Documentary credit - principle of autonomy – derogation

Sirius International Insurance Co Ltd v FAI General Insurance
[2003] EWCA Civ 470, English Court of Appeal, 4 April 2003

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DOCUMENTARY CREDIT – PRINCIPLE OF AUTONOMY – DEROGATION

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Facts

Agnew was a Lloyd's syndicate and had wished to reinsure its liabilities. FAI were proposed as the reinsurers. Agnew was not happy with this and wanted a stronger reinsurer. Sirius agreed to act as that reinsurer on the basis that FAI would in turn reimburse them if they were called upon to pay. As consideration for fronting the arrangement, Sirius insisted on the issue of a letter of credit in their favour. The agreement also provided that Sirius would not draw down under the letter of credit unless:

(a) FAI had agreed that Sirius should pay a claim but had not put Sirius in funds, or
(b) the syndicate obtained a judgment or arbitration award against Sirius and Sirius was obliged to pay.

In 2000, Sirius started an arbitration against FAI. In 2001, FAI went into provisional liquidation and the arbitration was stayed. In the course of proceedings, FAI acknowledged in a Tomlin order that it owed Sirius US$22.5 million. Sirius contended that the terms of the Tomlin order fulfilled the first condition entitling it to draw on the letter of credit. Sirius then demanded payment under the letter of credit and was duly paid by the bank. The monies, for the purposes of the dispute, were subsequently placed in an escrow account.

At first instance, Jacob J held that the condition was satisfied and FAI appealed against that decision. Two issues were under appeal:

(a) whether the condition was indeed satisfied by the acknowledgement in the Tomlin order, and,
(b) whether the letter of credit was autonomous to the extent that Sirius was entitled to draw on it without reference to the arrangement between themselves and FAI.

Decision

The Court of Appeal allowed the appeal – in respect of the first issue. It held that as a matter of construction, the acknowledgement in the Tomlin order by FAI that they were indebted to Sirius in the sum of US$22.5 million was not also an agreement by FAI that Sirius should pay the syndicate's claim as the condition required.

As to the second issue, the Court of Appeal agreed with the High Court that the letter of credit could not be drawn down by Sirius in contravention of their agreement with FAI. The court also stated that although letters of credit were autonomous in the sense that the court would not restrain payment where there was a dispute under the underlying sale contract; in the present case the terms agreed between the parties included express contractual restrictions on the circumstances in which Sirius would be entitled to draw on the letter of credit. To that extent, the court considered that the letter of credit was thus less than the equivalent of cash and Sirius's security was correspondingly restricted.

Comment

This decision is not entirely on secure grounds – as far as the point on the letter of credit is concerned. The court referred to three reasons in justifying its decision that the principle of autonomy might be derogated from (or did not apply) because of the unusual circumstances of the case:

(a) the contract in question was not a commercial transaction, like a contract of sale – what was in issue was an express agreement on the circumstances under which the letter of credit could be drawn down;
(b) equity would have prevented the drawing down of the money (*Doherty v Allman* (1878) 3 App Cas 709, *Insurance Co v Lloyd's Syndicate* [1995] 1 Lloyd's Rep 273);

(c) it was clear that FAI had not only a seriously arguable case, but a positive judgment, that Sirius was not entitled to draw on the letter of credit (*Deutsche Ruckverischerung v Walbrook Insurance* [1995] WLR 1017, *per* Phillips J at 1030).

As regards the first reason, the court seems to take the view that in other letter of credit arrangements, the underlying contract does not expressly prevent the drawing down of monies under the letter of credit. May LJ seems to take the view that where there exists an express agreement between the parties that the letter of credit's autonomy is to be limited that would reduce the letter of credit's status as the equivalent of cash. May LJ said:

> 'The present case is in more than one *important* respect a variant of the more typical. Here the relevant underlying agreement is, not the commercial transaction that the letter of credit was intended to support, as in the typical case the contract of sale or in the present case the retrocession treaties, but a related agreement regulating as between FAI and Sirius terms on which the letter of credit would be established.' (emphasis added)

The court went on to say that under such circumstances an injunction might be granted (although that was academic in the present case because the bank had already paid out under the letter of credit). It might be derived from the court's judgment that the principle of autonomy could be derogated from where there exists an express stipulation in the underlying contract as to when the letter of credit could be drawn on. If that were the case, it would amount to quite a devastating blow on the principle of credit autonomy. Or is the court saying that such express stipulations may not be inserted into ordinary sale contracts, thus preserving the principle in the realm of international sales? That would surely fly in the face of the principle of party autonomy in international trade contracts.

