The Operation of Letters of Credit with Particular Reference to the Doctrine of Strict Compliance, the Principle of Independence, the Fraud Exception and Conflict of Laws

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by

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Declaration

This thesis is my own work and has not been submitted for degree purposes at any other University.

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Abstract

The thesis covers aspects of the law relating to letters of credit. It deals with the operation of letters of credit with particular reference to the doctrine of strict compliance, the principle of independence, the fraud exception and conflict of laws.

According to the principle of independence, banks must make payment in terms of the letter of credit irrespective of any dispute that may exist between the buyer and the seller in an underlying contract or other contracts. Although the principle of independence is clearly established, it is not absolute. An exception occurs in the case of fraud. Thus, if the seller has committed fraud, such as tendering forged documents, the buyer can instruct the bank not to make payment in terms of the credit. If the bank refuses to dishonour the letter of credit, the buyer can apply to a court to interdict the bank from making payment. In South African law the buyer must establish that the seller was party to fraud in relation to the documents presented to the bank for payment before the court can grant an interdict. This thesis also examines the standard of proof of fraud required in letters of credit transactions and proposes a standard of proof which will not unduly favour the seller whose good faith is in dispute.

The fast growing technology of computers and telecommunications is rapidly changing the methods of transacting business by paper documentation and letter of credit transactions are no exception. At present the buyer can apply to the bank to issue a letter of credit through the computer and banks also communicate letter of credit transactions through computer networks. However, the beneficiary still has to present documents to the bank for payment in paper form. It is proposed that the Uniform Custom and Practice

For Documentary Credits (UCP) be amended to provide for fully computerised letters of credit transactions.

Another objective of the thesis is to examine the doctrine of strict compliance. In terms of the doctrine of strict compliance documents presented under the credit must comply strictly with the requirements set out in the credit. If banks are satisfied that the documents presented by the seller strictly conform with the requirements of the credit they are obliged to make payment as required by the credit. It is proposed that the doctrine of strict compliance should not be applied strictly. In other words, the banks should make payment in terms of the credit if the discrepancy in the documents is trivial.

The thesis also covers conflict of laws issues. As the UCP does not have rules dealing with conflict of laws, most jurisdictions have developed their own rules to be applied by the courts in cases of conflict of laws. The thesis examines the different rules of conflict of laws as developed and practiced by different jurisdictions.

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Lamborn v Lake Shore Banking & Trust Co 188 NYS 162 (1921)

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ACRONYMS

ABLU	Annual Banking Law Update
AC	Law Reports, Appeal Cases (UK)
AD	Appellate Division Reports (SA)
ALL ER	All England Law Reports
CCQ	Civil Code of Quebec
CIF	Carriage, Insurance, Freight
CILSA	Comparative and International Law Journal of Southern Africa
CIP	Freight/Carriage and Insurance Paid to
CLD	Cape Local Division
CLD	Commercial Law Digest
CLR	Commercial Law Reports
CLJ	Commercial Law Journal
CPD	Cape Provincial Division
DOUG	Douglas (English Reports Reprint)
EDI	Electronic Data Interchange
EEC	European Economic Community
FOB	Free on Board
F	Federal Reporter
F SUPP	Federal Supplement (USA)
HILL NY	Hill (New York Reports)
HKLR	Hong Kong Law Reports
ICC	International Chamber of Commerce
IMC	International Maritime Committee

IMF	International Monetary Fund
ISP	International Standard Practice
KB	King's Bench Division
Ll Ll Rep	Lloyd's List Law Reports
Lloyd's Rep	Lloyd's Reports
LMCLQ	Lloyd's Maritime and Commercial Law Quarterly
NE	North Eastern Reporter (National Reporter System)
NYS	New York Supplement (National Reporter System)
QB	Queen Bench Division Reports (UK)
RAECC	Regulations Affecting Export Commercial Credits
SA	South African Law Reports
SA MERC LJ	South African Mercantile Law Journal
SWIFT	Society of Worldwide Interbank Communication
TPD	Transvaal Provincial Division
TS	Transvaal Supreme Court Reports
UCC	Uniform Commercial Code
UCP	Uniform Customs and Practice for Documentary Credits
UNCITRAL	United Nation Conference on International Trade Law
URR	Uniform Rules For Bank-to-Bank Reimbursement
WLR	Weekly Law Reports (England)
WN	Weekly Notes (England)
2d	Second Series
3d	Third Series

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CHAPTER ONE

INTRODUCTION

1.1 Definition and economic context of letters of credit

A letter of credit is a commercial instrument that is widely used to finance international business transactions.[1] In an international business transaction, unlike a domestic business transaction, the seller and buyer may not have previously dealt with each other or may know nothing about one another and therefore may be faced with overwhelming risks in their contract. As a result of these risks the seller might not be prepared to ship the goods before receiving payment and the buyer might also not be prepared to make payment before he receives the goods. It is also impractical for the parties to effect delivery of the goods and payment of the price at the same time so there should be a payment mechanism that will protect the interests of both the buyer and the seller in the light of the risks inherent in their contract.

There are several ways in which that can be done. The buyer could make an advance payment, but this method will be unacceptable to the buyer because he pays the seller before he receives the goods and faces the risk of the seller shipping rubbish instead of the goods agreed upon or making no shipment at all.[2] Another method is the open account according to which the seller delivers the goods to the buyer before receiving payment.[3] The seller will not prefer this method because the buyer might not make

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[1] It is not a legal instrument but a commercial instrument created by bankers to finance international business transactions.

[2] See Hugo CF *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*, LLD Thesis, University of Stellenbosch (1996) at 3-4.

payment in terms of the credit after receiving the goods.[4] A documentary bill could also be used.[5] A documentary bill is a bill of exchange accompanied by shipping documents, invoices, insurance certificates and any other relevant document and is intended to be accepted or paid in exchange for the documents. The bill of exchange and shipping documents are forwarded to the buyer or a bank in his country, and the buyer is required to accept or pay the bill, depending on whether it is a sight or term bill, and return it to the seller. In a sight bill, the buyer receives the documents only on paying the bill and the seller protects himself by retaining control of the goods until payment of the bill is effected. However, the seller still faces the risk of the buyer not honouring the bill. In a term bill, the seller delivers the documents against acceptance of the bill and the seller faces the risk of the buyer dishonouring the bill.[6]

It is submitted that the only method that protects the interests of both the buyer and the seller is the documentary letter of credit.[7] A comprehensive definition of letters of credit is to be found in the Uniform Customs and Practice for Documentary Credits (1993 Revision). Article 2 provides:

> "For the purposes of these Articles, the expression 'Documentary credit(s)' and 'Standby Letters of credit' (hereinafter referred to as 'credit(s)'), mean any

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3 See Goode R *Commercial Law* 2 ed (1995) at 960.

4 Oelofse AN *The Law of Documentary Letters of Credit in Comparative Perspective* (1997) at 6.

5 See Goode *op cit* n 3 at 961.

6 See Hugo *op cit* n 2 at 4-5. See also Carr I *Principle of International Trade Law* 2 ed (1999) at 264-265.

7 The terms "letters of credit", "documentary letters of credit", "documentary credits" and "commercial credits" are synonymous. The terms came about as a result of practice and no legal significance should be attached to the use of one term rather than the other.

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 (Draft(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.

For the purposes of these Articles, branches of a bank in different countries are considered another bank."

The following points can be extracted from this definition

(a) A credit is opened by the issuing bank either on the instructions of a customer or on its own behalf. The most common way is for the issuing bank to act on the instructions of the applicant rather than on its own behalf.

(b) The documentary credit may either provide for payment by the issuing bank or by another bank which may be an advising or correspondent bank instructed both to advise and to pay against conforming documents or the issuing bank may authorise another bank to negotiate the credit.

(c) The issuing bank, advising or correspondent bank, if there is any, will make payment or accept drafts against stipulated documents.

(d) The payment or acceptance will be made only if the terms and conditions of the credit are complied with.

(e) The documentary credit may provide for the paying bank to pay by one of the following mechanisms: payment without the use of a bill of exchange (payment by cash); acceptance and payment of a bill of exchange (or simply payment in the case of sight bills) drawn by the beneficiary on the paying bank; negotiation by an authorised bank against stipulated documents. Negotiation in this context means the giving of value for drafts and documents by the bank authorised to negotiate.

English judges have described letters of credit as the "lifeblood of international commerce".[8] The parties may invoke the use of letters of credit by stipulating in their sale contract that payment will be made by letters of credit.

This thesis does not cover the other related instruments known as standby letter of credit. A standby letter of credit is superficially similar to the documentary credit but it is issued as a guarantee against the default by one party to the contract rather than as a payment instrument.

1.2 The purpose of the study

The purpose of this study is to examine the operation of letters of credit with specific reference to the doctrine of strict compliance, principle of independence, the fraud exception and conflict of laws issues in relation to letters of credit. The principle of

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[8] See *RD Harbottle (Mercantile) Ltd and another v National Westminster Bank Ltd* [1978] QB 146, *Intraco Ltd v Notis Shipping Corporation* [1981] 2 Lloyd's Rep 256.

independence is regarded as foundational to the letter of credit system. According to this principle the issuing bank or confirming bank, if there is any, is obliged to pay the seller in terms of the credit irrespective of any dispute that might exist between the buyer and the seller in the underlying contract or other contracts. The principle of independence is not absolute. An exception occurs in the case of fraud by the seller. So, the fraud exception applies where the seller has committed fraud such as tendering forged documents. If the buyer identifies fraud in the transaction he must inform the bank to stop payment in terms of the credit. If the bank refuses to stop payment, the buyer can apply to the court to grant an interdict restraining the bank from paying the seller.

In South African law a court can grant an interdict restraining a bank from honouring the credit if it is established that the seller was a party to fraud in relation to the documents presented to the bank for payment.[9] In other words, the onus is on the buyer to establish the fraud. The purpose of this thesis is to examine the standard of proof of fraud in South Africa and to propose a new standard of proof which will not unduly favour the seller whose good faith is in dispute.

Another objective of this study is to propose a fully computerised letter of credit operation. Nowadays technology is rapidly replacing the use of paper, and letter of credit transactions are no exception. The buyer can apply to the issuing bank to open the credit through a computer and banks communicate letters of credit instructions through advanced telecommunication like the Society of Worldwide Interbank Telecommunication (SWIFT). However, the seller has to present documents in paper

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9 *Loomcraft Fabrics CC v Nedbank Ltd and others* 1996 (1) SA 812 (A).

form to the bank to receive payment. It will be proposed that the Uniform Customs and Practice for Documentary Credits (UCP) be amended to provide for a fully computerised letters of credit operation.

Another objective of the thesis is to examine the principle of strict compliance. In terms of the doctrine of strict compliance documents presented under the credit must strictly comply with the requirements set out in the credit. If banks are satisfied that the documents presented by the seller strictly conform to the requirements of the credit, they are obliged to make payment as required by the credit. It is proposed that the doctrine of strict compliance should not be applied strictly. In other words, the banks must make payment in terms of the credit if the discrepancy is trivial.

The thesis will also cover conflict of laws issues. As the UCP does not have rules dealing with conflict of laws, most jurisdictions have developed their own rules to be applied by the courts in cases of conflict of laws. The thesis will examine the different rules of conflict of laws as developed and practiced by different jurisdictions and the way in which they can be applied to letters of credit.

1.3 Sources and approach

Reference will be frequently made to the Uniform Customs and Practice for Documentary Credits (UCP) as a codification of international standard rules for letters of credit. The UCP has been drafted by representatives of people and institutions who use them, banks in particular, and are referred to in letters of credit throughout the world. The UCP defines letters of credit but the nature of the documents is left to the national laws. It

provides detailed information on the form and notification of credit instruments, and spells out the main responsibilities of banks. It also deals in detail with the presentation of documents which is regarded as the thrust of letters of credit. The principle of independence is also provided for in the UCP. Some of the provisions of the UCP are intended to be guidelines for users, such as the type and amount of detail to be included in the credit. However, others are intended to have legal effects, such as the obligation of the issuing bank to pay the correspondent bank which has paid the beneficiary in terms of the credit. Article 5 of the American Uniform Commercial Code will also be referred to.

There is a paucity of legal material and cases on this field in South Africa so reference will often be made in the thesis to the legal material and cases of England and America. This thesis will however approach the study from a South African perspective.

1.4 Structure of the thesis

The thesis has been divided into eight chapters. Chapter One serves as an introduction to the thesis. Chapter Two investigates the history of letters of credit. It also deals with the laws relating to letters of credit focusing on the UCP and the American UCC. The nature of letters of credit is also discussed in this chapter. Chapter Three discusses the parties involved in letters of credit transaction and the different types of letters of credit. A letter of credit transaction involves many relationships which are discussed in Chapter Four. Chapter Five deals with the doctrine of strict compliance and the UCP requirements relating to transport documents. Chapter Six discusses the principle of independence and the fraud exception, while Chapter Seven deals with conflict of laws in letters of credit. Chapter Eight is a postscript and it summarises the conclusions reached in the thesis.

CHAPTER TWO

THE HISTORICAL BACKGROUND AND SOURCES OF LAWS RELATING TO LETTERS OF CREDIT

2.1 Introduction

The history of letters of credit dates back to the thirteenth century. In that century open letters of credit were used and not documentary letters of credit. Documentary credits developed from open credits during the first half of the nineteenth century. At that time there was no standardisation of documentary letters of credit practice until the bankers in America, Norway, France, Italy, Czechoslovakia, Argentine and Holland issued national regulations in the twentieth century. However, they lacked universal application. The International Chamber of Commerce (ICC) standardised the letters of credit practice by issuing the Uniform Regulations for Commercial Documentary Credits in 1930. The regulations were revised in 1933 and named the Uniform Customs and Practice for Documentary Credits (UCP). The UCP was revised several times, the 1993 revision being the latest. This revision has been adopted by banks in many countries, making its application nearly universal. The United States of America has its own law relating to letters of credit in the form of Article 5 of the Uniform Commercial Code.

The purpose of this Chapter is to investigate the history of letters of credit, the developments of the laws relating to letters of credit, and the way in which parties to a contract can trigger the application of these laws.

2.2 The historical background of letters of credit

In establishing the origin of letters of credit, it is necessary to distinguish between open letters of credit and documentary credits.[1] Open letters of credit are much older than documentary letters of credits and were issued for the first time by English kings of the thirteenth century.[2] Ellinger believes that Italian merchants may have used them in the fourteenth century,[3] but Hugo states that there is no conclusive evidence to suggest that Italian merchants did do so. He says the instruments issued in that century were letters of payment and not letters of credit.[4] English merchants and bankers began using open letters of credit in the seventeenth century[5] and they became sufficiently popular in the eighteenth century to result in them being discussed by Giles Jacobs in his two works, *Lex Mercatoria*[6] and *A New Law Dictionary*.[7] In that century open letters of credit also came to the attention of the courts.[8]

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1 See Ellinger EP *Documentary Letters of Credit, a Comparative Study* (1970) at 24-25.

2 "Letters of credit issued by the kings had nothing to do with trade. They were issued to loyal servants named in the letter to enable such servant to procure advances for the account of the issuer. The issuer, by the letter, constituted himself as the debtor for any loan made in accordance with the letter." (Hugo CF *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*, LLD Thesis, University of Stellenbosch (1996) at 61-63). See also Ellinger *op cit* n 1 at 5-6.

3 *Op cit* n 1 at 24.

4 *Op cit* n 2 at 63.

5 They were also described by Malynes G *Lex Mercatoria* (1622).

6 Jacobs G *Lex Mercatoria or the Merchant's Companion 2* ed (1729).

7 Jacobs G *A New Law Dictionary* (1729).

8 *Mason v Hunt* (1779) 1 Doug 297, *Russel v Langstaffe* (1780) 2 Doug 514. This study concerns letters of credit and therefore the history of open letters of credit will not be discussed comprehensively. For a comprehensive discussion of the history of open letters of credit see Hugo *op cit* n 2 at 62-72. See also Davis AG *The Law Relating to Commercial Letters of Credit* 3 ed 1963 at 2-11.

The history of documentary letters of credit, on the other hand, is not certain. It has been suggested that they came into being after the First World War.[9] But Ellinger suggests that they were used earlier than the First World War and that although Joint Stock Banks began issuing them at the end of the First World War other merchant bankers used them before that date. Although the archives of the merchant bankers were destroyed, Ellinger came to the conclusion that documentary credits slowly developed from open credits during the first half of the nineteenth century.[10]

Ellinger further states that merchant bankers suggest that they started to use them for the purposes of financing commercial transaction in the 1820s. The fact that merchant bankers began issuing documentary credits in the 1820s was supported in *Birckhead & Carlisle v Brown*[11] where Messrs Smith and Town of New York ordered their Brazilian representatives to purchase and ship them hides. Brown Bros of New York was requested by Smith & Town to order their correspondents, Messrs W & J Brown & Co of Liverpool to open an uncovered letter of credit in favour of the representatives of Smith & Town in Brazil. This was not a documentary letter of credit because no documents were required but it was a letter of credit opened by the banker at the request of a customer-importer in favour of the third party to finance a sale of goods.

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9 *The Kronprinsessan Margareta, The Parana and other Ships* [1921] 1 AC 486 at 510.

10 See Ellinger *op cit* n 1 at 26-27.

11 5 Hill NY 634 (1843).

The modern form of documentary credits developed during the latter half of the nineteenth century.[12] This type of credit was discussed in *Basse and Selve v Bank of Australasia.*[13] In that case, the plaintiff (a German firm), agreed to purchase a consignment of ore from an Australian firm. The German firm agreed to open a letter of credit in favour of the vendors through the Deustche Bank. The Deustche Bank had no correspondent in Australia and therefore instructed the London branch of the Bank of Australasia (the defendant) to open an irrevocable letter of credit, which it agreed to do. The fact that the letter of credit was opened shows that at the turn of the century letters of credit which are similar to the ones used today must have been frequently used.

Letters of credit became popular in the nineteenth century and textbooks on banking law also began to discuss them.[14] Although letters of credit were well known by bankers in England and America in the nineteenth century, their popularity increased in the twentieth century.[15] The reasons for the increasing use of documentary credits in the twentieth century are the breaking of trust between trading nations as a result of the First World War, the lack of economic stability and the fact that merchants prospered and became insolvent within a short time.[16]

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12 See De Rooy FP *Documentary Credits* (1984) at 7.

13 (1904) 90 LT 61.

14 See Hart HL *The Law of Banking* (1984) at 7.

15 See Hugo CF "The Developments of Letters of Credit as Reflected in the Uniform Customs and Practice for Documentary Credits" (1993) 5 *South African Mercantile Law Journal* 44 at 48-49.

2.3 The standardisation of letters of credit

The first standardisation of documentary letters of credit came from the United States of America. The New York Bankers' Commercial Credit Conference, which is one of the study groups established to look into the standardisation of existing banking practices, published the Regulations Affecting Export Commercial Credits ('RAECC') in 1920.[17] Thirty-four banking institutions, including the National Bank of South Africa and the Standard Bank of South Africa, subscribed to the regulations. The RAECC clarified unclear terms in the letter of credit practice and export terms were also incorporated. The export terms later came to be known as the American Foreign Trade Definitions.

In 1924 the United States Council on International Banking founded under the Junior Committee succeeded the New York Bankers' Credit Conference. The Junior Committee revised the RAECC.[18] Thirty-eight banks, excluding the two South African banks which subscribed to the 1920 version, adopted the RAECC revision in 1926. The American Trade Definitions were also included in the revision.

In 1922 the European Berliner Stempelvereinigung compiled rules for documentary credits. In 1923 the rules, the *Regulativ,* came into force. The provisions in the *Regulativ* were more comprehensive than those in the RAECC. Bankers in France and Norway also issued regulations in 1924, followed by Italy, Sweden and Czechoslovakia in 1925, the

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16 See Ellinger *op cit* n 1 at 37.

