [23]; and *UCP 600*, above n 2, art 9(a).

44 *Offshore International*, above n 5; *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 2 Lloyd's Rep 394 (CA); *Kredietbank*, above n 27; *Mizuho Corporate Bank*, above n 27.

45 *Kredietbank*, above n 27 at [105]. See further Part VI.

the issuing bank and the beneficiary.[46] Arguably a similar outcome would result in the case of a nominated bank.

Under art 4(1)(b) of Rome I, the issuing bank is the service provider in the contract between the issuing bank and the beneficiary. The law of the place of habitual residence of the issuing bank should govern regardless of the existence of a confirming or nominated bank. This outcome is consistent with the outcome under art 4(2) of the Rome Convention and it is questionable whether the reasoning applied in *The Bank of Baroda* could be applied under Rome I. Under Rome I it would be necessary to apply art 4(3) and the law of the confirming or nominated bank would have to be "manifestly more closely connected" to the contract to displace the law of the habitual residence of the issuing bank. It is certainly questionable whether the same approach would be possible under this higher threshold. Rome I does, however, require the courts to consider any connection with other contracts[47] and this may influence whether the law of a confirming or nominated bank is manifestly more closely connected to the contract between the issuing bank and the beneficiary.

In the context of the contract between the issuing bank and the beneficiary, there is arguably little inconsistency in applying the law of the issuing bank. However, in the context of the transaction in its entirety, the parties' commercial expectations do seem to point towards the application of the law of the nominated or confirming bank, given that this is where the performance of the transaction is carried out. As such, there is certainly merit in considering parties' commercial expectations as a factor in determining whether to apply art 4(5) in any given case.

3 The Contract between the Correspondent Bank and the Beneficiary

If there is no correspondent bank, or the correspondent bank is merely an advising bank, there is no independent contractual relationship with the beneficiary. Where the correspondent bank is a confirming bank, it will have an independent contractual relationship with the beneficiary.

At common law, the law of the confirming or nominated bank will have the closest and most real connection to this contract due to the provision of confirmation[48] or acceptance of documents,[49] respectively. Under art 4(2) of the Rome Convention, the characteristic performance is the confirmation of the letter of credit and payment to the beneficiary, and the governing law will be that of confirming or nominated bank's principal place of business. This was Mance J's position in *The Bank of Baroda* and is arguably the appropriate outcome in this case.

In the recent case of *Marconi Communications*, however, the law of

46 *The Bank of Baroda*, above n 5, art 93.

47 Rome I, above n 13, art 20.

48 *Kredietbank*, above n 27, at [42].

49 Ibid, at [44].

the confirming bank was not applied to the contract between the confirming bank and the beneficiary. In this case, an Indonesian seller applied to an Indonesian bank to issue a letter of credit in favour of the beneficiary. The letter of credit was to be advised (and potentially negotiated) through Standard Chartered Bank in London. Subsequently, another Indonesian bank added its confirmation to the letter of credit. Under art 4(2) of the Rome Convention, Indonesian law would have governed the letter of credit as it was confirmed in Indonesia.

The Court, however, applied art 4(5) and held that while Standard Chartered Bank never in fact negotiated the letter of credit, on the basis of the circumstances as a whole the letter of credit was more closely connected with English law because the letter of credit was opened in London, the documents were submitted and checked in England and payment was made in England.[50] The Court of Appeal in this case appeared to rely on a characterisation of Standard Chartered Bank as a negotiating bank, even though the letter of credit was never in fact negotiated. The practical result was that the law of the place of business of the advising bank was held to govern the contracts between the confirming bank and the beneficiary, the issuing bank and the beneficiary, and between the two Indonesian banks. The outcome in *Marconi Communications* must be incorrect for several significant reasons, which will be dealt with in Part VI. The same outcome is unlikely in the case of a nominated bank as, by its nature, the nominated bank would be the bank intended to negotiate the letter of credit.

Under Rome I, the contract would need to be "manifestly more closely connected" with another country and this higher standard may assist in preventing an outcome such as that in *Marconi Communications* in future cases where Rome I is applicable.

IV THE GOVERNING LAW IN TORT

The Governing Law of a Tort

While contractual claims are most common in the letter of credit context, claims in tort are also possible.[51]

New Zealand applies the common law rule of double actionability whereby a tort that occurs in another country will only be actionable in New Zealand if it is an actionable tort under New Zealand law and it is not

50 *Marconi Communications*, above n 5, at [66].

