

Enforceability of International Documentary Letters of Credit: An Italian Perspective

I. The Different Structures of Documentary Letters of Credit

Documentary (or commercial) letters of credit (DLCs) represent the means of payment normally adopted in connection with international sales of goods, since they constitute an effective tool to reduce the risks related to such transactions. The basic DLC transaction structure, which is rarely used in practice, implies a sale of goods (the “underlying contract”) in relation to which the purchaser (the “account party”) requests a bank (the “issuer”) to issue a DLC in favor of the seller (the “beneficiary”) in order to pay the purchase price. A DLC can be considered an undertaking to pay a certain amount to the beneficiary upon receipt of the documents listed in the same DLC. Accordingly, the issuer has to fulfill the payment obligation only if it verifies that the documents delivered conform with the conditions contained in the DLC. If the issuer meets the “condition of verification,” it is entitled to recover the advance made from the account party.

The main characteristic of a DLC is that the relationship between the issuer and the beneficiary is independent from the underlying contract (the “principle of independence”), so that the issuer is not entitled to any defense related to the same contract in order to refuse payment. The beneficiary, regardless of any event pertaining to the underlying contract, has the right to obtain payment of the amount indicated in the DLC when the documents delivered to the issuer conform with those listed in the same DLC.

The business practice presents different DLC schemes that can be selected by

*Member of the Rome Bar. Attorney, Gianni Origoni Tonucci, Rome. Visiting scholar, Yale Law School 1991-92.

**Member of the Rome Bar. Licensed Legal Consultant in New York. Attorney, Gianni Origoni Tonucci, New York. Co-chair, Western European Law Committee, New York State Bar Association.

the parties depending on what the parties intend to achieve. Italian courts have examined the following schemes of international DLC transactions.

A. CONFIRMED AND ADVISED DLC

In most cases the Italian account parties select an Italian bank as issuer. As a consequence, the foreign beneficiaries request a foreign bank (the "confirming bank") to confirm the DLC. The confirming bank undertakes to pay the amount indicated in the DLC to the beneficiary provided that the documents delivered to the confirming bank match those indicated in the DLC. In this respect, the Italian Court of Cassation held that the DLC's confirmation must be notified to the beneficiary prior to the documents' delivery, and that the beneficiary's obligation to tender the documents to the confirming bank is conditioned upon such notification.¹

Italian case law has also examined the role of the "advising bank." As a rule, the advising bank does not undertake to pay the beneficiary, since it acts only as the issuer's agent in order to notify the DLC's issuance to the beneficiary. In this transaction the Court of Appeal of Milan² held that the advising bank is not a party to the DLC relationship itself and is not responsible if the issuer fails to perform or delays the payment obligation contained in the DLC.³

B. REVOCABLE AND IRREVOCABLE DLC

As stated in article 9a of the Uniform Customs and Practice for Documentary Credit (UCP),⁴ which is usually incorporated by reference into the contract, "[a] revocable credit may be amended or cancelled by the issuer at any moment and without prior notice to the beneficiary." According to Italian commentators, the rationale of this provision is that the issuer does not have any obligation toward the beneficiary, since it is entitled to refuse the payment "at any moment."⁵

Some Italian courts have rejected the aforesaid position based on a literal interpretation of article 1530 (para. 2) of the Italian Civil Code (Civil Code).⁶ The ambiguous language of that provision has led the Italian courts to hold that only

1. Judgment of Sept. 15, 1989, No. 3928, Cass. [Supreme Court] (en banc), 1991 Rivista di Diritto Internazionale Privato e Processuale [Riv. Dir. Int. Priv. & Proc.] 479.

2. Judgment of Dec. 12, 1989, Corte app. Milano [Court of Appeal], 1992 Banca e Borsa II, at 68.

3. See also Judgment of Mar. 24, 1975, Corte app. Brescia [Court of Appeal], 1975 Banca e Borsa II, at 60; Judgment of Mar. 18, 1973, Trib. di Brescia [Court of First Instance], 1973 Banca e Borsa II, at 440.

4. ICC UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS art. 9a (UCP 400, 1983) [hereinafter UCP].

5. See, e.g., CONCETTO COSTA, "ASTRATTEZZA" ED ECCEZIONI OPPONIBILI NEL CREDITO DOCUMENTARIO IRREVOCABILE 8-9 (1989); MARIO SPINELLI & GIOVANNI GENTILE, DIRITTO BANCARIO 293 (1986).

6. Codice Civile [C.C.] art. 1530(2) provides that: "A bank which has confirmed the credit to the seller can only raise against him defenses based on the incompleteness or irregularity of the documents and those concerning the relationship derived from the confirmation of the credit."

a "confirmed" DLC must be deemed "irrevocable."⁷ This theory, which has been disregarded by Italian scholars, implies that the issuer is entitled to refuse payment if the DLC is not confirmed.

