

**THE DOCTRINE OF STRICT COMPLIANCE REGARDING LETTERS OF CREDIT: HAS
THERE BEEN A SIGNIFICANT IMPROVEMENT IN ITS APPLICATION?**

by

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Lastly, all grace, honour and glory to the Almighty Father for having bestowed such divine favour upon my life. Jeremiah 29:11

SUMMARY

Letters of credit have played a vital role in financing international trade transactions since the setup of the General Agreement on Tariffs and Trade (GATT). The continued dependence on letters of credit in international trade has rendered uniformity in the use thereof, as paramount. Such uniformity is governed by the Uniform Customs and Practice for Documentary Credits (UCP), a set of rules developed by the International Chamber of Commerce, which has been amended several times since it first came into force in 1933. The current version thereof is the UCP 600.

However, despite their global phenomena, letters of credit have caused international traders to experience a series of difficulties in complying with the high standards of documentary compliance required by banks. These intricate circumstances have led to the amendment of the doctrine of strict compliance as provided for in the UCP 600. With the omission of key words in the definition of the doctrine, it is argued that the standard of compliance has been relaxed and has paved the way for what is termed as “substantial compliance”. The possibility of international traders falling short in meeting the documentary compliance standards poses the risk of non-payment for the beneficiary (seller) which, in turn, could have catastrophic consequences for the international trade industry. From this, one can deduce that the governing rules were not set out clearly and thus left ample space for ambiguity. Courts have not assisted in this regard, as they too have created many controversial judicial decisions and standards that apply to similar situations.

A little closer to home, South Africa has not enacted a specific piece of national legislation dealing with documentary letters of credit nor has it incorporated the Uniform Customs and Practice for Documentary Credits into its national legislation. The absence of legislation does, however, not leave this area of the law ungoverned. The legal relationships that come into existence are governed by the law of contract. Furthermore, a closer look into whether or not South African courts have experienced any commonly known difficulties as far as the interpretation of the doctrine of strict compliance is concerned. This is achieved by considering the recent developments found in the UCP and the application of the doctrine of strict compliance by the South African courts.

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Chapter One: Letters of Credit

1 Introduction

Documentary letters of credit have been defined as follows:

“Any arrangement, however named or described, whereby a bank (the Issuing Bank), acting at the request and on the instructions of a customer (the Applicant) or on its own behalf,

- (i) is to make a payment to or to the order of a third party (the Beneficiary), or is to accept and pay bills of exchange (drafts(s)) drawn by the Beneficiary; or
- (ii) authorises another bank to effect such payment, or to accept and pay such bills of exchange (draft(s)); or
- (iii) authorises another bank to negotiate;

against stipulated document(s), provided that the terms and conditions of the Credit are complied with.”¹

The past few decades have led to the undeniable and prominent recognition of the rise in the value of documentary letters of credit, which are also simply known as ‘letters of credit’.² The role of documentary letters of credit becomes more apparent in cases of international trade³ as they are regularly described as the ‘lifeblood’ or ‘backbone’ thereof.⁴ The heightened utilisation of documentary letters of credit in international trade transactions is owed to the establishment of the General Agreements on Tariffs and Trade (‘GATT’)⁵ which occurred after the Second World War.⁶

¹ Van Houtte *The Law of International Trade* (1995) 259.

² Chew Choon Teck “Strict Compliance in Letters of Credit: The banker’s protection or bane?” 1990 *Singapore Academic Law Journal* 70.

³ Van Houtte 1. International trade law contains legal rules relating to transnational commercial transactions and the financial relations that go hand-in-hand with such transactions; thus rendering it a very broad subject as it encompasses rules pertaining to international law as well as domestic (national) law.

⁴ Schulze “The UCP 600: A New Law Applicable to Documentary Letters of Credit” 2009 *SA Merc LJ* 228.

⁵ Van Houtte 51-52 and 91. The author writes that after the Second World War the regulation of international trade and the establishment of an *International Trade Organisation* were paramount. There was a demand for the regulation of tariff and non-tariff restrictions imposed on trade as well as rules regarding fair trade practices - Article 46 of the Charter of Havana contained a thorough regulation of the latter. Unfortunately, the Charter of Havana, despite its great ambitions, never came into effect due to a lack of confidence and support from the United States of America. However, a part of the Charter namely GATT, was granted provisional effect from 1 January 1948 by a *Protocol for provisional application*. The initial idea surrounding the establishment of GATT was that it would serve as a provisional regulation until the Charter came into effect.

⁶ Chew Choon Teck 1990 *Singapore Academic Law Journal* 70.

Chew Choon Teck writes that the accelerated advancement of technology, in both communication and transportation systems, is another factor that contributed to the utilisation of documentary letters of credit.⁷ This is so because it resulted in banks having to adopt the role of intermediaries in the facilitation and consummation of international contracts.⁸ Kelly-Louw agrees with the aforementioned as she opines that the expansion of international trade practices resulted in the traditional method of furnishing a cash deposit⁹ becoming more restrictive as a result of it being too expensive to comply with.¹⁰ Contractors, exporters, sellers etc. soon realised the burden their cash flow would have to bear if they were to raise funds in order to settle the cash deposit themselves.¹¹ The reliance on financial institutions for assistance stems from this realisation and has since been incorporated into a convenient, more reliable and safer practice: the utilisation of documentary credit letters.¹²

In order to contextualise the topic and discussion, a closer look at the types of documentary letters of credit and the rules applicable thereto follows.

1 1 Commercial Letters of Credit versus Standby Letters of Credit

Horowitz quotes a segment of an essay that was published in 1991 by Goode in which he describes the features of an abstract payment undertaking as:

“a money promise which is independent of the transaction that gives it birth and which is considered binding when received by the beneficiary (or sometimes even when issued by the promisor) without acceptance, consideration, reliance, or execution in solemn form.”¹³

Therefore the two main characteristics that an abstract payment undertaking ought to exhibit are: firstly, the payment undertaking is independent from the underlying contractual agreement between the relevant parties thus granting the payment undertaking an

⁷ *Ibid.*

⁸ *Ibid.*

⁹ Traditionally a cash deposit served as a form of security indicating that the counterparty to a contractual agreement would in actual fact meet the obligations as stipulated in the contractual agreement.

¹⁰ Kelly-Louw “Initiatives of the International Chamber of Commerce to Prevent Fraudulent Calls on Demand Guarantees and Standby Letters of Credit” 2009 *SA Merc LJ* 710.

¹¹ *Ibid.*

¹² *Ibid.*

¹³ Horowitz *Letters of Credit and Demand Guarantees: Defences to Payments* (2010) 1.

autonomous status.¹⁴ Consequently, this precludes the debtor from relying on defences that stem from the underlying contractual agreement and further enables the marketing of the money claim as an unconditional source of payment.¹⁵ The latter is important to note because a vital characteristic of an abstract payment undertaking is that it is 'conditioned by the terms of the document in which it is contained'.¹⁶ Secondly, the payment undertaking will take effect even if the traditional elements that give rise to an obligation are absent.¹⁷

In her book, Horowitz addresses the two instruments that Goode categorised as abstract payment undertakings namely; commercial letters of credit and demand guarantees.¹⁸

A demand guarantee is often a brief and very simple instrument issued by a financial institution under which the obligation to pay to a beneficiary a stipulated amount of money (either fixed or not) arises only when a demand for such payment is made in the prescribed form within the period of the validity of the guarantee.¹⁹ In addition to the abovementioned, the beneficiary under a demand guarantee may be required to furnish the stipulated documents as set out in the guarantee in order for the guarantee to come into effect.²⁰ Demand guarantees are regarded as a substitute for cash deposits as not only must they be honoured upon presentation of the prescribed written demand; they also provide the beneficiary with a monetary remedy in instances where the principal is in breach.²¹ The notion behind the demand guarantee transaction, much like the commercial letter of credit, is that if all the required documents are presented in accordance with the terms of the guarantee then the bank is obliged to pay, failing which the bank must not pay. The demand guarantee therefore shares a number of characteristics with the commercial and standby letter of credit.²²

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Ibid.*

¹⁸ Horowitz 2.

¹⁹ Kelly-Louw 2009 SA Merc LJ 306.

²⁰ *Ibid.*

²¹ Kelly-Louw 2009 SA Merc LJ 307.

²² *Ibid.*

Commercial letters of credit, otherwise known as ‘letters of credit’ or ‘documentary credits’, involve an undertaking by a financial institution to pay a beneficiary upon presentation of the stipulated documents by the beneficiary.²³ Suffice it to say that the issuing bank is in no way bound by the underlying contractual agreement between the beneficiary and the principal thus any disputes between the latter parties that may surface do not affect the credit.²⁴ This simply means that a beneficiary may enforce a letter of credit, in the absence of fraud²⁵, even in instances where he has failed to satisfy his obligations as set out in the contractual agreement.²⁶

It is important to note the following features of commercial letters of credit: a commercial letter of credit is transferable to a second beneficiary provided that the issuing bank expressly designated it as transferable.²⁷ Furthermore, a letter of credit must be distinguished as either revocable or irrevocable and in cases where such distinction is not clear, it is deemed irrevocable.²⁸ Gozlan submits that most sellers often opt for irrevocable letters of credit for the very reason that they secure payment upon presentation of the stipulated documents, subject to them conforming to the terms and conditions of the letter of credit.²⁹

Although standby letters of credits are essentially the same type of instrument as the demand guarantee, their historical background and development differs greatly.³⁰ Standby letters of credit hail from the banks in the United States of America and their establishment was based on the premise that they would serve as an elongation of the traditional commercial letter of credit as it was used in international trade.³¹ Kelly-Louw

²³ *Ibid.* The documents presented by the beneficiary at the time of payment must strictly comply with the stipulated terms and conditions of the letter of credit. This is discussed further in par 2 1 below.

²⁴ Gozlan *International Letters of Credit: Resolving Conflict of Law Disputes* (1999) xx-xxi.

²⁵ This will be explained in par 2 2 below.

²⁶ Horowitz 2.

²⁷ Gozlan xxi.

²⁸ *Ibid.* A revocable letter of credit is one which can be revoked at any time up to the moment when the seller presents the stipulated documents. Whereas an irrevocable letter of credit is one which is final and can only be annulled upon agreement of all the parties to the transaction or upon proof of a “strong *prima facie* case of fraud” in the documents presented by the seller to his bank.

²⁹ Gozlan xxii.

³⁰ Kelly-Louw 2009 *SA Merc LJ* 711.

³¹ *Ibid.*

furnishes a reason for this namely; that these banks established the use of standby letters of credit due to the accepted construction of the United States' National Bank Act of 3 June 1864 (as amended) which prevented the US banks from issuing guarantees as part of their ordinary course of business and thus they adopted the phrase 'standby letters of credit' to deflect from the supposed language of guarantees.³² The rest of the world soon followed suit as countries whose banks were similarly forbidden to issue guarantees also began to make use of standby letters of credit in their international transactions.³³

It has since become common practice for international buyers with strong bargaining powers to request either a standby letter of credit or a demand guarantee from the supplier which serves as security indicating that the terms of their contractual agreement will be fulfilled.³⁴ It becomes clear that both these legal instruments serve to circumvent and further penalise unsatisfactory performance as well those instances in which either party to a contractual agreement operates with bad faith.³⁵

Pursuant to the aforementioned brief introduction to the role of these international payment instruments, it is necessary to provide background information with particular reference to the legal doctrines applicable thereto and finally, a look into the fraud exception set in place to counter the payment.

1 2 Nature and Scope of Dissertation

The nature of this dissertation comprises of an assessment into whether the amendments effected by the UCP 600, particularly with regard to the doctrine of strict compliance, have been effective. This aspect is crucial when one takes cognisance of the dissatisfaction of

³² *Ibid.*

³³ *Idem* 712.

³⁴ Kelly-Louw 2009 *SA Merc LJ* 712. The author acknowledges that this form of security has become an established section of international trade and that both instruments are often used in construction, engineering projects and international sale contracts. She further notes that both instruments are legal instruments used to serve as a guarantee "...eg, a buyer or employer (commonly referred to as the 'beneficiary' of the guarantee or standby letter of credit) – that the seller, exporter, supplier or contractor (commonly referred to as the 'principal' of the guarantee or the 'applicant' of the standby letter of credit) will either not prematurely withdraw from his tender (in the case of a tender guarantee or tender bond standby letter of credit), or will perform his obligations arising under the underlying contract (in the case of a performance guarantee or performance standby letter of credit), and is, purportedly, technically and financially capable of performing the underlying contract in line with its provisions."