51 These include a breach of the duty of care and skill owed by the issuing bank or even the advising bank to the applicant; a breach of the beneficiary's duty to present conforming documents to the issuing bank; and a deceit claim by the issuing bank in the case of payment against fraudulent or forged documents.

justifiable under the law of the foreign country in which it was committed.[52] It has been held that in order to determine where a tort occurred, "the right approach is, when the tort is completed, to look back over the series of events constituting it and ask the question, where in substance did this cause of action arise"?[53] This rule is subject to a flexible exception whereby a particular issue may be governed by the law of the country that has the most significant relationship with the occurrence between the parties.[54] In New Zealand, courts have adopted an approach of counting the connections with relevant countries to determine the country with which the alleged tort has the most significant relationship, rather than engaging in an analysis of the interests involved and weighing the relevant connections.[55] Importantly in the letter of credit context, a pre-existing contract between the parties is one factor that has been held to indicate that the flexible exception should apply.[56]

Recent developments in English law are also relevant in the context of this article. The most recent case[57] determining the governing law of a tort claim in the letter of credit context was determined under the Private International Law (Miscellaneous Provisions) Act 1995 (PIL Act).[58] Section 11 of the PIL Act provides that the governing law of a tort will be the law of the country in which the events constituting the tort occurred.[59] Where the elements of the events occur in different countries, the governing law will be the law of the country in which the most significant elements of those events occurred.[60] The PIL Act goes on to state that the general rule may be displaced if it appears from a comparison of the factors connecting the tort to a different country that it is substantially more appropriate for the law of that country to apply.[61]

Article 4 of Regulation (EC) No 864/2007[62] (Rome II) amended the English approach to determining the law governing tortious claims. Under Rome II, the law governing a non-contractual relationship arising out of a

52 *Baxter v RMC Group plc* [2003] 1 NZLR 304 (HC) [*Baxter*]. See also *Boys v Chaplin* [1971] AC 356 (HL) at 377, 381 and 389. This case has been held to require civil liability in the country in which the tort occurred: see 389 per Lord Wilberforce.

53 *Distillers Co (Biochemicals) Ltd v Thompson* [1971] 1 AC 458 (PC) at 468 per Lord Pearson. This will be determined according to the law of the forum (*Metall und Rohstoff AG v Donaldson Lufkin & Jenrette Inc* [1990] 1 QB 391).

54 *Boys v Chaplin*, above n 52, at 389–392 per Lord Wilberforce; *Red Sea Insurance Co Ltd v Bouygues SA* [1995] 1 AC 190 (PC) at 203–206. This exception has been used to displace both the *lex fori* in favour of the *lex loci delicti*: ibid, at 206 (and vice versa, *Boys v Chaplin*, above n 52, at 392) and may potentially be used to displace both in favour of a third law with a significantly closer relationship to the occurrence between the parties.

55 *Baxter*, above n 52, at [58].

56 *Johnson v Coventry Churchill International Ltd* [1992] 3 All ER 14 (QB) at 25.

57 *Kookmin Bank* (Aickens J), below n 67. This case is discussed in further detail in the following section.

58 Private International Law (Miscellaneous Provisions) Act 1995, c 42 (UK) [PIL Act].

59 Ibid, s 11(1).

60 Ibid, s 11(2)(c).

61 Ibid, s 12(1).

62 Regulation 864/2007 on the Law Applicable to Non-Contractual Obligations (Rome II) [2007] OJ L199/40 [Rome II]. The Law Applicable to Non-Contractual Obligations (England and Wales and Northern Ireland) Regulations 2008 were recently passed to make the PIL Act consistent with Rome II.

tort is the law of the country in which the damage occurred, irrespective of where the events giving rise to the damage occurred, and irrespective of the country in which the indirect consequences of the event occurred.[63] If both parties have their habitual residence[64] in the same country at the time when the damage occurred, the law of the country of the parties' habitual residence will apply.[65] Finally, art 4(3) of Rome II provides that arts 4(1) and 4(2) may be displaced where the tort is "manifestly more closely connected" with another country. This closer connection may be based on a pre-existing relationship between the parties, such as a contract, that is closely connected to the tort in question.[66]

Application in the Letter of Credit Context

1 Tort Claims in Connection with a Letter of Credit Contract

The most recent case on the governing law of a tort in the letter of credit context is *Trafigura Beheer BV v Kookmin Bank Co*,[67] in which the Court applied the PIL Act. In *Kookmin Bank*, Aikens J identified all the elements constituting the tort and made "a value judgment regarding the significance of the different elements in making up the tort alleged",[68] determining that the most significant events making up the alleged tort occurred in Singapore.

Aikens J went on to consider whether there were any factors that connected the tort with a different country, and if so, whether the significance of those factors made it substantially more appropriate for the law of the other country to govern the issues relating to the claim.[69] Most importantly, for the purposes of this article, Aikens J held that a factor relating to the parties can include a pre-existing relationship between the parties, contractual or otherwise, where the relationship has given rise to the events constituting the alleged tort in question.[70] Aikens J went on to state that the letter of credit contract was a pre-existing contractual relationship between the parties and English law governed that contract. As such, it was substantially more appropriate for English law to govern any non-contractual claims between the parties.[71]

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63 Rome II, above n 62, art 4(1).

64 Ibid, art 23.

65 Ibid, art 4(2).

66 Ibid, art 4(3).

67 *Trafigura Beheer BV v Kookmin Bank Co* [2006] EWHC 1450, [2006] 2 All ER (Comm) 1008 [*Kookmin Bank* (Aikens J)]. There are three first instance judgments in relation to this case: *Trafigura Beheer BV v Kookmin Bank Co* [2005] EWHC 2350 (Comm) [*Kookmin Bank* (Cooke J)]; *Kookmin Bank* (Aikens J); and *Trafigura Beheer BV v Kookmin Bank Co (No 2)* [2006] EWHC 1921, [2007] 1 Lloyd's Rep 669 (Comm). *Kookmin Bank* (Aikens J) considered the law governing a tort in the letter of credit context and this section of the article will deal with the judgment of Aikens J.