17 See Hugo *op cit* n 15 at 49-50.

18 See Hugo op *cit* n 15 at 51-52.

Argentine in 1926, and Holland in 1930.[19] All these national regulations clarified certain issues concerning documentary letters of credit, but they lacked universal application.[20]

2.4 The Uniform Customs and Practice for Documentary Credits (UCP)

2.4.1. The history of the UCP

As a result of the predominant usage of letters of credit in international transactions, the need for a universal standard practice emerged. The International Chamber of Commerce (ICC) instructed its Committee on Bills of Exchange and Cheques to investigate this need and to report back. The Committee prepared "Uniform Regulations on Export Commercial Credits". It also submitted an interim report to the 1927 ICC Congress in Stockholm with a mandate to the Congress to extend its mission to draft the uniform rules. The interim report was submitted as the "Draft Uniform Regulations on Export Commercial Credits". The final report of the Committee was presented to the 1929 ICC Congress in Amsterdam and published in 1930 as the Uniform Regulations for Commercial Documentary Credit. Only the banks in France and Belgium accepted the regulations.[21]

In 1931 the ICC in its congress instructed the Banking Committee for Documentary Credits to revise the Regulations for Commercial Documentary Credits. The regulations

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19 See Ellinger *op cit* n 1 at 37-38.

20 Hong Keng Kee & Helena HM Chan *Singapore Conferences on International Business Law, Current Problems of International Trade Financing* 2 ed (1983) at 5.

21 See Ellinger EP "The Uniform Customs and Practice for Documentary Credits – the 1993 Revision" (1994) *Lloyd's Maritime and Commercial Law Quarterly* 377 at 378.

were revised in 1933 and named the Uniform Customs and Practice for Documentary Credits (UCP). The 1933 revision was divided into five parts. Part A dealt with Form of Credits. It discussed inter alia the nature of the letters of credit and the principle of independence. Part B dealt with the liability of the bank to examine the documents. Part C discussed different types of transport documents. Part D provided for interpretation of terms and Part E dealt with the transfer of credit. The 1933 revision of the UCP was adopted for use in letter of credit transactions by the German, French, Italian, Rumanian, Swiss, Belgian, and Dutch banks.

The American banks, instead of adopting the UCP, revised the RAECC. The revision of the RAECC was adopted in 1934. The RAECC also included the American Foreign Trade Definitions. American banks adopted the UCP on an individual basis in 1938.[22] They adopted the UCP in relation to export credits only and subject to reservations. The reservations were labelled "Guiding Provisions" in the version of the UCP compiled by the Committee on Foreign Banking in America. The American Foreign Trade Definitions were also incorporated as a guiding provision.[23] The banks in the British Commonwealth did not accept the 1933 version because of differences between English letters of credit practice and the 1933 version.[24]

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[22] Although the UCP was adopted and followed in the USA, the law relating to letters of credit is basically to be found in article 5 of the Uniform Commercial Code. See 2.5 below for a detailed analysis of this article.

[23] See Hugo *op cit* n 15 at 54.

[24] See Gutteridge HC and Megrah M *The Law of Bankers' Commercial Credits* 7 ed (1984) at 6.

A revision of the UCP was issued in 1951. The purpose of the revision was to codify the customs and practice that had emerged since the 1933 version. There were no major changes in the 1951 revision. The Standard Forms for Issuing Documentary Credits were also adopted. This revision of the UCP was accepted by bankers in more countries than had accepted the 1933 version, including the bankers of the United States of America, but not those in England and most Commonwealth countries.[25] The American banks limited the application of the 1951 revision to export letters of credit and American Foreign Trade Definitions were still used. The American banks adopted the UCP to apply to import letters of credit in 1956. The American Foreign Trade Definitions were subsequently abrogated by disuse and replaced by the Incoterms.

The banks in England did not adopt the 1951 revision because it did not reflect letters of credit practice as established and developed in England. The other reason was that they were of the view that letters of credit practice was not yet ripe for codification and therefore had to develop from case to case. English banks were also against certain provisions of the UCP. Firstly, they were against Article 15, which identified documents to be presented in the absence of express stipulation in the letter of credit. They were of the view that before a documentary credit is issued, the buyer must in the application form give a detailed list of documents to be tendered. Secondly, the English bankers were of the view that reservations about the condition of the goods or of the packaging whether by means of express notation or by printed exemption clause rendered the documents unclean and therefore unacceptable. Other delegations were of the view that a document

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[25] See Purvis RN and Darvas R *The Law and Practice of Letters of Credit, Shipping Documents and Termination of Disputes* (1975) at 21-22.

was clean provided it did not include an express reservation by means of a notation. Thirdly, they were against Article 28, which allowed the tender of an insurance certificate in lieu of a policy and finally they were against Article 26 which provided that certification of weight on a way-bill was acceptable under a credit which called for a specific certificate of weight.[26]

In 1957, the ICC Commission on Banking Technique and Practice formed a working group to revise the UCP. The British delegation attended the ICC Commission's meeting and submitted a report suggesting changes that would enable British banks to accept the UCP. The UCP was revised in 1962 and this revision reflected the British practice. Article 24, for example, provided that "insurance documents must be specifically described in the credit and that cover notes issued by brokers will not be acceptable unless specifically authorised in the credit". This article adopted British practice and move away from the previous practice.[27]

The reason for the revision of the UCP was to secure the acceptance of the UCP by countries which had not accepted them. The revision succeeded in its stated purpose because it was accepted not only by bankers of countries that adopted the 1951 revision,

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26 See Ellinger *op cit* n 21 at 378-379.

27 See Hugo *op cit* n 15 at 62.

but also by bankers in England and most Commonwealth countries. The South African banks adhered to the 1962 revision on a collective basis on 1 July 1963.[28]

In 1964 The ICC Commission on Banking Technique and Practice appointed a working group to create new Standard Forms for Issuing Documentary Credits. The ICC accepted the revision in 1970.

In March 1971 the ICC tasked a working group to prepare a new revision of the UCP. The ICC was on this occasion assisted by the United Nations Commission on International Trade Law (UNCITRAL). The Commission on Banking Technique and Practice finalised the text in October 1974. It was approved by the Executive Committee of the ICC on 3 December 1974 and brought into operation on 1 October 1975.[29] There were changes in Articles 3, 7, 8, and 47 and also changes in the Articles relating to transport documents. In Article 3 the nature of the issuing and the confirming banks undertakings were set out in detail. Articles 7 and 8 cleared up the misunderstanding on the principle of strict compliance and strengthened this important principle of documentary credits. The new Article 47 provided:

> "The fact that a credit is not stated to be transferable shall not affect the beneficiary's rights to assign the proceeds of such credit in accordance with the provisions of the applicable law."

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28 See Hugo *op cit* n 15 at 58.

29 See Hugo *op cit* n 15 at 63-64.

This article clarified the uncertainty as to whether the beneficiary of a non-transferable credit could assign the proceeds of the credit. It also clarified the fact that the assignment of the beneficiary's right to obtain payment under the letter of credit was governed by the applicable law, that is, the law of the place at which the credit is payable.

The significant developments in international trade, especially the emergence of container transport and combined transport, were considered in the 1974 revision. As far as container transport is concerned, Article 19 provided that bills of lading "covering unitised cargoes, such as those in pallets or in Containers will be accepted". This article removed the uncertainty as to whether such bills of lading were acceptable.

With regard to combined transport, Article 23(a) provided that "if a credit calls for a combined document, i.e. one which provides for a combined transport by at least two different modes of transport, from a place at which the goods are taken in charge to a place designated for delivery, or if the credit provides for a combined transport, but in either case does not specify the form of documents required, and/or the issuer of such document, banks will accept such documents as tendered". The importance of combined transport documents is that one carrier is responsible for the entire carriage of goods. Thus, one contract is entered into between the shipper and the carrier or combined transport operator. Article 23 (a) accepts such transport documents.

Despite the popularity of the 1974 revision, the UCP was replaced nine years later by a new revision. In 1979, the Commission on Banking Technique and Practice appointed a

working group to make recommendations for a new revision which the Council of the ICC eventually approved on 21 June 1983, and which came into operation on 1 October 1984.[30] In this revision, special note was taken of:[31]

"- the continuing revolution in transport technology, the geographical extension of containerisation and combined transport;

- the increasing influence of trade facilitation activities on development of new documents and new methods of producing documents;

- the communications revolution, replacing paper as a means of transmitting information (data) relating to a trading transaction by methods of automated or electronic data processing (ADP/EDP);

- the development of new types of documentary credits, such as deferred payment and the standby credit;

- the increasing interest and influence in international trade of nations which are less developed and, therefore, less experienced in this area."

Although the 1974 revision addressed the developments in transport, many problems arose in practice. The 1983 revision solved those problems. In an attempt to establish the characteristics of an acceptable transport document, the 1983 revision distinguished three important situations: where the credits call for (a) marine bill of lading;[32] (b) postal receipts and certificates of posting;[33] and (c) other transport documents.[34] The 1983

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30 See Ellinger *op cit* n 21 at 380-381.

31 Introduction to the ICC Case Studies on Documentary Credits (ICC Publication No 459).

32 Article 26.

33 Article 30.

revision also introduced new forms of documentary credits, namely, standby credits and deferred payment credits.[35] It also provided for the credit instructions to be communicated by teletransmission.[36]

The International Chamber of Commerce (ICC) Commission on Banking Technique and Practice started work of another revision of the UCP in 1989. The revision was completed in March 1993 and accepted by the ICC in 1994. The aim of the revision was to clarify certain points left out in the 1983 revision: the classification of documentary credits[37] and the definition of liabilities between parties were clarified;[38] the procedure in respect of non-conforming documents was clarified and defined;[39] the provisions relating to transport documents[40] and the provisions with respect to transferable credits were also been revised.[41] The UCP (1993 revision) has been accepted by banks in over 160 countries, making its application nearly universal.[42]

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34 Article 25.

35 See Hugo *op cit* n 15 at 71-72.

36 See Schmitthoff CM *Export Trade: The Law and Practice of International Trade* 8 ed (1986) at 351.

37 Article 6.

38 Article 7 and 9.

39 Article 13 and 14.

40 Article 23-38.

41 Article 48.

42 See Jack R *Documentary Credits: The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees* 2 ed (1993) at 8-9.

2.4.2 The need for amendment of the 1993 revision of the UCP

The fast growing technology of computers and telecommunications is rapidly changing the methods of transacting business by paper documentation and letter of credit transactions are no exception. Letter of credit transactions revolve around documents. They are issued when the applicant makes an application to the issuing bank on a standard form and payment to the beneficiary is made upon presentation of documents. Electronic communication has taken over some aspects of letters of credit practice but not others. Banks use it in communicating with each other for the issuance, advice, confirmation or negotiation of letters of credit. In few cases applicants also use them to apply for the issuance of the credit.[43]

Most bank-to-bank communication concerning letters of credit is made through Society for World Wide Interstate Financial Telecommunication (SWIFT).[44] SWIFT is a Belgian non-profit organisation owned by banks for the transmission of financial transaction messages. The messages are structured in a uniform format. A bank communicates a message through the SWIFT access point. The message is then transferred on a dedicated data line to a regional process that validates it. From a regional processor it goes via a dedicated line to one of the two main switches. From the switches it goes through the regional processor to a SWIFT access bank to the receiving bank. The bank, which receives the SWIFT electronic message, does not need to send a reply to the effect that it accepts to advise, negotiate or pay the letter of credit. It must just advise, negotiate or pay

[43] Wells Fargo HSBC Trade Bank's Internet Letter of Credit Service allows its customers to apply for letters of credit on the Internet, to make changes and to receive reports from their home or through office computer (www.wellsfargo.com).

and the issuing bank will be entitled to reimburse it. The question then becomes when is the issuing bank bound by the electronic letter of credit? The UCP does not deal with this question. Section 5-106 (a) of the revised article 5 of the UCC provides that the electronic messages are effective and enforceable upon transmission by the issuing bank and not by delivery to the receiving bank. The SWIFT messages only facilitate the transmissions of letters of credit and do not transfer the funds from the issuing bank to other banks.

Although electronic data interchange can be used in the opening of the letter of credit and communication by the banks, documents are required at the heart of operation of letters of credit. The beneficiary has to present documents to claim payment. Banks also have to check whether documents presented to them comply with the terms of the credit.[45] It is submitted that the ICC must make amendments to the current revision of the UCP and publish new rules which will provide for fully computerised letters of credit operation. The effect will be to replace the paper documents with the computer-generated messages transmitted through telecommunication links. Thus the buyer could apply to the issuing bank to issue a letter of credit through the computer. The issuing bank could then inform the seller through electronic data interchange that a credit has been opened in his favour. The issuing bank could then request the correspondent bank to confirm or advise the credit through the computer system. The issuing bank or correspondent bank could make payment against presentation of documents from a seller through electronic data interchange.

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44 Rowe M *Letters of Credit* (1997) at 293.

45 *Ibid.*

There might be problems with this computerised method such as the way in which electronic messages are to be proved in court and the way in which an acceptable electronic data interchange, which is equivalent to a signature, should be used. It is submitted that electronic payment schemes will have to be established and the members should be bound by the rules of such schemes. Most legal problems which could be raised by this proposed method could be solved by having electronic interchange agreement. This agreement should deal with issues like the way in which the data in the computer is to be protected, the way in which the messages are to be transmitted and the admissibility of computer messages and records in court. Assistance can also be sought from other international organisations. For example, the International Maritime Committee has issued standard rules for electronic data interchange based transport documents and the ICC has issued the Uniform Rules for Interchange of Trade and Data by Teletransmission for use in agreements concluded electronically.[46]

This proposed computerised method will radically change the practical organisation of the letters of credit operation, but the basic nature of the banking undertaking will be fundamentally unchanged. For example, the responsibility of the issuing bank or confirming bank, if the credit is confirmed, to undertake liability and to check that the information presented complies with the terms of the credit will still be applicable.

The proposed method should not operate unless there are rules in place to regulate it. It is submitted that it is imperative that the ICC must take cognisance of the developments in

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[46] See Rowe *op cit* n 44 at 297-298.

e-commerce and produce rules, which will regulate a fully computerised letters of credit operation.

2.4.3 The legal nature of the UCP: The need for incorporation

The legal nature of the UCP has been a much-debated topic. Of interest is whether the UCP has the force of law, or whether the provisions of the UCP need to be incorporated into the contract between parties. Article 1 of the 1983 revision was self-contradictory in this respect. It read:

> "These articles apply to all documentary credits, and are binding on all parties thereto unless otherwise expressly agreed. They shall be incorporated into each documentary credit by wording in the credit indicating that such credit is subject to the Uniform Customs and Practice for Documentary credits, 1983 Revision, ICC Publication, No. 400."

If the UCP applies automatically to all documentary credits, then there is no need to incorporate them expressly.[47] However, the ICC does not have legislative power and therefore the UCP does not have legal force unless incorporated into the contract by parties. The UCP is different from any other Conventions, like the United Nations Convention on the Carriage of Goods by Sea, which have legal force in the countries that are parties to them. Therefore the first part of Article 1 can be regarded as being of no force and effect. The second part of Article 1 correctly states that the UCP must be

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[47] See Oelofse AN *The Law of Documentary Letters of Credit in Comparative Perspective* (1997) at 15-16.

incorporated into every documentary credit.[48] The 1993 revision is clear on this issue. Article 1 provides:

> "The Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No 500, shall apply to all Documentary Credits (including to the extent to which they may be applicable, Standby Letter(s) of Credit) where they are incorporated into the text of the credit. They are binding to all parties thereto unless otherwise expressly stipulated in the credit."

It is clear from the provisions of the revised Article 1 that the UCP has legal force only to the extent that it has been incorporated into the text of the credit and has not been expressly excluded from application by one of the parties to the letters of credit transaction. The application of the UCP can be secured by means of a statement issued by an individual bank, or by an association of banks in a country, that all credits issued by the bank, or by members of the association, are issued subject to the UCP.[49]

Another view is to accord the UCP the status of customary law. To qualify as customary law, the UCP has to meet the requirements that the legal system of a particular country sets for the recognition of a customary rule.[50] In most legal systems, one of the

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48 See Jack *op cit* n 42 at 9-10.

49 Jack *op cit* n 42 at 11-12.

50 Oelofse *op cit* n 47 at 17-19. See Also Maripe B "The Legal Aspect of Documentary Credit in International Trade: the case of Botswana" *The Comparative and International Law Journal of Southern Africa* (1999) 199 at 200-201.

requirements is that the custom must be long established.[51] In *Van Breda v Jacobs*[52] Solomon JA held that a custom must be immemorial, reasonable, continued without exception since time immemorial and must be certain. Judged by this requirement the UCP cannot as a whole qualify as custom because of the many different revisions. Although certain provisions can qualify as custom, the UCP as a whole cannot be regarded as custom.[53]

According to Hugo it is customary to incorporate a term subjecting the letter of credit to the UCP. As a result the UCP as a whole must be regarded as incorporated in a letter of credit by operation of law, unless excluded.[54] This view, it is submitted, is incorrect. Article 1 provides that the UCP applies if it is incorporated into the text of the credit. The incorporation depends on the issuer of the credit and therefore it is not a custom because the custom will have to apply independently of the issuer.[55] The better view regarding the legal nature of the UCP is that it is a set of model contractual terms which is incorporated into the letter of credit by agreement of the parties.[56]

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51 See Hugo CF "The Legal Nature of the Uniform Customs and Practice for Documentary Credits: Lex Mercatoria, Custom, or Contracts?" (1994) 2 *SA Merc LJ* 143 at 162-163.

52 1921 AD 330.

53 See Stassen JC "The Legal Nature of the Uniform Customs and Practice for Documentary Credits (UCP)" (1982) 4 *Modern Business Law* 125 at 127.

54 See Hugo *op cit* n 51 at 167-168.

55 See Oelofse *op cit* n 47 at p 17 f n 32.

56 See Oelofse *op cit* n 47 at 18.

Article 1 of UCP 500 makes it clear that the UCP shall apply if it is "incorporated into the text of the credit". It then follows that if the UCP is not incorporated, it should not apply. This problem does not arise in practice, since banks insist on the express adoption of the UCP and so incorporate them into their contract.[57]

2.5 American Uniform Commercial Code

2.5.1 Introduction

The Uniform Commercial Code (UCC) is a collection of statutes dealing with various aspects of commerce. The UCC is prepared by the Uniform Law Commissioners and co-sponsored by the Commissioners and the American Law Institute. The UCC covers a variety of subjects such as negotiable instruments, sales, and letters of credit, which are governed by article 5.[58] This means America has its own law dealing with letters of credit.

2.4.2 Article 5

Article 5 was issued in 1952 and is the first codification of domestic letters of credit law, although it does not purport to be a comprehensive codification.[59] Section 5-102 of the 1952 version specifically provides that it does not deal with all of the rules and concepts

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[57] See Ellinger EP "The Uniform Customs – Their nature and the 1983 Revision" 1984 *Lloyd's Maritime and Commercial Law Quarterly* 583 at 583-586.

[58] See Wunnicke DB and Turner PS *Standby and Commercial Letters of Credit* 2 ed (1996) at 70.

[59] See Lee WD "Letters of Credit: What does Article 5 have to offer to issuers?" (1996) Commercial *Law Journal* 234 at 234.

of letters of credit. This means that non-code law like the UCP will supplement Article 5. Article 5 governs letters of credit in America and fifty states have adopted it. States of New York, Alabama, Arizona and Missouri adopted Article 5 subject to certain amendments.[60] Section 5-102, which is adopted by the above-mentioned states, contains a subsection 4, which is absent from the original version. Subsection 4 provides:

> "Unless otherwise agreed, this Article 5 does not apply to a letter of credit or a credit if by its terms or by agreement, course of dealing or usage of trade, such letter of credit or credit is subject in whole or part to the Uniform Customs and Practice for Documentary Credits fixed by the thirteenth or any subsequent congress of the International Chamber of Commerce."