C. DEFERRED DLC

Any consideration of more complex DLC transactions (such as the anticipatory credit, the "back to back" credit, and the revolving credit)⁸ is omitted in order to focus on a credit instrument often used in Europe: the deferred payment credit ("deferred DLC"). The main feature of such an instrument is that the payment obligation is usually postponed sixty days from the document delivery date. Therefore, the account party's obligation to reimburse the issuer is extended. In practice the deferred DLC provides financing to the account party. However, some commentators interpret the purpose of the deferred DLC as to allow the account party to inspect the merchandise delivered prior to the payment and to raise defenses connected with the underlying contract performance.⁹

Such doctrine disregards the principle of independence outlined above, since it allows for the interference of any cause of action based on the underlying contract with the DLC relationship. The aim of the deferred DLC is only to finance the account party by extending the issuer's obligation of payment with respect to the documents' delivery.¹⁰

II. The Impact of Article 1530 of the Italian Civil Code on DLCs

The Civil Code contains a provision that regulates the essential aspects of a DLC. Article 1530 of the Code states that

[w]hen payment of the price is to be made through a bank, the seller cannot demand payment from the buyer until a refusal of payment by the bank on presentation of the documents in the form required by usage has been ascertained. A bank which has confirmed the credit to the seller can only raise defenses against him based on the incompleteness or irregularity of the documents and defenses concerning the relationship deriving from the confirmation of credit.¹¹

Regardless of the clear meaning of Civil Code article 1530, which sets out the "principle of independence," opinions have differed with respect to the legal nature of

7. See Judgment of June 10, 1983, No. 3999, Cass. [Supreme Court], 1985 Banca e Borsa II, at 160; ENRICO GABRIELLI, *VENDITA SU DOCUMENTI, ALIUD PRO ALIO, REVOCATA DEL MANDATO E COLLEGAMENTO NEGÓZIALE NELLA VICENDA DEL CREDITO DOCUMENTARIO*, IVI.

8. See generally G.D. PENN, A.M. SHEA & A. ARORA, *THE LAW & PRACTICE OF INTERNATIONAL BANKING* 305 (1987).

9. See Judgment of Apr. 27, 1976, Corte app. Milano [Court of Appeal], 1976 Banca e Borsa II, at 451.

10. See Judgment of May 15, 1981, Trib. di Bologna [Court of First Instance], 1981 Banca e Borsa II, at 170.

11. C.C. art. 1530. Such provision must be integrated with the UCP rules to the extent indicated below (see *infra* notes 21-23 and accompanying text).

a DLC and the rules applicable to the defenses that an account party may raise. Some authors believe that the issuer's defenses are limited to the DLC relationship. Conversely, defenses may be based on the theory of the applicability to DLCs of the provisions for delegating debt in articles 1268-1276 of the Civil Code.¹² Others maintain that the issuer would be entitled to refuse the payment when: (a) the underlying contract is null or void; (b) the relationship between the account party and the issuer is invalid; or (c) the goods delivered to the purchaser are defective.¹³ Such interpretation has been recently criticized by some scholars who hold that the discipline of delegation of debt cannot be applied to the DLCs because of their peculiar characteristics.¹⁴ Thus, DLCs should be regulated only under article 1530 of the Civil Code and the UCP rules. Such debate has affected the position of the Italian courts. In some cases they have adopted the "delegation" theory; in others they have strictly applied article 1530 of the Civil Code and the UCP rules.¹⁵

III. The Relationship Between the UCP Rules and the Italian Rules Applicable to Contracts

Since DLCs represent a typical instrument of international commercial practice, national legislatures tend not to regulate them through specific domestic provisions.¹⁶ For this reason, the UCP rules set forth by the International Chamber of Commerce play a key role in international documentary credit transaction practice.¹⁷ As a consequence, DLCs issued by Italian banks incorporate the UCP by reference.

The UCP regulates (i) the issuance of DLCs, (ii) the performance of the obligations that the issuer or the confirming bank have to fulfill, and (iii) the inspection of documents.

Some authors believe that the UCP rules should be applicable even though not incorporated by the DLC form, as the UCP represents a *lex mercatoria* generally applicable to all DLC transactions.¹⁸ Other commentators disregard such interpre-

12. C.c. art. 1268 provides:

If the debtor assigns to the creditor a new debtor, who binds himself to the creditor, the original debtor is not discharged from his obligation, unless the creditor expressly declares that he discharges him.

However, the creditor who has accepted the obligation of the third person has no remedy against the delegor unless he has previously requested payment from the delegee.

13. For bibliographical references on this issue, see *infra* note 57.

14. CAJO ENRICO BALOSSINI, *NORME ED USI UNIFORMI RELATIVI AI CREDITI DOCUMENTARI* 95 (1988); COSTA, *supra* note 5, at 105.

15. Judgment of Aug. 8, 1952, No. 2615, Cass. [Supreme Court], 1953, *Foro Italiano* [Foro It.] I, at 511; Judgment of Mar. 31, 1981, Corte app. Milano [Court of Appeal], 1981 *Banca e Borsa* II, at 433; Judgment of May 31, 1979, Corte app. Milano [Court of Appeal], 1979 *Banca e Borsa* II, at 106; Judgment of Apr. 27, 1976, Corte app. Milano [Court of Appeal], 1976 *Banca e Borsa* II, at 451.

16. Article 5 of the U.S. Uniform Commercial Code is one of the few domestic regulations on this topic.

17. The last version of the UCP rules, dated 1983, was recently revised. ICC UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (UCP 500, 1993). The new rules come into effect on January 1, 1994.