³⁵ *Ibid.*

key role players in a letters of credit transaction. Issues pertaining to how stringent the doctrine is and the threat it posed to the continued utilisation of letters of credit contributed to the revaluation thereof. The scope of this assessment is, however, limited to the position which South African courts' have taken in interpreting and applying the doctrine to letters of credit.

1 3 Methodology

The methodology for purposes of this research will consist of a review of legislation and legislative and policy instruments, text books, journal articles and court cases. The approach will be that of a critical analysis.

1 4 Chapter Lay-Out

The dissertation consists of four chapters. Chapter One is an introduction to the study and provides a roadmap of the dissertation. Chapter Two uncovers the background information regarding letters of credit, their regulation and the legal doctrines applicable thereto. Chapter Three is subdivided into two parts namely; Part A and Part B. The former delves into the prominent amendments of the UCP 500 as found in the UCP 600. While the latter, considers the application of the doctrine of strict compliance in South African courts. Lastly, chapter four consists of remarks and recommendations based on the findings of the research conducted throughout the writing process of this dissertation.

Chapter Two: Regulation of Letters of Credit

2 Background Information on Letters of Credit

2.1 Introduction

Letters of credit hail from “open” or “travellers” letter of credit and were established at the beginning of the nineteenth century.³⁶ The open letter or travellers’ letter of credit was produced by a banker (or merchant) to a person travelling abroad. This letter was addressed to the banker’s correspondents and promised them reimbursement for monies advanced to the holder of such letter (beneficiary).³⁷ This payment facility was the first of its kind³⁸; it served as an introduction of the ability to secure payment of the purchase price of goods shipped by the seller in one part of the world to the buyer in another. Security was obtainable with the previous system and was achieved if the seller could procure payment, before shipping the goods, issued by a third party who was of sound reputation (a case of suretyship).³⁹ Unfortunately, this task seemed nearly impossible to do hence the “open letter of travellers’ letter of credit” quickly gained popularity and it was the interposition of the third party that led to the development of letters of credit as we know them today.⁴⁰

The utilisation of letters of credit increased manifold from the end of the First World War.⁴¹ The continued reliance on letters of credit in international trade rendered uniformity in the use thereof, as paramount. Such uniformity is governed by the Uniform Customs and Practice for Documentary Credits⁴², a set of rules initiated in 1929 by the

³⁶ Ellinger and Neo 1. The earlier version is suspected to have originated in Italy during the thirteenth century and was sufficiently popular in England during the seventeenth and eighteenth century to be discussed in commercial texts.

³⁷ *Ibid.*

³⁸ Prior to this payment facility, payment was effected by the attachment of the bill of lading for the goods to a bill of exchange drawn on the buyer. This system was, however, flawed as goods were shipped on the reliance of the buyer’s promise to accept and pay the bill of exchange. If he was unable to the seller had no choice but to resell the goods in the foreign country to which they had been shipped. See Ellinger and Neo 2.

³⁹ *Ibid.*

⁴⁰ For more on this refer to Ellinger and Neo 2 – 3.

⁴¹ Ellinger and Neo 3.

⁴² Hereinafter referred to as “UCP”.

Congress of the International Chamber of Commerce⁴³ in Amsterdam.⁴⁴ Initially, the set of regulations were only adopted by France and Belgium.⁴⁵ A revised version of the text followed in 1933 and was eagerly adopted by a vast majority of bankers in European countries and by a few banks in the United States.⁴⁶

The Code underwent yet another revision in 1951 which was adopted by the International Chamber of Commerce (ICC's) 13th Congress held in Lisbon and was further adopted by bankers in a number of countries in Africa, America, Asia, and Europe.⁴⁷ The Code was, however, rejected by a number of banks in the United Kingdom the immediate result of which was that the practice regarding letters of credit were divided into the British and the UCP practice.⁴⁸ Ellinger and Neo remark that naturally, the existence of two distinct systems of letters of credit resulted in an immense amount of pressure on international banking practice which necessitated a form of compromise which was agreed upon in 1962 when the UCP underwent further revision.⁴⁹

Notably, the UCP is the centre-piece, the only universally recognised source of law that regulates all practices in respect of letters of credit. The following paragraphs refer to the UCP in order to establish the legal doctrines that are applicable to letters of credit, as found therein.

2 2 Legal Doctrines Applicable to Letters of Credit

2 2 1 The Principle of Autonomy

Article 4(a) of the UCP 600 unequivocally provides that a credit, by its nature, forms a separate transaction from the sale or any other contract from which it originates.⁵⁰ It further stipulates that banks are to deal with documents only and not the goods, services or performance to which the documents relate, thus restricting the effects any potential

⁴³ Hereinafter referred to as "the ICC".

⁴⁴ Ellinger and Neo *The Law and Practice of Documentary Letters of Credit* (2010) 23.

⁴⁵ *Ibid.*

⁴⁶ *Ibid.*

⁴⁷ Ellinger and Neo 24.

⁴⁸ *Ibid.* For a more detailed discussion please see Chapter Two from page 22.

⁴⁹ Ellinger and Neo 25. More on this in Chapter Three titled "Recent Developments under the UCP 600 and the South African Courts' Interpretation of the Doctrine of Strict Compliance", paragraph 3.1.

⁵⁰ Ellinger and Neo 138.

disputes surrounding the underlying contractual agreement may have on the various parties to the contractual agreement.⁵¹ This therefore renders the bank's obligation to pay the beneficiary under the letter of credit as independent from the underlying contractual relationship between the applicant and the beneficiary.⁵²

This is the case even in instances where the bank has knowledge of some or other discrepancy, such as the shipment of defective goods, which would ordinarily invalidate the payment due. The bank is still obliged to honour all its obligations under the letter of credit on the sole condition that the required documents are presented, subject to the fraud exception, discussed below in paragraph 2.3, which serves as the only exception to the autonomous principle.⁵³

The *locus classicus* for this principle is the case of *Sztejn v J Henry Schroder Banking Corporation*⁵⁴ where Shientag J put it as follows:

It is well established that a letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade. One of the chief purposes of the letter of credit is to furnish the seller with a ready means of obtaining prompt payment for his merchandise. It would be a most unfortunate interference with business transactions if a bank, before honouring drafts drawn upon it, was obliged or even allowed to go behind the documents at the request of the buyer, and enter into controversies between the buyer and the seller regarding the quality of the merchandise shipped. If the buyer and the seller intended the bank to do this, they could have so provided in the letter of credit itself, and in the absence of such provision, the Court will not demand, or even permit, the bank to delay paying drafts which are proper in form.⁵⁵

The premise for the principle of autonomy originates from the simple fact that the role of letters of credit in international trade was to assure the seller that upon presentation of the required documents, he would receive his payment before passing over control or

⁵¹ *Ibid.*

⁵² *Ibid.*

⁵³ *Ibid* and Van Houtte 273.

⁵⁴ (1941) 31 NYS 2d 631

⁵⁵ Sharrock *et al The law of Banking and Payment in South Africa* (2016) 422.

possession of the goods.⁵⁶ Due to the fact that the contractual relationship concerns a matter of international trade, such assurance is indispensable to the seller because the buyer is often from a different country and any other alternative methods of recovering the said payment would be troublesome for the buyer.⁵⁷ The principle therefore ensures that once the seller has complied with the terms and conditions of the credit, he is automatically entitled to payment irrespective of (i) whether he has performed his obligations as per the contract of sale or (ii) whether the issuing bank will be reimbursed by the buyer once it has made payment.⁵⁸

The result is that if a dispute surrounding the underlying contractual agreement arises, it is for the applicant to seek redress against the beneficiary by lodging a separate action and not by withholding any part of the payment agreed upon.⁵⁹

2 2 2 The Doctrine of Strict Compliance

Viscount Sumner certainly left a mark in legal history when he made the following statement in *Equitable Trust Company of New York v. Dawson Partners Ltd*⁶⁰, which continues to resonate with each generation of lawyers.⁶¹ The renowned judge indicated that:

It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorized to accept are in the matter of the accompanying documents strictly observed. There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines.⁶²

When one takes cognisance of the restriction of the bank's discretion in examining the documents presented for payment, it becomes clear that the sole purpose of the doctrine of strict compliance is to protect the buyer.⁶³ It does so by limiting the likelihood that the

⁵⁶ Ellinger and Neo 139.

⁵⁷ *Ibid.*

⁵⁸ Sharrock *et al* (2016) 422.

⁵⁹ Ellinger and Neo 139.

⁶⁰ [1926] 27 LLR 49 as found in Chew Choon Teck 1990 *Singapore Academic Law Journal* 70.

⁶¹ Chew Choon Teck 1990 *Singapore Academic Law Journal* 70.

⁶² *Ibid.*

⁶³ Chew Choon Teck 1990 *Singapore Academic Law Journal* 71.

unprincipled seller may be concealing fraud or any other act of bad faith in the underlying contractual agreement.⁶⁴ Because at the end of the day, the buyer's main concern is whether the seller has shipped the goods that were agreed upon in the underlying contractual agreement before the buyer becomes obligated to settle the credit.⁶⁵ Sadly, the mere presentation of conforming documents does not entirely guarantee that the seller has complied with his end of the bargain, but it does offer the buyer some form of assurance that the seller has shipped the desired goods.⁶⁶

The bank, be it the advising⁶⁷, confirming⁶⁸ or the nominated bank⁶⁹, essentially acts as an agent of the issuing bank which in turn, acts as an agent of the buyer.⁷⁰ Krazovska highlights that it is commonly known in the law of contracts, that where an agent with limited authority acts *ultra vires* (beyond the scope of his authority) the principal is entitled to renounce the act of the agent and thus render him (the agent) personally liable for the transaction.⁷¹

Krazovska further acknowledges that international trade is so intricate that it often happens that the banks, who as previously mentioned act as agents of the buyer, do not fully comprehend all the technical terms used in the relevant documents.⁷² Especially because most of these terms are interchangeable.⁷³ In light of this, Krazovska opines that

⁶⁴ *Ibid.*

⁶⁵ Krazovska Impact of the Doctrine of Strict Compliance on a Letter of Credit Transaction (Master's Thesis 2008 University of Aarhus) 24.

⁶⁶ *Ibid.*

⁶⁷ Houtte 259; Gozlan 7. The issuing bank often authorises a bank that is established in the seller's (beneficiary) country to examine the specified documents and to further accept, negotiate or pay the seller. This is known as the advising bank. Important to note that the advising bank has no obligation toward the seller, instead it has a duty towards the issuing bank to advise the letter of credit.

⁶⁸ Gozlan 7. When a bank confirms a letter of credit, it commits itself to the seller that either of the following will occur: it will pay the stipulated amount upon presentation of the said documents or to confirm that the letter of credit issued by the issuing bank will be honoured.

⁶⁹ Houtte 259. In instances where the issuing bank is without a branch or subsidiary in the seller's country, the bank will be obliged to identify a local bank with which it conducts business with on a regular basis and subsequently appoint that bank as a nominated bank, also known as a correspondent bank.

⁷⁰ Krazovska 11.

⁷¹ *Ibid.*

⁷² Krazovska 12.

⁷³ *Ibid.*

it is highly inappropriate to expect a bank to undertake the task of determining whether the goods described in the draft are actually the same as those delivered.⁷⁴

Therefore, under the doctrine of strict compliance, banks deal with the financial aspect of the transaction and not in goods as they normally have little to no expert knowledge of the particular trade.⁷⁵ Hence such a heavy burden is placed on them to strictly follow the instructions given by the buyer throughout their examination of the presented documents. Whether or not the documents presented conform to the terms and conditions of the letter of credit, international banking practice and the relevant provisions of the UCP rules is determined on a *prima facie* basis which must be attained in good faith and in an honest manner.⁷⁶

It is for the courts to establish whether any existing discrepancies between the documents presented and the letter of credit warrant the banks the right to reject the documents and to refuse to make the payment.⁷⁷ The most popular approach that the courts have adopted, after interpreting the UCP rules, is the “strict compliance standard” while the remaining few have interpreted the standard as “allowing deviations that do not cause ostensible harm”.⁷⁸ This standard is otherwise known as “substantial compliance” which basically holds that if, from all the documents presented to the bank by the seller there is: firstly, substantial compliance with the terms and conditions of the letter of credit and secondly, there is no possibility that the submitted documents could mislead the bank to its own detriment. If both requirements are met, then there is compliance with the letter of credit.⁷⁹ Krazovska is of the opinion that if courts simply utilise a “mirror-image interpretation”, this would inevitably create loopholes and thus grant dubious issuing banks the power to refuse payment based on minor discrepancies such as missing punctuation marks.⁸⁰ The relaxation of the doctrine is discussed in Part B of Chapter 3 under paragraph 3 2 1.

