



*LECTURE FOR THE 3RD GENERAL MEETING OF SHIPARRESTED.COM,
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**“FRAUD IN BILLS OF LADING - CONSEQUENCES FOR THE BENEFICIARY
UNDER A LETTER OF CREDIT”**

We as maritime lawyers very well know what the functions are of a bill of lading in shipping.
It is:

- declaration of the carrier of receipt of the goods on board the carrying vessel;
- evidence of the contract of carriage and laying down the terms and conditions;
- document of title, representing the goods;
- entitling the rightful b/l holder to delivery of the cargo.

The b/l is equally important in the trade as so called third party document which the seller of the goods must present to the bank in order to receive payment of the purchase price under a letter of credit. This makes I think the b/l a key document in international shipping and trade, standing on the cross roads of shipping, trade and banking law. Perhaps due to its crucial function, the b/l has still not found its place in a paperless world.

A good example of how the Supreme Court of the Netherlands sees a b/l is a recent decision¹. A Korean seller of folding ladders had bribed the carrier's local agent in Korea, who issued bills of lading stating to have loaded on board 44 containers with folding ladders. In reality only 9 containers were loaded. The Supreme court attributed this fraud in the bill of lading to the carrier, such in light of the overriding principle in maritime law and in the interest of international trade, a third party bill of lading holder must be able to trust the correctness of it and be protected if it is not. The carrier had to reimburse the bill of lading holder for the shortage of 35 containers.

¹ Damco Maritime International BV v. Meister Werkzeuge Werkzeugfabrik GmbH, 4 April 2003, NJ 2003, Nr. 122.





The more important a document, the more perhaps it is vulnerable for fraud². There are various types of fraud with b/l's. The b/l may come in the hands of a person who is not the rightful holder and not entitled to take delivery of the goods. Or a person presents a false b/l (better: a fictitious b/l or non-document) to the sea carrier. In such situations owners may deliver the goods to the wrong person and perhaps be held liable for this theft. This triggered b/l's with so called "*Maersk clauses*" in which the carrier excludes liability for delivery of the cargo against a forged b/l. Under English law, such "fraude proof" b/l's seem to have been accepted by the courts³.

I would however concentrate today on another form of "b/l fraud": an as such genuine b/l but having an untrue contents. A famous but also criticized decision is the *American Accord*⁴ case, in which the English House of Lords held that the deliberately wrong dating of a b/l by the loading broker of the carrier is no reason to release the issuing bank from paying out under the letter of credit. Backdating of a b/l may seem very harmless, yet in trade a difference of one day can make a big difference as prices may go up and down heavily on a daily basis. Anyhow, this aspect apparently did not play a role and the bank was ordered to pay out under the letter of credit to the beneficiary who had no knowledge of this "fraud". The fraud therefore had no consequence for the position of the beneficiary under the LC.

This can be different in other scenario's. What in case a master had put remarks into his mate's receipt as to the condition of the cargo but nevertheless issued a "clean" b/l in exchange for a Letter of Indemnity (LOI) given by the charterer? The shipper of the goods, also the beneficiary under the LC, need not necessarily be aware of this. Should the beneficiary be protected as in the *American Accord* case? There exists case law in the US, saying for establishing fraud, there should be a *material* false representation. An example once given by a well-known speaker during a seminar on LC law, was a b/l stating to have on board 100 bicycles, whereas the seller/shipper knew the ship carried 99 bicycles. Under US law, this does not constitute a fraud, because it is not "material" enough.

² For decades a large sky sign in the city of Rotterdam bears the text: "*All what has value, is defenceless*", a poem of a great Dutch poet and painter, Lucebert.

³ Jeremy Smith, "Bills of Lading Clauses, The Legal Background", in: 2006 Annual Survey of Letter of Credit Law & Practice.

⁴ *United City Merchants v. The Royal Bank of Canada*, House of Lords, 1982, 2 Lloyd's Rep. 1 (H.L.).



Do we then have to distinguish the severity of misrepresentation and types of fraud? And how far do we have to go protecting the innocent beneficiary under an LC for fraudulent third party documents⁵? These questions touch upon the function and value of a b/l. On the other hand, one should realize that clean b/l's issued in exchange of an LOI does not necessarily need to involve fraud. I would not exclude master, being afraid for cargo claims, may sometimes tend to frivolously include cargo remarks in their mate's receipt in order to force the charterer to give a LOI which LOI should give him cover against cargo claims. The master may even deliberately have misrepresented the condition of the goods and not the bill of lading. Another possibility is that the master was either in doubt of the sound condition, or the inaccurate remarks were intentionally made to protect himself against cargo claims.

It is therefore not always crystal clear the b/l in actual fact *does* contain an untrue content. Ship owners should be aware though that an LOI may not give the protection they seek. Under various jurisdictions, an LOI may be held unenforceable on the charterer and the P&I Clubs will usually not give cover for unjustly issued clean b/l's.

The initiative for issuing a clean b/l against LOI can, however, also come from the charterer as he knows that for the shipper, a claused b/l is worthless, in fact unacceptable, as usually with an unmarked b/l, only then the shipper will be entitled to payment under an LC. Commercial practice therefore sometimes dictates the carrier issues a b/l without any mentioning of defective cargo or insufficient packing⁶. Whether such commercial practice can or should be allowed – it seems to be in the *American Accord* case – is another question. It would in my opinion jeopardize the function of a b/l, particularly its document of title function. Just as the Dutch Supreme Court ruled, a third party b/l holder must be able to trust the correctness and be protected if it is not.

The questions I just raised (distinguishing severity/types of fraud, protection of the beneficiary) are difficult to answer though, as these are not to be found in any international

⁵ See my article "Fraud In Third Party Transport Documents – From an LC Beneficiary's Perspective" in: 2004 Annual Survey of Letter of Credit Law & Practice.

⁶ Under UCP 500 and the ISBP, clause 90-92, banks may not require the word "clean" to appear on the B/L.



regulations. Maritime conventions, conventions on international trade such as the Vienna Convention, but even the UCP 500 (Uniform Customs and Practice for Documentary Credits) are silent on what is considered “b/l fraud” and what the consequences are for the position of the innocent beneficiary under the LC.

Courts or arbitrators dealing with such matters shall have to fall back on the applicable national law. Yet, they will give due regard to case law in other countries and legal writing on this topic as usually national law systems do neither contain specific provisions on “LC fraud”. In case one of you have to deal with such case, many articles and case law are to be found in the yearly handbook, the Annual Survey of Letter of Credit Practice and Law, published by the Institute of International Banking Law & Practice (www.iiblp.org).

Interesting in this context is that China is ahead of any other country and very recently created specific rules on how to deal with LC fraud and disputes around it⁷. Of particular importance is Article 8:

Any of the following circumstances shall be considered to constitute L/C fraud:

- (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(ies), presents documents while no real underlying transactions exist;*
- (IV) Other circumstances where fraud under an L/C may be found.*

This provision seems to focus on fraud committed by the beneficiary. It therefore leaves open the position of the beneficiary in case of a fraudulent b/l in which the beneficiary had no part. This, however, may fall under subsection IV, but this remains I think to be seen.

My conclusion is that the position of LC beneficiaries is rather uncertain in case of fraud with b/l's. Particularly I would say in cases where it has come to the surface that possible deficiencies of the cargo or its packing were covered up by a “clean” b/l and LOI. I am afraid

⁷ For a quick overview and translation of these new rules, click to www.lcvviews.com.



to have raised more questions than that I have given any answers. It does hopefully contribute to some extra awareness.

Thank you.

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