18. See Cajo Enrico Balossini, *Le categorie del "diritto dei privati" nei rapporti commerciali "internazionali,"* 1968 *RIVISTA TRIMESTRALE DI DIRITTO PUBBLICO* [RIV. TRIM. DIR. PUBBL.] 50.

tation on the grounds that the *lex mercatoria*, in most cases, is not enforceable and can be applied only to the extent permitted by domestic provisions. Therefore, when UCP rules are not incorporated in the DLC form, their applicability has to be determined on the basis of the domestic law that regulates the DLC relationship.¹⁹ In this regard, the Tribunal of Padova has held that since the DLC relationship is a "unilateral" contract and, according to Italian conflict of law rules, such contracts are deemed to be concluded in the place where the addressee (the beneficiary) is located, the DLC relationship has to be construed according to the law of the beneficiary's country.²⁰

As far as the relationship between the UCP and Italian law is concerned, Italian jurisprudence has adopted different interpretations. Some decisions hold that UCP rules are "statutory usages" that are followed as standard business practices even in the absence of a specific contractual provision under article 1374 of Civil Code.²¹ Therefore, UCP rules should apply to the contractual relationship pursuant to article 8 of the Preliminary Provisions of the Italian Civil Code.²² Conversely, Italian courts have found that UCP rules are "contractual usages" (that is, standard contractual provisions incorporated by reference in a single contract). Consequently, the UCP would be applicable to the extent that a DLC form makes reference to it.²³ As a practical matter such debate is irrelevant because Italian banks always include the reference to UCP rules in DLC forms and the UCP rules and Italian domestic provisions (for example, article 1530 of the Civil Code and related rules) are consistent.

IV. The Relationship Between the Account Party and the Issuer

As mentioned above, the DLC structure implies different relationships that, although linked from an economic standpoint, are legally independent. Courts generally construe the relationship between the account party and the issuer as a mandate contract without power of attorney regulated by articles 1703-1730 of

19. See Michael J. Bonell, *The Relevance of Courses of Dealing, Usages and Customs in the Interpretation of International Commercial Contracts*, in UNIDROIT, *NEW DIRECTIONS IN INTERNATIONAL TRADE LAW* 109, 118-19 (1976).

20. See Judgment of Apr. 11, 1985, Trib. di Padova [Court of First Instance], 1987 Banca e Borsa II, at 373; Judgment of Mar. 21, 1985, Trib. di Padova [Court of First Instance], 1985 Banca e Borsa II, at 374. However, this interpretation must be viewed in light of the provisions on contractual obligations set forth by the Convention of Rome of 1980. See Riccardo Luzzato, *L'entrata in vigore della Convenzione di Roma del 1980 e il nuovo diritto internazionale dei contratti*, 1991 DIR. COMM. INT. 259.

21. C.c. art. 1374 provides: "A contract binds the parties not only to what it expressly provides, but also to all the consequences deriving from it by law or, in its absence, according to usage and equity."

22. C.c. Preliminary Provisions [Disp. Prel.] art. 8 provides: "In matters regulated by statutes and regulations usage has effect only to the extent indicated by them." For this interpretation, see Judgment of Jan. 11, 1980, Corte app. Milano [Court of Appeals], 1981 Banca e Borsa II, at 438.

23. Judgment of June 10, 1983, No. 3992, Cass. [Supreme Court], 1983 Banca e Borsa II, at 160; Judgment of Feb. 1982, No. 693, Cass. [Supreme Court], 1982 Banca e Borsa II, at 131; Judgment of Feb. 22, 1979, No. 1130, Cass. [Supreme Court], 1979 Banca e Borsa II, at 257.

the Civil Code.²⁴ However, since the issuer has a specific interest in performing the obligation indicated in the DLC, the contract has to be considered a mandate contract *in rem propriam* (that is, also in the interest of the agent). Therefore, article 1723 (para. 2) of the Civil Code, which provides that “[a] mandate which is given also in the interest of the mandatory or of third persons is not extinguished by revocation by the principal, unless it is otherwise agreed or unless there is a just cause for such revocation.”²⁵ In light of article 1723 (para. 2) of the Civil Code some Italian courts have held that the account party is entitled to revoke the mandate contract if certain events (for example, the beneficiary’s default) related to the underlying contract occur.²⁶ Such events can be considered a “just cause” of revocation of the mandate contract.

Other decisions have pointed out that, pursuant to the principle of independence, any event that affects the underlying contract cannot be deemed a “just cause” of revocation of the mandate contract, because the contract is executed when the DLC is issued.²⁷ Therefore, even if a “just cause” occurs, the account party is not entitled to revoke a mandate contract already executed.²⁸ Moreover, the principle of independence, provided by article 1530 (para. 2) of the Civil Code and article 3 of the UCP,²⁹ does not allow the issuer to refuse payment because of events related to the mandate contract.

V. The Account Party’s Bankruptcy

The effect of the account party’s bankruptcy on the DLC relationship is partially connected to the issuer’s payment obligation. The principle of independence infers

24. According to C.c. art. 1703, “[a] mandate is a contract whereby one party binds himself to accomplish one or more legal transactions on behalf of another party.” See Judgment of Feb. 10, 1990, No. 975, Cass. [Supreme Court], Banca e Borsa II, at 454; Judgment of Apr. 16, 1975, No. 1445, Cass. [Supreme Court], 1975 Foro It. I, at 1085; Judgment of July 7, 1964, No. 2168, Cass. [Supreme Court], 1964 Banca e Borsa II, at 484; Judgment of June 9, 1964, No. 1423, Cass. [Supreme Court], 1964 Banca e Borsa II, at 330; Judgment of Apr. 12, 1957, No. 1252, Cass. [Supreme Court], not published; Judgment of Jan. 11, 1980, Corte app. Milano [Court of Appeal], 1981 Banca e Borsa II, at 438.

25. Conchetto Costa, *Brevi note in tema di termine di presentazione dei documenti e di termine di rifiuto degli stessi nel credito*, 1991 Banca e Borsa II, at 624.