The effect of this subsection is that the UCC provisions will not be applicable even if the UCP is partly incorporated into the contract and irrespective of whether or not the UCC and UCP agree or conflict on a specific point. However since the preamble of section 5-102 (4) commences with the words "unless otherwise agreed", the parties can expressly provide that Article 5 of the UCC will remain applicable in so far as it does not conflict with the UCP.[61] In states that have not adopted section 5-102(4), the specific provisions of Article 5 may be excluded by agreement, and are excluded by the incorporation of the UCP if it conflicts with Article 5. However, contracting out of the UCC is limited. Section 1-102 (3) of the UCC provides that contracting out of the obligations of good faith, diligence, and care prescribed by the UCC is not possible, although the parties may

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60 See Oelofse *op cit* n 47 at 12.

61 See Oelofse *op cit* n 47 at 13.

by agreement determine the standards by which the performance of such obligation are to be measured if such standards are not manifestly clear.

The American Law Institute and National Conference of Commissioners on Uniform States Law revised Article 5 in 1995.[62] The developments in letters of credit, such as the use of standby letters of credit and the increasing use of deferred payment letters of credit, necessitated the revision. Section 5-116 (c) read with section 5-103(c) of the revised Article 5 provides that if rules of custom or practice, like the UCP, are incorporated in a letter of credit and such incorporated rules conflict with the rules of the UCC which would otherwise apply, then such incorporated rules will apply to the exclusion of the conflicting UCC provisions. The above sections make it clear that except for a few non-variable provisions,[63] in the event of conflict between the UCC and the UCP, the UCP shall apply.[64] Section 5-103 (a), which express the general preposition that the rules in article 5 apply to letters of credit, and section 5-103 (c) which lists non-variable provisions cannot be contracted out because they establish the basic ground rules for Article 5. In terms of Section 5 –102 (a) (10) a letter of credit definition is non-variable because the parties cannot invoke Article 5 by agreeing that an undertaking that lacks the requisites formality will be subject to Article 5.

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[62] See Barnes G and Byrne E "Revision of UCC Article 5" (1995) *The Business Lawyer* 1449 at 449-1451.

[63] Section 5-102 (a) (9) and (10), 5-103(a) and (d), 5-106 (d), 5-114 (d) and 5-117 (d) cannot be contracted out. They are non-variable provisions.

[64] See Stern S "Varying Article 5 of the UCC by Agreement" 114 1997 *Banking Law Journal* 516 at 517-521.

2.6 Conclusion

The ICC has been successful in compiling uniform rules for letters of credit. The latest revision of the UCP (the 1993 revision) is comprehensive, especially in the field of transport documents, where the provisions on marine bills of lading have been extended to include non-negotiable sea waybills. South African banks adopted the UCP on collective basis in 1963. Any letter of credit issued by them will be subject to the UCP provided, of course, that it has been incorporated into the contract. The 1993 revision also takes note of communication revolution by providing for the opening of letters of credit by telecommunication.[65] The fast growing technology of computers necessitates the amendment of the 1993 revision of the UCP and the drafting of the new rules which will provide for fully computerised letter of credit transactions. It is proposed that the ICC should draft the new rules.

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[65] Article 11 of the UCP.

CHAPTER THREE

DIFFERENT TYPES OF LETTERS OF CREDIT

3.1 Introduction

There are various parties involved in a letter of credit transaction: the buyer, the seller, the issuing bank and the correspondent bank. The intermediary bank may assume different functions depending on the instructions given to it. It may act as an advising bank, confirming bank, nominated bank, collecting bank, paying bank, negotiation bank or correspondent issuer.

There are different types of letters of credit. The Uniform Customs and Practice for Documentary Credits (UCP) classifies the types of letters of credit as revocable and irrevocable, as well as confirmed and unconfirmed credits. The first classification relates to the obligations of the issuing bank and the second to those of the correspondent bank. The UCP also categorise credits by means of payment obligations.

The purpose of this chapter is to look at the operation of letters of credit, the parties involved in the transaction and different types of letters of credit.

3.2 The operation of letters of credit

An importer (buyer) and exporter (seller) enter into a contract of sale, referred to as the underlying contract, in terms of which payment is to be effected by means of a letter of

credit.[1] The sale contract must specify, among others, the type of credit required, its terms, the bank to which documents are to be presented and the documents required for presentation by the seller in order to obtain payment. Although the contract of sale is the origin of the letter of credit, it is a separate contract to which the UCP has no application.

The buyer will then instruct a bank at the buyer's place of business to open a letter of credit in favour of the seller.[2] The issuing bank will, after satisfying itself as to the credit standing of the buyer, issue a letter of credit in favour of the seller. The issuing bank will then notify the seller that a letter of credit has been opened in his favour. The issuing bank can either dispatch the letter of credit direct to the seller or employ the services of a second bank, which operates in the country of the seller.[3] This correspondent bank advises the seller that a letter of credit has been opened by the issuing bank and, if required to do so by the issuing bank, adds its confirmation. By issuing a letter of credit the issuing bank undertakes either to pay at sight, or to accept or to negotiate a bill of exchange drawn on it by the beneficiary, against delivery to it of certain documents specified in the credit.[4]

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1 See Schmitthoff CM *Schmitthoff's Export Trade: The Law and Practice of International Trade* 8 ed (1986) at 339.

2 See Guest AG (Gen Ed) *Benjamin's Sale of Goods* 2 ed (1997) at para 23-005.

3 See Hugo CF "Documentary Letters of Credit: Reflections on Recent Developments" (1993) *Annual Banking Law Update* 181 at 182.

4 Article 9 (a).

The seller must then ship the goods and acquire the documents specified in the letter of credit. The documents must be presented to the issuing bank or, if any, the nominated bank. The correspondent bank must inspect the documents rigorously to determine whether they comply with the requirements of the letter of credit. If the correspondent bank is satisfied that the documents do comply with the credit, it must pay the seller if it undertook to do so. If the documents are not in order, the correspondent bank must reject them. Before it rejects the documents the correspondent bank may at the seller's request ask the issuing bank or the applicant whether the applicant is prepared to accept the documents even if they do not conform to the terms of the credit. If the seller is prepared to waive the discrepancies the correspondent bank may take the documents and pay.

The nominated bank as confirming bank must then present the documents to the issuing bank, which must reimburse it if the documents are in conformity with the credit.[5] If the issuing bank finds the documents not to be in accordance with the credit, it will send a notice of refusal to the correspondent bank, unless the buyer is prepared to waive the discrepancies. If the documents comply with the credit, the issuing bank will then present them to the buyer. If, according to the buyer, the documents do not conform to the credit, the buyer will reject them. If the documents are in order, he will pay the issuing bank. Armed with those documents, the buyer can obtain possession of the goods.

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5 See Guest *op cit* n 2 at para 23-006.

3.3 The parties to letters of credit transaction

The underlying transaction that gives rise to the need for a letter of credit is usually a contract of sale between parties in different countries. However, the use of letters of credit is not limited to the contract of sale.[6] The party who arranges for the opening of a credit is referred to as the "applicant". The seller, who is to be paid in terms of the letter of credit, is referred to as the "beneficiary". The bank that is requested by the applicant to open a credit is called the "issuing bank". The bank that is instructed to advise the credit to the beneficiary is called the "correspondent bank". Depending on the instructions that the intermediary bank receives in the individual matter, it may act in various capacities namely, as advising bank, as nominated bank, as confirming bank, as paying bank, as correspondent issuer, as collecting bank or as negotiation bank.

3.3.1 Capacities in which the intermediary bank may act

3.3.1.1 As advising bank

The correspondent bank is termed the advising bank when it advises the beneficiary that a letter of credit has been opened in his favour. In advising the credit the correspondent bank acts as an agent of the issuing bank.[7] Article 7 of the UCP provides that the advising bank can act without engagement on its part which in practical terms means that the advising bank acts without confirmation. If the advising bank does not add its

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[6] See Jack R *Documentary Credits: The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees* 2 ed (1993) at 3.

[7] See *Bank Melli v Barclays Bank (Dominion, Colonial and Overseas)* [1951] 2 Lloyd's Rep 367.

confirmation to the credit, it will not have any obligation to the beneficiary in respect of payment. The obligation of payment will be with the issuing bank.

The correspondent bank has a choice of either advising the credit or not. If a bank chooses to advise the credit, it must take reasonable care to check the authenticity of the credit. It must check whether the credit is instructed by the issuing bank which appears to have instructed it, and in the terms in which it appears that has occurred.[8] If the advising bank does not establish authenticity of the instructions, it must without delay inform the bank from which they were purported to have come. The advising bank may advise the credit nonetheless provided that it informs the beneficiary that it has not been able to establish the authenticity.[9] If the issuing bank refuses to accept the documents on the ground that the advising bank did not advise the credit correctly, the beneficiary can claim from the issuing bank. He will not have an action against the advising bank because the issuing bank is bound by the advise given by the advising bank even if it did not act as instructed by the issuing bank. The terms so advised falls within the authority of the advising bank.[10]

3.3.1.2 As the nominated bank

The correspondent bank acts as a nominated bank where it is authorised to pay, incur a deferred payment or to negotiate the credit.[11] In such cases the documents have to be

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8 Article 7 (a).

9 Article 7 (b).

10 See Jack *op cit* n 6 at 116-117.

11 Article 10 (b) (ii).

presented to the nominated bank and where the credit calls for the use of drafts, the drafts must also be presented to the nominated bank.[12] The nominated bank will not be obliged to pay the beneficiary unless it acts as a confirming bank. Thus, where it does not confirm the credit, the nominated bank will not be liable to pay the beneficiary upon receipt and examination of the documents.[13] If the nominated bank agrees to confirm the credit, it must pay the beneficiary against presentation of documents that appear on their face to be in compliance with the terms and conditions of the credit.[14] The issuing bank must then reimburse the nominated bank if it has paid against conforming documents.

3.3.1.3 As the confirming bank

If the correspondent bank is requested by the issuing bank to confirm the credit but is not prepared to do so, it must inform the issuing bank.[15] If the correspondent bank confirms the credit issued by the issuing bank, it is called the confirming bank. The confirming bank incurs the same obligations to pay as the issuing bank. It undertakes to pay at sight or on a deferred date, to accept bills drawn on it, and to be responsible for the acceptance of bills drawn on other drawees.[16] If the correspondent bank confirms a credit subject to conditions, the credit will not be treated as a confirmed credit. The seller may also use silent confirmation or seller's confirmation.[17] This kind of confirmation is not provided

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12 Article 10 (b) (ii).

13 Article 10 (c).

14 Article 10 (d).

15 Article 14 (a).

16 Article 9 (b) of the UCP.

for in the UCP. It comes into being when the seller approaches a bank in his country to confirm the credit opened by the issuing bank. The seller may do so if the buyer is not prepared to bear the costs of confirmation. If the bank agrees to confirm the credit the seller will then bear the costs of confirmation.[18] The confirming bank in this instance will not have any rights against the issuing bank for payment arising out of confirmation.

3.3.1.4 As the bank nominated to pay

The correspondent can act as a paying bank. In such circumstances it acts as an agent of the issuing bank that has made an undertaking that payment will be made.[19] The bank will be obliged to pay as against the issuing bank but not as against the beneficiary even if it did not confirm the credit.

3.3.1.5 As the correspondent issuer

The correspondent bank may be required to issue the credit in its own name. In such instances it makes a sole undertaking to pay the beneficiary. Its relationship with the bank which gave it instructions to open the credit is similar to that of the applicant of the credit and the issuing bank.[20] There will be no relationship between the beneficiary and the bank which requested the correspondent bank to issue the credit.

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17 See generally Schmitthoff *op cit* n 1 at 362-363. See also Jack R *op cit* n 6 at 121–122, Goode R *Commercial Law* 2 ed (1995) at 972.

18 *British Imex Industries Ltd v Midland Bank* Ltd [1958] QB 542.

19 See Jack *op cit* n 6 at 120.

3.3.1.6 As the collecting bank

A collecting bank is a bank which is requested by the beneficiary to present the documents under the credit on the beneficiary's behalf. If it agrees, then it becomes the agent of the beneficiary to present the documents to the issuing bank and to receive payment on the beneficiary's behalf. If the beneficiary is aware that the documents are fraudulent on presentation the issuing or confirming bank will not be obliged to pay the collecting bank.[21]

3.3.1.7 As the negotiation bank

There are two ways in which a correspondent bank may negotiate documents. The first way is where it is nominated in the credit to negotiate them and the second way is where it is approached by the beneficiary of the credit and agrees to do so.[22] Either way, the negotiation bank can negotiate, that is buy, the documents from the beneficiary and present them to the issuing bank in its own name (an its own behalf). It will become a contracting party to the credit and will have a right to sue the issuing and the confirming bank if they do not honour the undertakings in the credit. The negotiation bank acts as a principal and not as the agent of the issuing bank or beneficiary.

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20 See Jack *op cit* n 6 at 123.

21 See *United City Merchants v Royal Bank of Canada* [1983] 1 AC 168.

22 See Jack *op cit* n 6 at 122.

3.4 Types of letters of credit

3.4.1 Revocable and irrevocable credits

Article 6 (a) of the UCP provides that a credit may be either revocable or irrevocable. A revocable credit is one which may be cancelled by the issuing bank without the consent of the beneficiary.[23] An irrevocable credit can be cancelled only with the consent of the applicant, the beneficiary and the issuing bank. Article 6 (c) provides that in the absence of any indication of whether a credit is revocable or irrevocable the credit is deemed to be irrevocable. Whether a credit is revocable or irrevocable depends on the undertaking given by the issuing bank to the seller.[24]

3.4.1.1 Revocable credits

A revocable credit provides no security to the beneficiary as the issuing bank has no obligation to inform the beneficiary that the credit has been revoked. They are best suited for parties who have well-established business relationships. In *Cape Asbestos Co Ltd* v *Lloyds Bank Ltd*[25] the plaintiffs agreed to sell 30 tons of asbestos sheets to buyers in Warsaw who opened a revocable credit through Lloyds Bank. Lloyds Bank opened the credit, adding the clause "this is merely an advice of the opening of the above-mentioned credit and is not a confirmation of the same". The shipment of 17 tons was made and Lloyds Bank paid the seller under the credit. Lloyds Bank was informed that the credit was cancelled, but Lloyds Bank did not inform the seller of this. The seller made a

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23 Article 8 (a).

24 See Todd P *Bills of Lading and Bankers' Documentary Credits* 2 ed (1993) at 29-32.

25 (1921) WN 274.

second shipment of the remaining asbestos, unaware that the credit had been cancelled. The documents were presented to Lloyds Bank and were refused. The seller sued Lloyds Bank claiming that the bank was under a duty to give it reasonable notice of the cancellation of the credit. Bailharche J held that a bank may cancel a revocable credit at any time and is under no duty to inform the seller that a revocable credit had been cancelled. This case shows that revocable credits are insecure and a bank is not obliged to give the beneficiary a notice of cancellation of the credit.

Article 8 (b) offers protection for any bank which has already paid before receiving a notice of amendment. It states that an issuing bank must reimburse a bank to which a revocable credit has been made available for payment, acceptance or negotiation, in respect of any payment, acceptance or negotiation made by such bank before receiving a notice of cancellation or amendment. That payment must have been made against documents which appear on their face to be in compliance with the terms and conditions of the credit.

3.4.1.2 Irrevocable credits

Almost all credits issued today are irrevocable.[26] An irrevocable credit constitutes a definite undertaking on the part of the issuing bank that the provisions for payment contained in the credit will be duly fulfilled, provided that the terms and conditions are complied with and stipulated documents are presented. The issuing bank may undertake to pay where the credit provides for sight payment or deferred payment, or it may

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[26] See Jack *op cit* n 6 at 23.

undertake to accept drafts drawn on it, or to be responsible for their acceptance and payment at maturity if they are to be drawn on another bank; or where the credit provides for negotiation, it may undertake to pay against appropriate drafts without recourse to drawers or *bona fide* holders, or to provide for negotiation by another bank and to pay if negotiation is not effected.[27]

An irrevocable credit offers security to the beneficiary in the sense that the undertaking of the issuing bank to pay is irrevocable. Article 9 (d) (i) of the UCP provides that the banker's undertaking in an irrevocable credit can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank, if any, and the beneficiary.

3.4.2 Confirmed and unconfirmed credits

A credit is confirmed when the correspondent bank undertakes that it will make payment, and a credit is unconfirmed when the undertaking to pay is only made by the issuing bank.

3.4.2.1 Confirmed credit

Article 9 (b) of the UCP provides that by confirming the credit the correspondent bank undertakes to pay at sight or on a deferred date, to accept bills drawn on itself, and to be responsible for the acceptance of bills drawn on other drawees, and to negotiate without

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[27] Article 9 (a).

recourse bills drawn by the beneficiary on any drawee apart from itself.[28] The confirming bank adds its own definite undertaking to pay to that of the issuing bank and if the issuing bank refuses to reimburse it after it has made payment, the confirming bank will have no recourse against the beneficiary. A credit may be irrevocable without being confirmed, but a confirmed credit is always irrevocable.[29] The advantage of a confirmed credit is that it localises the all-important payment obligation of an export transaction in the seller's country.[30] If a respected bank in the seller's country confirms a credit, he can be sure of obtaining payment as arranged in the contract with the buyer provided he tenders the correct documents.

3.4.2.2 Unconfirmed credits

Article 9 (c) (i) of the UCP provides that if the correspondent bank is requested to confirm a credit but is not prepared to do so, it must so inform the issuing bank without delay. If it decides not to confirm the credit, it may advise the credit to the beneficiary without adding its confirmation. In an unconfirmed credit transaction, the intermediary bank acts solely as the agent of the issuing bank.[31] It assumes the role of a nominated bank and receives the documents tendered by the seller on behalf of the issuing bank. While these credits are cheaper than confirmed credits, their disadvantage is that if the documents are refused by the bank to whom they are presented, the seller will have a

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28 In *Ian Stach v Baker Bosley Ltd* [1958] 2 QB 130 Lord Diplock held that a confirmed credit constitutes "a direct undertaking by the banker that the seller, if he presents documents as required in the required time, will receive payment". See also *Hamzeh Malas and Sons v British Imex Industries Ltd* [1958] 2 QB 127.

29 See Goode *op cit* n 17 at 971.

30 See Schmitthoff *op cit* n 1 at 362.

remedy only against the issuing bank, which is abroad, and so proceedings may be more difficult than if he had an undertaking from a bank in his own country.[32]

3.4.3 Categorisation of credits by payment obligation

Article 10 (a) of the UCP provides:

> "All credits must clearly indicate whether they are available by sight payment, by deferred payment, by acceptance or by negotiation."

3.4.3.1 Sight payment credits

The credit is available by sight payment when the issuing bank or, if any, the confirming bank, is obliged to pay the beneficiary monies due to him against delivery of documents which are in compliance with the credit.[33] The seller has to draw a sight bill on the issuing bank or correspondent bank for immediate payment.[34] The bill remains with the bank after payment since no acceptance is needed.

3.4.3.2 Deferred payment credits

In a deferred payment credit the correspondent bank is authorised to pay or to make arrangement for payment at some future date determinable in accordance with the terms

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31 See Jack *op cit* n 6 at 24-25.