68 *Kookmin Bank* (Aikens J), above n 67, at [79].

69 Ibid, at [97].

70 Ibid, at [103]. See Adrian Briggs "The Further Consequences of a Choice of Law?" (2007) 123 LQR 18 for a critique of Aikens J's determination of the governing law of the tort by reference to the related contract.

71 *Kookmin Bank* (Aikens J), above n 67, at [118]–[119].

Under Rome II, it is likely that the Court would come to the same conclusion if art 4 was applied. Article 4(3) of Rome II specifies that a pre-existing contractual relationship may be a basis for establishing that a tort is manifestly more closely connected with another country. Furthermore, if an interests analysis is applied to the flexible exception to the double actionability rule, it is also likely that the flexible exception would be applied to find in favour of English law, based on the significance of the pre-existing contractual relationship.[72] This outcome is far from certain, however, under the current New Zealand approach to the double actionability rule,[73] as the contractual relationship based on the letter of credit will only be one of a number of factors for the court to consider.

This article suggests that giving significant weight to a pre-existing contractual relationship in determining the governing law of a tort is the correct approach where the tort arises in connection with that pre-existing relationship. This approach takes into account the realities of the relationship between the parties and provides for a uniform law to be applied to both contractual and tortious claims surrounding the same event. This is particularly useful in the letter of credit context where the relationship between the parties is often solely evidenced in the letter of credit contract. As such, this article further suggests that the current New Zealand approach is outdated and that it is necessary to apply at least an interests analysis under the flexible exception to the double actionability rule or, preferably, to legislate to provide a systematic method for determining the law governing claims in tort. In particular, the legislation should specify that pre-existing contractual relationships will be a significant consideration when a tort arises in connection with those relationships.

2 Tort Claims Unconnected to a Letter of Credit Contract

It is also possible that a tort arising in the letter of credit context may be unconnected to a letter of credit contract.[74] Under both the common law and Rome II, it is necessary to determine where a tort occurred. In the letter of credit context, as in general tort cases, where a tort occurs will be specific to an individual case, thereby making it impossible to specify a governing law for any given case.

V THE LAW GOVERNING RESTITUTION

Situations in which parties make restitutionary claims in the letter of

72 *Johnson*, above n 56.

73 *Baxter*, above n 52.

74 For example, a claim by an applicant or a beneficiary against an advising bank for a breach of the advising bank's duty of skill and care.

credit context are relatively rare and have been met with varied degrees of success.[75] In the letter of credit context, restitutionary claims will almost always be made in connection with one of the contracts making up the letter of credit. The general private international law rule with respect to restitution is that "a claim for unjust enrichment will be governed by the proper law of the obligation".[76]

Where an obligation arises in connection with a contract, the governing law of the obligation will be synonymous with the governing law of the contract at common law.[77] Under art 10(1) of Rome II, where a non-contractual obligation concerning unjust enrichment involves an existing relationship between the parties, the law that governs that relationship will govern the obligation. In order to determine the governing law of the contract under which the obligation arose, recourse will have to be made to the contractual private international law rules under common law, the Rome Convention or Rome I.[78]

If the restitutionary claim is made in connection with the commission of a tort, it is likely that the law that governs the obligation will be the same as the governing law of the tort at common law.[79] Similarly, art 10(1) of Rome II provides that the law that governs the relationship in tort will also govern the obligation in unjust enrichment. As such, in order to determine the law governing a restitutionary claim in connection with the commission of a tort, reference would have to be made to the common law or Rome II in order to determine the governing law of the tort.[80]

It is unlikely that a restitutionary claim will arise in the letter of credit context that is unconnected with either a contract or tort. If such a claim arises, however, the common law provides that the governing law will be the law of the country where the enrichment occurs.[81] Under art 10(2) of Rome II, where a claim in unjust enrichment is unconnected to a pre-existing relationship between the parties, and the parties have their habitual residence in the same country at the time of the event giving rise to unjust enrichment, the law of that country shall apply. Where the parties do not have their habitual residence in the same country (as will most likely be the case in the letter of credit context), the law of the place where the unjust enrichment occurred will govern the obligation.[82] As such, applying either

75 These situations include: mistaken payment claims relating to discrepant documentation; unjust enrichment claims; and mistaken payment against materially false or forged documents. All of these claims will be subject to the usual defences (including counter restitution becoming impossible, the beneficiary changing its position in good faith and estoppel).

76 Lawrence Collins and others (eds) *Dicey, Morris and Collins The Conflict of Laws* (14th ed, Sweet & Maxwell Ltd, London, 2006) vol 2 [Collins vol 2] at 1863.

77 *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32 (HL); *Dimskal Shipping Co SA v International Transport Workers Federation* [1992] 2 AC 152 (HL); *Arab Monetary Fund v Hashim* [1993] 1 Lloyd's Rep 543 (QB).