2 3 Defences to Payment

⁷⁴ *Ibid.*

⁷⁵ *Ibid.*

⁷⁶ Chew Choon Teck (1990) 71; Krazovska 11.

⁷⁷ Krazovska 23.

⁷⁸ *Ibid.*

⁷⁹ Kang J What Should be the Limitations of the Doctrine of Strict Compliance? (2008) 1 Asian Bus. Law. 97

⁸⁰ *Ibid.*

Fraud is marked as an important exception to the principle of autonomy.⁸¹ Where it exists, a bank is required to look behind the documents and refuse to tender payment to the seller despite the documents' facial conformity. The rationale behind the fraud rule is:

a) To close a loophole in the law:

The parties involved in a letter of credit transaction do not deal with the goods and services that gave rise to the letter of credit but solely with the documents related thereto. Where the presented documents comply with the terms and conditions of the letter of credit, the bank is obliged to honour its payment to the seller.⁸² However, the principle of autonomy can be regarded as counterproductive when there is fraud in the transaction⁸³; the distinction between the underlying transaction and the letter of credit creates a loophole in the law because all that is required are documents that conform to the terms and conditions of the letter of credit. It is immaterial whether the seller may have breached the underlying transaction as evidenced in the *Phillips*⁸⁴ case. The fraud rule was therefore created to minimise this effect.⁸⁵

b) To protect public policy from the control of fraud:

"...there is as much public interest in discouraging and limiting fraud as there is in encouraging and promoting the use of Letters of Credit."⁸⁶ The rationale behind the fraud rule is that it cannot be in the interest of justice for a dishonest seller, who defrauds the buyer, to receive payment by relying on the principle of autonomy.⁸⁷

c) And finally, to maintain the commercial utility of letters of credit:

⁸¹ Ellinger 139. The UCP does not make provision for the fraud exception, instead the exception is generally embedded in the domestic law of the country in which it applies.

⁸² This is otherwise known as the principle of autonomy as discussed in paragraph 2.2.1 above.

⁸³ Discussed in more detail in paragraph 2.3.2 below.

⁸⁴ *Phillips & Another v Standard Bank of South Africa Ltd & Others 1985 (3) SA 301 (W)*. In this case the court declared that a mere (innocent) breach of the underlying transaction by the seller does not entitle the buyer to restrain the bank from making payment to the seller by way of an interdict. This judgment is often brought under fire because the court deliberately refrained from making any comments on the extent to which or even the circumstances under which the fraud exception would be considered.

⁸⁵ Fieties L Letters of Credit – The Fraud Exception: A Time for Conformity (Masters Thesis 2013 University of the Western Cape) 12.

⁸⁶ The case of *Dynamics Corporation of America v The Citizens and Southern National Bank 356 F Supp 991 (ND Ga 1973) 1000* as found in Fieties L (2013) 12.

⁸⁷ *Ibid* at 13.

The admiration of letters of credit is rooted in the good faith of its users and it therefore goes with saying that the existence of fraud in the international trade market will have adverse effects on the status of these payment instruments.⁸⁸ Letters of credit allow parties to contract on equal footing thus creating a fair balance of competing interests; The buyer is shielded from any inappropriate calls on the credit due while the seller is guaranteed access to the credit due to him.⁸⁹ Fraud poses a threat to this balance hence the application of the fraud rule – to restrict the effect that fraudsters have on the commercial utility of letters of credit.

When discussing the relationship between fraud and letters of credit, traditionally, one ought to consider the decision in *Sztejn v J Henry Schroder Banking Corp*⁹⁰. Horowitz points out the fact that the court in the aforementioned case, which paved the way for the decisions in later cases, first relied upon the autonomy principle before turning to the infamous defence of fraud.⁹¹ The simplified facts of the case are as follows:

The buyer purported that the seller deliberately shipped cow-hair, rubbish and other useless materials in place of the bristles that were agreed upon in the contract of sale, all in an attempt to defraud the buyer.⁹² The buyer's application to the Supreme Court of New York for an injunction to stop the issuing bank from delivering payment to the seller was successful.⁹³ The buyer further alleged that the documents accompanying the draft were "fraudulent" in that they did "not represent actual merchandise but instead cover[ed] boxes fraudulently with worthless material".⁹⁴ The seller's confirming bank, Chartered Bank, sought to have the matter dismissed on the basis that the facts provided were not sufficient to constitute a cause of action and that as the confirming bank, it was "only concerned with the documents on their face and on their face these conform[ed] to the requirements of the letter of credit".⁹⁵ The court had to ponder on the issue of whether fraud could permit non-payment under the letter

⁸⁸ Smith GWL "Irrevocable Letters of Credit and Third Party Fraud: The American Accord" (1983) 24 *Virginia Journal of International Law* 55 96.

⁸⁹ Fieties L (2013) 13.

⁹⁰ 31 NYS 2d 631 (1941) as found in Horowitz 15.

⁹¹ Horowitz 15.

⁹² Ellinger and Neo 140.

⁹³ *Discount Records Ltd. v. Barclays Bank Ltd.* (1975) 1 W.L.R. 315 as found in Van Houtte 274. The facts of this case were similar to those of *Sztejn* to the extent that the buyer's application to prevent payment by the bank was declared unfounded because the buyer was unable to prove actual fraud.

⁹⁴ Horowitz 16.

⁹⁵ *Ibid.*

of credit or whether documents which *prima facie* appeared to conform to the requirements of the letter of credit, were sufficient to require payment.⁹⁶

The presiding judge, Shientag J, commenced by portraying a strong adherence to the principle of autonomy as seen by the quote in paragraph 2 2 1⁹⁷ but went further to say:

This is not a controversy between the buyer and the seller concerning a mere breach of warranty regarding the quality of the merchandise; on the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect unscrupulous seller... The distinction between a breach of warranty and active fraud on the part of the seller is supported by authority and reason.⁹⁸

Shientag J went on to impose a noteworthy condition namely; "...the application of this doctrine presupposes that the documents accompanying the draft are *genuine* and conform in terms to the requirements of the letter of credit".⁹⁹ Horowitz submits that as much as Shientag J commenced his judgment with a confirmation of the principle of autonomy, his statement suggests that he was also prepared to admit to the existence of other parts of the spectrum namely; that the presentation of non-complying documents may serve as a justification for non-payment.¹⁰⁰ Shientag J's decision is regarded as the first judicial acceptance of a fraud defence to payment under letters of credit and that, despite the importance of the principle of autonomy, the abstraction of credit may be moderated by a simple application of the fraud defence.¹⁰¹

In South Africa, the fraud exception is found in the common law and is established through case law – much like in the United Kingdom.¹⁰² South African courts distinguish between fraud and an ordinary (innocent) breach of contract and evidence shows that the courts will adopt a wide approach to the fraud exception in order to uphold the principle of autonomy as

⁹⁶ *Ibid.*

⁹⁷ Also found in Horowitz 17.

⁹⁸ *Sztejn v J Henry Schroder Banking Corporation* (1941) 31 NYS 2d 631 at 634-5.

⁹⁹ Horowitz 17.

¹⁰⁰ *Ibid.*

¹⁰¹ Horowitz 18.

¹⁰² Fieties L (2013) 34.

opposed to granting an interdict to prevent a bank from issuing payment where the basis for such interdict is fraud by the seller (beneficiary) in the underlying transaction.¹⁰³

Van Houtte believes that fraud can be classified into three situations and provides modest solutions for each of these situations:

- a) Where a customer applies for an injunction in order to prevent the bank from honouring the credit by purporting that he suspects fraud in the bill of lading but fails to provide evidence thereof. In such instance the bank is still obliged to pay in accordance with the letter of credit.¹⁰⁴ In *Phillips & Another v Standard Bank of South Africa Ltd & Others*¹⁰⁵ the applicant (buyer) had imported shoes from an Italian manufacturer and immediately sought to invoke an interdict to prevent Standard Bank from paying the manufacturer because some of the shoes were defective. The court, however, rejected the application and held that, that constituted a breach of contract between the parties and had nothing to do with the letter of credit.¹⁰⁶
- b) Where fraud has been established to the satisfaction of the bank but the bank is unable to prove that the beneficiary (seller) had knowledge of this fraud. The *House of Lords* in the case of *United City Merchants (Investments) Ltd. v. Royal Bank of Canada*¹⁰⁷ held that:

“...this is a clear application of the maxim *ex turpi causa non oritur actio* or, if plain English is to be preferred, ‘fraud unravels all’. The courts will not allow their process to be used by a dishonest person to carry out a fraud.”¹⁰⁸

It was on this basis that the court accordingly held that the rights of the seller who had not been dishonest would remain protected by the principle of autonomy and would not be influenced by the fraud of a third party of which the seller had been unaware of.¹⁰⁹ The bank was still obliged to pay in accordance with the letter of credit *in casu*.

¹⁰³ *Ibid.*

¹⁰⁴ Van Houtte 274.

¹⁰⁵ 1985 (3) SA 301 (W).

¹⁰⁶ Fieties L (2013) 5.

¹⁰⁷ (1983) 1 A.C. 168 (H.L.) as found in Van Houtte 274.

¹⁰⁸ (1983) 1 AC 168, 184 as found in Ellinger and Neo 141.

¹⁰⁹ Ellinger and Neo 141; Fieties L (2013) 13.

- c) Where the bank has evidence of fraud and the beneficiary has actual knowledge of the fraud: the bank is not obliged to pay in accordance with the letter of credit, provided that the fraud is clearly and unambiguously established.¹¹⁰

A brief discussion of the types of defences that fall under the fraud exception follows.

2 3 1 Fraud in the Documents/ Documentary Fraud

Fraud in the documents/ documentary fraud is otherwise known as “fraud in the narrow sense” and occurs when the seller presents documents to the bank which contain a material false representation.¹¹¹ With regards to commercial letters of credit, the phrase “fraud in the documents” encompasses both forged documents and fraudulent documents with incorrect data or other deceptive particulars.¹¹² Needless to say that both forged and fraudulent documents with distorted particulars are regarded as non-conforming as they simply do not comply with the terms and conditions of the letter of credit. A bank is therefore entitled to refuse to honour the credit.¹¹³ This fact is illustrated by an observation that was made by the court in *Bank of Nova Scotia v. Angelica-Whitewear Ltd et al*¹¹⁴ namely; “[t]he general rule with respect to fraud is that a bank is not responsible for payment against forged or false documents which appear on their face to be regular.”¹¹⁵

2 3 2 Fraud in the Transaction

Chhina refers to a statement made by Raymond Jack which holds that “fraud in the transaction” is “an extension of the exception to a situation where the documents presented are truthful but there is fraud in the underlying transaction”.¹¹⁶

It is therefore pivotal that a clear distinction be drawn between the “fraud in the documents” defence and the “fraud in the transaction” defence because the fraudulent representation in the former exhibits itself in the documents whereas in the latter it is linked to the underlying

¹¹⁰ Van Houte 274.

¹¹¹ Ngoma W Towards a More Flexible Approach to the Fraud Exception in Letters of Credit under South African Law: A Comparative Analysis with Select Common Law Approaches and the UNCITRAL Convention (Masters Thesis 2015 University of Cape Town) 23.

¹¹² Chhina 33.

¹¹³ *Ibid.*

¹¹⁴ [1987] 1 S.C.R. 59 as found in Chhina 33.

¹¹⁵ *Ibid.*

¹¹⁶ Chhina 47.

transaction and occurs where the seller knowingly submits a demand for payment when he is not entitled to payment under the underlying transaction.¹¹⁷

Chhina further submits that the “fraud in the documents” defence should not be narrowly interpreted for standby letters of credit by limiting the fraud enquiry to the presented documents but that the enquiry should be extended to allow for the underlying contractual agreement to be taken into consideration.¹¹⁸ Logically, this makes sense because standby letters of credit often require the presentation of fewer documents in comparison to those required for commercial letters of credit.¹¹⁹ This would in turn render it challenging to determine any fraudulent acts relating to documentary fraud by the beneficiary under the standby letter of credit without a proper examination of the underlying contractual agreement.