32 See Schmitthoff *op cit* n 1 at 360. See also Todd *op cit* n 24 at 25, and Jack *op cit* n 6 at 25.

33 See Schmitthoff *op cit* n 1 at 356.

34 See Goode *op cit* n 17 at 972.

of the credit.[35] Under a revocable credit the correspondent bank is entitled to reimbursement if it incurs a deferred obligation.[36]

3.4.3.3 Acceptance credit

Under an acceptance credit the seller draws the bill of exchange on either the issuing or correspondent bank. If the bill provides for payment on a date after the acceptance of the bill, payment will only be effected when that time comes.[37] After effecting payment the correspondent bank will debit the issuing bank with the face value of the bill and its commission. Once the correspondent bank accepts the bill it provides the seller with security because if he does not want to hold the bill until it matures, he may sell or discount it by negotiating and delivering it.[38]

3.4.3.4 Credit available by negotiation

In terms of this credit the issuing and correspondent bank undertakes to negotiate the beneficiary's draft against presentation of complying documents and the money acquired as a result is passed to the beneficiary.[39]

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35 Article 9 (a) (ii) of the UCP.

36 Article 14 (a) of the UCP.

37 See Jack *op cit* n 6 at 26.

38 See Schmitthoff *op cit* n 1 at 357.

39 See Hugo CF *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*, LLD Thesis, University of Stellenbosch (1996) at 39.

3.4.4 Straight credits

A straight credit is one under which the undertaking of the issuing bank, or if it is confirmed, the confirming bank, is directed to the named beneficiary alone.[40] The beneficiary can cede the rights against the issuing bank. The cessionary steps into the shoes of the cedent and defences available to the cedent remain available to the cessionary.[41]

3.4.5 Negotiation credits

Article 10 (b) (ii) of the UCP defines negotiation as the giving of value for a draft or document, but only when the bank has been authorised to negotiate. In a negotiation credit the issuing bank's undertaking is not confined to the beneficiary but extends to a person to whom the beneficiary has negotiated the documents. A negotiating credit may be open to anyone who wishes to negotiate it or it may be restricted to a designated bank.[42] The negotiating bank negotiates (or buys) the documents from the beneficiary, presents them under the credit and receives payment in due course. The beneficiary acquires his money immediately by selling the documents to the negotiating bank. The negotiating bank can, if a need arises, sue in its own name and not as an agent of the issuing bank.[43] Negotiation credits are recognised by Article 10 (b) (i) of the UCP. It states that:

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40 See Guest *op cit* n 2 at para 23-043.

41 Oelofse AN The *Law of Documentary Letters of Credit in Comparative Perspective* (1997) at 59.

42 See Goode *op cit* n 17 at 982.

"Unless the credit stipulates that it is available only with the Issuing Bank, all credits must nominate the bank (the 'Nominated bank'), which is authorised to pay, to incur a deferred payment undertaking, to accept Draft(s) or *to negotiate*. In a freely negotiable credit, any bank is a Nominated Bank...."[44]

3.4.6 Transferable and non-transferable credits

In a transferable credit the seller transfers the rights and duties arising under the credit to another person, usually a supplier, in such a way that the supplier is assured of payment out of the funds to be made available by the ultimate buyer. The seller must make sure that the terms of the contract he has entered into with the supplier will be met by the transfer of the credit which he has contracted with the buyer.[45] The concept of transferable credit is a misleading one. A letter of credit cannot be transferred by indorsement and delivery because it is not a negotiable instrument. What actually happens is that if the seller wishes to transfer a transferable credit issued by the issuing bank, he should return the letter of credit to the transferring bank which at seller's request issues a new letter of credit to the seller's supplier for the whole or part of the amount of the original credit. A transferable credit is defined in Article 48 (a) of the UCP as

"a Credit under which the Beneficiary (First Beneficiary) may request the bank authorised to pay, incur a deferred payment undertaking, accept or negotiate (the 'Transferring Bank'), or in the case of a freely negotiable Credit, the bank specifically authorised in the Credit as a Transferring Bank, to make the Credit

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43 See Jack *op cit* n 6 at 27,135.

44 The italics are mine.

45 See Jack *op cit* n 6 at 30.

available in whole or part to one or more other Beneficiary (ies) (Second Beneficiary (ies))".

In general a letter of credit is not transferable. It will only be transferable if it is expressly stated to be transferable.[46] The seller has no right to demand transfer, but may request it. The bank is not obliged to agree to the request except to the extent and in the manner expressly consented by such bank.[47] It is the whole credit and not the proceeds which are transferable. A credit can only be transferred once.[48] Therefore the second beneficiary cannot transfer the credit to the third beneficiary. The effect of a transfer of the credit on the different relationships among parties in the credit transactions is not dealt with by the UCP. South African case law is also silent on this point. Jack correctly suggests that a transferable credit constitutes a variation of the contract between the issuing bank and the beneficiary and a new contract comes into being between the issuing bank and the second beneficiary.[49] Jack also indicates that by requesting a transfer the beneficiary accepts that he will only collect the difference between the value of his invoice and that of the second beneficiary.[50]

3.4.7 Back-to-Back Credits

As a transferable credit can only transferred once, it is not suitable for sales where the same goods are sold over and over again through intermediaries. In such situations back-

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46 Article 48 (b).

47 Article 48 (c).

48 Article 48 (g).

49 See Jack *op cit* n 6 at 243.

50 See Jack *op cit* n 6 at 242.

to-back credits may be used.[51] A back-to-back credit has been defined as a credit where the documents received through its operation, with the substitution of other documents like the invoice, may be presented to obtain payment under another credit.[52] Thus, the seller requests the bank to issue a credit to his supplier on the security of the credit opened in the seller's favour.

Back-to-back credits, unlike transferable credits, are not provided for in the UCP. The seller's bank will, if it agreed to issue a back-to-back credit, take possession of the credit issued to the seller and issue a countervailing letter of credit. The original credit and the second one will be identical, apart from the price. The original credit is not transferred: in fact, there are two separate contracts. The risk of using back-to-back credits is that a bank is obliged to pay the beneficiary of the credit which it has opened, even if its customer is unable to obtain payment under the backing credit.[53] The other risk is the insolvency of the beneficiary of the main credit. Oelofse states that to avoid the risk it should be agreed that the rights of the documents and goods presented under the back-to-back credit pass directly to the issuer. The goods and documents will then not form part of the insolvent estate of the beneficiary.[54] As a result of the risks involved banks tend to avoid using back-to-back credits.[55]

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51 See *Ian Stach v Baker Bosley Ltd supra* at n 28 where Devlin J describe the way in which transferable credits and back-to-back credits may be used to provide payment in a string of contracts.

52 See Jack *op cit* n 6 at 30-31.

53 See Goode *op cit* n 17 at 1025.

54 See Oelofse *op cit* n 41 at 63-64.

55 See Carr I *Principle of International Trade Law* 2 ed (1999) at 64.

3.4.8 Assignment of the benefits of the credit

The seller can assign the benefits accruing to him under the credit to his supplier or any other third party. Assignment may take place before the delivery of the goods or after the delivery of conforming documents. Article 49 of the UCP provides for assignment:

> "The fact that a credit is not stated to be transferable shall not affect the Beneficiary's rights to assign any proceeds to which he may be, or may become, entitled under such credit, in accordance with the provisions of the applicable law. This Article relates only to the assignment of proceeds and not the assignment of the right to perform under the Credit itself."

The UCP admits that the benefit of a letter of credit can be assigned even if the credit is not stated to be transferable, but the assignability of such benefit may be excluded by a term to that effect in the credit.

3.4.9 Red clause[56] and green clause

The red clause originated in the wool trade in South Africa, New Zealand and Australia.[57] This credit is called a red clause because it was originally written in red ink, enabling the seller to receive his payment prior to the shipment of the goods.[58] In terms of this credit the bank is instructed to pay against the production of documents like warehouse receipts

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56 Red clause is also known as "anticipatory credit" or "packing credit".

57 See Carr *op cit* n 55 at 286-287.

58 See Schmitthoff *op cit* n 1 at 365. See *Tukan Timber Ltd v Barclays Bank plc* [1987] 1 Lloyd's Rep 171 where an example of a red clause was given.

(that the goods are in existence) or the forwarder's certificate of receipts (affirming that the goods have been received for shipment) and not transport documents.[59] A red clause can be used where the buyer has a good business relationship with the seller and can trust him.

A green clause is a refinement of red clause. They originated in the coffee trade in Zaire.[60] It allows the seller to get payment before the shipment of the goods, but provides for storage in the name of the bank.[61]

3.4.10 Revolving Credits

If the buyer is a regular customer of the seller, he can arrange a revolving credit in favour of the latter. Revolving credits enables the beneficiary to present documents as often as he likes during the credit period, which at no time shall exceed the overall limit. The credit is reduced by payment made by the bank while payment by the buyer replenishes it.[62] Revolving credits are used mainly in contracts of sale which contemplate delivery of goods by instalments and are commonly found in petroleum industries.[63] In *Nordskog & Co v National Bank*[64] an expert witness explained the meaning of revolving credits:[65]

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59 See Jack *op cit* n 6 at 33.

60 See Carr *op cit* n 55 at 287.

61 See Goode *op cit* n 17 at 983.

62 See Goode *op cit* n 17 at 983-984.

63 See Guest *op cit* n 2 at para 23-048.

64 (1922) 10 Ll L Rep 652.

"It is a little difficult to define, but a revolving credit technically means a credit for a certain sum at any one time outstanding, which is automatically renewed by putting on at the bottom that which is taken off at the top. If you have a revolving credit for £50,000 open for three months, to be operated on by drafts at 30 day's sight as drafts are drawn, they temporarily reduce the amount of the credit below the £50,000. As these drafts run off and are presented and paid they are added again to the top of the credit, and restore it again to £50,000. This is what is known technically as a revolving credit, and it is automatic in its operation and does not need any renewal."

3.4.11 Standby Credits

Standby credits are used to assure the beneficiary that the other party to the underlying contract will perform his obligation, for example to build something or render service. The bank will be obliged to pay when the beneficiary confirms that the other party has failed to perform his contract to the beneficiary. Their effect is similar to that of an independent bank guarantee.[66] They originated in the United States and came about as a result of federal laws which prohibit national banking associations from issuing guarantees. In modern practice standby letters of credit are used in international trade. Article 1 of the UCP states that:

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65 At 663.

66 See Todd *op cit* n 24 at 42-43.

"The Uniform Customs ... shall apply to all Documentary Credits (including the extent to which they may be applicable, Standby Letter(s) of credit) where they are incorporated into the text of the credit...."

The effect of this section is that standby credits can be issued subject to the UCP by incorporating them into the text of the credit.

There are rules for standby letters of credit drafted by the International Financial Services Association, the trade association representing the major banks in the USA in this field and the Institute of International Banking Law & Practice, Inc. The Secretariat of the United Nations Commission on International Trade Law (UNCITRAL) and the International Chamber of Commerce (ICC) Banking Commission also participated.[67] The reasons for drafting the rules has been described by Professor James Byrne:[68]

"Those rules (the UCP) are inappropriate for standby letters of credit and over the years have caused a number of anticipated problems, both practical and legal. Because of the increased use of standby credits both in the United States and around the world, the letter of credit community decided to go forward with separate rules for standby letters of credit, and the International Standby Practice (ISP) is the result of the work."

The rules came into effective on 1 January 1999.

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[67] Byrne J "New Rules for Standby Letters of Credit: The International Standby Practices/ ISP 98." (1998) *Business Credit* 32 at 32.

[68] Hollis K "Standby Letters of Credit Subject to New Set of Rules" (1999) *Memphis Business Journal* 7 at 7.

There is also a Convention called the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit of 1995, which regulates standby letters of credit. It came into force on 1 January 2000 for those countries which have ratified or acceded to it.

3.5 Conclusion

There are different categorisations of credits and the most important classifications are those between revocable and irrevocable credits, and confirmed and unconfirmed credits. The categorisation is important because it deals with the undertaking of the banks to the parties in a letter of credit transaction. An irrevocable credit is usually preferred above a revocable credit because of the security it offers. It cannot be revoked without the consent of the issuing bank, the confirming bank and the beneficiary. Article 6 (c) provides that in the absence of the indication whether a credit is revocable or irrevocable the credit is deemed to be irrevocable. It is submitted that a revocable credit can be used where the parties have a well-established business relationship.

Although an unconfirmed credit is cheaper that a confirmed credit it will be advisable for the seller to require the correspondent bank to confirm the credit. The advantage of a confirmed credit is that the seller obtains payment from a bank in his country and in cases of disputes he can sue in his own country.

CHAPTER FOUR

CONTRACTUAL RELATIONSHIPS BETWEEN PARTIES INVOLVED IN A LETTER OF CREDIT TRANSACTION

4.1 Introduction

Five contracts are brought into play by a transaction which involves a letter of credit. The contracts are: the sale contract between the buyer and seller; the contract between the buyer and issuing bank; the contract between the issuing bank and the correspondent bank; the contract between the seller and confirming bank and the contract between the seller and issuing bank.[1] These contracts are separate from each other. Nonetheless, the contracts are related in that the terms and conditions in the various contracts relating to the documents which the seller has to present under the credit usually correspond.

4.2 The contract between the buyer and the seller

4.2.1 The duty of the buyer to open a letter of credit

A letter of credit is usually opened when a buyer and seller agree in their underlying contract, which is commonly of sale, that payment should be effected by the furnishing of a letter of credit. In such cases the buyer has to present the letter of credit before the seller can deliver the goods.[2] In English law if the buyer does not provide the credit, the seller can treat himself as discharged from any further performance in terms of the

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1 These contractual relationships were mentioned by Lord Diplock in *United City Merchants v Royal Bank of Canada* [1983] 1 AC 168 at 182-183. He, however, omitted to mention the contract between the issuing bank and the seller.

2 A contract of sale may impose on the seller a duty to perform before the buyer can open the credit. In *Knotz v Fairclough Dodds and Jones Ltd* [1952] 1 Lloyd's Rep 226 it was held that the provisional invoice was a condition precedent to the buyers' obligation to open the credit.

contract of sale and sue the buyer for damages for not providing the credit.[3] In South African law the seller can cancel the contract if it contains a *lex commissoria,* that is a cancellation clause which allows the seller to cancel the contract if the buyer fails to perform in time, or where time is of essence of the contract.[4] In other instances, a condition precedent to the formation of the contract is that a letter of credit be opened. That is, it is a condition which must be fulfilled before any contract is concluded at all.[5] It depends on the intention of the parties whether a letter of credit should be opened before the seller can deliver the goods or before the conclusion of the contract.

The contract should spell out with sufficient particularity the terms and conditions of the credit, such as whether the credit is revocable or irrevocable, confirmed or unconfirmed, whether documents are to be presented, the time of presentation of the documents, the person to whom they must be presented and the method of payment.[6] If the credit provides for the opening of a confirmed credit, the furnishing of a revocable credit,[7] or an irrevocable but unconfirmed credit, will not be sufficient.[8] Similarly, if the contract of sale provides for an irrevocable credit to be opened in London, an irrevocable credit opened in another place will not do.[9]

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3 *Trans Trust S P R L v Danuban Trading Co Ltd* [1952] 2 QB 297.

4 See Christie RH *The Law of Contract in South Africa* 3 ed (1996) at 561-565.

5 T*rans Trust S P R L v Danuban supra* n 3.

6 See Brindle M *The Law of Bank Payments* (1996) at 413.

7 *Panoustous v Raymond Hadley Corporation* [1917] 2 KB 473.

8 *Soproma SPA v Marine and Animal By-Products Corporation* [1966] 1 Lloyd's Rep 367.

9 *Enrico Furst (E) & Co v W E Fisher Ltd* [1960] 2 Lloyd's Rep 340.

Difficulties arise when the contract of sale is silent on whether the credit is revocable or irrevocable, or confirmed or unconfirmed. As a revocable credit offers no security to the parties, it may be presumed that the intention of the parties is to provide security and therefore an irrevocable credit should be furnished.[10] In *Giddens v Anglo-African Produce Co Ltd*[11] the contract called for the credit to be established with the National Bank of South Africa. The buyer furnished a revocable credit. The seller declined to ship the goods and as a result the buyer instituted an action against the seller. In dismissing the action Bailchane J held that the revocable credit furnished by the buyers could not be construed as an established credit. The judge treated the term "established credit" to mean "irrevocable credit". This case shows that if a contract of sale does not specify the type of credit to be opened, the courts will construe the contract as stipulating that an irrevocable credit be opened.[12] However the contract of sale will be incomplete if the parties do not agree on the type of the credit to be opened.[13]

If the sale contract does not specify whether the credit is to be confirmed or unconfirmed, the buyer will discharge his obligation by opening an irrevocable credit.[14] If the seller requires a confirmed credit he should indicate that in the sale contract. If the sale contract does not fully define or does not define at all the terms of the proposed letter of credit, the terms may either be found by other means or the contract may be held to be void for

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10 See Jack R *Documentary Credits The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees* 2 ed (1993) at 39.

11 [1923] 14 Ll L Rep 230.

12 See Guest A G (Gen Ed) *Benjamin's Sale of Goods* 2 ed (1997) at para 23-063.

13 *Schijveschuurder and others v Canon (Export) Ltd* [1952] 2 Lloyd's Rep 196.

14 See Jack *op cit* n 10 at 39.

uncertainty. Some terms of the credit may be filled from other provisions of the contract of sale or by custom of trade. In *Ficom SA v Sociedad Cadex Ltd*[15] Goff J examined ways in which the correct terms of the credit might be established. He said that if the parties do not in their sale contract define the terms of the proposed letter of credit, the letter of credit as subsequently agreed between the parties might fill the contractual gap and supplement the sale contract. To determine whether the parties have agreed to vary the terms of the sale contract or to supplement its express terms the intention of the parties must be ascertained. He, however, was reluctant to formulate a general rule on whether the terms of the letter of credit so agreed are binding contractually on the parties. He regarded it as important that the terms be binding. If there is no agreement in the sale as to the terms of the credit, the dispute can be resolved by defining where possible by means of implication or by resort to any approved custom of the trade, the terms upon which the parties must be taken to have agreed that the letter of credit should in due course be issued.[16]

4.2.2 Time for opening of a credit

The credit must be opened within the time provided by the contract of sale.[17] Where the contract requires that the credit be opened immediately, the buyer must have such time as

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15 [1980] 2 Lloyd's Rep 118.

16 At 131,132.

17 See Jack *op cit* n 10 at 42.

is needed by a person of reasonable diligence to get the credit established.[18] The facts of each and every case are to be taken into consideration in determining a reasonable time.[19]

Difficulties arise if the time is unclear. In *Transpetrol Ltd v Transol Olieprodukten Nederland BV*[20] the contract required that the buyer furnish the letter of credit within one day following the receipt of the seller's nomination of the vessel, but the seller had in addition to give three days' notice to the buyer of his intention to nominate. The seller nominated a vessel without sending the required notice to the buyer. The buyer claimed that the seller's failure to notify him of the nomination resulted in delays in the actual furnishing of the letter of credit. Phillips J rejected the buyer's argument and held that to require the seller to give a minimum of three days notice of intention to nominate was nonsensical because it was of no use to the buyer. He further held that the only stipulation respecting the credit was that it be furnished within one day of the date of nomination and as the buyer failed to comply, the seller acquired the right to repudiate the contract.

It is advisable for the parties to provide the time for the opening of the credit in the underlying contract. The time so stipulated should also be clear. The use of a complex clause will lead to difficulties in interpretation of the period, as happened in *Transpetrol*.

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18 *Garcia v Page & Co Ltd* [1936] 55 LI L Rep 391.

19 In *Etablissements Chainbaux SARL v Harbormaster Ltd* [1955] Lloyd's Rep 303 Devlin J quoted with approval the case of *Hick v Raymond and Reid* [1893] AC 22, that where the law implies that a contract should be performed within a reasonable time, "it has invariably been held to mean that the party whom it is incumbent duly fulfils his obligation, notwithstanding protracted delay, so long as the delay is attributed to causes beyond his control, and he has neither acted negligently nor unreasonably".