78 See Parts II and III.

79 Collins vol 2, above n 76, at 1878, citing *Berry Trade Ltd v Moussavi* [2004] EWHC 49 (Comm).

80 See Part V.

81 Collins vol 2, above n 76, at 1863.

82 Rome II, above n 62, art 10(3).

the common law, or the provisions under art 10(2) or art 10(3) of Rome II, could result in a range of potential governing laws dependent on which party to the transaction was unjustly enriched and whether the parties had the same habitual residence at the time of the unjust enrichment.

VI THE GOVERNING LAW OF A FREELY NEGOTIABLE LETTER OF CREDIT

A freely negotiable letter of credit allows the beneficiary to present the required documents to any bank willing to negotiate the letter of credit. Freely negotiable letters of credit are of particular interest because the current law on the subject indicates that the governing law in the absence of choice may be entirely unconnected to the transaction. Moreover, as the private international law rules of tort and restitution largely rely on the contractual governing law in the letter of credit context, the governing law of a freely negotiable letter of credit contract will have ramifications for the law that will govern a tortious or restitutionary claim arising in connection with that letter of credit.

This Part outlines three possible approaches to determining the governing law of a freely negotiable letter of credit. The subsequent conduct approach and the fresh agreement approach apply different methods currently employed by the courts and accept that the governing law of a letter of credit contract may be unconnected to the parties and the transaction. The third approach suggests a framework for establishing a private international law rule that points towards a fixed law applying in the case of freely negotiable letters of credit and attempts to ensure that a freely negotiable letter of credit contract will not be governed by an arbitrary law.

Variable Law Approaches

Where a letter of credit is available for negotiation, the law of the nominated or negotiating bank has been held to displace the law of the issuing bank at the point at which the nominated or negotiating bank acts on the letter of credit by acceptance of the documentation.[83] This approach will potentially conflict with the general rule of private international law whereby the governing law of a contract must be determined at the time the contract is concluded.[84] The most recent case on the law governing letter of credit contracts is *Marconi Communications*, which arguably dealt with exactly this point.

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83 *Kredietbank*, above n 27, at [105].

84 *James Miller*, above n 8, at 615 (subsequent conduct was deemed irrelevant by Viscount Dilhorne unless it were to found an estoppel or subsequent agreement).

1 Marconi Communications

The Court of Appeal in *Marconi Communications* found that the law of what was effectively an advising bank governed the contract between the confirming bank and the beneficiary due to the parties' intention that the advising bank would also act as a negotiating bank.[85] There were two main reasons why the Court came to this conclusion.

First, the Court failed to realise that the letter of credit was freely negotiable, even though the letter of credit stated:[86]

> We hereby agree with drawers, endorsers and bonafide holders of drafts drawn under and in compliance with the terms of this credit will be honoured and that drafts accepted within the term of this credit will be duly honoured at maturity[.]

Courts have commonly held that including a clause such as this in a letter of credit makes it freely negotiable.[87] As this was a freely negotiable letter of credit, the negotiating bank could have been any bank. Therefore any reliance on the intended negotiating bank and the place of performance in determining the governing law at the time the contract was concluded seems strained.[88] Moreover, Rome I appears to be a distinct move towards legal certainty, requiring that another law is "manifestly" more closely connected to the contract. In this context, it is unlikely that English law was manifestly more closely connected to the contract under Rome I, as Standard Chartered Bank never in fact negotiated the letter of credit.

Secondly, the Court held that the correct approach to determining the governing law of a contract was to consider "how the contract was intended by its terms to operate at the time it was made, rather than to look at what in fact occurred".[89] As it was envisaged by all parties that Standard Chartered Bank would negotiate the letter of credit, the Court found in favour of English law, even though Standard Chartered Bank never negotiated the letter of credit. While it is possible that this outcome may be explained as an implied choice of law based on the parties' intentions at the time of contracting, it is necessary to re-examine this decision in light of the appropriate methods of interpreting letter of credit contracts and recent case law on contract interpretation.

2 Solutions to the Problem

It is clear that a large part of the reasoning in *Marconi Communications* is

85 *Marconi Communications*, above n 5, at 83.

86 Ibid, at 75.

87 *Cruickshank v Westpac Banking Corp* [1989] 1 NZLR 114 (HC) at 117; *Sinotani*, above n 31, at [12]; Christopher Hare "The Rome Convention and Letters of Credit" [2005] LMCLQ 417 at 420.

88 Hare, above n 87, at 420.

89 *Marconi Communications*, above n 5, at 83.

based on the Court's belief that the law governing the contract should be determined at the time the contract was concluded. This article submits that there are two possible ways to deal with this outcome to make it more consistent with what in fact occurred.

(a) Contract Interpretation and the Subsequent Conduct Approach

Contract interpretation has traditionally been subject to a textual approach, whereby a court will consider only the text of a contract, unless the contract is ambiguous, in which case the court will look to the surrounding circumstances at the time of contracting.[90] More recently, courts have moved towards a contextual approach to contract interpretation whereby a court will give a document the meaning it would convey to a "reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract".[91]

This article submits that a textual approach to contract interpretation should be retained in the letter of credit context. The contextual approach has yet to be applied to a letter of credit, and to do so would be inappropriate.[92] A letter of credit is an inherently commercial document and the interests of commercial certainty point toward taking a literal approach in interpreting letter of credit contracts. The principle of autonomy is central to a letter of credit transaction and it would be inconsistent for courts to adopt a contextual approach to contract interpretation that risks undermining this principle.[93] Indeed, if a textual approach had been taken in *Marconi Communications*, the letter of credit would clearly have been freely negotiable and any reliance on the parties' intentions would be unwarranted as the contract was unambiguous.