Having learnt about the legal doctrines that are applicable to letters of credit transactions, the principle of autonomy and the doctrine of strict compliance - both of which are embedded in the UCP 600, Article 4(a) and Article 14 respectively, and that the fraud exception is not provided for in the UCP 600, it seems appropriate to have a look at some of the revised provisions of the UCP 600. It is for that reason that the next chapter focuses on the UCP 600’s recent developments and the impact that the new rules have had on the application of letters of credit and further discusses aspects relating to the doctrine of strict compliance, particularly the application thereof in South Africa.

¹¹⁷ Chhina 46; Ngoma W (2015) 23.

¹¹⁸ Chhina 33.

¹¹⁹ *Ibid.*

Chapter Three: UCP 600 and the Doctrine of strict Compliance in South Africa

Part A: Recent Developments under the UCP 600

3 1 Background on the UCP 600

There is currently no comprehensive treaty that serves as a source of law for letters of credit. The primary sources of law for international letters of credit are; the Uniform Customs and Practice for Documentary Credits¹²⁰ (the “UCP”) and in the United States of America, article 5 of the Uniform Commercial Code (hereafter the “UCC”).¹²¹ The first UCP was published in 1933 and has undergone periodic revision ever since.¹²²

The first domestic attempt to harmonise and unify the legal principles and banking practices applicable to letters of credit dates back to after the First World War.¹²³ The first step toward an *international* standardisation was inducted by the 1929 Congress of the International Chamber of Commerce and the set of regulations were adopted in France and Belgium. A revised version of the text was adopted by the ICC’s 7th Congress, held in Vienna in 1933,

¹²⁰ The UCP is issued by the International Chamber of Commerce (ICC) which is a nongovernmental business organisation that represents every industry from all parts of the world. The primary objective of the ICC is to “promote trade and investment across frontiers” but the rules issued thereby remain voluntary, including those established in the UCP. Therefore, the UCP does not enjoy an automatic application and only applies to letters of credit in which the parties thereto agree that it (the letter of credit) be subject to the rules of the UCP. The effect of which is that the rules are binding on the parties unless “expressly modified or excluded by the credit”. It is advisable that the parties expressly stipulate which version of the UCP is applicable to their letter of credit so as to avoid any confusion.

¹²¹ The UCC acknowledges that parties to a letter of credit that is otherwise governed by the UCC may exclude the rules/ provisions of the UCC in favour of the UCP.

¹²² Doise D “The 2007 Revision of The Uniform Customs and Practice for Documentary Credits (UCP 600)” *Int’l Bus. L.J* (2007) 110. The UCP was revised in the following years; 1951, 1962, 1974, 1983 and 1993 (this version came into effect on the 1st of January 1994 and is known as the UCP 500).

¹²³ Ellinger and Neo 23. The New American Commercial Credit Conference (1920) took place in New York and established a set of regulations to be utilised for letter of credit transactions carried only within the borders of the USA. Other countries caught wind of this and followed suit, banks in Berlin selected a committee in 1923 to compile regulations and standard forms; France and Norway followed in 1924; Czechoslovakia, Italy and Sweden in 1925; Argentine in 1926; Denmark in 1928 and the Netherlands in 1930.

and was adopted by the bankers in a few European countries and by some banks in the USA, on an individual basis.¹²⁴

The Code was subjected to an exhaustive revision in 1951 and was adopted by the ICC's 13th Congress held in Lisbon as well as bankers in a number of countries in Asia, Africa, Europe and America. The Code was, however, rejected by a significant number of banks in the Commonwealth of Nations and in the UK.¹²⁵ Consequently, the legal practice pertaining to letters of credit was divided into the British and the UCP practice which essentially meant that each division had to familiarise themselves with the practice that was prevalent in the other.¹²⁶ Inevitably the existence of two distinct systems in respect of letters of credit resulted in an immense amount of pressure on international banking practices and it was in 1962 that the ICC formed a committee tasked with the revision of the Code, which was completed in November of that year.¹²⁷ The British Banks were adequately represented, their reservations attended to and the new version which came into effect on the 1st of July 1963 was not only adopted by its previous participants but also by the British Banks as well as the entire Commonwealth of Nations.¹²⁸

The year 1974 saw yet another revision of the Code not only because it had enjoyed a decade's worth of world-wide application and was in need of an update, but also due to the fact that there were some serious concerns about the Code being adopted by countries which had played no role in its promulgation.¹²⁹ It was ultimately decided that any proposals made by the ICC would have to be scrutinised by the United Nations Commission on International Trade Law (UNCITRAL) thus enabling banking organisations to make contributions to the

¹²⁴ *Ibid.*

¹²⁵ *Idem* 24. The British Banks' reservations stemmed from a number of reasons: firstly, there was a general consensus that the law pertaining to letters of credit was not ready for any form of codification as that would have a detrimental effect on the development of new (international) trade practices. Secondly, the banks were opposed to certain provisions in the Code particularly article 15, which contained a list of documents that had to be presented in the absence of express/explicit stipulation in the documentary credit. The British Banks were of the opinion that a letter of credit should be issued only if the account party gave comprehensive details on this point in the application form. In addition, the British Banks were opposed to article 28 which required the presentation of an insurance certificate as opposed to a policy certificate.

¹²⁶ *Ibid.*

¹²⁷ Ellinger and Neo 25.

¹²⁸ *Ibid.*

¹²⁹ *Ibid.*

Code. The following years presented a series of new problems such as technological advancements which led to the introduction of electronic documents and subsequently necessitated the need to revisit the Code's provisions and so the 1983 revision occurred.¹³⁰

The UCP 500 was first published in 1993 and although the current version's text was approved on the 25th of October 2006, the UCP 600 only came into effect of the 1st of July 2007 and has replaced the UCP 500 in its entirety.¹³¹ The drafting and promulgation of the UCP 600 is largely owed to the heightened technical rejections of documents under the UCP 500 commercial credits, which sat at an unprecedented seventy percent of first presentation.¹³² Accordingly, this statistic had "a negative effect on the letter of credit being seen as a means of payment, [which] could have serious implications for maintaining or increasing its market share as a recognized means of settlement in international trade."¹³³ Furthermore, the 2006 revision addresses modern advancements in all the relevant industries; banking, transport and insurance and lastly, the language and structure of the UCP 600's predecessor was in dire need of change because it often resulted in an inconsistent application and interpretation of the UCP.¹³⁴

Having been subjected to such rigorous revisions, this chapter seeks to explore whether the seventh revision to the UCP has been efficient in resolving any previous issues that were experienced during the reign of the UCP 500.

3 2 The Legal Effect of the UCP

As previously discussed, the UCP are a set of rules that were issued by the ICC with the hope of creating a uniform and standardised set of terms which would govern the manner in

¹³⁰ Ellinger and Neo 26. This is otherwise known as the UCP 400.

¹³¹ Manganaro NP "About-Face: The New Rules of Strict Compliance Under the Uniform Customs and Practice for Documentary Credits (UCP 600)" 14 *Int'l Trade & Bus. L. Rev.* (2011) 279-280; *supra* n 3.

¹³² Wood JS "Drafting Letters of Credit: Basic Issues under Article 5 of the Uniform Commercial Code, UCP 600, and ISP98 (2008)" 125 *Banking L.J* 104; Sutton WB "The Documentary Credit Phoenix" (2012) 37 *DAJV Newsl.* 63.

¹³³ Sutton WB (2012) 63. An explanation for the unsound levels of rejected presentations could be the debut of a discrepancy fee. It is suggested that banks were amped to make questionable and erratic rejections with the sole purpose of collecting this fee. This in turn, explains the notion as to why the UCP 600 is now more favourable for trade customers as opposed to banks/ issuers of letters of credit.

¹³⁴ *Ibid.*

which banks may issue letters of credit.¹³⁵ In addition to the above mentioned, the inspiration behind the compilation of the UCP was to enable the standardisation of the interpretation of documentary credit practice and to further regulate certain aspects of documentary credits, excluding the relationship between the applicant (buyer) and the issuing bank (this exception is owed to the autonomy principle).¹³⁶

The UCP are predominantly intended to serve as a guideline for banking practice in respect of letters of credit and consequently do not provide a thorough acknowledgment of legal rights and duties. This in turn, leaves room for countries to fill in the gaps through the application of their national legislation. Although the UCP has received a worldwide acceptance they are still not regarded as law and they are neither a statute nor a code.¹³⁷ Rather they are a set of private compilations of rules that were sampled by businessmen, the terms and conditions of which are only applicable if the parties expressly agree to their application.¹³⁸ Article 1 of the UCP 600 accredits this view and based on the wording found therein namely; that the UCP “shall be incorporated into each documentary credit by wording in the credit indicating that such credit is issued subject to” the UCP (the date or version of which should be clearly stipulated), it is contended that the draftsmen would not have incorporated a provision such as this if it were believed that the UCP had become an independent source of law.¹³⁹

Conversely, while technically not regarded as law, the UCP is granted the force of law because of the hefty reliance on the rules stipulated therein and the recent evolvement of the UCP which now contains definitions and coverage on party liability and responsibility, both of which are general characteristics of statutes.¹⁴⁰ The UCP are therefore considered to be “*de facto* law” or “*quasi-law*”; the foundation of the law relating to letters of credit which has rendered them highly recognisable by the courts and legislatures because of their realistic reflection of industry practice.¹⁴¹

¹³⁵ Kelly-Louw *Selective Legal Aspects of and Demand Guarantees* (Unpublished LLD thesis University of South Africa 2008) 100.

¹³⁶ *Ibid.*

¹³⁷ *Idem* 101.

¹³⁸ Ellinger and Neo 44; Woods JS (2008) 106.

¹³⁹ Ellinger and Neo 45.

¹⁴⁰ Kelly-Louw (2008) 101.

¹⁴¹ *Ibid.*

3 3 The Main Amendments (Developments) under the UCP 600

3 3 1 Simplified Drafting

The revision of the UCP 600 is described as “innovative” because of the difference in structure and substance in comparison to both the UCP 400 and 500.¹⁴² From a general point of view, the drafting of the UCP 600 has been modified and subsequently simplified as is evidenced by the removal of phrases such as “unless otherwise stipulated in the credit” which had previously appeared seventeen times throughout several corresponding Articles of the UCP.¹⁴³ Another phrase that had also been repeated countless times, “appear on its (their) face”, now makes a single appearance in Article 14(a) of the UCP 600. This particular modification is regarded as “fortunate” because it indorses the banks’ obligation to verify the conformity of any presented documents with the provisions of the letter of credit, whereas a continued repetition of the phrase resulted in confusion as to when such obligation would arise and when not.¹⁴⁴

3 3 2 Layout and Nomenclature

The UCP 500 contained a total of forty-nine provisions, several of which have since been combined so as to reduce the number of provisions in the UCP 600 to a mere thirty-nine.¹⁴⁵ This gave way to a more logical flow of the UCP.

¹⁴² Ellinger and Neo 33; Doise D *The 2007 Revision of The Uniform Customs and Practice for Documentary Credits (UCP 600)* 2007 Int’l Bus. L.J 111. With regards to the drafting of the UCP 600, numerous tasks were tasked to and prepared by a Drafting Group that consisted of members of different nationalities from the *Commission on Banking Technique and Practice* of the ICC namely; G. Collyer, R. Katz, N. Keller, L. Kooy, K. Lehr, O. Malmqvist, P. Miserez, R. Mueller, Chee Seng Soh, D. Taylor and A. Zelenov. A second group referred to as the Consulting Group, also part of the ICC, consisted of more than forty people who were practitioners from both banks and shipping companies with origins from twenty-six countries. Their task was to review and comment on the work completed by the Drafting Group as they were made available.

¹⁴³ Doise D (2007) 111; Ellinger and Neo 33. The phrase “unless otherwise stipulated by the credit” is found in Article 1 of the UCP 600 (which was also included in Article 1 of the UCP 500) and is used to remind the reader that the provisions of the UCP 600 shall only apply if the parties to a letter of credit expressly incorporate it therein. Important to note that revocable letters of credit (Articles 6 and 8 of the UCP 500) no longer fall within the scope of the UCP 600’s ambit. Should parties wish to utilise a revocable credit, it is advised that they incorporate an earlier version of the UCP into their credit.