4.2.2.1 Carriage insurance freight (CIF) contracts[21]

A CIF contract usually states the period of shipment and not the time of the opening of the credit. In such circumstances, it is uncertain whether the letter of credit must be furnished, at the latest, on the first day on which shipment takes place or at a reasonable time before that date. In *Pavia & Co SPA v Thurmann-Neilsen*[22] a contract for the sale of groundnuts CIF against confirmed credit called for shipment during February-April 1949. The buyers did not open the required documentary credit until April 22. In holding that the buyers had failed to furnish the documentary credit on time Sommervell LJ said:[23] "I think when a seller is given a right to ship over a period and there is machinery for payment, that machinery must be available over the whole shipment period." Denning LJ said *obiter*:[24]

> "[I]n the absence of express stipulation ... the credit must be made available to the seller at the beginning of the shipment period. The reason is because the seller is entitled, before he ships the goods, to be assured that, on shipment he will get paid. The seller is not bound to tell the buyer the precise date when he is going to ship, and whenever he does ship the goods, he must be able to draw on the credit. He may ship on the very first day of the shipment period. If, therefore, the buyer is to fulfil his obligation he must make the credit available to the seller at the very

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20 [1989] 1 Lloyd's Rep 309. See also *Sohio Supply Co v Gatoil (USA) Inc* [1989] 1 Lloyd's Rep 588.

21 A CIF contract is an agreement to sell goods at an inclusive price covering costs of the goods, insurance and freight. See Guest *op cit* n 12 at para 23-069.

22 [1952] 2 QB 84.

23 At 88.

24 At 88-89.

first date when the goods may be lawfully shipped in compliance with the contract."

The view that the letter of credit must be available at a reasonable time before shipment finds support in *Plasticmoda SPA v Davidsons (Manchester) Ltd*[25] where Denning LJ began his judgment by indicating that *Pavia* established that when nothing is said the credit must be established by the buyer at the beginning of the shipment period. In this case the contract provided for a shipment date and not a shipment period as in *Pavia*. Denning LJ held that the letter of credit must be established at a reasonable time before that date. The view was also supported in *Sinason Teicher Inter American Grain Corporation v Oilcakes and Oilseeds Trading Co Ltd*[26] where Lord Devlin agreed that the *Pavia* case does not decide that the buyer can delay in providing the credit up to the date of shipment, and stated that it must be provided at a reasonable time before that date.

4.2.2.2 Free on board (FOB) contracts[27]

In *Ian Stach Ltd v Baker Bosley Ltd*[28] a contract for the sale of ship plates to be delivered FOB Benelux port of shipment to Canada "August-September" provided for payment by confirmed irrevocable credit. The buyers were responsible for shipping arrangements and for choosing the exact shipment date. They failed to open the credit either by the time the shipment period started or by August 8 when the sellers called for it to be opened

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25 [1952] 1 Lloyd's Rep 527.

26 [1954] 1 WLR 1394. Although this case involves a banker's guarantee and not a letter of credit, it was held that a bank guarantee was to be treated the same way as a letter of credit.

27 In an FOB contract the seller undertakes to place the goods on board a ship named by the buyer and incur all charges up to and including the delivery of the goods over the ship's rail and the buyer will be responsible for the subsequent charges. See Schmitthoff CM *The Law and Practice of International Trade* 8 ed (1986) at 15.

28 [1958] 2 QB 130.

immediately. On August 14 the sellers informed them that they would be responsible for the consequences. The buyer nonetheless never opened the credit and towards the end of the shipment period the seller consulted the buyers and sold the goods elsewhere at a price lower than the contract price. In holding that it was the duty of the buyers under the contract to open the letter of credit by August at the latest Lord Diplock said that "in the case of an ordinary FOB contract financed by a confirmed banker's credit, the prima facie rule is that the credit must be opened at the latest by the earliest shipping date."[29] It is clear that Lord Diplock applied to this case a principle similar to the one proposed in *Pavia & Co SPA v Thormann-Nielsen*[30] in regard to CIF contracts and disregarded Denning LJ view in *Sinason Teicher,*[31] as being *obiter.*[32]

It is clear that the above cases do not offer any assistance either in the case of CIF and FOB as to what the position will be if the contract states a period of shipment and not the time of the opening of the credit. The matter is still open for debate. The view that the credit has to be established at a reasonable time before shipment is to be preferred for the seller should know that the credit has been opened before he prepares the goods for shipment. At face value *Pavia* supports the view that the credit must be available at the latest on the first day of shipment, but a closer look suggests otherwise. By indicating that the seller is entitled to be assured of payment before shipment may take place, *Pavia*

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29 At 144.

30 *Supra* n 22.

31 *Supra* n 26.

32 At 141.

supports the view that the credit must be available at a reasonable time before that date. Lord Denning also supported this interpretation in *Sinason-Teicher*.

4.2.2.3 Where no shipment date is specified

Where there is no shipment date, the credit must be opened within a reasonable time of the contract being made.[33] The reason is that the seller must have the credit before he prepares the goods for shipment. The buyer's duty cannot be excused by a delay caused by factors beyond his control.[34]

4.2.3 Waiver of the time for the opening of the credit

If the seller ships the goods despite the buyer's failure to open the credit either on the due date or in its appropriate form, it is important to consider whether the seller waived the breach or has agreed to a variation of the contract.[35] In most cases courts regard the seller's acceptance of a credit which does not conform to the contract as a waiver. In *Panoustus v Raymond Hardley Corporation of New York*[36] a contract for the sale of flour to be shipped not later than November 7 was concluded. The contract provided that each shipment "shall be deemed a separate contract" and that payment should be by an

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33 See *Plasticmoda SPA v Davidsons Manchester Ltd supra* n 25.

34 See *Lindsay (A E) & Co Ltd v Cook* [1953] 1 Lloyd's Rep 328.

35 A waiver is a unilateral decision to abandon a right or remedy without altering the contract. See Kerr A J *The Principles of the Law of Contract* 5 ed (1998) at 435, See also Van der Merwe S *Contract: General Principles* (1993) at 119. A variation of a contract is an alteration to the legal consequences of the contract effected by the mutual agreement of the parties, and includes not merely changing the effect of a term, but also excising a term of the contract. In letters of credit an original contract is varied by the letter of credit.

irrevocable credit. The buyer opened a banker's credit which was revocable and the seller, aware of that fact, made several shipments and received payment therefor by means of the credit, and also obtained from the buyer an extension of time to November 30 for the shipment of the balance of the flour. On November 25 the seller cancelled the contract as to the shipment of the balance of the flour, without any previous notice, upon the ground that the credit was not in accordance with the contract. The court held that if the seller chose to ship without the safeguard of a confirmed banker's credit, it was entitled to do so. The court further held that the buyer performed his part of the contract by paying for the goods shipped, though there was no confirmed banker's credit. As the buyer had been led to believe that the breach of the condition precedent had been waived, he was entitled to a reasonable notice to enable him to comply with the condition in regard to the remaining shipment.[37]

In *WJ Allan & Co Ltd v El Nasr Export and Import Co*[38] the sellers entered into a contract for the sale of coffee to the buyers at the price of 262 Kenyan Shillings per ton. The buyers furnished a confirmed credit in sterling and the seller did not object to that. In fact, the sellers began to operate the credit and asked for an extension of the shipping time. After the sellers had made the second shipment and before the presentation of the documents the sterling was devalued. The Kenyan shilling was not affected and as a result the credit was less valuable than it would have been had Kenyan shillings been used. The sellers were paid under a confirmed credit. They sued the buyers for the

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[36] [1917] 2 KB 473. A similar approach was followed in *Plasticmoda SPA v Davidsons Manchester Ltd supra* at note 25. See also *Enrico Furst & Co v WE Fisher Ltd supra* n 9.

[37] At 477-478.

[38] [1972] 2 QB 189.

difference between the amount paid and the amount in Kenyan shillings for which the credit ought to have been opened.

The Court of Appeal held that the sellers were not entitled to recover. Lord Denning said that the sellers by accepting the letter of credit in sterling waived their right to receive payment in Kenyan shillings.[39] Megaw LJ held that there was a variation of the obligation in the underlying contract. He conceded that if there was no variation of the contract, the buyers could still succeed on the ground of waiver.[40] Stephenson LJ held that the sellers could not claim against the buyers because that will be an attempt to assert liability, which, whether by variation or waiver, they allowed the buyers to alter.[41]

It depends on the circumstances of each and every case whether the seller's conduct amount to waiver or variation of the contract.

4.2.4 Failure by the buyer to open the credit

If the buyer fails to open the credit at the date fixed in the contract, expressly or by implication, the seller may cancel the contract.[42] South African courts have adopted the English doctrine of "time is of essence" in contracts.[43] As a result, the seller can cancel the contract if a buyer does not provide the credit at the date specified in the contract because time will be of essence. The seller can also after the conclusion of the contract

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39 At 214.

40 At 217–218.

41 At 221.

42 See Jack *op cit* n 10 at 46.

make time of the essence by giving the buyer a notice that he reserves the right to cancel the contract if the buyer fails to open the credit at a certain date.[44] In the notice the seller must allow the buyer reasonable time to open the credit, taking into account the steps which the buyer may have to take after receiving the notice in order to effect performance.

The seller will have a right to cancel the contract if the buyer does not open the credit after the notice has been served. Where the contract is not performed because of the buyer's failure to open the credit, the seller will be entitled to sue him for damages. The seller will be entitled to the difference between the total value which his estate would have had if the breach of contract had not occurred and the total value of his estate as it is, now that the contract has been breached.[45]

4.2.5 Failure of the credit to provide payment

The seller may fail to obtain payment through the credit even though he presents documents in accordance with the terms and conditions of the credit. It may be because the bank is insolvent or that it wrongfully refuses to accept the documents.[46] The question then arises whether the buyer has a right to claim payment from the buyer or the bank.[47]

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43 See Kerr *op cit* n 35 at 544.

44 See Van der Merwe *op cit* n 35 at 249.

45 See Van der Merwe *op cit* n 35 at 297.

46 See Brindle *op cit* n 6 at 416. See also *ED & F Man Ltd v Nigerian & Confectionary Co Ltd* [1977] 2 Lloyd's Rep 50, *Ng Chee Chong, Ng Weng Chong, Ng Cheng and Ng Yew (a firm trading as Maran Road Saw Will) v Austin Taylor & Co Ltd* [1975] 1 Lloyd's Rep 156.

47 In English law the terminology used is whether a letter of credit amounts to conditional or absolute payment. In *W J Alan & Co v El Nasr Export and Import supra* n 38 it was held that if the letter

The English cases seem to support the view that the buyer's obligation to pay the price of the goods is not absolutely discharged by the opening of the credit, and that upon the banker's default the seller can claim payment from the buyer. In *Newman Industries Ltd v Indo-British Industries (Govindram Bros Ltd Third Parties)*[48] the plaintiffs agreed to manufacture and sell a generator to the defendants. The latter agreed to sell it to an Indian firm. An irrevocable credit was opened by the bankers in favour of the plaintiffs, but a draft presented by the plaintiffs was dishonoured. The plaintiffs brought an action against the defendants. The defendant's main defence was that no contract of sale was completed and, alternatively, that they were only agents of the Indian firm. Sellers J then discussed whether the opening of the credit released the defendants altogether, and said: [49]

> "I do not think that there is any evidence to establish, or any inference to be drawn, that the draft under the letter of credit was to be taken in absolute payment. I see no reason why the plaintiffs, in the circumstances which have so unfortunately arisen, should not look to the defendants, as buyers, for payment."

It is submitted that there is no reason why the English approach should not apply in South Africa. The English cases do not, however, deal with situations where there is a confirming bank. It is submitted that if the confirming bank is insolvent, the seller must seek payment from the issuing bank first before claiming from the buyer. That is so

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of credit is absolute payment of the price, the buyer can look for the bank for payment. He cannot look to the buyer. Where the credit is a conditional payment, the seller has a right to claim from the buyer if the conditions are not met.

[48] [1956] 2 Lloyd's Rep 219. See also *Soproma SPA v Marine Animal By-Products* n 8 where McNair J stated that the buyer performs his obligation by providing the seller with a reliable and solvent paymaster from whom he can obtain payment.

[49] At 236.

because the buyer's obligation to pay is a last resort and therefore any payment mechanisms have to be exhausted first.

In American law the delivery to the seller of a proper letter of credit suspends the buyer's obligation to pay. If the bank dishonors the letter of credit the seller may upon notification seek payment from the buyer.[50]

4.3 The contract between the buyer and the issuing bank

4.3.1 The opening of the credit

The contract between the buyer and the issuing bank is described by Lord Diplock in *United City Merchants (Investments) v Royal Bank of Canada*[51] as the one under which the issuing bank agrees to issue the credit and either itself or through the confirming bank notifies the seller that a credit has been opened in his favour and make payments to the seller against presentation of stipulated documents. The buyer should reimburse the issuing bank for payment it made under the credit.

The contract between the buyer and the issuing bank is like that of a bank and customer in the case of a cheque account.[52] The difference lies in the fact that the former is regulated by the UCP and the latter contract is informal. The buyer makes an offer by applying to the issuing bank, usually on the bank's standard form, which incorporates the UCP, to open a letter of credit. Acceptance takes place when the issuing bank agrees to open the credit. The issuing bank can reject the offer by refusing to open the credit. If the

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50 Section 2-325 (2) of the UCC.

51 *Supra* n 1 at 183-184.

52 See Goode R *Commercial Law* 2 ed (1995) at 998.

credit is opened, the buyer would have executed his duties arising from the contract of sale to open the credit.[53] The contract is one of mandate and the bank acts as the applicant's mandatary.[54] The issuing bank has a duty to observe the terms of the mandate and to act with reasonable care and skill with regard to the credit. It must ensure that the letter of credit issued to the seller complies with the instructions contained in the application form.

Article 5 of the UCP provides that the instructions must be complete and precise and state precisely the documents against which payment, acceptance or negotiation is to be made. It also provides that in order to avoid confusion and misunderstanding the banks are discouraged from including excessive detail in the credit. If the instructions are not clear to the issuing bank it should not open the credit until clear instructions are given.[55] But if the issuing bank has accepted instructions which later appear to be unclear, it must seek clarification if it is still open to it to do so. If the instructions are ambiguous, the issuing bank will be entitled to reimbursement if it construed them reasonably. In *Midland Bank Ltd v Seymour*[56] the defendant, an English merchant, agreed to purchase a consignment of Hong Kong duck feathers from a seller in Hong Kong. He instructed the issuing bank to

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53 The instructions of the buyer to the issuing bank must accord with the terms of the contract of sale relating to letters of credit.

54 See Brindle *op cit* n 6 at 421. Although the issuing bank opens the credit on the instruction of the buyer, its undertaking to the seller is given as a principal and not the buyer's agent. See also Goode *op cit* n 52 at 989.

55 Article 14 covers the advising bank only if unclear instructions are given. It provides that if incomplete or unclear instructions are received to confirm or amend the credit, the bank may give preliminary notification to the beneficiary for information only without responsibility. It is submitted that this section must also cover the issuing bank.

56 [1955] 2 Lloyd's Rep 147. See also *Commercial Banking Co of Sydney Ltd v Jalsard (Pty) Ltd* [1973] AC 279.

open a documentary credit to be available in Hong Kong. The bank opened a documentary credit, which provided for the acceptance of drafts in London instead of Hong Kong. The Midland Bank accepted the drafts but the defendant refused to reimburse it on the ground that the letter of credit opened was not in accordance with the terms of the application form since it was made available in London instead of Hong Kong. Devlin J held that if the issuing bank was authorised to pay or accept only in Hong Kong, then, although the place of payment might be commercially immaterial, the bank had exceeded its mandate and could not recover. He however held that acceptance in London was also within the bank's mandate and therefore the defence failed. He held that:[57]

> " ...when an agent acts upon ambiguous instructions he is not in default if he can show that he adopted what is a reasonable meaning. It is not enough to say afterwards that if he had construed the documents properly he would on the whole have arrived at the conclusion that in an ambiguous documents the meaning which he did not give to it could be better supported than the meaning which he did give to it."[58]

In *European Asian Bank AG v Punjab & Sind Bank*[59] Goff LJ gave some limit to the principle stated in *Midland Bank v Seymour* . He said that:[60]

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57 At 153.

58 It was wrong for Devlin J to refer to the issuing bank as an agent.

59 [1983] 1 WLR 642.

60 At 656.

"Obviously it cannot be open for every contracting party to act upon a bona fide, but mistaken, interpretation of a contractual document prepared by the other, and to hold the other party to that interpretation. ... If instructions are given to an agent, it is understandable that he should expect to act on those instructions without more, but if, for example, the ambiguity is patent on the face of the document it may well be right ... to have his instructions clarified by the principal, if time permits, before acting upon them."

If the issuing bank fails to comply with the instructions the buyer may sue it for damages, sustained as a result of failure, for breach of contract.[61]

4.3.2 The issuing bank's duty to accept and examine the documents

By opening a letter of credit, the issuing bank undertakes towards the buyer a duty to accept from the seller a draft accompanied by complying documents.[62] The issuing bank has an obligation to examine all the documents stipulated in the credit with reasonable care in order to ascertain whether or not they appear on their face to be in compliance with the terms and conditions of the credit.[63] The expression "on their face" is intended to indicate that the decision whether the documents conform to the credit is to be based exclusively upon the bank's determination of the documents and not upon someone else's understanding.[64] If the documents appear on their face not to be in compliance with the

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61 See Jack *op cit* n 10 at 70.

62 See Guest *op cit* n 12 at para 23-107.

63 Article 13.

terms and conditions of the credit, such bank may refuse to take up the documents.[65] If the seller presents complying documents, the issuing bank is obliged to pay.

4.3.3 The issuing bank's duty of care

The bank does not have a general duty to advise the buyer as to the terms of the credit although it has a greater knowledge and understanding of letters of credit than the customer.[66] In *Midland Bank v Seymour*[67] the customer, who had instructed his bank to open a documentary credit, pleaded that the bank had failed to convey to him some adverse information about the exporter. It was held that on the facts the customer had made no request for information and that the bank had not been negligent.[68]

It depends on the facts of each and every case whether the bank had undertaken a duty to advise the buyer as to the credit.

4.3.4 Limitation of liability

The UCP places several limitations upon the issuing bank's liability. Firstly, Article 16 provides that banks assume no liability for the consequences arising out of delay or loss in transit of messages, letters or documents or telecommunication. Banks will also not be liable for the error in the translation of technical terms and have the right to transmit the credit terms without translating them. Secondly, Article 18 provides that banks using the

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64 See Brindle *op cit* n 6 at 424-425. As ICC 400 and 500 Compared (ICC Publication No.511) puts it "it is not intended to distinguish between the face and the reverse" at 39.

65 Article 14 (b).

66 See Jack *op cit* n 10 at 74-75. See also Guest *op cit* n 12 at para 23-102.

67 *Supra* n 56.

services of another bank for the purpose of giving effect to the instructions of the applicant do so at the risk of such applicant. It further indicates that banks assume no liability should the instructions they transmit not be carried out, even if they have chosen the bank in default. The issuing bank is exonerated from the errors of the advising bank, provided that the issuing bank had not been guilty of negligence itself.[69] Thirdly, Article 15 states that banks assume no liability or responsibility for the form, sufficiency, genuiness, falsification or legal effect of any documents or for the general or particular conditions stipulated in the documents or superimposed thereon, nor do they assume liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by any documents, or for the good faith or acts and/or omissions, solvency, performance or standing of the consignors, the carriers, the forwarders, the consignees or the insurers of goods, or any other person whomsoever. Fourthly, Article 17 covers the bank's position in *force majeure* situations. It provides that banks assume no liability or responsibility for the consequences arising out of the interruption of their businesses by acts of God, riots, civil commotions, or by strikes or lockouts. Unless specifically authorised, banks will not, upon resumption of their business, pay, incur a deferred payment undertaking, accept draft(s) or negotiate under any credits which expired during such interruption of their business.