While this article maintains that the traditional textual approach is appropriate for the interpretation of letter of credit contracts, if the contextual approach were to be applied to a letter of credit, it is necessary to consider whether subsequent conduct evidence should be used in contract interpretation. Traditionally, courts have rejected subsequent conduct evidence in contract interpretation.[94] However, the Supreme Court recently confirmed its admissibility in New Zealand.[95] Most importantly

90 *Melanesian Mission Trust Board v Australian Mutual Provident Society* [1997] 1 NZLR 391 (PC).

91 *Investors Compensation Scheme Ltd v West Bromwich Building Society Ltd* [1998] 1 WLR 896 (HL) [*ICS*] at 912. Lord Hoffmann later qualified this statement, stating that the factual background only includes "anything which a reasonable man would have regarded as *relevant*": *Bank of Credit and Commerce International SA v Ali* [2001] UKHL 8, [2002] 1 AC 251 at [39].

92 But see *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd* [2004] UKHL 54, [2004] 1 WLR 3251 (where the contextual method of interpretation was applied to a Tomlin order which dealt with a letter of credit).

93 *Attock Cement*, above n 3.

94 *James Miller*, above n 8; *Compagnie d'Armement Maritime*, above n 9, at 592 per Viscount Dilhorne. Note, however, in *ICS* Lord Hoffmann did not expressly exclude the admissibility of subsequent conduct.

95 *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37, [2008] 1 NZLR 277 at [7] per Elias CJ, [50]–[63] per Tipping J and [111]–[122] per Thomas J.

in the context of *Marconi Communications* and interpretation under the Rome Convention, the Giuliano–Lagarde Report expressly states that in determining the "country with which the contract is most closely connected, it is also possible to take account of factors which supervened after the conclusion of the contract".[96]

With this in mind, it becomes clear that Standard Chartered Bank never negotiated the letter of credit. As such, the reasoning establishing English law as the governing law of the contract under art 4(5) is undermined. If the contract is considered as a whole, including the subsequent events, it is clearly not more closely connected to English than Indonesian law (the governing law under art 4(2)). Moreover, this would ensure that Indonesian law governed both the contracts with the beneficiary and the contract between the banks themselves.[97] Potter LJ cited *The Bank of Baroda* and advocated this policy outcome in *Marconi Communications*,[98] but failed to achieve it in the final result. The Court used art 4(5) to apply English law to the contracts between the beneficiary and each of the issuing bank and confirming bank, but Indonesian law still applied to the inter-bank contract. Under art 4(2), Indonesian law would apply to all three contracts.

Furthermore, evidence of subsequent conduct would allow for clear ascertainment of the law governing a freely negotiable letter of credit. When a negotiating bank accepts documents from the beneficiary, that conduct could be relied upon to establish clearly that the governing law of the contract is that of the negotiating bank. Where the letter of credit is not negotiated, there will be no indication suggesting a governing law different from that of the issuing bank.

There are also disadvantages to adopting this approach, however. A contextual approach to interpreting letter of credit contracts (with or without subsequent conduct) creates inherently uncertain situations, which are inappropriate in the context of bare commercial documents. Furthermore, it may be possible to characterise this situation as a 'floating' choice of law clause whereby the governing law is not determined until some unilateral future act occurs, in this case the negotiation of the letter of credit. The courts have deemed clauses of this variety to be of no legal effect[99] as "contracts are incapable of existing in a legal vacuum".[100] While the law of the issuing bank will govern the contract prior to it being negotiated, it is questionable whether subsequent conduct will be a sufficient basis to change the governing law where agreement between the parties is generally required.[101]

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96 Giuliano–Lagarde Report, above n 12, art 4 at [2]. Rome I, above n 13, makes no mention of "supervening events". However, it may be possible to consider supervening events as part of the circumstances that indicate a contract is manifestly more closely connected to another country.

97 Hare, above n 87, 422–423.

98 *Marconi Communications*, above n 5, at 83.

99 *Dubai Electricity Co v Islamic Republic of Iran Shipping Lines (The "Iran Vojdan")* [1984] 2 Lloyd's Rep 380 (QB) at 385.

100 *Amin Rasheed Shipping*, above n 9, at 65.

101 *James Miller*, above n 8, at 615.

While this article concedes that if the contextual method of contract interpretation were adopted, it would be appropriate to consider subsequent conduct, it maintains that it would be more appropriate, given the commercial nature of a letter of credit contract, to retain the traditional textual approach to contract interpretation.