¹⁴⁴ *Idem* 112.

¹⁴⁵ Doise D (2007) 112.

Doise points out that the draftsmanship of the UCP 600 is regarded to have been influenced by Anglo-American writing. Article 2 contains a list of definitions of the terms that are used in the UCP 600, the benefit of which is two-fold namely; having a “definition” clause circumvents the tedious and often lengthy reiteration of certain words and further assists in clarifying any ambiguities surrounding a particular word and ultimately enables one to better understand letters of credit.¹⁴⁶

An example of the latter, highlighted by Doise, is the word “negotiation” which had the following definition under Article 10(b)(ii) of UCP 500: “giving of value by the bank authorised to negotiate”. Article 2 of UCP 600 now defines it as follows: “negotiation means the purchase of the nominated bank of drafts (drawn on bank other than the nominated bank) and/or documents under a complying presentation, by either advancing or agreeing to advance funds to the beneficiary”.¹⁴⁷ Simply put, the phrase “purchase... to advance money to the beneficiary” has replaced the words “for value” as found in UCP 500.¹⁴⁸

As far as interpretations are involved, a novel Article 3 simply gathers the principles of interpretation that were historically dispersed in different provisions of the UCP 500 such as Article 2 titled “Branches of banks”, Article 30 for signatures and words such as “first class” and Article 46 for expressions with regards to dates.¹⁴⁹

3 3 3 Final Presentation of the Documents/ Completion of the Credit

Article 6(a) provides that a credit must state the bank with which it is available. The article further provides that a credit that is available with a nominated bank is also available with the issuing bank. Therefore where a credit is available at a bank other than the issuing bank, the seller (beneficiary) may present the documents at the issuing bank.¹⁵⁰ The word “available” is, however, not defined in the UCP 600 but according to Ellinger and Neo, a closer analysis

¹⁴⁶ *Ibid.*

¹⁴⁷ Ellinger and Neo 34.

¹⁴⁸ *Ibid.* The former definition was problematic to the extent that “negotiation”, practically, only applied if the legal document (facility) involved the drawing of bills of exchange. The other issue was that the words “for value” were ambiguous. The first issue has been resolved by the new definition which expressly provides that documents may be “negotiated” even if the legal document does not involve the drawing of a bill. It is unclear as to whether or not the second issue has been resolved because the words that follow “purchase” are not as straightforward as one would hope.

¹⁴⁹ Ellinger and Neo 34.

¹⁵⁰ Doise D (2007) 113.

of the word “presentation”¹⁵¹ as found in Article 2 leads to the deduction that “availability” refers to the place at which the documents ought to be presented.¹⁵² Article 6(d)(ii) solidifies the afore reached conclusion as it provides that the place of the bank with which the credit is available is the place for presentation thus the ultimate place for performance is the issuing bank.¹⁵³

3 3 4 Amendments to Letters of Credit

Article 10 is dedicated to resolving any disputes that may occur as a result of the amendments, if any, a letter of credit may have undergone and replaces Article 9(d) of the UCP 500. Article 10(a) provides that a credit can neither be amended nor cancelled without the express agreement of the issuing bank, the confirming bank, if any, as well as the seller (beneficiary). While Article 10(b) stipulates that the issuer is irreversibly bound by an amendment as of the time of its issuance. Presumably, an amendment becomes inoperative and unbinding on any party when it is rejected.¹⁵⁴

Article 10(c) neatly sets out the position of the seller (beneficiary) by stating that the original credit remains operational until he has expressed his acceptance of the amendment to the bank which notified him of it.¹⁵⁵ However, because the amendment is fully enforceable on the issuing bank from the time of its issuance, the beneficiary still has the option to either accept or reject it until presentation of the documents.¹⁵⁶ Finally, Doise points out that Article 10(f) incorporates the solution proposed in Position Paper no.1 of the ICC Banking Commission, dated 1st of September 1994, which essentially disregarded any provision in an amendment that seeks to deem it valid unless rejected within a certain time by the beneficiary.¹⁵⁷

¹⁵¹ Ellinger and Neo 34. “Presentation” is defined as *inter alia* “the act of delivering documents under a credit to the issuing bank or nominated bank”.

¹⁵² *Ibid.*

¹⁵³ Ellinger and Neo 35. A credit must expressly state whether it is available by sight payment (payable at sight), deferred payment (payable at maturity), acceptance or negotiation (the acceptance and payment of the credit) [Article 6(b)].

¹⁵⁴ *Idem* 38.

¹⁵⁵ *Ibid.*

¹⁵⁶ *Ibid.*

¹⁵⁷ Doise D (2007) 113-114; Ellinger and Neo 39.

3 3 5 Principle of Autonomy

The autonomous nature of letters of credit was defined in Article 3 and 4 of the UCP 600's predecessor. The former article, also known as the positive definition, stated that by its nature, the documentary credit was a separate transaction from the underlying transaction it originates from. Whereas the latter, known as the negative definition, provided that all interested parties were to only take the sole documents into consideration and exclude the corresponding goods, services and the like.¹⁵⁸

The positive definition remains and is currently embedded in Article 4(a) of the UCP 600. However, Article 4(b) is more directive in its nature as it instructs the issuer of letters of credit to dissuade "any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, pro-forma invoices and the like". Though it often occurs that the parties to a letter of credit are not on equal footing, some applicants (buyer) are in a stronger position with access to the services of different banks. As a result, the effectiveness of Article 4(b) is brought to question and is yet to be witnessed in practice.

The negative definition was subjected to a sizeable modification as it now limits the duty to examine documents solely to the banks.¹⁵⁹ This duty is found in Article 5 of the UCP 600 and asserts that banks deal with documents and not with goods and services let alone a performance related to the documents.¹⁶⁰ Having stripped "all interested parties" of the duty to examine the presented documents, the seller (beneficiary) is left with the sole duty of ensuring that he presents truthful documents so as to forestall fraudulent transactions.

3 3 6 Standard for Examination of Documents

The bank's role in a letter of credit transaction becomes more prominent when a presentation is made, and the bank has to determine whether such presentation complies with the terms and conditions of the letter of credit.¹⁶¹ This is achieved by examining the documents

¹⁵⁸ Doise D (2007) 114.

¹⁵⁹ *Ibid.*

¹⁶⁰ Ellinger and Neo 34.

¹⁶¹ Ellinger and Neo 39 and 43. As a consequence of the international status of letters of credit, it is important to note that banks will not incur liability for any errors in translation or interpretation of technical terms and are afforded leeway to transmit credit terms without translating/ interpreting them [Article 35 of the UCP 600]. In addition to this form of security, Article 36 of the UCP 600 provides that banks will also not incur any liability in the case of *force majeure*. Thus, the bank will not be held accountable for any acts of God, riots, acts of

presented. Once the issuing bank has established compliance, it incurs the duty to honour the payment.¹⁶² The standard for the examination of these documents has been the stronghold of the UCP and while the 1993 revision required banks to examine the documents with “reasonable care”¹⁶³, the UCP 600 has since removed the phrase from its provisions.¹⁶⁴

At the forefront of this alteration is Article 14(a) which provides that the current rule does not apply to “banks” in the generic sense of the word but to a nominated bank acting on its own nomination, the confirming bank and the issuing bank.¹⁶⁵ With the removal of the words “reasonable care”, the bank’s remaining duty is to “examine the presentation to determine, on the documents alone, whether or not the documents appear on their face to constitute a complying presentation”.¹⁶⁶ An important aspect to bear in mind is that as a result of the bank-customer relationship, which for all intents and purposes is a contractual agreement, the bank may still be obliged to exercise reasonable care in respect of the examination.¹⁶⁷

Historically, the UCP allowed for a “reasonable time” with regards to the time given to banks for the examination of the documents. Article 13(b) of UCP 500 permitted a “reasonable time not to exceed seven banking days” whereas the updated version of Article 14(b) of the UCP 600 permits only five (banking) days. In addition, the Article provides that the five-day period “does not depend on any upcoming expiry date or last day for presentation”. Ellinger and Neo remark that the rationale behind this addition is challenging to discern because the expiry date is indicative of the last day for presentation and to state that the time frame allowed for examination is not subject to it is unfathomable.¹⁶⁸ This Article denotes the fact that the rules

terrorism etc. but the expiry date on which performance is due will certainly not be prolonged by a *force majeure*.

¹⁶² Article 15(a) of the UCP 600.

¹⁶³ Article 13(a) of the UCP 500.

¹⁶⁴ Ellinger and Neo 39 and 43.

¹⁶⁵ Ellinger and Neo 39. The authors write that despite the modification, the rule has not changed in substance because a credit is freely negotiable thereby rendering every bank as a nominated bank.

¹⁶⁶ *Ibid.*

¹⁶⁷ *Ibid.*

¹⁶⁸ Ellinger and Neo 39 – 40.

have become more stringent towards the banks and are generally more favourable to trade consumers.¹⁶⁹

Arguably, the provisions of Article 14(d) may be regarded as relaxation of the traditional standard of compliance in respect of the documents.¹⁷⁰ The Article provides that the data in a document, when read in the context of the credit, the document itself and the international standard banking practice, *need not be identical with, but must not conflict with* (own emphasis added), data in (i) that document, (ii) any other stipulated document, or the credit itself. Should any inconsistencies be detected then the document will be regarded as irregular.¹⁷¹

3 3 7 The Rejection Formula

Article 16(a) of the UCP 600 provides that when a presentation does not satisfy the standard of compliance, the bank is entitled to refuse to honour or to negotiate it.¹⁷² When a bank opts to refuse to honour or negotiate a letter of credit transaction, it must give “a single notice to that effect to the presenter”.¹⁷³ Such notice of discrepancies must be submitted no later than the close of the fifth banking day following the day of presentation and such notice must be submitted by telecommunication and in instances where that is not possible, by any other expeditious means.¹⁷⁴ The notice has to set out the following:

- a) It has to declare that the bank refuses to honour or to negotiate.
- b) It has to point out “each discrepancy in respect of which the bank refuses to honour or to negotiate”.
- c) It must state the course adopted in respect of the documents.¹⁷⁵

¹⁶⁹ Sutton WB (2012) 62. The writer submits that there has been a significant reduction in the usage of the UCP 600 which is owed to the fact that the Code favours trade customers over banks.

¹⁷⁰ Woods JS (2008) 121. Article 14(d) is but one of the four provisions that were altered to restrict the role played by immaterial inconsistencies or errors in the presentation of documents. The remaining three provisions are Articles 14(e), 14(f) and 14(j).

¹⁷¹ *Ibid.*

¹⁷² Article 16 of the UCP 600 applies to a nominated bank that acts upon its nomination, to a confirming bank, if any, and to an issuing bank.

¹⁷³ Article 16(c) of the UCP 600.

¹⁷⁴ Article 16(d) of the UCP 600.

¹⁷⁵ *Supra* n 173.

With regards to the course adopted in respect of the documents, Article 14(d)(ii) of the UCP 500 required the notice to expressly state whether the documents were held by the bank or being returned to the presenter. Ellinger and Neo point out that this amounted to a series of practical difficulties; although banks sought to secure their freedom to reject documents, they did not intend to give up their custody without their customers consent.¹⁷⁶ Under the new provision, banks have been afforded the opportunity to make use of one of the following formulas:¹⁷⁷

- a) that it is holding the documents pending further instructions from the presenter;
- b) in the case of the issuing bank, 'that it is holding the documents until it receives a waiver from the applicant and agrees to accept it, or received further instructions from the presenter prior to agreeing to accept a waiver';
- c) that it is returning the documents; or
- d) that it is acting in accordance with an instruction previously received from the presenter.