It is clear that the above provisions are in the issuing bank's favour and constitute an attempt to absolve the issuing bank from any responsibility, even for its own negligence. The burden will be upon a plaintiff seeking to contest the efficacy of these provisions to

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68 At 155. See also *Commercial Banking Co of Sydney Ltd v Jaslard Pty Ltd supra* n 56.

69 UCP 400 & 500 Compared (ICC Publication No. 511) *op cit* n 64 at 53.

show that they do not or should not apply in the particular circumstances. The validity of these limitations can be excluded for being unreasonable in terms of the English Unfair Contract Terms Act of 1977 and the German Gesetz zur Regelung des Rechts der Allgemeinen Geschaftsbedingungen (AGBG) of 1976 or *contra bonos mores* in terms of South African law.[70]

4.3.5 The buyer's duties

4.3.5.1 To issue security

The issuing bank will usually take security from the applicant for the payment of the price, the usual form being a floating charge over the company's assets.[71] The documents presented under the credit such as a bill of lading and an insurance policy can be retained by the bank as security.[72] It is usually expressly stipulated in the application form of the credit that the documents will be used as a security and the bank retains them when they are delivered to it.

4.3.5.2 To pay costs

The buyer is liable for any charges of the credit, including commissions, fees, costs, or expenses incurred in connection with its instructions.[73] The fees to be paid have to be agreed upon by the parties. The advising bank's expenses should be paid for by the issuing bank or upon agreement by the beneficiary. If the advising bank's fees cannot be

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70 See Oelofse AN *The Law of Documentary Letters of Credit in Comparative Perspective* (1997) at 124-138 for a detailed analysis of the Acts.

71 See Brindle *op cit* n 6 at 425.

72 See Jack *op cit* n 10 at 75-76.

73 Article 18 c (i).

recovered from the beneficiary they should be recovered from the issuing bank. The issuing bank will then recover them from the beneficiary.[74]

4.4 The contract between the issuing bank and the correspondent bank

As indicated earlier the correspondent bank may act in various capacities depending on the instructions received from the issuing bank.[75] Therefore the nature of the contract depends on whether the correspondent bank is asked to issue the credit itself or to confirm the credit opened by the issuing bank or to advise it. When the correspondent bank is asked by the buyer's bank to open the credit, the latter steps into the shoes of the buyer and the correspondent issuer becomes the issuing bank.[76] Thus, the principle, which applies to the relationship between the issuing bank and the buyer applies in the relationship between the instructing banker and correspondent issuer.

In so far as the relationship between the issuing bank and the confirming bank is concerned the English commentators state that the confirming bank acts in a dual capacity.[77] It acts as an agent of the issuing bank when it notifies the seller that a letter of credit has been opened in his favour and acts as a principal when confirming the credit. In South African law the contract between the issuing bank and the confirming bank can be regarded as that of a principal and agent. That is so because the confirming bank as a mandatary is authorised by a contract of mandate to perform a juristic act, which is to advise and pay the beneficiary on behalf of the issuing bank as the principal. The

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74 Article 18 c (ii).

75 See chapter two.

76 See Ellinger *Documentary Letters of Credit A comparative Study* (1970) at 217. See also Guest *op cit* n 12 at para 23-155.

77 See Jack *op cit* n 10 at 17, Guest *op cit* n 12 at para 23-155, Ellinger *op cit* n 76 at 220.

correspondent bank must comply strictly with the mandate in order to be reimbursed by the issuing bank. The issuing bank may instruct its branch or another bank to reimburse the correspondent bank.[78] Article 19 (c) of the UCP provides that the issuing bank will be liable to reimburse the correspondent bank if the reimbursing bank does not pay. As there is no privity of contract between the reimbursing bank and the correspondent bank, the latter will have no right against the former in case of non-payment. The correspondent bank will have a right of recourse against the issuing bank. The issuing bank will also be liable for any loss of interest if reimbursement is not made on first demand or as specified in the credit or as may be mutually agreed.[79]

The UCP provides a brief guidance on the subject of reimbursement in Article 19. As a result the International Chamber of Commerce (ICC) has published a set of rules dealing with bank-to-bank reimbursement.[80] The rules are not intended to amend the provisions of the UCP, but to supplement them. The rules apply if the issuing bank incorporates them into the text of the reimbursement authorisation which is sent to the reimbursing bank. After incorporation they are binding on all the parties.[81] The reimbursement procedures are separate from the underlying credit to which they refer and they are not bound by the terms of the credits.[82]

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78 Article 19 (a) of the UCP.

79 Article 19 (a) of the UCP.

80 The rules are known as "ICC Uniform Rules for Bank-to-Bank Reimbursement under Documentary Credits (URR)" [ICC Publication No 525].

81 Article 1 of the URR.

82 Article 3 of the URR.

The reimbursement authorisation and any amendments must be issued in the form of an authenticated teletransmission or a signed letter. If a mail confirmation is sent it will be disregarded and the teletransmission will be operative. The reimbursing bank has no obligation to check the mail confirmation against the instructions send by teletransmission.[83] A reimbursement authorisation must state the credit number, currency and amount, additional amount payable and tolerance, if any, claiming bank details and parties responsible for charges.[84] If a draft is to be presented for acceptance, details of the tenor, drawer and parties responsible for any charges must be specified.[85]

The reimbursing bank may be requested by the issuing bank to give an undertaking to the claiming bank, which, if given is irrevocable and must contain information similar to that contained in the reimbursement authorisation. If the reimbursing bank is not prepared to issue the reimbursement undertaking it must so inform the issuing bank without delay.[86] Except where an reimbursement undertaking is involved, the issuing bank can at any time cancel or amend its reimbursement authorisation by notice to the reimbursing bank.[87] If the amendment affects the claim procedure the issuing bank must inform the nominated bank or advising bank if the credit is freely negotiable. If the original instructions are cancelled prior to the expiry of the credit the issuing bank has to furnish the nominated or negotiating bank with new instructions.[88] An irrevocable reimbursement undertaking

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83 Article 6 (a) of the URR.

84 Article 6 (d) of the URR.

85 Article 6 (e) of the URR.

86 Article 9 (d) of the URR.

87 Article 8 (a) of the URR.

issued by the reimbursing bank cannot be amended or cancelled without the agreement of the reimbursing bank.[89] In turn the reimbursing bank cannot amend or cancel the reimbursement undertaking without the agreement of the claiming bank.[90]

The reimbursing bank must make payment promptly. The period must not exceed three banking days following the receipt of the reimbursement claim.[91] If the claim is received outside banking hours it is deemed to have been received on the next banking day. A reimbursement authorisation must not have an expiry date or latest date for presentation of claim except as agreed to by the reimbursing bank.[92] If the reimbursement bank decides not to reimburse the claiming bank it must give notice to the issuing bank and the claiming bank by telecommunication or by other expeditious means and if a reimbursement undertaking has been given, the reasons for non-payment must be explained.[93] The notice should not be sent to the reimbursement bank until either the due date or the close of business on the third day following the receipt of the claim.[94] The reimbursing bank's charges are to be paid by the issuing bank. If the charges are to be paid by another party the issuing bank should provide that information in the credit and the reimbursement authorisation.[95]

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88 Article 8 (b) of the URR.

89 Article 9 (g) (i) of the URR.

90 Article 9 (h) (i) of the URR.

91 Article 11 (a) (ii) of the URR.

92 Article 7 of the URR.

93 Article 11 (a) (ii) of the URR.

94 Article 11 (c) (iii) of the URR.

95 Article 16 (a) of the URR.

This reimbursement procedure is advantageous to parties in the letter of credit transaction. For instance by providing for payment in the seller's country the issuing bank avoids delays associated with exchange control rules in its own country. The most enticing thing about the procedure is that the reimbursing bank pays against a simple claim by the claiming bank and is not concerned with the underlying contract. In other words, the reimbursing bank does not have to check whether the terms and conditions of the credit are complied with. In fact, it does not see the documents which have been presented in the credit because they are sent directly to the issuing bank.[96]

4.5 The contracts of the issuing bank and the confirming bank with the seller

These two contracts are considered together because when the confirming bank gives an undertaking to pay the credit which has been opened by the issuing bank, it repeats as binding on itself an undertaking which has been given by the issuing bank.[97] Therefore in so far as the beneficiary is concerned, the liability of an advising bank acting as a confirming bank is the same as that of the issuing bank.

The legal nature of the relationship between the bank and the beneficiary has been assumed by English and South African cases to be contractual. In *United City Merchant v Royal Bank of Canada*[98] Lord Diplock held that the contractual nature of the relationship is trite law. In South Africa Scott AJA held in *Loomcraft Fabrics CC v Nedbank Ltd &*

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96 See Rowe M *Letters of Credit* 2 ed (1997) at 185-186.

97 There will be no contract if the advising bank did not confirm the credit.

98 *Supra* n 1 at 183.

another[99] that the essential feature of the letter of credit is that it establish a contractual obligation on the part of the bank to pay the beneficiary under the credit. There are many theories which seek to define this relationship and the dominant theory in the English literature is the offer and acceptance theory.[100] According to this theory, which is mainly supported by Davis, the issuing of the letter of credit by the bank to the beneficiary is an offer which can be accepted by the beneficiary.[101] It is an offer to what is called in English law a "unilateral contract".[102] As the beneficiary does not promise to do anything when a credit is given to him, the contract must be unilateral.[103]

The difficulty with the offer and acceptance theory in letters of credit is the difficulty of identifying the manner of acceptance by the beneficiary and whether the requirement of consideration has been satisfied. In letters of credit transactions when the seller receives the letter of credit he gives no express acceptance of the offer. If he is satisfied with the letter of credit he presents the documents to the issuing bank.[104] According to Davis, the offer is accepted by conduct when the beneficiary act on it, at the latest when the goods

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99 1996 (1) SA 812 (A). See also *Lendalease Finance Ltd v Corporacion de Mercadeo Agricola* 1976 (4) SA 464 (A), *Phillips and another v Standard Bank of South Africa and others* 1985 (3) SA 301 (W), *Ex Parte Sapan Trading Pty Ltd* 1995 (1) SA 218 (W).

100 See Hugo CF "Documentary Credits: The Basis of the Bank's Obligation" (2000) 117 *South African Law Journal* 224 at 230. See also Hugo CF *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*, LLD Thesis, University of Stellenbosch (1996) at para 532 for a discussion of other theories.

101 Davis AG *The Law Relating to Commercial Letters of Credit* 3 ed (1963). See also Davis AG "The Relationship between Banker and Seller under a Confirmed Credit" 1936 *Law Quarterly Review* 225 at 234.

102 McCurdy WE "Commercial Letters of Credit" 1921-22 35 *Harvard Law Review* 539 at 571. See also Hugo *op cit* n 100 at 230.

103 See Hugo *op cit* n 100 at 230.

104 See Oelofse *op cit* n 70 at 39.

are shipped.[105] Davis disagrees with Gutteridge and Megrah who are of the view that the tender of documents by the seller constitute acceptance of the offer.[106] He quotes the case of *Urquhart Lindsay & Co Ltd v Eastern Bank Ltd*[107] to support his view. In that case Rowlatt J said:[108]

> "There can be no doubt that upon the plaintiffs acting upon the undertaking contained in this letter of credit consideration moved to the plaintiffs which bound the defendants to the irrevocable character of the arrangement between the defendants and the plaintiffs."

Davis argues that the judge seems to suggest that the contract was concluded by the plaintiffs acting upon the undertaking and that their acting was sufficient acceptance of the defendant's offer. He further states that although the judge did not explain the phrase "acting upon the undertaking", in the circumstances it seems that consideration moved on acting upon the undertaking and not on the tender of documents as Gutteridge and Megrah suggest.[109] Davis' theory is in accordance with the principle of English law that an offer of a unilateral contract cannot be revoked once the offeree partly performs.[110]

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105 See Davis *op cit* n 101 at 73-77.

106 Gutteridge HC and Megrah M *The Law of Bankers' Commercial Credits* 7 ed (1984) at 30-31. See also Jack *op cit* n 10 at 81.

107 [1922] 1 KB 318.

108 At 321.

109 See Davis *op cit* n 101 at 229-230.

110 Beale HG (Gen Ed) *Chitty on Contracts General Principles* 28 ed (1999) at para 2-071 – 2-075.

Ellinger states that the Davis theory will lead to difficulties. Firstly, he submits that the theory is vague because the banker will not know when his offer has been accepted and turned into a contract. Another objection to the theory is that it is against cases which held that irrevocability commences when the seller receives the letter of credit. He further states that the Davis theory would make the letter of credit irrevocable when the seller acts on it and before that the banker can cancel the credit.[111] This will not be the intention of the parties since the credit should offer security. Davis argues that there is no reason to provide security to the seller before he commences to perform his sale contract because he will suffer no damage.[112] According to Ellinger, Davis' view is incorrect because if the banker is allowed to cancel the irrevocable credit before the seller acts on it that will lead to financial losses for the seller. Ellinger gives an example to the effect that if the buyer fails to perform or become insolvent before the seller performs and the bank revokes the credit, the seller may have to sell the goods at a loss. He therefore states that the credit should become irrevocable earlier than when the seller acts on the offer.[113] According to Oelofse it should be regarded as a rule of banking custom that has become engrafted into the principles of offer and acceptance that in English law an irrevocable letter of credit becomes binding when the seller receives it.[114]

In South Africa the traditional view is that an offer can always be revoked before acceptance unless the offeror is bound by the contract not to do so. In other words, the

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111 See Ellinger *op cit* n 76 at 89.

112 See Davis *op cit* n 101 at 233.

113 See Ellinger *op cit* n 76 at 90-91.

114 See Oelofse *op cit* n 70 at 45.

unilateral declaration by the offeror that the offer is irrevocable does not make it irrevocable.[115] It follows that in so far as letters of credits are concerned in South African law, as in English law, the offer by the bank can only become irrevocable once accepted by the seller. In America the revised section 5-106 states that a letter of credit becomes irrevocable when the issuing bank sends or otherwise transmits it to the beneficiary.[116]

It is a requirement of English law that for a contractual promise which is under seal to be enforceable, there must be consideration from the promisee.[117] In relation to letters of credit the bank will be required to receive consideration from the beneficiary for the bank's undertaking. It is difficult in letters of credit to reconcile the offer and acceptance theory with the English law requirement of consideration.[118] The English courts are not of assistance on this point. In *Dexters Ltd v Schenker & Co*[119] the defence of no consideration was raised but withdrawn by the counsel and in *Urquhart Lindsay and Company v Eastern Bank Ltd*[120] the existence of consideration was assumed. According to Ellinger, McCurdy's view that the commencement of the performance of the contract of sale would be past consideration on the ground that the seller has a duty to the buyer to perform his contract and the obligation precedes the opening of the credit, is incorrect. He states that the seller's obligation to commence performance of the contract of sale should

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115 *Kotze v Newmont SA Ltd* 1977 (3) SA 368 (NC), *Anglo Carpets (Pty) Ltd v Snyman* 1978 (3) SA 528 (T).

116 Section 5-106 (a) of the UCC.

117 See Beale *op cit* n 110 at para 3-001.

118 See Hugo *op cit* n 100 at 233.

119 [1923] 14 Ll L Rep 586.

120 [1922] 1 KB 318.

not be taken as preceding the opening of the irrevocable credit because the contract of sale imposes on the buyer a duty to procure the credit and the obligation of the buyer is a condition precedent to the seller's obligation to perform his bargain.[121]

According to Todd, the performance by the seller of the contract of sale constitutes consideration for the new contract between the seller and the bank.[122] Hugo however argues that Todd's view does not take regard of the principle of independence because seeking consideration for the bank's promise in the different relationship violates the principle.[123]

Jack suggests that irrevocable letters of credit governed by English law should constitute an exception to the rules of English law as to consideration. He states that the undertakings of the issuing bank and the confirming bank are binding even if they are not supported by consideration from the seller. Jack's view is supported by the fact that since the first development of irrevocable credits bankers and traders have intended and accepted banks to be bound.[124]

It is difficult in South African law, as in English law, to categorise the opening of a revocable credit as constituting the contract between the bank and the seller. A contract is

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121 Ellinger *op cit* n 76 at 88-89.

122 See Todd PN "Sellers and Documentary Credits" 1983 *Journal of Business Law* 468 at 475.

123 See Hugo *op cit* n 100 at 233.

124 See Jack *op cit* n 10 at 80.

established when one party makes an offer to the other and the latter accepts the offer.[125] There is no particular form in which the offer is made. Thus, the offeror may make it in any way that he thinks is appropriate and may prescribe formalities which should apply in the particular contract. An offer can be distinguished from any other proposal or statement by determining whether the offeror has the intention to be bound by the acceptance of the offer. In *Wasmuth v Jacobs*[126] Levy J said that an offer should be certain, definite in its terms and firm. In *Spes Bona Bank v Portals Water Treatment South Africa Ltd*[127] the court had to decide whether an invoice sent to the bank was an offer. The Appellate Division, as it then was, held that it did not constitute an offer and took into account the fact that it did not appear on the face to be an offer, and the person who prepared and sent it did not intend it to be an offer.

An offer can be withdrawn at any time before the acceptance by the offeree and it lapses if it is not accepted within a reasonable time. In documentary letters of credit the issuing bank or confirming bank, if there is any, makes an offer to pay to the seller against presentation of the documents which are in compliance with the terms of the credit. In South Africa the problem of consideration does not occur because the doctrine of valuable consideration is not part of our law.[128]

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125 The general principles of offer and acceptance in South Africa are discussed below. See generally Kerr op *cit* n 35 at 61-121, Van Der Merwe *op cit* n 35 at 42-70 for the discussion of the principles. See also *Watermeyer v Murray* 1911 AD 61 at 70 where Solomon J said that every contract consist of an offer made by one party and accepted by the other. See also *Reid Bros (SA) Ltd v Fisher Bearing Ltd* 1941 AD 232.

126 1987 (3) SA 629 (SWA). It was also held that the offer must be firm in *Efroiken v Simon* 1921 CPD 367 and *Crawley v Rex* 1909 TS 1005.

127 1983 (1) SA 978 (A).

128 See *Conradie v Rossouw* 1919 AD 279.

No contract comes into existence unless an offer is accepted.[129] For the offeree to accept the offer, he must have been aware of it. If he was not aware of it then there will be no contract. In *Bloom v American Swiss Watch Co*[130] the appellant gave information while unaware of the offer and afterwards claimed a reward. He was unsuccessful because he gave the information in ignorance of the offer and therefore there was no legal tie between the parties. An acceptance is effective if it corresponds with the terms set out in the offer.[131] In *JRM Furniture Holdings v Cowlin*[132] it was held that the acceptance must be absolute, unconditional and identical with the offer, failing which there will be no consensus and therefore no contract. If the offeree accepts the offer subject to conditions, that constitutes a counter-offer and a rejection of the original offer.

The acceptance must be clear and unambiguous to the extent that the recipient using ordinary reason and knowledge can know that the agreement is complete. This proposition was examined in *Berne v Harris*[133] where it was claimed that a lease had been renewed by a letter. Greenberg JA held:[134]

> "It seems to me to follow that the letter, in order to be effective as an exercise of the right of renewal, must unequivocally convey to the recipient, using ordinary

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129 See *Dietrichsen v Dietrichsen* 1911 TPD 486, *Whittle v Henly* 1924 AD 138, *Rudolph v Cynos* 1930 TPD 85, *Tel Peda Investigation Bureau (Pty) Ltd v Van Zyl* 1965 (4) SA 475 (E).

130 1915 AD 100. See also *Jurgens and others v Volskas Bank Ltd* 1993 1 SA 214 (A).

131 *Joubert v English* 1910 AD 6.

132 1983 (4) SA 541 (W). See also *Men's Flair (Pty) Ltd v Bible Society of South Africa* 1976 (4) SA 12 (T).

133 1949 (1) SA 793 (A). See also *Hutchinson v Hylton Holdings and another* 1993 (2) SA 403 (T).