26. See Judgment of May 3, 1978, No. 2048, Cass. [Supreme Court], 1978 Foro It. I, at 2212 (with regard to a criminal procedure for fraud connected to the underlying contract); Judgment of June 10, 1983, No. 3999, Cass. [Supreme Court], 1983 Banca e Borsa II, at 160; Judgment of July 24, 1976, Corte app. Milano [Court of Appeal], 1976 Banca e Borsa II, at 451.

27. See C.c. art. 1722(1), which states: “The mandate is extinguished . . . by completion by the mandatory of the transaction for which the mandate was given.”

28. See Judgment of Mar. 31, 1981, Corte app. Milano [Court of Appeal], 1981 Banca e Borsa II, at 433; Judgment of May 15, 1981, Trib. di Bologna [Court of First Instance], 1981 Banca e Borsa II, at 170; Judgment of May 31, 1979, Trib. di Milano [Court of First Instance], 1982 Banca e Borsa II, at 106.

29. UCP art. 3, *supra* note 4, specifies that: “Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit.”

that the account party's bankruptcy does not exempt the issuer from honoring the DLC payment if the documents satisfy the conditions of the DLC. Moreover, payment of the DLC does not prejudice the creditors' rights, since such performance does not reduce the debtor's assets³⁰ and, consequently, does not affect the pro rata distribution rule. The issuer, having honored its payment obligation, will be entitled to claim against the account party in a bankruptcy proceeding.

The Court of Cassation seems to disregard such an interpretation. In decision No. 1445, rendered on April 16, 1975,³¹ the Court of Cassation held that a payment made by the issuer pursuant to the DLC is subject to the "preference rule" provided by article 67 of Royal Decree of March 16, 1942, No. 267 (the Italian Bankruptcy Statute), since it affects the pro rata distribution set forth in the Italian Bankruptcy Statute. If certain conditions under article 67 are met, any payments made by the issuer two years before the account party is declared bankrupt might be considered preferential payments.

VI. The Relationship Between the Issuer and the Beneficiary: The Conformity of the Documents

The conformity of the DLC documents is one of the most important issues related to the DLC discipline. Article 1530 (para. 2) of the Civil Code states that "the incompleteness or irregularity of the documents and those concerning the relationship deriving from the confirmation of credit" are the only defenses the issuer is entitled to raise. The standards usually adopted in the banking community to check the conformity of the documents tendered by the beneficiary are relevant. While it is undisputed that the issuer is entitled to refuse payment when the documents tendered do not conform to the conditions of the DLC,³² the procedures that an issuer must follow in order to check the compliance of the tendered documents are still not settled.

Some Italian courts apply the "strict compliance" standard, by which the issuer has to adopt a "formal" approach in checking the documents. Under this standard even a minor irregularity of the documents listed in the DLC allows the issuer to reject the tendered documents and dishonor payment.³³ Other courts follow a more flexible (or "reasonable") standard in order to limit the absolute discretion

30. See COSTA, *supra* note 5, at 150.

31. 1976 Banca e Borsa II, at 296.

32. See, among the American authors, Boris Kozolchyk, *Strict Compliance and the Reasonable Document Checker*, 56 BROOK. L. REV. 45 (1990); Boris Kozolchyk, *Is Present Letter of Credit Law up to its Task?*, 8 GEO. MASON U. L. REV. 285; and among the Italian authors, COSTA, *supra* note 5, at 155.

33. See Judgment of Apr. 12, 1957, No. 1257, Cass. [Supreme Court], 1957 Banca e Borsa II, at 332; Judgment of Oct. 14, 1953, No. 3417, Cass. [Supreme Court], 1954 Giurisprudenza Completa della Corte Suprema di Cassazione [Giur. Compl. Cass. Civ.] V, at 284; Judgment of Dec. 9, 1963, Trib. di Milano [Court of First Instance], 1964 Banca e Borsa II, at 114; Judgment of May 26, 1955, Trib. di Genova [Court of First Instance], 1955 Banca e Borsa II, at 532; Judgment of Aug. 1948, Trib. di Genova [Court of First Instance], 1949 Banca e Borsa II, at 56.

of the issuer to reject the documents based on a formalistic approach under the strict compliance rule. According to the reasonable standard, the issuer must inspect the documents tendered in good faith³⁴ in order to evaluate whether the documents have a "commercial value" (that is, such documents would be reasonably acceptable in commercial and banking practice). The commercial value approach does not consider minor defects lacking substantial relevance.³⁵ In this regard, the revised draft of the UCP rules seems to have adopted the reasonable standard by requiring that the issuer check the documents pursuant to the standard generally adopted in international banking practice.³⁶

A related issue is the construction of the phrase "reasonable time" with respect to the time granted to the issuer in order to check the documents.³⁷ According to the Italian practice, the term "reasonable time" generally means three business days, even though in some cases three days may be too short to accurately check voluminous documents. In such cases, adopting a more flexible standard and considering the general banking practice in the area in which the issuer is located as well as the structure of the banks involved in the transaction would be advisable.³⁸ However, the issuer has the burden of proving a reasonable time pursuant to local banking practice insufficient because of the documents' complexity, and pursuant to the new version of article 13 of the UCP (contained in the latest revised draft of the UCP rules), the time to check the documents shall not be longer than seven business days starting from the receipt of the documents tendered.