The court built its rejection of the principle of autonomy in the present case on the premise that the principle is not absolute – its sanctity, for example, will yield to fraud. The court saw no objection in equity extending the exception to an express contractual proscription where the circumstances are deemed unusual. It is unclear what the court meant by 'unusual' – it would appear from the judgment that as there was no underlying commercial transaction, the circumstances were unusual. What is troubling is why (and to what extent) the unusual circumstances of a case should affect the autonomy of the letter of credit. The court's emphasis on the unusual arrangement does not take sufficient account of the bank's role – how should a bank with or without notice of the 'unusual' circumstances act, what about the position of correspondent banks which have negotiated the drafts drawn under the letter of credit, etc?

The court had to justify its departure from the general rule by finding that the unusual circumstances of the case meant that the commercial effectiveness of documentary credits had not been watered down by its decision. It thus turned to Phillips J's dicta in *Deutsche Ruckverischerung* that no court should grant an injunction simply on the basis that the applicant had shown that there was a seriously arguable case that the claim under the underlying contract was invalid and stated that the circumstances in the present case were so decisive that there was more than a mere seriously arguable case.

The Court of Appeal also confirmed the general view that the majority decision in *Themehelp Limited v West* [1996] QB 84 is questionable. Indeed, FAI's counsel was careful not to rely too strongly on it. That case, it might be recalled, held that an injunction might be granted to restrain the beneficiary from drawing on the performance guarantee where there was a seriously arguable prospect of the applicant satisfying the court at trial that the only realistic inference to draw was that the sale contract had been induced by fraudulent misrepresentation. That case had no place in the present context because as May LJ said, there was no allegation of fraud in the present case and it was not the case that FAI (the applicant) had *undertaken* that Sirius (the beneficiary) would have the benefit of the letter of credit under the terms. In contrast, FAI had placed express restrictions on Sirius' entitlement to draw on the letter of credit. The main difference as far as the court was concerned was that in one case, *Themehelp*, the applicant was purportedly acting in breach of his undertaking to ensure that payment under the letter of credit would be made whilst in the other he was acting to prevent the beneficiary to breach his undertaking not to seek payment under the letter of credit. On that basis,

there was no need to examine the validity of the granting of the injunction in *Themehelp*. Thus, as far as the court was concerned, the cases were distinguishable. It is difficult to see how this distinction renders it any easier for the court to deny the beneficiary from seeking payment under the letter of credit when it was not entirely clear that there was a contractual prohibition against it. Indeed, the very basis of the appeal was the fact that the court at first instance had held that Sirius had satisfied the condition for payment under the retrocession agreements. The prohibition was unclear – it had to be made the subject of judicial construction. It would seem rational to permit the pay now, argue later maxim to apply here.

It seems clear that the court had indeed extended the categories of exceptions to the principle of autonomy. It is regrettable that the extension whilst doing justice to the parties in the present case by placing the monies drawn down in the hands of the liquidators and not Sirius, has not been fully considered as regards its general applicability and application.

JC

COMMERCIAL AGENCY – NATIONAL LAW – PRIOR REGISTRATION – VALIDITY – COMMERCIAL AGENCY DIRECTIVE

Francesca Caprini v Conservatore Camera di Commercio, Industria, Artigianato e Agricoltura (CCIAA)

European Court of Justice, Case C-485/01, 6 March 2003

Facts

Under Italian law, a register of commercial agents and representatives is maintained in which all persons wishing to pursue such an activity are obliged to apply for registration. Failure to do so would

result in a civil fine. Caprini was not registered in that register. She then applied to be listed in another register, the register of undertakings, but that application was rejected on the basis that she was not registered as a commercial agent under the former register. She challenged the validity of the Italian law before the Tribunale civile e penale di Trento. The tribunal decided to refer the matter to the European Court of Justice. That question was whether the Directive on self employed commercial agents precluded a rule of national law which makes the enrolment of a commercial agent in the register of undertakings conditional on that agent's name having been entered in an appropriate register.

Decision

The ECJ held that as long as non-registration in the register of undertakings did not affect the validity of an agency contract entered into between the agent and the principal or that the consequences of non-registration did not adversely affect in any other way the protection which the directive has conferred on commercial agents, the Italian law requiring registration would be valid.