(b) Fresh Agreements Approach

A similar outcome can be reached by applying the textual method of contract interpretation and the reasoning in *Kredietbank NV v Sinotani Pacific PTE Ltd (Agricultural Bank of China, Third Party).*[102]

In *Kredietbank*, Chan Seng Onn JC accepted that the governing law of a contract is determined at the time of contracting.[103] Furthermore, it was accepted that in cases where a letter of credit is freely negotiable, or where a nominated bank chooses not to negotiate, it is not possible to determine the place of performance at the time the contract was concluded. When the letter of credit is issued, the law of the issuing bank would govern the contract and on negotiation, the law of the negotiating or nominated bank would displace the law of the issuing bank. This change in the governing law was characterised as a fresh agreement between the parties about the governing law at the time of negotiation, rather than as a retrospective determination of the governing law.[104]

There is certainly some argument that this approach is preferable in the context of letter of credit transactions. If the textual approach to contractual interpretation is indeed more appropriate in letter of credit transactions due to the lack of commercial certainty associated with the contextual approach, the subsequent conduct approach to determining the governing law of a freely negotiable letter of credit will be inappropriate. The fresh agreements approach allows for the governing law of a letter of credit to be determined after it is issued by characterising particular subsequent events as 'fresh agreements' between the parties, but it does not require courts to consider events outside of the letter of credit transaction. One benefit of this approach is that it confines courts to considering a specified subsequent agreement, rather than any subsequent conduct affecting the letter of credit. As such, this approach provides for more certainty than would otherwise be achieved by a general allowance for consideration of subsequent conduct.

If the courts accept the characterisation of negotiation as a fresh agreement between the parties as to the governing law of a letter of credit contract, the fact that the governing law may be unconnected to the letter

102 *Kredietbank*, above n 27. While this case was appealed in *Sinotani*, above n 31, the appeal was dismissed and as the Court considered the letter of credit to be an unconfirmed straight letter of credit it engaged in significantly less discussion than the High Court on the subject of the governing law of a freely negotiable letter of credit. For this reason the fresh agreements approach relies on reasoning discussed in *Kredietbank*, above n 27.

103 *Kredietbank*, above n 27, at [116].

104 Ibid, at [118].

of credit will not be an issue. The court will no longer be attempting to determine the objective governing law of a contract in the absence of choice, but rather, the court will be applying the parties' implied choice of law. In such a scenario it is not necessary that the governing law be closely connected to the contract.

The fresh agreements approach does present its own problems, however. Similar to the subsequent conduct approach, it may be possible to characterise this situation as a 'floating' choice of law clause.[105] Again, the governing law of the contract will not be undetermined at the time the contract is concluded as the contract will be governed by the law of the issuing bank. In contrast to the situation under the subsequent conduct approach, however, under the fresh agreements approach the change in the governing law is not reliant upon subsequent conduct generally, but rather the subsequent agreement of the parties, an accepted practice in private international law.[106]

Another potential issue with the fresh agreements approach is that the concept of a fresh agreement may be strained in the letter of credit context. The issuing bank is not technically involved in the agreement between the negotiating bank and the beneficiary. In *Kredietbank* the Court was unconcerned with the issuing bank's lack of express agreement due to its willingness to issue the freely negotiable letter of credit initially and its understanding of the consequences.[107] It may be possible, however, to imply the agreement of the issuing bank into any subsequent agreement between the negotiating bank and the beneficiary. It has been suggested in the sale of goods context that an implied change of law may be possible if it "could be demonstrated with reasonable certainty."[108] Analogously, one could imply the agreement of the issuing bank into the agreement to negotiate the letter of credit on the basis that the issuing bank consented to the initial offer to the world of a freely negotiable letter of credit.

If the possibility of a floating choice of law clause and the agreement of the issuing bank can be accounted for, this approach does provide a framework within which to determine consistently the governing law of a letter of credit.

Fixed Law Approach

The same policy issues discussed throughout this article plague the determination of a fixed governing law in the context of a freely negotiable letter of credit.

When a negotiating bank negotiates the letter of credit, it gains the

105 See section (a) Contract Interpretation and the Subsequent Conduct Approach, above.

106 *James Miller*, above n 8, at 615.

107 *Kredietbank*, above n 27, at [45].

108 Rome Convention, above n 12, art 3(1). See also Mance LJ in *Aeolian Shipping SA v ISS Machinery Services Ltd* [2001] EWCA Civ 1162, [2001] 2 Lloyd's Rep 641 at 647.

benefit of the issuing bank's undertakings to the beneficiary.[109] The law governing the contract between the negotiating bank and the issuing bank, therefore, will be the same as the law governing the contract between the beneficiary and the issuing bank. This article submits that in the context of a freely negotiable letter of credit, the law of the issuing bank should govern the contract between the beneficiary and the issuing bank (or, in the case of a confirmed letter of credit, the law of the confirming bank)[110] and the contract between the issuing bank and the negotiating bank. However, the law of the negotiating bank should govern the contract between the beneficiary and the negotiating bank.

Admittedly, this is a significant departure from the line of cases, starting with *Offshore International*, advocating the application of the same governing law to certain contracts in the letter of credit transaction. In *The Bank of Baroda*, Mance J relied on the commercial expectations of the parties as a basis for establishing that the same law governed both contracts with the beneficiary. These commercial expectations cannot be relied upon, however, in the context of a freely negotiable letter of credit. While this policy concern is relevant, it is time to move away from these concerns where the commercial expectations of the parties do not support this outcome. In this context, the parties' commercial expectations are more likely to indicate that different governing laws should be applied due to the fact that the letter of credit is freely negotiable. Moreover, if applying the same law to both contracts with the beneficiary is held to be the primary policy concern in this context, this outcome will be at the expense of other important policy objectives — namely, providing for legal certainty and determining the governing law that is most closely connected to the contract.