VII. The Nullity of the Underlying Contract

The nullity of the underlying contract has been a major issue relating to DLC transactions. The principle of independence holds that any fact related to the underlying contract generally does not affect the independent DLC payment obligation between the issuer and the beneficiary. The majority of Italian commentators and some Italian courts follow such an interpretation.³⁹ Prevailing case law, however, disregards the independence principle. Rather, the prevailing case law

34. See arts. 1366 and 1375 of the C.c., according to which the contract must be interpreted and performed in good faith.

35. See Judgment of Oct. 8, 1985, Corte app. Roma [Court of Appeal], 1986 *Rivista del Diritto Commerciale e del Diritto Generale Delle Obbligazioni* [Riv. Dir. Comm. & Obblig.] II, at 367; Judgment of Jan 25, 1952, Corte app. Milano [Court of Appeal], 1953 *Banca e Borsa* II, at 46; Judgment of May 23, 1983, Trib. di Napoli [Court of First Instance], 1985 *Banca e Borsa* II, at 524; Judgment of May 9, 1981, Trib. di Roma [Court of First Instance], 1982 *Banca e Borsa* II, at 295; Judgment of Dec. 29, 1948, Trib. di Torino [Court of First Instance], 1949 *Banca e Borsa* II, 259.

36. See comment, 1991 LC UPDATE 3.

37. See UCP art. 16(c), *supra* note 4, which states: "The issuing bank shall have a reasonable time in which to examine the documents and to determine as above whether to take up or to refuse the documents."

38. See Judgment of Jan. 26, 1990, Corte app. Bologna [Court of Appeal], 1991 *Banca e Borsa* II, at 612; Costa, *supra* note 25, at 170.

39. See GIUSEPPE PORTALE, *LE GARANZIE BANCARIE INTERNAZIONALI* 49 (1989); Judgment of Apr. 13, 1960, Corte app. Milano [Court of Appeal], 1960 *Banca e Borsa* II, at 397.

considers DLC relationships within the parameters of debt delegation pursuant to article 1271 (para. 2) of the Civil Code.⁴⁰

Issues regarding the nullity of the DLC and the unlawfulness of the underlying contract deserve special attention. If the DLC relationship is null, the issuer is entitled to refuse payment pursuant to Civil Code article 1530 (para. 2), regardless of the actual documents' conformity.⁴¹ The principle of independence does not come into play in this instance, since the issuer's refusal to pay is based upon an event pertaining to the DLC contractual relationship.

In instances where the unlawfulness of the underlying contract is concerned, under certain circumstances (such as a criminal investigation promoted against the beneficiary in connection with fraud related to the underlying contract), the Italian courts have held that the principle of independence can be derogated.⁴²

VIII. The Breach of the Underlying Contract

According to the principle of independence, the beneficiary's default in the underlying contract should not affect the performance of the DLC. Nevertheless, the account party frequently alleges the wrong or inaccurate performance of the underlying contract (for instance, defects in the goods delivered to the account party) as grounds to enjoin the issuer from paying. In some decisions the Italian courts have supported such a position by ruling that the breach of the underlying contract is a defense that the account party or the issuer is entitled to raise in order to enjoin, or refuse, payment.⁴³

Most recent commentators disregard this interpretation, as does the majority of Italian case law that applies the principle of independence to the DLCs and considers irrelevant any circumstance that relates to the performance of the underlying contract.⁴⁴ Such principle also applies to deferred DLCs.⁴⁵ The beneficiary's

40. C.c. art. 1271, ¶ 2 provides: "Unless the parties have otherwise agreed, the delegee [issuer] cannot interpose against the creditor [beneficiary] those defenses which the former might have set up against the delegor [account party] even if the creditor had knowledge of them, *unless the relationship between the delegor and the delegee is void.*" (Emphasis added.) See Judgment of Mar. 31, 1981, Corte app. Milano [Court of Appeal], 1981 Banca e Borsa II, at 433; Judgment of Apr. 27, 1976, Corte app. Milano [Court of Appeal], 1976 Banca e Borsa II, at 451.

41. See PORTALE, *supra* note 39, at 132.

42. See Judgment of Jan. 28, 1983, No. 813, Cass. [Supreme Court], 1983 Banca e Borsa II, at 393. For a case in which a violation of the exchange control law occurred, see Judgment of July 8, 1983, No. 4605, Cass. [Supreme Court], 1985 Banca e Borsa II, at 145. The exchange control legislation was revised in 1988 with the passage of Presidential Decree of Mar. 31, 1988, in order to liberalize the movement of capital from Italy to foreign countries.

43. See Judgment of June 10, 1983, No. 3999, Cass. [Supreme Court], 1985 Banca e Borsa II, at 160; Judgment of May 11, 1967, Corte app. Firenze [Court of Appeal], 1968 Banca e Borsa II, at 94. *Contra* Judgment of Nov. 7, 1969, No. 3641, Cass. [Supreme Court], Mass. Foro It., 1969.

44. See Judgment of Jan. 28, 1983, Banca e Borsa II, at 393; Judgment of Jan. 11, 1980, Corte app. Milano [Court of Appeal], 1981 Banca e Borsa II, at 438; Judgment of Oct. 25, 1990, Trib. di Milano [Court of First Instance], 1992 Banca e Borsa II, at 68; Judgment of May 31, 1979, Trib. di Milano [Court of First Instance], 1982 Banca e Borsa II, at 106.

45. For details on deferred DLCs, see *supra* notes 9-10 and accompanying text. See Judgment of May 15, 1981, Trib. di Bologna [Court of First Instance], 1982 Banca e Borsa II, at 170.

credit, even though collectable upon expiration of the maturity date, becomes "uncontested" and "liquid" when the issuer (or, in case of confirmed DLC, the confirming bank) accepts the documents. The documents' acceptance precludes the issuer or the account party from raising any objections or defenses except in cases of material fraud.