Comment

The appeal was brought primarily on the back of an earlier ECJ decision (Case C-215/97 *Bellone* [1998] ECR I-2191) that that Italian law, in its former guise, was invalid as it rendered all agency contracts unlawful where the agent concerned was not enrolled in the register of commercial agents and representatives. The directive states that whilst Member States are free to require that the commercial agency contract should be expressed in writing, they are not to make the contract subject to any other formal requirement. It is obvious that a requirement that the commercial agency should be registered would constitute a formal requirement but it remains to be seen whether that was a formal requirement which affected the legality of the contract.

In *Bellone*, the national law at issue in the main proceedings did not only require every commercial agent to be entered on that register, but also made the validity of the agency contract conditional upon such registration, with the result that an agent who was not registered was deprived of any legal protection, in particular once the contract was terminated. In that respect it should be borne in mind, first, that the Directive is designed to protect commercial agents, within the meaning of the Directive. According to Article 1(2), 'a commercial agent is a self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person . . . or to negotiate and conclude such transactions on behalf of and in the name of that principal'. Since entry in a register is not referred to as a condition for protection under the Directive, it follows that protection under the Directive is not conditional upon entry in a register.

It is also important to note that the directive on self employed commercial agents was not only intended to protect the commercial agent from exploitation by the principal following the termination of the agency contract but also to promote the free movement of services and establishment, as set out in Recitals 1 and 2 in the Preamble. In *Bellone*, although Italian practice appeared not to apply the condition of entry in the register to foreign agents, the national provisions at issue in the main proceedings, which were drafted in general terms, nevertheless also encompassed agency relationships between parties established in different Member States. They were still capable of significantly hindering the conclusion and operation of agency contracts between parties in different Member States and therefore from that point of view also were contrary to the aims of the Directive. That law was thus in breach of EU law.

This ground was not relied on in *Caprini*; although Caprini argued that in the absence of registration in the register of undertakings, Italian chambers of commerce would refuse to issue the certification enabling commercial agents to comply with the fiscal and social regulations for the commencement and proper conduct of their activity. It was further contended that an agent would not therefore be able to perform his contract of agency made with his principal without that certification. As such the Italian law was inconsistent with the provisions of the Directive.

As far as the Advocate General was concerned, Caprini's argument was not sufficiently persuasive. He was not convinced that it was clear that the consequences which Caprini described as flowing from non-inclusion in the register of commercial agents, namely that unregistered commercial agents will be unable to obtain entry on the register of undertakings, with repercussions for the regulation of their fiscal and social affairs, could be said to curtail the protection which the Directive provides to commercial agents in legal relations with their principals.

The ECJ, however, avoided deciding on the issue by relying on the principle of separation of powers implicit in the preliminary reference procedure under article 234 – that is to say, the ECJ will only offer guidance on the legal test but it is for the national tribunal to decide on the facts whether that legal test was met. On that basis, it merely stated the test to be whether:

> 'national provisions such as those in issue in the main proceedings, which state that an agent who is not enrolled in the register of commercial agents and representatives cannot be registered in the register of undertakings do not, according to the information provided by the national court, appear to affect the validity of the agency contract or otherwise have a bearing on the relations between the parties to that contract.'

It would then be the tribunal's duty to assess whether in the light of the specific circumstances the Italian requirements did have a bearing on the validity of the agency contract. The ECJ in *Bellone* was prepared to inquire into the validity of the Italian law but not here. That course of action might be explained away on the basis that in *Bellone*, it was clear that the Italian law provided positively that the commercial agency contract made without registration of the agent was unlawful whilst in the present case, that was not plainly obvious. It is not always clear when the ECJ in exercising its powers under article 234 would be prepared to inquire into the circumstances of the main proceedings (Case C-261/81 *Walter Rau Lebensmittelwerke v De Smedt PVBA* [1982] ECR 3961; Case C-315/92 *Verband Sozialer Wettbewerb eV v Clinique Laboratoires SNC et Estee Lauder Cosmetics GmbH* [1994] ECR I-317).

On balance, the ECJ's approach is preferable – to the extent that the question of the full impact of the Italian registration requirements is best tried by the Italian court which should have better knowledge of the commercial and socio-political implications in Italy for an unregistered commercial agent.

JC