Article 16(f) proclaims the consequences of an issuing bank or confirming bank which fails to follow the appropriate procedure for the rejection of the documents and such bank shall be "precluded from claiming that the documents do not constitute a complying presentation". Complying with the rejection procedure has its advantages as such bank is entitled to claim a refund, with interest, of any reimbursement made.¹⁷⁸

3 3 8 Provisions in respect to the Documents

Queries pertaining to "original documents" and/or "copies" are dealt with in Article 17 of the UCP 600.¹⁷⁹ According to Ellinger and Neo a series of cases under the UCP 500 demonstrated that the meaning of the word "original" had come under fire so the motive behind the re-wording of this Article was to provide clarity in that regard.¹⁸⁰ Sub-clause (a) states that at least one original copy of each document stipulated in the letter of credit must be presented while (b) provides that "a bank shall treat as original any document bearing an apparent original signature, mark, stamp or label of the issuer of the document, unless the

¹⁷⁶ Ellinger and Neo 41.

¹⁷⁷ Article 16(c) of the UCP 600 as found in Ellinger and Neo 41.

¹⁷⁸ Article 16(g) of the UCP 600.

¹⁷⁹ This Article replaces Article 20(b) of the UCP 500.

¹⁸⁰ Ellinger and Neo 42.

document itself indicates that it is not an original". A document may, in any event, be treated as an original if:¹⁸¹

- a) it appears to be written, typed, perforated or stamped by the document issuer's hand;
- b) appears to be on the document issuer's original stationary; or
- c) states that it is original "unless the statement appears not to apply to the document presented".

Two more provisions were included for further clarity and for the sake of completeness; Article 17(d) which stipulates that if a letter of credit requires presentation of copies of documents, presentation of either originals or copies will suffice, and Article 17(e) which provides that where multiple documents are required for presentation, the presentation of at least one original and the remaining number in copies will satisfy the requirement.

3 4 Conclusion

Trade regulations have been in existence since the beginning of time and their primary objective is to facilitate the exchange of goods and services between two or more parties. As pointed out by Sutton, the laws may have been amended throughout the years and although their form and content have changed, their intent remains the same.¹⁸² The UCP is no different, even though it is not acclaimed as a source of law. The latest version thereof swerves from its predecessors' trend of "internal protection" in that instead of favouring banking, transporting and insurance institutions, it was drafted in a manner that limits the banks' rights and duties in the administration of letters of credit.¹⁸³

The UCP 600, described as "a new-born phoenix in international trade", is commended for having definitively outlined the rights and duties of both trade customers and banks as parties to a letter of credit transaction and especially for having taken the shortcomings of the UCP 500 into consideration throughout the drafting process. However, Sutton remarks that the insertion of the "express modification rule" found under Article 1 threatens the very existence of the Code. By permitting the parties to a letter of credit transaction to modify the rules governing credit transactions, the strength and utility of the UCP will ultimately be destabilised. Opportunely, the ICC Banking Commission has already addressed some of the

¹⁸¹ Article 17(c) of the UCP 600.

¹⁸² Sutton WB (2012) 65.

¹⁸³ *Ibid.*

issues surrounding certain Articles through the issuance of opinions and clarifications where necessary.¹⁸⁴ Hopefully the same courtesy will be extended to this particular issue thus preserving the soundness of the UCP 600.

¹⁸⁴ *Ibid.*

Part B: The South African Courts' Interpretation of the Doctrine of Strict Compliance

3 1 The Application of the UCP in South Africa

The law applicable to a contract is known as its proper law.¹⁸⁵ It is trite that the South African private international law affords contractual parties the discretion to freely, expressly or tacitly¹⁸⁶ elect the proper law applicable to their contract.¹⁸⁷ There is rarely a need to ascertain the law governing a letter of credit because commercial banks typically incorporate the UCP in the letters of credit they issue.¹⁸⁸ What is clear is that the law governing the credit is separate from that governing the contractual relationship between the buyer and the seller.¹⁸⁹

As mentioned above, the parties to a letter of credit can elect a legal system to govern their contractual relationship. Fredericks and Neels illustrate that since the UCP is not an international convention, it cannot be ratified to form part of South Africa's domestic law.¹⁹⁰ The way the UCP is incorporated into letters of credit is through incorporation by reference; provided that such incorporation is recognised by the proper law governing the underlying contract. This requires the parties to ascertain whether their chosen legal system allows the incorporation of the UCP by a mere reference to it.¹⁹¹

South African law permits incorporation by reference and the relevant test applied is as follows: whether one can reasonably assume from the client's conduct in continuing with the

¹⁸⁵ Fredericks and Neels "The Proper Law of a Documentary Letter of Credit (Part 1)" 2003 15 *SA Mer LJ* 64 and 69. The place of performance (*locus solutionis*) is used to determine the proper law; a principle that stands unless specific circumstances indicate another legal system.

¹⁸⁶ Practices of this nature are referred to as "trade usages".

¹⁸⁷ *Ibid*; Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* (2000) 221.

¹⁸⁸ *Ibid*; Murray, Holloway and Timson-Hunt *The Law and Practice of International Trade* (2012) 216. Article 1 of the UCP neatly highlights the incorporation: "The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600 ('UCP') are rules that apply to any documentary credit ('credit') (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicate that it is subject to these rules. They are binding on all parties thereto unless expressly modified or excluded by the credit."

¹⁸⁹ *Ibid*.

¹⁹⁰ Fredericks and Neels (2003) 64.

¹⁹¹ *Idem* 65.

contract that he has either read the UCP and assented to its terms, or is prepared to be bound to the Rules without reading them, that is an implied term.¹⁹²

The judgment delivered by Corbett AJA in *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration*¹⁹³ has been labelled as “the *locus classicus* on the implication of terms”.¹⁹⁴ He defined the concept of “implied term” as:

[I]t is used to describe an unexpressed provision of the contract which the law imports therein, generally as a matter of course, without reference to the actual intention of the parties. ...[I]t does not originate in the contractual *consensus*: it is imposed by the law from without. ... Such implied terms may derive from the common law, *trade usage or custom*, or from statute. ... The implied term ... is essentially a standardised one, amounting to a rule of law which the Court will apply unless validly excluded by the contract itself. While it may have originated partly in the contractual intention, often other factors, such as *legal policy*, will have contributed to its creation.¹⁹⁵

Fredericks and Neels suggest that this dictum advances the following questions:¹⁹⁶ what is the legal nature and status of the UCP where it is not explicitly incorporated in the letter of credit? And, what are the implications where no reference to a legal system is made?

3 1 1 Incorporation by way of Trade Usage or Custom

Where the UCP is not expressly incorporated in the contract between the applicant and the issuing bank or one between the issuing bank and the beneficiary, Van Niekerk and Schulze indicate that it will not form part of the contract unless it qualifies as a residual term.¹⁹⁷ The argument is that in such cases the UCP serves as a custom or trade usage. A custom or trade will be rendered a residual term, in other words, a term which is read into a contract *ex lege* once it forms part of the contract regardless of whether the parties knew or thought of it and consequently agreed on it.¹⁹⁸

¹⁹² *Ibid* with reference to *Home Fires Transvaal CC v Van Wyk* 2002 (2) SA 375 (W) at 381E-H.

¹⁹³ 1974 3 SA 506 (A).

¹⁹⁴ Hugo “The Law Relating to Documentary Letters of Credit from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks (unpublished doctoral thesis, University of Stellenbosch (1996)) 172.

¹⁹⁵ *Idem* 173.

¹⁹⁶ Frederick and Neels (2003) 64-65.

¹⁹⁷ Van Niekerk and Schulze 219.

¹⁹⁸ *Ibid*.

All the requirements of a custom or trade usage must be complied with before the law will imply the UCP into a contract.¹⁹⁹ One of the requirements is that the custom or trade must be long-established. Considering this, the Appellate Division in *Van Breda v Jacobs*²⁰⁰ found that there exists “a marked agreement between the Roman-Dutch and the English law”²⁰¹ and that the only profound difference is that English law calls for custom to have an immemorial origin, while Roman-Dutch law simply requests that the custom be old. The court also listed the following as requirements for a custom in South African law, it had to be (i) long established, (ii) reasonable, (iii) uniformly observed and (iv) certain.²⁰²

However, the English law distinguishes between a custom and a trade usage. As previously mentioned, according to English law a custom must, inter alia have an immemorial origin whilst trade usages need not have an immemorial origin.²⁰³ The requirements for trade usage were established as follows:²⁰⁴

[I]t must be universally and uniformly observed within the trade concerned; established; well known; reasonable; certain; and not in conflict with the law or with the clear provisions of the contract.

The said requirements were skilfully summarised by Van der Riet J when he made use of the English law in *Coutts v Jacobs*²⁰⁵ by requiring a trade usage to be “notorious, certain and reasonable and not contrary to positive law”²⁰⁶ This was subsequent to his finding that the *Van Breda* case could not be regarded as “sufficient authority for holding that our law

¹⁹⁹ *Idem* 220. The requirements are as follows: the term must be universally and uniformly observed within the trade concerned; notorious; reasonable; certain; in accordance with the positive law and in accordance with the clear provisions of the parties' contract.

²⁰⁰ 1921 AD 330.

²⁰¹ *Idem* 333 – 334 as per Hugo (1996) 173.

²⁰² *Ibid.* These requirements are derived from the Roman-Dutch authority, Voet.

²⁰³ Van Niekerk and Schulze 219. See *African Mining & Financial Association v De Catelin & Muller* (1897) 4 OR 344. A practice may be incorporated not only by operation of law but also be way of a tacit term i.e. the unexpressed consensus of the parties. These practices are termed trade usages. Hugo (1996) 175.

²⁰⁴ As stated by Cameron J in *Absa Bank Ltd v Blumberg and Wilkinson* 1995 4 SA 403 (W) 409I.

²⁰⁵ 1927 EDL 120.

²⁰⁶ Hugo (1996) 174.

recognizes customs only and differs from English law in regard to customs of trade or trade usages".²⁰⁷

Hugo correctly discerns that the *Coutts* case purports that South African law distinguishes between custom and trade usage in the same way as English law.²⁰⁸ The ideology was rejected in *Catering Equipment Centre v Friesland Hotel*²⁰⁹ where the court found that there was no Roman-Dutch authority that supports the distinction.²¹⁰ The court was quick to emphasise the difference between English and South African requirements for custom by stating:

It is quite clear from the authorities that a custom in order to be valid in Roman-Dutch Law should not necessarily, actually or presumptively, date from time immemorial. From a historical point of view, it is of the greatest significance that time immemorial has nowhere been emphasized as an essential to the validity of a custom in Roman-Dutch Law.²¹¹

The deduction is that practices that would constitute 'trade usages' under English law could very well meet the Roman-Dutch law test for custom. To close off the matter, the court concluded that "the old Roman-Dutch Law was concerned with customs only and they included trade customs".²¹² In the context of South African law the term 'trade custom' is indicative of practices that can be incorporated into a contract *ex lege*, as previously noted.²¹³

Due to the rigorous revision the UCP has been subjected to, arguments have disqualified it as a custom or trade usage in most legal systems.²¹⁴ Hugo notes that English analysts have unswervingly forbidden the notion that the UCP may qualify as custom and that although the

²⁰⁷ *Ibid.*

²⁰⁸ *Ibid.*

²⁰⁹ 1967 4 SA 336 (O) 339A-340E.

²¹⁰ Hugo (1996) 175; Van Niekerk and Schulze 220.

²¹¹ Hugo (1996) 175. South Africa's positive law has since proceeded on the basis that it does not distinguish between custom and trade usage.

²¹² *Ibid.*

²¹³ *Idem* 176. Hugo confirms that while there is a stronghold in South African law for the incorporation of trade customs by operation of law, there is no South African case wherein a letter of credit has been interpreted in this manner. There are, however, cases in which bills of exchange have been subjected to such interpretation. See *Tropic Plastic and Packaging Industry v Standard Bank of SA Ltd* 1969 4 SA 108 (D).

²¹⁴ Van Niekerk and Schulze 219. The numerous revisions are at odds with the requirement that a custom ought to have continued without interruption since its immemorial inception.

term is utilised to “designate the UCP”, the term is not applied in the technical sense pronounced above.²¹⁵ From this, it follows that only those principles that remain unaltered through the various revisions could comply with the immemorial requirement and therefore possibly qualify as custom.

Traditionally, the UCP is incorporated by express or tacit contractual incorporation. Where a letter of credit transaction is without such incorporation, South African law is likely to afford some form of incorporation by operation of law. As noted above, this is true for the provisions of the UCP which comply with the requirements for a trade custom. It is important to note that incorporation by law is likely to occur in exceptional circumstances because express contractual incorporation is the norm. Therefore, one cannot argue that the UCP in its entirety be regarded as a trade custom and be incorporated by way of operation of law. This argument will be rejected in South Africa particularly because it has been rejected elsewhere but also because of the numerous revisions the UCP has been subjected to.