The same principle should be applied when the confirming bank pays the beneficiary prior to the maturity date indicated in the DLC and calls for reimbursement of the advance made after expiration of the maturity date. In such a case the issuer is under an obligation to reimburse the confirming bank unless the latter failed in checking the documents tendered. The confirming bank undertakes to pay the beneficiary on the basis of an independent DLC relationship. As a result, provided that the documents tendered are correct, the confirming bank is entitled to pay the beneficiary prior to the maturity date, since such term is "in favor" of the debtor according to article 1184 of the Civil Code.⁴⁶

IX. Injunction and Other Interim Measures

A survey of case law shows that issuers are reluctant to refuse payment when the documents delivered are correct, even though the account party alleges fraud in the underlying transaction.⁴⁷ In such cases the account parties usually seek to obtain an interim measure in order to enjoin the payment. Italian law, however, does not provide an ad hoc interim measure. In theory, three different measures of general application are available to the account party under the Italian Civil Procedure Code (Civil Procedure Code): (i) judicial seizure;⁴⁸ (ii) conservative seizure;⁴⁹ or (iii) injunction.⁵⁰

46. C.C. art. 1184 provides: "If a time limit is established for performance, it is presumed to be in favor of the debtor unless it appears to have been established in favor of the creditor or of both." See Judgment of Mar. 31, 1981, Corte app. Milano [Court of Appeals], 1981 Banca e Borsa II, at 433; Judgment of Apr. 13, 1960, Corte app. Milano [Court of Appeals], 1960 Banca e Borsa II, at 397; Judgment of May 15, 1981, 1982 Banca e Borsa II, at 170.

47. The practical reasons for such conduct are the following: (i) considering the time limit granted for checking documents, issuers do not have enough time to verify whether the account party's allegations are grounded; (ii) the evidence of fraud is often unclear and inconclusive; and (iii) by refusing payment when the documents conform to the DLC list, issuers may prejudice their reputation as a reliable bank in international transactions.

48. CODICE DI PROCEDURA CIVILE [C.P.C.] art. 670 provides:

A Court has the power to grant a judicial seizure with respect to:

(1) movables, immovables, ongoing concerns or other universality of movables when the property right or the possession are [sic] disputed and it is advisable to keep them under custody or to administer them temporarily;
 (2) books, registers, documents, patterns, samples and any other thing relevant as evidence, when the right to exhibit them is disputed and it is advisable to keep them temporarily under custody.

49. C.P.C. art. 671 provides: "A Court, upon petition of a creditor who is reasonably concerned to lose the guaranty of its credit, is empowered to grant a conservative seizure on debtor's movable or immovable assets or on credits to the extent the law allows the attachment of such assets."

50. C.P.C. art. 700 provides:

In cases other than those regulated by provisions of the previous Sections of this Chapter, one who is reasonably concerned that, during the time necessary to obtain a decision on the merits to protect his interest, such right might be threatened by an irreparable prejudice, is entitled to request a Court to grant the measures which are, under the circumstances, more appropriate to produce temporarily the effects of the decision on the merits.

Under article 670 of the Civil Procedure Code judicial seizure can be granted only with respect to rights in rem. As a consequence, the account party cannot obtain a judicial seizure with regard to the credit the issuer has to pay to the beneficiary.⁵¹ As far as conservative seizure is concerned, some courts have granted this measure to account parties.⁵²

The interim measure mostly used by account parties to restrain an issuer from paying is the injunction under article 700 of the Civil Procedure Code. Italian courts have usually granted the injunction in cases where the beneficiary acted fraudulently.⁵³ Indeed, the prevailing case law holds that an injunction granted pursuant to article 700 is the only remedy available to the account party in order to avoid irreparable harm.⁵⁴ Such decisions have found that the account party (although according to the principle of independence it is a "third party" with respect to the DLC relationship) would have a specific interest in requesting the injunction and avoiding the fraudulent credit call since it would suffer the economic consequences of the beneficiary's bad faith.

In injunctive proceedings Italian courts have a significant degree of discretion in evaluating the prerequisites to grant this interim measure, namely: (i) prima facie evidence of the petitioner's right (the *fumus boni iuris*); or (ii) the petitioner's irreparable harm in case the injunction is not granted (the *periculum in mora*). As far as the *fumus boni iuris* is concerned, the courts have held that the injunction may be granted when the petitioner submits the "liquid" evidence of the beneficiary's fraud.⁵⁵ The exact meaning of the "liquid" evidence prerequisite is not resolved. According to some commentators, the "liquid" evidence can only be based on documents such as certifications released by custom authorities, reports made by a court-appointed expert, and the like.⁵⁶ However, commentators considering the purpose of the injunctive proceeding, which is essentially aimed at a

51. Judgment of Mar 3, 1958, Trib. di Bolzano [Court of First Instance], 1959 Banca e Borsa II, at 238.

52. See Judgment of Mar. 2, 1988, Trib. di Legnano [Court of Appeal], not published; Judgment of Sept. 5, 1957, Trib. di Milano [Court of First Instance], 1958 Banca e Borsa II, at 608. *Contra* Judgment of Mar. 14, 1989, Pret. di Legnano [Court of First Instance], 1990 Banca e Borsa II, at 669 (dictum).