134 At 801.

reason and knowledge, that it is intended to be such an exercise. It must leave no room for doubt. The recipient is not required to apply any special knowledge or ingenuity in ascertaining the meaning of the letter."

That person must accept an offer made to a specific person.[135] If the other person accepts it, it does not bring about the conclusion of a contract. If an offer is made to the public, the identity of the acceptor is irrelevant, but a member of the public cannot validly accept the offer unless he can show that he has performed an act which is specified in the offer for acceptance.[136] The offeree must not only accept the offer but must communicate it to the offeror. Therefore there will be no contract until the offeror knows that he and the offeree are in agreement. The offeror may expressly or impliedly dispense with the normal requirement that the offeree's acceptance be communicated to him by prescribing a method of acceptance. If the offeree fails to communicate acceptance or rejection of the offer to the offeror, the latter cannot ordinarily take the silence as acceptance. However, where circumstances such as the business relationship of the parties and previous dealings are such that the offeree would be expected to speak if he wishes to reject the offer, failure by him to respond can amount to acceptance.[137]

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135 See *Levin v Drieprok Properties (Pty) Ltd* 1975 (2) SA 397 (A).

136 See *Wege v Kemp* 1912 TPD 135. See also *Sephton & others* v *American Swiss Watch Co* 1913 CPD 673.

137 See Wessels (ed Roberts) *The Law of Contract in South Africa* (1951) at para 270-1 which has been regarded as authoritative by our courts. See also *East Asiantic Co (SA) Ltd v Midlands Manufacturing Co (Pty) Ltd* 1954 (2) SA 387 (C), *Sun Radio & Furnishers v Republic Timber & Hardware (Pty) Ltd* 1969 (4) SA 378 (T), *Mcwilliams v First Consolitated Holdings (Pty) Ltd* 1982 2 SA 1 (A), *Resisto Dairy (Pty) Ltd v Auto Protection Insurance Co Ltd* 1963 1 SA 632 (A).

An exception to the rule that the offeree's acceptance of the offer must be communicated to the offeror was considered in *Cape Explosives Works Ltd v SA Oil and Fat Industries Ltd.*[138] It was held that contracts through the post are concluded at the place and moment of posting of acceptance. But if the offeror, in his offer, stipulates that the contract is concluded only if the letter is delivered to him or even read by him, acceptance will take place if that happens. Therefore in contracts concluded through the post South African law does not require the offeror to know that an acceptance has taken place.

The position in contract concluded through the post cannot be applied to documentary letters of credit because acceptance will have to take place when the beneficiary ships or arranges for the shipment of goods. That will be against the English authorities that the bank is bound when the beneficiary accepts the credit. According to Hugo, the beneficiary accepts the offer by not rejecting it.[139] Although the offeror can indicate a method of acceptance he cannot prescribe the method of refusal.[140] He cannot stipulate that silence amounts to acceptance of the offer.[141] Silence may amount to acceptance of the offer by the offeree if there is a general duty on the offeree to speak if he is not prepared to accept the offer. Thus, the business relationship between the parties can lead to the conclusion that the offeree will be expected to reply if he decides to reject the offer and if he does not the offeror will infer that by remaining silent the offeree accept the offer. In relation to letters of credit trade usage leads one to conclude that if the

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138 1921 TPD 244. See also *Kergeulen Sealing and Whaling Co Ltd v Commissioner for Inland Revenue* 1939 AD 487.

139 See Hugo *op cit* n 100 at 255.

140 See Kerr *op cit* n 35 at 118.

beneficiary does not reject the offer made by the issuing and confirming bank a contract comes into being. Thus, the bank should be bound contractually and the credit should be irrevocable when the seller does not reject the offer.[142]

4.6 Conclusion

The legal nature of the contract between the issuing and confirming bank with the seller is the most problematic contract of all the contracts in documentary letters of credit. It is difficult to find any form of acceptance by the seller of the offer made by the issuing bank or confirming bank. When the seller receives a letter of credit he does not expressly indicate to the bank that he accepts the offer. Some commentators suggest that the offer is accepted by conduct and others suggest that the beneficiary accepts the offer by tendering the documents in terms of the credit. South African courts have never considered this problem and English courts also offer no assistance on this point. South African courts should allow an exception to the offer and acceptance rules. In other words, a contract between the issuing bank or confirming bank with the seller should come into being when the seller does not reject the letter of credit presented to him.

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141 *Collen v Reitfountein Engineering Works* 1948 1 SA 413 (A).

142 See Oelofse *op cit* n 70 at 47.

CHAPTER FIVE

THE DOCTRINE OF STRICT COMPLIANCE

5.1 Introduction

In letters of credit transactions banks deal in documents and their most important duty is to receive and examine the documents. In terms of the doctrine of strict compliance documents presented under the credit must comply strictly with the requirements set out in the credit. If banks are satisfied that the documents presented by the seller conform with the requirements of the credit, they are obliged to make payment as required by the credit. The doctrine of strict compliance applies between the seller and the issuing bank, between the buyer and the issuing bank, between the issuing and nominated bank, between the issuing and negotiating bank and between the issuing bank and the confirming bank.[1] The purpose of this chapter is to discuss the doctrine of strict compliance and the UCP requirements relating to the documents presented under a credit.

5.2 The doctrine of strict compliance

The doctrine of strict compliance has its origin in *Equitable Trust Co of New York v Dawson Partners Ltd.*[2] In that case the customer, who was a CIF purchaser of vanilla beans, originally required the bank to pay only against, *inter alia*, a Dutch Government certificate certifying that the goods were sound, sweet and of prime quality. The Chamber of Commerce later varied the agreement, substituting for the certificate of the Dutch

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1 See Carr I *The Principles of International Trade Law* 2 ed (1999) at 277.

2 [1927] 2 Lloyd's Rep 49.

Government a certificate of quality to be issued and signed by experts who were sworn brokers. The words "experts" and "brokers" were in the plural. The bank paid against the certificate issued by one broker only and signed not by the Chamber of Commerce, but by the Batavia Trade Association. It was held that payment by the bank against a certificate issued by one person only was payment on non-conforming documents which did not entitle the bank to reimbursement in terms of the contract of mandate with the applicant. In the course of his judgment Lord Sumner said:[3]

> "It is both common good and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorised to accept are in the manner of the accompanying documents strictly observed. There is no room for documents which are almost the same, or will do just as well. Business could not proceed surely on any other lines. The bank's branch abroad, which knows nothing officially of the details of the transaction thus financed, cannot take upon itself to decide what will do well enough and what will not. If it does as it is told, it is safe, if it declines to do anything else, it is safe, if it departs from the conditions laid down, it acts at its own risk. The documents tendered were not exactly the documents which the defendants had promised to take up, and *prima facie* they were right in refusing to take them."

It was suggested in the case of *Banque de l'Indochine et de Seuz SA v JH Rayner (Mincing Lane) Ltd*[4] that the doctrine formulated by Lord Sumner must not be applied

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[3] At 52. In *Gian Sighn & Co Ltd v Banque de l'Indochine* [1974] 1 WLR 1234 at 1240 it was said "this often-cited passage has never been questioned or improved upon".

[4] [1983] 1 QB 711. Parker J said, "I also accept ... that Lord Sumner's statement cannot be taken as requiring 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 compliance."

strictly. In other words, there may exist some discrepancy in the documents so trivial that it may be ignored. In contrast, the case of *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran*[5] applied the doctrine restrictively. In that case the letter of credit required the letter of credit number and the buyer's name to appear on all the documents. They did not appear on a certain document. Lloyd LJ refused to regard the discrepancy as trivial and held that the court cannot regard as trivial something which the credit requires. He also held that it is difficult to define a trivial discrepancy.

In *J H Rayner & Co Ltd and Oilseeds Trading Co Ltd v Hambros Bank Ltd*[6] a bank received instructions from a customer to open a credit in favour of the plaintiffs covering a cargo of "Coromandel groundnuts". The bank opened the credit and notified the plaintiff that it was available against invoice and bills of lading for "Coromandel groundnuts". The plaintiff tendered bills of lading for "machine-shelled groundnut kernels", which Atkison J accepted were universally understood in the trade to be identical to "Coromandel groundnuts". The bank refused payment, and the plaintiff sued them for breach of the undertaking in the letter of credit. Atkinson J gave judgment for the plaintiff and the bank appealed. In reversing the decision Mackinnon LJ held, after quoting Lord Sumner's passage in *Equitable Trust Company of New York v Dawson Partners Ltd,*[7] that the issuing bank was entitled to reject the documents, the bill of lading in particular, because they were not in compliance with the terms of the letter of credit.

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5 [1993] 1 Lloyd's Rep 236 (CA).

6 [1943] 1 KB 37.

7 *Supra* n 2.

There is no authority in South African law on the content and limits of the doctrine of strict compliance, but two cases acknowledge the principle. In *Delfs v Kuehne and Nagel (Pty) Ltd*[8] the plaintiff, a shipping and forwarding agent, concluded an oral agreement with the defendant, an exporter of game, in terms of which the plaintiff undertook to act as the defendant's agent for the shipment of certain game, namely 50 oryx gazelles, 100 impalas and 2 cheetahs, to Saudi Arabia. Payment was to be made by means of a letter of credit issued by Barclays Bank in London. One of the stipulations in the letter of credit was that the description of the goods contained in the delivery documentation should correspond with that in the letter of credit, which set out the numbers of the various species of game in accordance with the agreement of sale.

The animals were transported by air and when they arrived at the airport, there were only 47 gazelles, 104 impalas and 2 cheetahs. At that time it was impractical to reduce the surplus and impossible to supplement the shortfall. It was then decided, with the consent of the buyer, that since the flight could not be delayed, the animals could be dispatched despite the discrepancy in the numbers. The agent made up the documents so as to reflect the actual cargo dispatched. The animals were duly delivered and the letter of credit presented, but the issuing bank refused to honour it on the grounds that there were discrepancies between the specification of the goods in the letter of credit and in the delivery documents. The buyer in Saudi Arabia did not pay and the defendant was informed that it was in a parlous financial position and would not be able to pay. The plaintiff instituted an action for certain fees and reimbursements in terms of the contract but the defendant counterclaimed for damages on the basis that it was an implied term of

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[8] 1990 (1) SA 822 (A).

the agreement that the plaintiff would see to it that all requirements relating to the necessary documentation were complied with and that on due presentation the bank would honour the credit. The court was prepared to read a tacit term into the contract, subject to the provision that the correct number of animals was delivered on dispatch. The claim was dismissed because the proviso had not been met.

The other case is *Nedcor Bank Ltd v Hartzer.*[9] Hartzer sold and exported ostrich skins to ITC, a German company. A letter of credit was issued by a German Bank, Hypobank, and confirmed with Hartzer by the plaintiff, Nedcor Bank Ltd. Hartzer delivered the documents to Nedcor. Several discrepancies were found to exist. Hypobank, however, was told by ITC that the discrepancies could be waived. Hypobank thereupon informed Nedcor that it could pay against the documents. Nedcor paid the beneficiary and delivered the documents to Hypobank. Hypobank then discovered further discrepancies which resulted in Nedcor having to repay Hypobank the amount it paid under the credit. Nedcor thereupon instituted action against Hartzer on the basis of misrepresentation and mistaken payment. It was held that the defendants had made no representations to the plaintiff to the effect that the documents conformed to the letter of credit and that the representations that might have been made by the defendants were neither falsely nor negligently made. It was held that the plaintiff had not proven payment in error and that if payment had been made in error, it was a reasonable error.[10] Hypobank was entitled to reject the documents because further discrepancies were not waived by it even if the beneficiary was prepared to waive them.

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9 1993 (4) CLD 278 (W).

Although the two cases did not discuss the doctrine of strict compliance *per se*, they illustrate another related principle: that a waiver of discrepancies by the applicant only does not mean that the issuing bank will be obliged to pay.[11]

5.2.1 Examination of documents

Article 13 of the UCP provides:

> "Banks must 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. Compliance of stipulated documents on their face with the terms and conditions of the credit shall be determined by international standard banking practice as reflected in these Articles. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance with the terms and conditions of the credit."

A bank must evaluate each and every document submitted to determine whether or not it appear on its face to comply with the terms and conditions of the credit.[12] Article13 (a) refers to reasonable care. Jack suggests that the assumption must be that the bank will detect all discrepancies which appear on the face of the documents when exercising reasonable care.[13] If that assumption is correct, it follows that a bank exercising

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10 At 284-285.

11 See Oelofse AN *The Law of Documentary Letters of Credit in Comparative Perspective* (1997) at 289.

12 See Gerarthy JP "Many a Slip ... Acceptance by a Bank of Documents under an International Documentary Credit" (1999) 11 *South African Mercantile Law Journal* 331 at 333.

13 See Jack R *Documentary Credits: The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees* 2 ed (1993) at 142-143.

reasonable care will be entitled to reimbursement. If it is not correct, the question will then be whether the bank will be entitled to reimbursement if it paid on discrepant documents despite reasonable care. It is submitted that in those instances the bank will still be entitled to reimbursement. Article 14 (a) supports that view. It provides:

> "When the Issuing Bank authorises another bank to pay, incur a deferred payment undertaking, accept Draft(s), or negotiate against the documents which appear on their face to be in compliance with the terms and conditions of the Credit, the Issuing Bank and the Confirming Bank, if any, are bound:
>
> (i) to reimburse the Nominated Bank which has paid, incurred a deferred payment undertaking, accepted Draft(s), or negotiate,
>
> (ii) to take up the documents."

Article 14 (a) does not state that the bank must exercise reasonable care before being reimbursed but provides that the documents must appear on their face to be in compliance with the credit. Thus, in order to be reimbursed, the bank has to pay on documents which conform with the credit regardless of whether they exercised reasonable care or not. In *Gian Singh & Co v Banque del'Indochine,*[14] one of the documents required was a certificate signed by Balwant Singh, a holder of Malaysian passport E-13276. The certificate presented was forged and was not signed by Balwant Singh. Lord Diplock stated that the requirement imposed an additional duty upon the issuing bank to take reasonable care to see that Balwant Singh signed the certificate. He held that the buyer did not succeed in proving that the bank did not exercise reasonable care in failing to detect the forgery of the certificate.

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14 *Supra* n 3.

This case is authority for saying that reasonable care plays a role where the document is forged and a reasonable person would in the circumstances of the particular case have realised that it is a forgery.[15] The bank will be protected by Article 15 of the UCP if it paid in good faith on forged documents, even if it could have detected the forgery had it exercised reasonable care.

Article 13 (a) prescribes an objective standard which banks are required to use in order to determine whether or not the documents comply with the terms and conditions of the letter of credit. The objective standard is "international standard practice". The standard can create problems in that it may be difficult for a checker in one bank in one country to know whether a practice of which he is aware is indeed "international standard practice".[16]

Article 13 (a) also provides that documents which appear to be inconsistent with one another will be regarded as non-conforming. It follows that if one or more documents do not follow the requirements of the credit, the set of documents will be non-conforming and the fact that they are inconsistent with each other will render them more non-conforming. Oelofse suggest that the principle of consistency should not be applied

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15 See Oelofse *op cit* n 11 at 274.

16 According to Ellinger "The Uniform Customs and Practice for Documentary Credit-1993 Revision" 1994 *Lloyds Maritime and Commercial Law Quarterly* 377 at 391, "the reference to international standard practice lends support to a new trend, manifest in some decisions, suggesting that not every minor mistake in a document, such as a misprint or typographical error, constitutes discrepancies".

strictly. Thus, each document must be conforming on its own and the set must be consistent.[17]

5.2.2 Views on the doctrine of strict compliance

The doctrine of strict compliance produces a practical paradox. It is regarded as essential for a letter of credit transaction to be effective but it is the principal reason why in one-half to two-thirds of such transactions the tendered documents are rejected when first presented.[18] This inability to meet the standard of strict compliance raises a very important question as to whether the letter of credit transaction really works. The decision in the case of *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran*[19] that the bank is entitled to reject the documents even if the discrepancy is trivial, is with due respect, incorrect. Parker J's opinion in *Banque de l'Indochine et de Seutz v JH Rayner (Mincing Lane) Ltd*[20] that the doctrine does not require meticulous fulfilment of precise wording in all cases and some margin can and must be allowed, should be adopted. If the doctrine is applied restrictively it will delay the operation of letter of credit transactions and the function of the credit to provide payment will also be defeated. The doctrine is strict to the extent that it is not affected by the *de minimis non curat lex* principle.[21] It is submitted that there is no reason why the *de minimis non curat lex* principle should not

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17 See Oelofse *op cit* n 11 at 276.

18 See *Bankers' Trust Co v State Bank of India* [1991] 2 Lloyds Rep 443.

19 *Supra* n 5.

20 *Supra* n 4. See also *Hing Yip Fat Co Ltd v Daiwa Bank Ltd* [1991] 2 HKLR 35 where a mere typographical error was held not to amount to a discrepancy.

21 See *Soproma SpA v Marine & Animal By-Products Corporation* [1966] 1 Lloyd's Rep 367, *Astro Axito Navegacion SA v Chase Manhattan Bank NA* [1986] 1 Lloyd's Rep 455, *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran supra* n 5. *Moralice (London) Ltd v ED & F Man* [1954] 2 Lloyd's Rep 526.

apply to letters of credit. If a discrepancy is trivial, for example, if there is a small error in a name or numbers, the bank should accept the document. As Gutteridge and Megrah states the doctrine of strict compliance does not extend to the dotting of i's or to crossing obvious t's or to obvious typographical errors either in the credit or the documents.[22]

Article 39 (b) of the UCP provides:

> "Unless a credit stipulates that the quantity of the goods specified must not be exceeded or reduced, a tolerance of 5 % or more or 5 % less will be permissible, always provided that the amount of the drawings does not exceed the amount of the Credit. This tolerance does not apply when the credit stipulates the quantity in terms of a stated number of packing units or individual terms except where the credit stipulates that the quantity of the goods is not to be exceeded or reduced."

The UCP allows tolerance in quantity and weight of goods and in the same vein the banks should allow some tolerance where there is a trivial discrepancy in the documents presented for payment.

In America although the principle of strict compliance is followed, some cases applied the standard of substantial compliance.[23] The concept of substantial compliance allows a

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[22] See Gutteridge HC and Megrah M *The Law of Banker's Commercial Credits* 7 ed (1984) at 120. See also Guest AG *Benjamin's Sale of Goods* 2 ed (1997) at para 23-1179 where it is stated that to treat a typographical error as a discrepancy will convert the commercial transaction covered by letter of credit into a proof reading exercise.

[23] See *Banco Espanol de Credito v Sytate Street Bank & Trust Co* 385 F 2d 230 (1967), *Flagship Cruises Ltd v New England Merchants National Bank of Boston* 569 F 2d 699 (1978). See also Oelofse AN *op cit* n 11 for a discussion of the cases dealing with the doctrine of strict compliance and substantial compliance.

bank to go beyond mere technical discrepancies and to determine if compliance exists in every material respect.[24] Dolan argues that the enquiry required by the substantial compliance takes more time and requires more legal analysis than document examiners can give and more than the credit can afford.[25] However, the American approach was supported in an *obiter dictum* by Stegmann J in *Savage & Lovemore Mining (Pty) Ltd v International Shipping Co (Pty) Ltd*[26] after referring to Gutteridge and Megrah with approval:[27]

> "The learned authors conclude that, if there is an apparent *material divergence* between the mere wording of such description of the *merx* in the letter of credit and the wording of such description in the shipping documents, the banker is not obliged to go into the question whether, in the relevant trade, the two correspondent with each other, that *he is free* to decline to pay." [28]

It is submitted that this dictum is to be supported because it gives the bank discretion to accept non-conforming documents when it is of a view that a discrepancy is not material. That will ensure the smooth running of the letter of credit process without unnecessary delay. Gerarthy submits that the doctrine of substantial compliance is against the principle of independence because it extends the obligation of the bank beyond mere

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[24] See Gerarthy *op cit* n 12 at 335.