3 1 2 The implications where no reference to a legal system is made

In the absence of a valid choice-of-law clause, South African law provides for two views. In the first instance, a presumption is made by the courts that the parties intended some or other legal system to apply to their contract.²¹⁶ The second view, which is believed to be correct, is that the relevant legal system is established by determining the law with which the contract had its “closest and most real connection”²¹⁷, which is an English common law test.²¹⁸ The aforementioned test necessitates the application of the following rules to ascertain which legal system governs the letter of credit:

²¹⁵ Hugo (1996) 164.

²¹⁶ Fredericks and Neels (2003) 66. Although the parties clearly had no intention, the Appellate Division in *Standard Bank of SA Ltd v Efroiken and Newman* 1924 AD 171 at 185 still presumed that the parties must have had some legal system in mind. The authors contend this viewpoint by highlighting that “Forsyth correctly states that it is artificial to refer to the parties’ presumed intention”. Other cases in support of this view include *Ex parte Spinazze* 1985 (3) SA 633 (A) at 665H and *Herbst v Surti* 1991 (2) SA 75 (Z) at 79C.

²¹⁷ Article 4(1) of the Rome Convention provides that where parties have not chosen a law to govern the contract, this article preserves the general position at common law that the applicable law is to be that of the country with which it is most closely connected.

²¹⁸ Frederick and Neels (2003) 66; Van Niekerk and Schulze 221; Murray, Holloway and Timson-Hunt 216.

- a) the contractual relationship between the applicant (buyer) and the issuing bank is typically governed by the law of the country in which the bank carries on business and has issued the credit.
- b) If neither a confirming nor nominating bank were selected, the contractual relationship between the beneficiary (seller) and the issuing bank will be governed by the law of the place wherein the beneficiary is required to present documents to obtain payment.
- c) In the absence of a nominated bank, the relationship between the confirming bank and the beneficiary is regulated by the legal system of the seat of the confirming bank.²¹⁹

Fredericks and Neels substantiate the support for this viewpoint with reference to the obiter dicta in *Improvair (Cape) (Pty) Ltd v Establishments Neu*²²⁰ and *Laconian Maritime Enterprises Ltd v Agromar Lineas Ltd*²²¹, wherein the judges, although in favour of the second view, stated that they were bound by the *Efroiken and Newman* case. Furthermore, they suggested that they would have reached the same conclusion because the same factors are considered under both the presumed intention and closest connection tests.²²² The factors are as follows:

- a) The *locus solutionis* (the place of performance);
- b) The *locus contractus* (the place of the conclusion of the contract);
- c) The place of the offer;
- d) The place of acceptance;
- e) The place of agreed arbitration;
- f) The choice of jurisdiction;
- g) The domicile of the parties;
- h) The place where the parties carry on business;
- i) The domicile of the agents or mandataries of the parties;
- j) The future domicile of the parties;
- k) The (habitual) residence of the parties;
- l) The nationality of the parties;
- m) The form, terminology, and language of the contract;

²¹⁹ Van Niekerk and Schulze 221-222; Murray, Holloway and Timson-Hunt 217-218.

²²⁰ 1983 (2) SA 138 (C) at 146-147.

²²¹ 1986 (3) SA 509 (D) at 526D-H and 530H-I.

²²² Fredericks and Neels (2003) 67.

- n) The *locus rei sitae* (the place where the property is situated);
- o) The *locus libri siti* (the place where the property is registered);
- p) The *locus expeditionis* (the place of despatch);
- q) The *locus destinationis* (the place of destination);
- r) The place of registration of the vehicle (means of conveyance) by which the *res vendita* is transported;
- s) The currency in which the contractual obligation of payment is expressed; and
- t) The incorporation of a statute in the contract.²²³

It is important to note that not all the above-mentioned factors have the same weight. The most significant factor in establishing the proper law is the *locus solutionis* (the place of performance) as evidenced by South African case law.²²⁴ The principle taken from case law is that the *locus solutionis* constitutes the proper law of a contract unless specific circumstances point to another legal system.²²⁵

3 2 The Doctrine of Strict Compliance in South African Courts

This doctrine, as discussed and defined in paragraph 2.2.2, essentially provides that the bank may reject any tendered documents which do not subscribe to the terms and conditions set out in the letter of credit as well as those that do not appear, on their face, to be consistent with one another.²²⁶ Consistency and certainty serve as pivotal qualities in this regard; if the documents are rejected this will result in unnecessary delay and expenditure in re-selling the goods elsewhere.²²⁷

The doctrine has however not seen sufficient application in South African case law to date but it was recognised by Nugent JA in *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd*²²⁸. The court held that:

²²³ *Ibid* to 68.

²²⁴ Note *Hulscher v Voorschotkasvoor Zuid-Afrika* 1908 TH 542 at 546 and *Shacklock v Shacklock* 1948 (2) SA 40 (W) at 51.

²²⁵ Fredericks and Neels provide the case of *Collins (SW) Ltd v Kruger* 1923 PH A 78 (SWA) as an example. The contractual parties preferred the *lex domicilii* to both the *lex loci solutionis* and the *lex loci contractus*.

²²⁶ Fieties L *Letters of Credit – The Fraud Exception: A time for Conformity* (2013) 5 Masters Thesis

²²⁷ *Ibid*.

²²⁸ As per Sharrock *et al The Law of Banking and Payment in South Africa* (2016) 415.

A bank... that establishes a letter of credit at the request and on the instructions of a customer thereby undertakes to pay a sum of money to the beneficiary against the presentation to the issuing bank of stipulated documents...The documents that are to be presented...are stipulated by the customer and the issuing bank generally has no interest in their nature or in their terms (*Commercial Banking Co of Sydney Ltd v Jalsard Pty Ltd* [1973] AC279 (PC) at 286C-D; *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (A) at 815G-I). Its interest is confined to ensuring that the documents that are presented conform with the client's instructions (as reflected in the letter of credit) in which event the issuing bank is obliged to pay the beneficiary. If the presented documents do not conform with the terms of the letter of credit the issuing bank is neither obliged nor entitled to pay the beneficiary without its customer's consent. The obligation of the issuing bank was expressed as follows in *Midland Bank Ltd v Seymour* [1955] 2 Llyod's Rep 147 at 151:

'There is, of course, no doubt that the bank has to comply strictly with the instructions that it is given by its customer. It is not for the bank to reason why. It is not for it to say: 'This, that or the other does not seem to us very much matter.' It is not for it to say: 'What is on the bill of lading is just as good as what is in the letter of credit and means substantially the same thing.' All that is well established by authority. The bank must conform strictly to the instructions which it receives.'

The doctrine received further acknowledgment in *Delfs v Kuehne and Nagel (Pty) Ltd*²²⁹ where under a contract a sale, a Namibian seller had sold 50 Oryx gazelles, 100 impalas and two cheetahs to a firm in London. The firm then sold the game to a third party, the end buyer, in Saudi Arabia. The payment method stipulated within the contract of sale was that of an irrevocable letter of credit issued by a British bank. The seller planned with a transport agent to transport the animals from South Africa to Saudi Arabia by air. However, only 47 gazelles, the two cheetahs and 104 impalas were handed over to the transport agent for forwarding at the designated South African airport. As a result of the impractical implications of removing four impalas from the crates or waiting for the three gazelles to be sent from Namibia, the buyer's representative agreed to have the available animals forwarded to Saudi Arabia. The

²²⁹ 1990 (1) SA 822 (A) at 830A-C as found in Van Niekerk and Schulze 248-249.

transport agent correctly noted in the invoice and air waybill the number of animals that were forwarded namely; 47 gazelles, 104 impalas and two cheetahs.²³⁰

Upon the animals' safe arrival in Saudi Arabia, the letter of credit was presented for payment. The bank was entitled to refuse payment as it rejected the air waybill and the commercial invoice because they did not conform to the terms of the letter of credit. The buyer had incurred some financial difficulties after the animals were forwarded but before the documents were presented to the bank and was therefore unable to pay. The seller instituted a claim of damages against the transport agent on the sole reliance of an alleged implied term that posed a duty on the transport agent to ensure that the documents conformed to the letter of credit. The Court rejected his claim and held that such duty would have only come into being had the correct number of animals been delivered to the transport agent for forwarding.²³¹

Due to the insignificant application of the doctrine in South Africa and as illustrated by the dictum in the *OK Bazaars* case highlighted above, our courts hold English case law of high regard in the law relating to letters of credit.²³² Hugo asserts that this is owed to the immeasurable attention given to the doctrine by the English courts, a tradition that dates to 1927.²³³

The common law "rule of insignificance", known as the *de minimis non curat lex*, therefore does not apply to letters of credit. Against this background, the next segment of the work will highlight the significance, if any, of what has been termed as substantial compliance.

3 2 1 Substantial Compliance

Revisions to the UCP rules have attempted to relax the effect of the doctrine of strict compliance but the banks generally still operate in a narrow margin when examining the presented documents as a result of court-inspired of fear.²³⁴ To avoid being victimised, the

²³⁰ *Ibid.*

²³¹ *Ibid.*

²³² Sharrock *et al* (2016) 415.

²³³ *Ibid.* The relevant case is *Equitable Trust Company of New York v Dawson Partners Ltd* [1926] 27 LI L Rep 49 (HL) 52 (discussed in paragraph above) in which Lord Viscount Sumner vehemently said "[t]here is no room for documents which are almost the same, or which will do just as well". The same was held in a preceding case namely; *English, Scottish & Australia Bank Ltd v Bank of South Africa* [1922] 13 LI L Rep 21 at 24 where the judge held that "a person who ships in reliance on a letter of credit must do so in exact compliance with its terms"

²³⁴ Krazovska 14.

banks abide to the judiciary's level of strictness and therefore employ serious precautionary measures which unfortunately causes high levels of documents being rejected.²³⁵

Strict compliance is typically enforced on both the seller and issuer(bank) and comes with its own set of problems.²³⁶ The following problems, inter alia are popular in this regard: when the seller fails to provide an accurate description of the goods in the letter of credit, inconsistent data²³⁷, discrepant documents of transportation²³⁸, drafts which are not signed or the submission of invoices which are inconsistent with the credit.²³⁹ While the doctrine of strict compliance may seem stringent to sellers, its enforcement ensures certainty and consistency in letters of credit transactions.

Although the above mentioned may be true, it is also clear that the application of the doctrine should not lead to what was coined as "oppressive perfectionalism" in the American case *New Braunfels National Bank v Odiorne*.²⁴⁰ The same notion was held by Parker J when he remarked as follows:

I also accept...that Lord Sumner's statement cannot be taken as requiring rigid meticulous fulfilment of precise wording in all cases. Some margin must and can be allowed, but it is slight, and banks will be at risk in most cases where there is less than strict compliance. They may pay on a reasonable interpretation...where instructions are ambiguous, but where instructions are clear they are obliged to see to it that the instructions are complied with and entitled to refuse payment to the beneficiary unless they are.²⁴¹

The Drafting Group of the UCP 600 took heed of the views and problems surrounding the application of the doctrine and consequently deleted the phrase "reasonable care" as it appeared in Article 13 of the UCP 500.²⁴² The UCP 600 therefore does not call for a "mirror

²³⁵ *Ibid.*

²³⁶ Kang J "What Should Be the Limitations of the Doctrine of Strict Compliance?" 2008 1 Asian Bus. Law 95.

²³⁷ Article 14(d) of UCP 600.

²³⁸ Article 19.

²³⁹ Article 28; Kang (2008) 95; Alavi H "Documentary Letters of Credit, Principle of Strict Compliance and Risk of Documentary Discrepancy" 2016 19 Kor. U. L. Rev. 7.

²⁴⁰ 780 2d 313 (1989) at 316-317.

²⁴¹ *Banque de l'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd* [1983] 1 QB 711 (CA) at 721E-G.

²⁴² Article 13(a) provided that banks were to "examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit".

image of data between LC and required documents” which suggests that simple errors and typographic mistakes might not be regarded as non-conforming during the examination of documents.²⁴³ Simply put, it is highly unlikely that banks will reject documents with trivial errors.