53. See decisions cited *infra* note 54.

54. Judgment of Dec. 6, 1990, Pret. di Torino [Court of First Instance], 1992 Banca e Borsa II, at 69; Judgment of May 28, 1990, Pret. di Foligno [Court of First Instance], 1991 Nuova Giurisprudenza Civile Commentata [Nuova Giur. Civ. Comm.] I, at 670; Judgment of Mar. 14, 1989, Pret. di Legnano [Court of First Instance], 1990 Banca e Borsa II, at 669; Judgment of Dec. 21, 1982, Pret. di Perugia [Court of First Instance], 1983 Foro It. I, at 1777; Judgment of May 13, 1981, Trib. di Bologna [Court of First Instance], 1981 Banca e Borsa II, at 180; Judgment of Oct. 1, 1980, Pret. di Milano [Court of First Instance], 1982 Banca e Borsa II, at 180; Judgment of July 18, 1980, Pret. di S. Miniato [Court of First Instance], 1982 Banca e Borsa II, at 180.

55. See Judgment of May 28, 1990, Pret. di Foligno [Court of First Instance], 1991 Nuova Giur. Civ. Comm. I, at 670; Judgment of Dec. 21, 1982, Pret. di Perugia [Court of First Instance], 1982 Foro It. I, at 1777.

56. See FULVIO MASTROPAOLO, I CONTRATTI AUTONOMI DI GARANZIA 307 (1989); CALDERALE, FIDEIUSSIONE ECONTRATTO AUTONOMO DI GARANZIA 306 (1989).

temporary restraining order, have adopted a more flexible approach, arguing that the petitioner might satisfy the relative burden of proof even through presumptions.⁵⁷

Italian case law holds that a preliminary injunction may be granted in each of the following circumstances: (i) documentary evidence shows that the beneficiary calls the credit, even though the beneficiary has not performed a material obligation under the contract;⁵⁸ (ii) an appraisal made by an expert appointed by the petitioner shows that the beneficiary has fraudulently shipped defective merchandise to the account party;⁵⁹ (iii) customs authorities declare the documents tendered by the beneficiary to be null and void and a foreign court issues interim measures to enjoin payment by a confirming bank;⁶⁰ (iv) the account party alleges the beneficiary's default of the underlying contract;⁶¹ or (v) the confirming bank tenders false documents and the merchandise has not been shipped, notwithstanding that the delivery date has expired.⁶²

The injunction may be granted when evidence shows that the petitioner would suffer irreparable harm if an injunction is not obtained. Courts have generally recognized the existence of a potential irreparable harm when the beneficiary is located abroad, regardless of the account party's ability to bring an action for breach of the underlying contract or for "unjust enrichment" in the foreign jurisdiction.⁶³ The courts have never adequately clarified the prejudice that the account party would suffer while bringing an action in a foreign court. However, such interpretation is to be disregarded, since it identifies the account party's irreparable harm with the difficulty in recovering monies paid in advance to a foreign beneficiary. Moreover, it must be considered that the account party itself selects the beneficiary, and when the account party enters into the underlying contract with a foreign party, it is fully aware of the risks involved in bringing

57. See, e.g., Franco Bonelli, *Escussione abusiva delle garanzie bancarie a prima richiesta*, 1988 DIR. COMM. INT. 506.

58. See Judgment of Mar. 14, 1989, 1990 Banca e Borsa II, at 669.

59. See Judgment of May 28, 1990, 1991 Nuova Giur. Civ. Comm. I, at 670.

60. Judgment of Oct. 1, 1980, Pret. di Milano [Court of First Instance], 1982 Banca e Borsa II, at 180.

61. Judgment of Dec. 6, 1990, Pret. di Torino [Court of First Instance], 1992 Banca e Borsa II, at 69; Judgment of July 18, 1980, Pret. di S. Miniato [Court of First Instance], 1982 Banca e Borsa II, at 180. *Contra* Judgment of Dec. 10, 1984, Pret. di Torre del Greco [Court of First Instance], 1984 Banca e Borsa II, at 671.

62. See Judgment of Dec. 21, 1981, Pret. di Perugia [Court of First Instance], 1983 Foro It. I, at 1777.

63. See Judgment of Mar. 14, 1989, Pret. di Legnano [Court of First Instance], 1990 Banca e Borsa II, at 669 (in which the beneficiary was a Malta company); Judgment of May 28, 1990, Pret. di Foligno [Court of First Instance], 1991 Nuova Giur. Civ. Comm. I, at 670 (in which the beneficiary was an Israeli company); Judgment of Dec. 21, 1982, Pret. di Perugia [Court of First Instance], 1983 Foro It. I, at 1777 (in which the beneficiary was a German company).

an action before a foreign court. The risks of bringing an action abroad, then, cannot be considered irreparable harm.⁶⁴

Other factors have to be taken into account in order to evaluate the "irreparability" of the harm. Such factors include: (i) the risk of bankruptcy by either the account party or the beneficiary; (ii) adverse economic effects on the account party resulting from the reimbursement obligations due to the issuer;⁶⁵ and (iii) political and social events that militate against an impartial judgment before the foreign court.⁶⁶ In light of such elements it is possible to evaluate the economic situation of the parties as well as the circumstances of the case, and if "the prejudice which the petitioner might suffer in case the injunction is not granted is, in qualitative and quantitative terms, greater than the prejudice the beneficiary might suffer in case the injunction is granted."⁶⁷

X. Some International Aspects of the Injunction

In international transactions DLCs are "confirmed" by banks located in the beneficiary's country. In this context, Italian courts have dealt with cases in which account parties sought to enjoin foreign confirming banks from paying the beneficiary. Assuming that Italian law applies to the contractual relationship between the issuer and the confirming bank,⁶⁸ the rules of the mandate contract would apply and the account party would be entitled to institute an action pursuant to article 1717 of the Civil Code.⁶⁹ Thus, the account party would have the right to sue the "subagent" (the confirming bank) in order to obtain an injunction that restrains the latter from paying the beneficiary.