1 The Contract between the Beneficiary and the Issuing Bank

Under the current law, it is likely that the law of the negotiating bank will be applied to the contract between the beneficiary and the issuing bank.[111] This section will discuss the potential for applying the law of the issuing bank to the contract between the beneficiary and the issuing bank, and thus the contract between the negotiating bank and the issuing bank.

Under a freely negotiable letter of credit, the law of the place of payment against conforming documents may not be the law with the closest and most real connection to the contract. While the *locus solutionis* is generally considered a significant factor in determining the governing law of a contract at common law,[112] in the context of a freely negotiable

109 Jack, Malek and Quest, above n 2, at 407–408.

110 In the subsequent discussion, this article will refer to the law of the issuing bank as the appropriate fixed law under a freely negotiable letter of credit. However, where a letter of credit is confirmed, the law of the confirming bank may apply.

111 *Kredietbank*, above n 27, at [115] (common law); *The Bank of Baroda*, above n 5 (the Rome Convention).

112 Collins 11th ed, above n 11, at 1193.

letter of credit, the place of negotiation and payment will not necessarily be closely connected to the contract between the beneficiary and the issuing bank. In this context, the source of the obligations and the place at which the contract was concluded are likely to be more significant connecting factors. Admittedly, these connecting factors are not considered highly significant in modern private international law thinking.[113] However, in the specific context of freely negotiable letters of credit, these factors are likely to be more closely connected to the contract between the issuing bank and the beneficiary than the place of payment against documents.

While relying upon connecting factors that are not commonplace in determining the governing law of the contract creates uncertainty, such reliance is in keeping with the commercial expectations of the parties involved. When entering into a freely negotiable letter of credit transaction, it is far more likely that commercial parties will focus on the place at which the letter of credit is issued than on the place of performance (which could be anywhere).

Article 4(2) of the Rome Convention indicates that the governing law will be that of the principal place of business of the party undertaking the characteristic performance of the contract. As such, the contract between the beneficiary and the issuing bank would be governed by the law of the issuing bank's principal place of business. In *The Bank of Baroda*, however, Mance J employed art 4(5) to disregard the presumption under art 4(2) and apply the law of the confirming bank.

Applying this reasoning in the context of a freely negotiable letter of credit is problematic for several reasons. Mance J relied on the commercial expectations of the parties as the underlying reason for applying the same law to both contracts with the beneficiary.[114] Where the commercial expectations of the parties do not point towards the application of the same law to both contracts, there appears to be substantially less support for the application of art 4(5).

Furthermore, under art 4(5) of the Rome Convention, the presumption under art 4(2) will only be disregarded where the law of another country is more closely connected to the contract. In *The Bank of Baroda*, it is arguable that the law of a confirming bank was indeed more closely connected to the contract than the law of the issuing bank, and thus the application of art 4(5) was justified. In the context of a freely negotiable letter of credit, however, the law of the negotiating bank is not more closely connected to the contract than the law of the issuing or confirming bank. Similarly to the situation under the common law, placing substantial weight on the *locus solutionis* is not justified in the context of freely negotiable letters of credit.

In addition, applying the law of the negotiating bank conflicts with the objectives of legal certainty and uniformity under the Rome

113 Ibid, at 1165. See also *Amin Rasheed Shipping*, above n 9, at 62.

114 Fentiman, above n 41, at 50.

Convention.[115] While a confirming bank or nominated bank is specified in the letter of credit, the negotiating bank is unknown to the parties until the beneficiary attempts to negotiate. As such, the uncertainty associated with the application of the law of the negotiating bank favours the application of the law of the issuing bank in the context of freely negotiable letters of credit.

The introduction of Rome I decreases the likelihood that the law of the issuing bank will be disregarded. The law of the habitual residence of the issuing bank governs the contract between the issuing bank and the beneficiary under art 4(1)(b), as the issuing bank is the service provider. While the law of the issuing bank can be displaced under art 4(3), the higher threshold makes it unlikely that the law of the habitual residence of the negotiating bank will be considered manifestly more closely connected to the contract.

2 The Contract between the Beneficiary and the Negotiating Bank

Currently, it is most likely that the law of the negotiating bank will be applied to the contract between the beneficiary and the negotiating bank.[116] Considering the policy objectives on which the determination of the governing law in the context of a freely negotiable letter of credit is based, this outcome is not particularly problematic. It allows for legal certainty, as both the beneficiary and the negotiating bank are privy to the governing law at the time the letter of credit is negotiated. Furthermore, the law of the negotiating bank is clearly the law most closely connected to the contract between the beneficiary and the negotiating bank, as this is where payment against documents occurs and where the contract is concluded. In addition, if the policy concerns discussed in *Offshore International* and *The Bank of Baroda* are indeed irrelevant in determining the law governing a freely negotiable letter of credit due to fundamentally different commercial expectations, there is no reason to apply the law of the issuing bank in this context.