Hugo correctly denotes the tension between the insistence on strict compliance on the one hand and trivial discrepancies that can be ignored on the other.²⁴⁴ However, distinguishing a trivial error from that which is significant may prove difficult to do as evidenced in *Seaconsar Far East Ltd v Bank Markazi Jomhuri Islami Iran*.²⁴⁵ Fortunately, certain provisions of the UCP 600 were drafted to serve as a guideline in this regard and are briefly discussed here below.

To start with, Article 14(a) of the UCP 600 did not deviate from the language used in Article 13(a) of the UCP 500 and provides that “the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation”. Article 14(a) therefore serves the same purpose as Article 13(a) of the UCP 500 did, namely; it establishes the approach banks should follow when examining documents submitted for presentation. Article 2 of the UCP 600 affords interested parties greater clarity by encompassing a definition for “complying presentation” as found in Article 14(a). The phrase is defined as “a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice”. It is submitted that the reference to “international standard banking practice” is not in reference to the ISBP (2007 revision) or even the ISBP itself.²⁴⁶ Instead, it means international standard banking practice in a much wider sense which encompasses both the ISBP (2007 revision) and the ISBP, but is not necessarily limited to them.²⁴⁷

²⁴³ *Ibid.*

²⁴⁴ Sharrock R *et al The Law of Banking and Payment in South Africa* (2016) 416; The ICC highlighted global statistics suggesting that 70% of documents submitted under letters of credit were rejected on first presentation as a result of discrepancies.

²⁴⁵ 3 W.LR 756 (HL), 1 Lloyd’s Rep. 236 (CA. 1993).

²⁴⁶ Kelly-Louw “Selective Legal Aspects of Bank Demand Guarantees” unpublished LLD thesis 2008 64. The International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP) is a set of rules issued by the ICC as a “necessary companion” of the UCP. Much like the UCP, its status is uncertain.

²⁴⁷ *Ibid.*

In addition to this, Article 14(d) reads as follows: “Data in a document, when read in context with the credit, the document itself, and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit”.

Manganaro remarks that the Drafting Group realised that banks were more prone to cite a substantial number of unjustified discrepancies when documents contained both typographical and grammatical errors. Change that would call for a reduction of discrepancies was dire. The phrase must “not conflict with” was elected with the full intention of narrowing down the scope banks required to make a determination. Thus, a determination would be based purely “on the compliance of the data itself”.²⁴⁸

The aforementioned is contained in paragraph A23 of the ISBP (2013 Revision) which provides the following:

A misspelling or typing error that does not affect the meaning of a word or the sentence in which it occurs, does not make a document discrepant. For example, a description of the goods as ‘mashine’ instead of ‘machine’, ‘fountan pen’ instead of ‘fountain pen’ or ‘modle’ instead of ‘model’ would not be regarded as a conflict of data [ie would not be regarded as non-complying] under UCP 600 sub-article 14(d). However, a description shown as, for example, ‘model 123’ instead of ‘model 321’ will be regarded as a conflict with data under that sub-article.

Article 18(c) of the UCP 600 is also worthy of mentioning as it provides that “[t]he description of goods, services or performance in a commercial invoice must correspond with that appearing in the credit”. Pursuant to this, article 14(e) permits a description of goods and services that is far less technical. It provides that “[i]n documents other than the commercial invoice, the description of the goods, services or performance, if stated, may be in general terms not conflict with their description in the credit”.

²⁴⁸ Manganaro NP “About-Face: The New Rules of Strict Compliance Under the Uniform Customs and Practice for Documentary Credits (UCP 600)” 2011 14 Int’l Trade & Bus. L. Rev 283. The Drafting Group summed the “new” approach to the examination of documents as follows:

“The requirements of the documentary credit, the structure and purpose of the document itself and international standard banking practice need to be assessed, understood and to be taken into consideration in determining compliance of a document. ... [T]he new standard of ‘not conflict with’ relates the data contained in the document to what was required by the documentary credit, to what is stated in any other stipulated document and to international standard banking practice”.

Kelly-Louw acknowledges Adodo's suggestion with regards to the applicable test that ought to be used to determine whether a discrepancy is sufficiently material to entitle the bank to reject the document as "the hypothetical opinion of a reasonable banker located in the jurisdiction of the presenting bank or beneficiary, depending on the character of the omitted or misspelled terminology in issue in the individual case".²⁴⁹ Furthermore, it is suggested that "an omitted word, a spelling mistake, or a false description is material if it invites the reasonable overseer of a bank document to enquire whether the documents presented might prompt litigation, mislead the bank, necessitate legal advice, increase the likelihood of non-performance of the underlying contract, or lead to fraud by the beneficiary".²⁵⁰

In South Africa, it is still unclear what the required standard of compliance is regarding documents that are presented in terms of a letter of credit transaction. When one takes account of the case law, it is implied that the doctrine of strict compliance is applicable.²⁵¹ Moreover when one takes cognisance of the fact that South African courts are traditionally steered by English law judgments pertaining to letters of credit transactions.

Summarily, substantial compliance simply requires the banker to "look beyond the face of the documents, investigate the realities of the transaction and weigh the credibility of documents, customers and beneficiaries".²⁵² Considering this, substantial compliance has been said to contradict Article 5 of the UCP 600 which poses restrictions on the banks responsibility to deal with documents and not goods. In response to this, Kelly-Louw opines that the UCP has "not watered down the principle of strict compliance". It has, however, eradicated the likelihood of documents being rejected for trivial discrepancies.²⁵³

3 3 Conclusion

The benefit of strict compliance, as demonstrated by Article 13 of the UCP 500, is the level of certainty and consistency it provides the bank. The bank, as issuer, is rest assured that the documents presented are for the same transaction under which the credit was issued. It

²⁴⁹ Kelly-Louw "The Doctrine of Strict Compliance in the Context of Demand Guarantees" 2016 *XLIX CILSA* 95.

²⁵⁰ *Ibid.*

²⁵¹ Kelly-Louw points out that there is no authority in South African case law that provides direct answers to the matter.

²⁵² Alavi (2016) 9.

²⁵³ Kelly-Louw (2008) 65.

further grants the bank absolution from making judgmental decisions by placing a restriction on the banks responsibility to deal strictly with documents. One look at the revised provisions within the UCP and it becomes ever so clear that the doctrine has succumbed to immense pressure following the heightened number of rejected transactions. In response to this, the Drafting Group of the UCP 600 altered the compliance standard to that which is more accommodating than the infamous standard of strict compliance; one that would pave the way to a reduction in the number of rejected transactions.

The implications of the new standard, substantial compliance, are a contentious issue. On the one end of the spectrum, renounced academics have submitted that substantial compliance has not done away with the certainty and consistency offered by the principle of strict compliance. On the contrary, substantial compliance serves to maintain that same level of certainty and consistency by enabling international transactions, facilitated by letters of credit, to not be hindered or delayed by trivial discrepancies found in the presented documents. On the other end, it has been argued that the root of the discrepancies in letters of credit has not been attended to. Article 18(c) of the UCP 600 still calls for data in a commercial invoice to reflect that which is specified in the letter of credit. This provision affords banks leeway to ultimately reject the documents thus stalling the payment, which unfortunately reverts to the initial problem.

The next chapter contains a summary of the various topics that have been discussed in this essay and is supplemented by recommendations that are aimed at contributing to this area of banking law.

Chapter Four: Remarks and Recommendations

4 1 Concluding remarks

Letters of credit have assumed a crucial role in the facilitation of international trade. So much so that they have been accredited as the 'lifeblood' or 'backbone' thereof. The heightened recognition of this infamous abstract payment tool is largely owed to the advancement of technology which rendered the traditional method of furnishing a cash deposit as restrictive and too costly to comply with. Contractors, exporters, sellers etc. resorted to relying on financial institutions for assistance in this regard following the realisation that their cash flow would bear an immense burden if they were to fund the deposit themselves.

One of the core characteristics of an abstract payment is that the payment undertaking is independent from the underlying contractual agreement. Naturally, this affords the payment undertaking an autonomous status. This principle has been termed that of autonomy and is applicable to letters of credit alongside the doctrine of strict compliance. The former is encompassed in Article 4(a) of the UCP 600 which summarily distinguishes a credit from the sale or any other contract from which it originates. The Article further absolves financial institutions from making judgmental decisions by restricting their responsibility to only dealing with documents and not goods. Therefore, financial institutions need only concern themselves with the documents presented for payment and not dwell on any surrounding circumstances which would ordinarily nullify the payment due.

The doctrine of strict compliance requires banks to deal with the financial aspect of an international transaction because they usually have little to no expertise of the trade in question. With this truth in mind and in theory, it is sensible that banks ought to strictly follow the instructions given by the buyer throughout the examination process before honouring its obligations under the credit. In practice, however, the application of this doctrine has resulted in large volumes of presented documents being rejected for non-conformity. As a result, the doctrine has come under excessive scrutiny which has led to the alteration of Article 13 of the UCP 500 under which the doctrine of strict compliance was housed.

The revised examination standard is now found in Article 14 of the UCP 600 which saw the removal of the phrase "reasonable care". This was in response to cries for an examination standard that permits "deviations that do not cause ostensible harm" and would also ensure a reduction of the rejected documents, which had inadvertently caused a delay in

international transactions and further elevated the costs associated thereto. From this alone, one would be compelled to believe that there has been an improvement in the application of the doctrine. After all, the substantial compliance principle offers what the principle of strict compliance did not – leniency. Trivial errors, found in documents submitted for presentation, which would otherwise be rejected for non-compliance under the principle of strict compliance are more likely to be accommodated now. A good demonstration of this is the case of *Seaconsar Far East Limited v Bank Markazi Jomhuri Islami Iran*, as highlighted above.

Article 18(c) poses a threat to the effectiveness of substantial compliance. This provision still requires data in a commercial invoice to be a mirror-image of what is contained in the letter of credit. Undoubtedly, this provision contains traces of the doctrine of strict compliance. The UCP appears to have created a loophole that begs the question, can the two examination standards co-exist? In other words, where presented documents do not comply with the doctrine of strict compliance, can banks, in the alternative, apply substantial compliance?

South Africa, as pointed out in the preceding chapter, has insufficient case law relating to letters of credit which makes it difficult to determine the country's stance in this regard. Perhaps the country's limited case law on the matter is largely owed to the fact that there is currently no legislation that regulates transactions relating to not only letters of credit, but demand guarantees too. Regardless of this drawback, it is accepted that the few reported cases that have been settled in South African court rooms are of sound reasoning. This is indicative of South Africa's ability to facilitate and give effect to intricate international transactions. True as this may be, it cannot be said with absolute certainty that South Africa has indeed seen an improvement in the application of the doctrine of strict compliance. What can be appreciated about the revised examination standard is that it does not water down the essence of strict compliance. It merely acknowledges that documents that are compiled and processed by human beings are susceptible to human error, for which nobody can be faulted.

4 2 Recommendations

This part of the dissertation consists of recommendations that are aimed at addressing the key issue namely; preserving the integrity of letters of credit in South Africa, by ensuring a feasible examination standard is set in place.

South African banks are well rehearsed with both the UCP 500 and 600 as evidenced by the issuance of letters of credit which are subject to either one of the rules. Due to the lack of

legislation in this area, it is again submitted that South Africa follow the example led by the United States and ratify the UCP to form part of our domestic law. The ratification of the UCP would go a long way in providing clarity and consistency to some of the problem areas identified herein, starting with the precise examination standard that should be applied.

Traditionally, South Africa is directed by English law judgments pertaining to letters of credit. English law is generally known to be stringent in all its applications which is why it is submitted that South Africa adapt a more flexible approach. This approach may encompass the co-existence of both the doctrine of strict compliance and that of substantial compliance so that the latter serves as a safety net for all the documents that fail to comply with the former. Much like what is done in the United States, they establish what constitutes strict compliance by considering the standard of practice as found in the UCP, any other rules released by financial institutions and their application on a local and regional scale. The UCP does not contain any provision which precludes such integration between the two principles. Opportunely, this may be right time for South Africa to not only codify legislation that regulates letters of credit but to also be in the forefront of a new era, founded on existing principles.

In the alternative, international transactions could be categorised in such a way that distinguishes those that are subject to strict compliance from those that where only substantial compliance is required. In other words, those that are regarded as exceptional circumstances. Whether these submissions are feasible and practical is debatable and the effectiveness thereof can only be established if applied in practice.

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