As far as the procedural aspects are concerned, an injunction issued by an Italian court may not be enforceable in the confirming bank's country. In the absence of an international convention on jurisdiction between the account party's country and the confirming bank's country, the injunction granted by an Italian court is, basically, unenforceable abroad. Furthermore, even if the EC Convention of Brussels of 1968 on Jurisdiction and Enforcement of Judgments applies,

64. Judgment of July 31, 1990, Pret. di Udine [Court of First Instance], 1992 Banca e Borsa II, at 68.

65. See Judgment of Dec. 21, 1982, Pret. di Perugia [Court of First Instance], 1983 Foro It. I, at 1777; Judgment of Dec. 6, 1992, Pret. di Torino [Court of First Instance], 1992 Banca e Borsa II, at 69.

66. In this respect, the case of the Iran revolution is a clear example.

67. See Judgment of May 11, 1987, Pret. di Roma [Court of First Instance], 1987 Foro Padano [Foro Pad.] I, at 379.

68. The national law applicable to such relationship can be determined according to the rules set forth by the Convention of Rome of 1980 on contractual obligations with respect to EC Member States or according to the conflict of law rules set forth by preliminary provisions to C.c. (¶ 3).

69. C.c. art. 1717 provides, inter alia: "The principal [i.e., the account party] can exercise his right of action directly against the person substituted [i.e., the confirming bank] for the mandatory [i.e., the issuer]."

and even if the account party and the confirming bank are established in the European Community, the injunction granted by an Italian court *inaudita altera parte* (that is, in the absence of the respondent) would not be enforceable in another Member State. In *Bernard Denilauer v. S.n.c. Couchet Frères*⁷⁰ the European Court of Justice held that the rules regarding the enforceability in one of the Member States of the decisions rendered in another Member State are not applicable when interim measures are granted *inaudita altera parte*.⁷¹ In light of the above factors, the Italian account party has, in principle, few chances to succeed in restraining payment by the foreign confirming bank and reimbursement by the issuer to the foreign confirming bank.

XI. Fraud and Documents' Negotiation

A defense based on a defrauded beneficiary is difficult to invoke when the credit is called by a party other than the beneficiary (for example, the confirming bank or a merchant bank that has negotiated the documents or the credit) who has already paid the beneficiary on the basis of conforming documents. In such cases the account party has to prove the third party's bad faith or gross negligence in negotiating the documents in order to restrain the issuer from reimbursing the confirming bank. If such preconditions are not met, the account party is not entitled to apply for an injunction. The Tribunal of Bologna, in a decision rendered on May 15, 1981,⁷² ruled that an injunction aimed at enjoining the issuer from reimbursing the confirming bank cannot be granted if the confirming bank has already paid the beneficiary on the basis of documents complying with the DLC requirements. However, such a rule does not apply when the documents' negotiation or, in the case of a deferred DLC, payments prior to the maturity date are explicitly prohibited by a specific clause in the DLC.⁷³ In this case, a payment by the confirming or negotiating bank in violation of a specific contractual provision may be construed as an assignment of proceeds.⁷⁴ As a consequence, the account party is entitled to raise against the third party (confirming or negotiating banks) the same defenses it would have been entitled to raise against the beneficiary.⁷⁵

70. 1980 E.C.R. 1553, [1981] 1 C.M.L.R. 62.

71. See Antonietta di Blase, *Provvedimenti cautelari e convenzione di Bruxelles*, 1987 RIVISTA DI DIRITTO INTERNAZIONALE [RIV. DIR. INT.] 5. The European Court of Justice, Case 143/78, de Cavel v. de Cavel, 1979 E.C.R. 1055, [1979] 2 C.M.L.R. 547, held that in relation to the matters covered by the Brussels Convention no legal basis exists for drawing a distinction between interim and final measures.

72. 1982 Banca e Borsa II, at 170

73. See Judgment of Jan. 28, 1983, No. 813, Cass. [Supreme Court], 1983 Banca e Borsa II, at 393.

74. UCP art. 55, *supra* note 4, provides: "The fact that a credit is not stated to be transferable shall not affect the beneficiary's right to assign any proceeds to which he may be, or may become, entitled under such credit, in accordance with the provisions of the applicable law."

75. See Rolf Eberth & E.P. Ellinger, *Deferred Payment Credits: A Comparative Analysis of Their Special Problems*, 14 J. MAR. L. & COM. 387 (1983).

XII. Conclusion

Recent developments in Italian case law consider the need to protect foreign parties such as beneficiaries and confirming and advising banks in international DLC transactions. The rigorous application of the principle of independence reduces a foreign bank's exposure to risks related to the performance of the underlying contract.

The Italian legal system and the UCP rules safeguard the interests of foreign banks and beneficiaries. Careful drafting of the DLC is an additional tool to allocate risks and prevent unnecessary litigation and related costs. From a practical standpoint two aspects deserve attention in drafting DLCs: (i) DLC forms should not include any "nondocumentary conditions" that may create an interdependence between the DLC relationship and the underlying contract, and (ii) the possibility for the foreign banks to negotiate the DLC should be expressly provided in the DLC form.