While this article takes the position that the policy concerns advocated in *Offshore International* and *The Bank of Baroda* should be departed from in the context of freely negotiable letters of credit, it is still relevant to consider a commercially consistent method for determining a fixed governing law for freely negotiable letters of credit that incorporates such concerns. In order to apply the same law to all the contractual relationships, it will be necessary to either apply the law of the issuing bank to the contract between the negotiating bank and the beneficiary, or to apply the law of the negotiating bank to the contract between the beneficiary and the issuing bank.

The objectives of legal certainty and finding the law most closely

115 Rome Convention, above n 12, art 18.

116 *Kredietbank*, above n 27, at [115] (common law); *Marconi Communications*, above n 5 (Rome Convention).

connected to the contract are best served by applying the law of the issuing bank to the contract between the beneficiary and the issuing bank and the contract between the beneficiary and the negotiating bank. Applying the law of the issuing bank to the contract between the beneficiary and the negotiating bank will not undermine legal certainty, as both parties will have knowledge of the law governing the letter of credit prior to the negotiation. Although this arguably undermines the aim of applying the law most closely connected to the contract, the law of the issuing bank will be most closely connected to the letter of credit transaction in its entirety.

The policy objectives therefore seem to support the application of the law of the issuing bank to the contract between the negotiating bank and the beneficiary as the more preferable of two problematic results. However, it is unlikely that the current law can be utilised to this end. Under the common law, it would be necessary to accept that the law of the issuing bank is not most closely connected to the contract, but nevertheless apply it on policy grounds.

The negotiating bank undertakes the characteristic performance for the purposes of art 4(2) of the Rome Convention, and is the service provider under art 4(1)(b) of Rome I. As such, the law of the principal place of business or habitual residence of the negotiating bank will govern the contract between the negotiating bank and the beneficiary. For the law of the issuing bank to apply, it must be more closely connected to the contract under art 4(5) of the Rome Convention, and manifestly more closely connected to the contract under art 4(3) of Rome I. Rome I establishes a higher threshold for displacing the art 4(1)(b) presumption. The European Council and Parliament specifically state, however, that in deciding if a law is manifestly more closely connected to a contract, regard should be had to other contracts in the transaction. The application of the law of the issuing bank to all the other contracts in the transaction may therefore be an indication in favour of finding that the contract between the negotiating bank and the beneficiary is manifestly more closely connected to the law of the habitual residence of the issuing bank.

It may be possible, therefore, to apply the law of the issuing bank to the contract between the negotiating bank and the beneficiary, but this seems strained in the context of both the current law and the commercial realities of the situation. It is the position of this article that the law of the negotiating bank should be applied to the contract between the negotiating bank and the beneficiary in the context of freely negotiable letters of credit. While the same law will not apply to both contracts with the beneficiary, the commercial expectations of the parties do not require this outcome for a freely negotiable letter of credit and the objectives of legal certainty and determining the law most closely connected to the contract are satisfied.

VII CONCLUSION

Many of the inconsistencies and difficulties in the letter of credit context arise from three competing policy objectives. It is desirable to create a system whereby the governing law in the absence of choice can be determined in a way that allows for legal certainty, establishes a governing law most closely connected to the contract and takes into account parties' commercial expectations. The desire to account for commercial expectations has manifested itself in a 'rule' in the letter of credit context whereby courts have attempted to apply the same law throughout the letter of credit transaction. While this is sometimes a valid commercial objective, it is not appropriate in all cases. Where there is little commercial incentive for applying the same law throughout the transaction, this article contends that determining the governing law most closely connected to the transaction is a more important policy objective. Applying a consistent law throughout the transaction is desirable, but should not be the overriding policy consideration. Determining an appropriate balance between these policy concerns in the contractual setting is particularly important, as the contractual governing law will have a significant influence on the governing law of any tortious or restitutionary claim arising in connection with a letter of credit contract.

These policy objectives come to the forefront in determining the appropriate governing law in the context of freely negotiable letters of credit. This article suggests that the most appropriate outcome, given the current law and the commercial realities, would be for the courts either to adopt the fresh agreements approach based on an implied choice of law (thereby avoiding the problems associated with finding the law most closely connected to the contract), or to establish a fixed law in the context of freely negotiable letters of credit. In this case, the law of the issuing bank would apply to the contract between the issuing bank and the beneficiary and to the contract between the issuing bank and the negotiating bank. Furthermore, given the current law, the law of the negotiating bank should be retained as the governing law of the contract between the negotiating bank and the beneficiary.

Both approaches face significant difficulties and require some departure from traditional private international law rules. Particularly, this article dispenses with the requirement that the same law apply to all contracts with the beneficiary. This approach allows for both greater legal certainty between parties and, if the fixed law approach is adopted, the application of a governing law that is most closely connected to the particular contracts in a freely negotiable letter of credit. Furthermore, as the governing law of a tortious or restitutionary claim arising in connection with a contract will be influenced by that contract, the advocated outcome will provide a commercially sound result for both contractual and most non-contractual claims arising in connection with a letter of credit contract.