[25] See Dolan JF *The Law of Letters of Credit: Commercial and Standby Credits* 2 ed (1991) at para 6-4.

[26] 1987 (2) SA 149 (W).

[27] At 180.

[28] The italics are mine.

examination of the documents on their face.[29] But as long as the doctrine of strict compliance reigns, dealing securely with letters of credit transactions will require the most pedantic attention to detail, which may not be practically possible.[30] The doctrine should not be applied strictly.

5.2.3 The procedure for rejection of discrepant documents

The issuing bank or confirming bank, if any, or nominated bank must upon receipt of the documents under the credit decide on the basis of them alone whether or not they appear on their face to be in compliance with the terms and conditions of the credit.[31] The bank must not take into consideration any information apart from the documents themselves. Thus, it may not take into account information relating to the quality of the goods shown by the documents. If the documents appear on their face not to be in compliance with the terms and conditions of the credit, the bank must refuse them. The issuing bank or confirming bank, if any, or nominated bank must give its notice of refusal by telecommunication or by other expeditious means to the bank from which it received the documents, or to the beneficiary, if it received the documents directly from him.[32]

In *Rafsanjan Pistachio Co-Operative v Bank Leimu (UK) plc*[33] it was held that article 14 (d) (i)[34] does not prescribe a particular form of telecommunication to be used, but if the

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29 See Gerarthy *op cit* n 12 at 336-337.

30 See Buckley RP "Potential Pitfalls with Letters of Credit" (1996) 70 *Australian Law Journal* 217 at 223.

31 Article 14 (b).

32 Article 14 (d) (i).

33 [1992] 2 Lloyd's Rep 513.

bank decides to reject documents it must send the message in writing. In contrast, in *Hing Yip Hing Fat Company Ltd v Daiwa Bank*[35] it was held that telecommunication of some sort, viz telephone, telex or fax ought to be used where possible, and that advice by mail, courier or messenger was not the equivalent. It is submitted that Article 14 (d) (i) does not require any mail confirmation and the transmission of messages by telecommunication is sufficient. If a mail confirmation was required then the article would have provided therefor.

The notice must be given promptly but no later than at the close of the seventh banking day following the day on which the bank received the documents.[36] The notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at its disposal or is returning them to the presenter.[37]

The issuing bank or confirming bank, if any, is precluded from claiming that the documents are not in compliance with the terms and conditions of the credit if it fails to act in accordance with the provisions of Article 14.[38] The preclusion under Article 14 does not affect the nominated bank. Instead of refusing non-complying documents, the issuing bank may in its sole judgment approach the applicant for a waiver of the discrepancies.[39] It is clear that Article 14 (c) gives the issuing bank the discretion to

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34 Article 16 (d) as it then was.

35 *Supra* n 20.

36 Article 14 (d) (i).

37 Article 14 (d) (ii) of the. Article 16 (d) of the 1983 referred to "the discrepancies" as opposed to "all discrepancies" in 1993 revision.

38 Article 14(e).

approach the applicant. There is no duty on it to do so. The bank need only consult the applicant before rejecting the documents if such a duty arises out of express instructions to the bank. If there were express instructions, the applicant might have a claim for breach of contract against the bank which rejected the documents without consultation in circumstances where the applicant would have wished to accept.

Article 14 (c) does not provide for situations involving the confirming bank because where discrepant documents are initially presented to it, the confirming bank would consult the issuing bank which would in turn consult the applicant to determine whether the documents should be accepted.

The issuing bank or confirming bank may, instead of rejecting the documents which are not in compliance with the credit, make payment under reserve or against indemnity. [40] To avoid disputes on the effect of the banks acceptance of the documents under reserve, the paying bank and the beneficiary should agree upon their rights and liabilities in the event of the applicant rejecting the documents.[41] If the parties do not agree on the consequences of such acceptance under reserve difficulties such that in *Banque del'Indochine et de Suez v JH Rayner*[42] will arise. A Djibouti bank opened a credit in

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39 Article 14 (c).

40 See Jack *op cit* n 13 at 94-95. Section 5-113 of the UCC provides for payment under reserve or indemnity. It provides "(1) A bank seeking to obtain (whether itself or another) honor, negotiation or reimbursement under the credit may give an indemnity to induce such an honor, negotiation or reimbursement. (2) An indemnity agreement including honor, negotiation or reimbursement (a) unless otherwise explicitly agreed applies to defects in the documents but not I the goods; and (b) unless a longer time is explicitly agreed expires at the end of ten business days following receipt of the documents by the ultimate customer unless notice of objection is sent before the expiry date ...".

41 See Brindle M *The Law of Bank Payments* (1996) at 430.

42 *Supra* n 4.

favour of the defendant sugar merchants. The plaintiff bank confirmed the credit. The defendants presented documents under the credit and after examining them, the plaintiff considered the tender to be defective. Following a telephone conversation between representatives of the parties it was agreed that payment should be made by the bank "under reserve" because of certain discrepancies. There was no indication given as to the consequences of payment being made under reserve. The issuing bank in Djibouti rejected the documents as their clients, the buyers, would not lift the reserve. The plaintiffs claimed that as the documents had been rejected for the specific discrepancies they were entitled to repayment from the sellers.

Parker J held that the plaintiffs were entitled to demand their money back unless the documents were bad tender, which he found they were. In dismissing the appeal the Court of Appeal said that the expression "payment under reserve" had no defined and generally accepted meaning.[43] It however held that the parties, by using the expression, meant that the defendants would be bound to repay the money paid on demand should the Djibouti bank reject the documents on its own initiative or on the buyer's instructions. In rendering his judgment Sir John Donaldson suggested that the ICC should consider the meaning of "payment by reserve" in the next revision. However, the ICC was not able to do so because of the difficulty created by the use of the phrase in other banking contexts.[44]

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[43] At 727.

[44] ICC Publication 411, UCP 1974/1983 Revisions Compared and Explained at 33.

In *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islam Iran*[45] a letter of credit was opened by Bank Markazi in favour of Seaconsar at the request of the Iranian Deputy Minister of Defence covering "special equipments" (the equipments were a large number of howitzer artillery shells to be shipped from Setubal in Portugal to Bandar Abbas in Iran) as per a contract between Seaconsar and the Ministry of Defence. Partial shipments and drawings were allowed and the credit was available by sight payment at the counters of the London branch of Bank Melli against presentation of certain prescribed documents. The first shipment contained 5000 howitzer shells and the presentation of certain prescribed documents with respect to this shipment was made on 1 October 1987. On 5 October 1987 a total of seven discrepancies were found in the documents and Bank Melli did not pay. Bank Melli told Mr Appiano of Seaconsar that they did not pay because there were discrepancies in the documents. Mr Appiano corrected only four discrepancies but not the others. Bank Melli did not pay because of the remaining discrepancies. On 6 October Bank Melli (through its official, Mr Mansouri) telexed Bank Markazi for permission to pay despite the discrepancies, but no reply was given. The second shipment concerned 7000 howitzer shells and the presentation of documents with respect to this shipment was made under cover of a letter dated 1 December 1987. Bank Melli received the documents on 3 December 1987. Bank Melli checked the documents and four discrepancies were found. On 8 December 1987 Bank Melli sent a telex to Seaconsar advising it of the discrepancies and further informing it that the documents were held at Seaconsar's risk. On 10 December 1987, Mr Appiano corrected two of the discrepancies but the other two remained. On the following day, as with the first presentation, Bank

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[45] [1997] 2 Lloyd's Rep 89. Although the letter of credit was issued subject to the 1993 revision of the UCP. The judgment concerns the interpretation and application of Article 16 of the 1983 revision. See Oelofse AN "Developments of the Law of Letters of Credit" *Ablu* (1998) 1 at 8-15.

Melli asked Bank Markazi for permission to pay despite the discrepancies, but again no reply was given. It followed that the amount claimed on presentation, as with the first one, was not paid, and the documents presented in each case remained with Bank Melli.

Seaconsar finally received payment of the capital amount due under the underlying contract on 23 March 1994. The documents had been deficient and they could therefore be rejected. Seaconsar's case was that Bank Melli had not followed the prescribed procedure in terms of Article 16, with the result that Bank Markazi was liable for the loss of interest up to 23 March 1994. The first question, which the court had to answer, was whether Mr Mansouri had orally rejected the first set of documents under Article 16 (d) on 5 October 1987. Tuckey J held: [46]

> "What must be communicated under article 16 (d) is the fact of rejecting the discrepancies upon which such rejection is based and whether the bank is holding the documents at the disposal of the beneficiary or returning to them. No particular form of words, however, is prescribed or required. What matters is the substance and the effect of the words used."

The conclusion therefore was that the documents had indeed been orally rejected on 5 October and such rejection, assuming that such oral rejection is a valid rejection under article 16, complied with the requirements of Article 16 (d).

The second question was whether an oral rejection was valid under Article 16 (d). It was held that "as telecommunication without delay was not possible, article 16 did permit

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[46] At 93.

Bank Melli to use other expeditious means. Oral communication to Mr Appiano at their meeting was other expeditious means of giving notice in the circumstances."[47]

It was contended by Seaconsar's counsel that if oral rejection was possible, banking practice showed that written confirmation or proper authentication of the oral rejection was required and that no such confirmation or authentication had taken place. Conflicting expert evidence was led to that effect. Tuckey J held that it was unnecessary to resolve the conflict of expert evidence because experts differ about banking practice. He also held that best banking practice requires that written communication of rejection be given as soon as possible. He further held that Article 16 (d) permits oral rejection by telephone and does not require written confirmation or proper authentication.[48] The court concluded that Bank Markazi's oral rejection of Seaconsar's documents was valid under Article 16 (d).

The third question concerned the time when the second set of documents was rejected. It was held that the documents were rejected on 8 December 1987 when the telex was sent. The fourth question was whether the rejection took place within the time constraints imposed by Article 16 (c) and (d). Seaconsar alleged that a time for examination of the documents, making a decision to reject and for communicating the decision was no more than three days. Seaconsar's argument was based on the fact that a distinction should be made between the time allowed for examination of the documents and making a decision to reject and, on the other hand, the time allowed for communicating that decision. In other words, it was argued that Article 16 (c) and (d) of the UCP require an examination

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[47] At 94.

and a decision to reject the documents within a "reasonable time" and communication of the decision "without delay" after it has been taken. It was further argued that since the decision to reject had been taken on Friday, 4 December 1987, but the notice was not given until 8 December, the notice was not given "without delay" as required by Article 16 (d).

Tuckey J declined to split the time for completing the rejection procedure in two different enquiries. He held that even if the words "reasonable time and without delay" cannot be taken as meaning the same thing, the beneficiary's only concern is the time between the bank's receipt of the documents and receipt of the notice that they had been rejected by the bank. He further held that if a bank takes a long time in making a decision to reject the documents, it would have less time to give notice.[49] Tuckey J's decision is in accordance with Article 13 (b) of the 1993 revision which provides that a reasonable time not exceeding seven days is allowed for examining the documents, deciding whether to take them or to reject them and to give notice of the decision.[50]

In *Bankers Trust Co v State Bank of India*[51] the State Bank of India had, as a confirming bank, made payment to the beneficiary and was seeking reimbursement from Bankers Trust Company, the issuing bank. The bank had checked some 900 pages of documents within three days but had then allowed further days to expire during which it had allowed the applicant, its customer, to check the documents again. The 1983 revision of the UCP,

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48 *Ibid.*

49 At 95.

50 Article 16 (c) of the 1983 revision referred only to reasonable time to examine the documents and to make a decision.

51 *Supra* n 18.

which applied in this case, did not give any guidance as to what was a reasonable time for inspection of the documents. All the judges were unanimous on the fact that reasonable time is not intended to include a second examination by the bank's customer in addition to the bank's own examination. It was such additional time which rendered the period excessive and led to the conclusion that the issuing bank had exceeded a reasonable time between the presentation and purported rejection. The members of the Court of Appeal differed as to whether the reasonable time provided by what was then Article 16 (c) for examination and determination of taking up or refusal, should take into account any time required to consult the applicant. The majority of the court (Farquharson LJ and Sir John Megaw) held that time should be assessed taking into account such time as was reasonably taken up in approaching the applicant. The minority (Lloyd LJ) held that it should not.[52]

It appears from the decision of the majority that in deciding what was or was not reasonable, time should be computed for the actual examination of the documents, to which might then be added a further period of consultation with the customer and not examination of documents by him.

The decision of the majority has been adopted by the 1993 revision of the UCP. Article 14 (c) provides that the bank is entitled to approach the applicant of a credit for a waiver of any discrepancies but that does not extend the time provided for in Article 13 (b) which allows a maximum of seven days for the process of examination and notification to

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[52] In *Co-Operative Centrale Raiffeissen-Boereleenbank BA ("Rabobank Nederland") v The Sumitomo Bank Ltd* [1987] 1 Lloyd's Rep 345 Gatehouse J said that consultation with the applicant extend reasonable time.

be completed. Article 14 (c) and 13 (b) accord with the decision of the majority in the *Bankers Trust* case in that the bank can consult with its customer about waiver of discrepancies before following the rejection procedure, provided that the consultation does not exceed seven days should the applicant not waive the discrepancies.

5.3 The approach of the UCP to documentation

In the 1974 revision of the UCP separate provisions were made for marine bills of lading, combined transport documents and other shipping documents. These articles gave rise to important difficulties, which lead the 1983 revision to adopt a different approach. In doing so, the 1983 revision dealt with marine bills of lading separately and lumped together all other types transport documents.[53] The generally acceptable characteristics of transport documents were also set out. The reason for the 1983 revision was to avoid difficulties raised by the 1974 revision, but it failed to do so.[54] The 1993 revision adopted a different approach by creating different articles for specific types of transport documents rather than defining broadly the generally acceptable characteristics.[55]

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[53] Article 25 dealt with other forms of transport documents excluding marine bills of lading which were dealt with by Article 26. This raised difficulties because Article 25 considered together disparate forms of documents.

[54] Nearly half of the queries which were brought to the International Chamber of Commerce on the 1983 revision concerned transport documents. See Todd P *Bills of Lading and Bankers' Documentary Credits* 2 ed (1993) 135.

[55] Article 23 deals with marine bills of lading, while charter party bills of lading are dealt with by Article 25, non-negotiable waybills by Article 24, multimodal transport document by Article 26, air transport documents by Article 27, road, rail or inland waterway transport documents by Article 28, courier and post receipts by Article 29, transport documents issued by freight forwarders by Article 30, clean documents by Article 32 and freight by Article 33.

5.4 General requirements regarding documents

5.4.1 Time for the presentation of the documents

There are three periods to be considered in the presentation of documents. Firstly, the documents must be presented when the credit is still valid. Secondly, where a credit calls for a transport document, the documents must be presented within a period calculated from the date of shipment. Thirdly, it may be that shipment must be made within a defined period or by a particular date.[56] The periods are discussed below.

5.4.1.1 Expiry date

All credits must stipulate an expiry date for the presentation of documents for payment, acceptance or, with the exception of a freely negotiable credits, a place for presentation of documents for negotiation.[57] In a negotiation credit it is the negotiation which must take place by the expiry date and not the presentation by the negotiating bank to the correspondent or issuing bank.[58] Except where there is an extension as provided in Article 44(a), documents must be presented on or before such expiry date.[59] If an issuing bank does not specify the date from which the time is to run, the date of issuance of the credit by the issuing bank will be deemed to be the first day from which such time is to run.[60]

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56 See Jack *op cit* n 13 at 86.

57 Article 42 (a).

58 See Article 10 (b) (i) of the UCP which provides that with a freely negotiable credit any bank is nominated bank.

59 Article 42 (b).

60 Article 42 (c).

5.4.1.2 Time for the presentation of transport documents

A credit which calls for a transport document should also stipulate a specific period after the date of shipment during which presentation must be made in compliance with the terms and conditions of the credit.[61] In the absence of any other period prescribed by the credit, transport documents must be presented within 21 days of the date of issue. The reason for requiring transport documents to be presented within a specific period is to ensure that they are available in time to enable applicants of the credit to take possession of the goods.

5.4.1.3 Extension of time under Article 44

Article 44 provides that the time for the presentation of documents is extended to the first following business day on which the bank is open where the last day, either the expiry date of the credit or the last day for presentation of transport documents, falls on a day on which the bank is closed for reason other than those referred in Article 17.[62] The reasons referred to in article 17 are acts of God, riots, civil commotions, insurrections, wars or any other causes beyond their control, or by any strikes or lockouts. Where extension is made, the bank to whom presentation is made on the first following business day must provide a statement that the documents were presented with the time limits extended in accordance with Article 44(a) of the Uniform Customs and Practice for Documentary Credits, 1993 revision.[63] The latest date for shipment cannot be extended by reason of the extension of the expiry date or the period of time after the date of shipment for

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61 Article 43 (a).

62 Article 44 (a).

63 Article 44 (c).

presentation of documents in terms of Article 44(a). If no such latest date for shipment is stipulated in the credit, the bank will reject transport documents indicating a date for issuance later than the expiry date.[64]

5.4.1.4 Shipment period

The shipment period must be indicated in the contract of sale and be repeated in the letter of credit so that transport documents bearing wrong dates can be rejected. The expression "shipment" used in stipulating a latest date for shipment will be understood to include expressions such as, "loading on board", "dispatch", "accepted for carriage", "date of post receipt", "date of loading on board" and, in the case of a credit calling for a multimodal transport document, the expression "taking in charge".[65]

5.4.1.5 Banking Hours

Banks are under no obligation to accept presentation of documents outside the banking hours.[66] If a bank wishes to restrict the hours within which presentation may be made to a lesser period than its ordinary banking hours, that must be stated in the credit.[67] Banks can also accept documents outside banking hours on agreement with the beneficiary.

5.4.2 Original documents and copy documents: Signatures

It is a general rule that original documents must be submitted. Article 20 (b) of the UCP provides that banks will also accept as an original document, a document produced or

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64 Article 44 (b).

65 Article 46 (a).

66 Article 45.

67 UCP 500 and 400 Compared (ICC Publication No 511).

appearing to have been produced by reprographic, automated or computerized systems, and as carbon copies provided that it is marked as original and, where necessary, appears to be signed.[68] A document labelled "copy" or not marked as an original will be accepted as a copy.[69] In *Glencore International AG and another v Bank of China*[70] the underlying sale of goods contract was for the shipment of 1,500 metric tons of aluminium ingots CIF Zhangjiagang (China) with shipment in June 1995 ex Far Eastern port. The sale contract stipulated "Origin: Western, excluding India/Egypt". Payment was to be by letter of credit and two letters of credit in identical terms were opened by Bank of China. On 5 July 1995 the seller, Glencore, tendered documents under the letters of credit to Vereinsbank in London, which negotiated them, and on 12 July 1995 tendered them to the Bank of China. One of the relevant documents was a beneficiary's certificate. This was created by Glencore on a word processor, printed on blank A4 paper and then photocopied as many times as required on the same paper as used for the original printout.

At face value, the photocopies were indistinguishable from the original printout. One document, assumed for the purposes of litigation to be a photocopy, was then signed by the beneficiary and included in the tendered documents. Counsel for Glencore submitted that the certificates were original documents by virtue of the signature whereas Counsel for the bank submitted that the documents were "produced ... by reprographic ... systems" and were therefore copies and under Article 20 could be treated as original only if they

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[68] Article 20 (b). It also provides that a document may be signed by handwriting, by facsimile signature, by perforated signature, by stamp, by symbol, or by any other mechanical or electronic method of authentication.

[69] Article 20 (c) (i).

[70] [1996] 1 Lloyd's Rep 135.

complied with the proviso and were "marked as original". The court of first instance upheld the argument of the bank. The matter went on appeal. The Court of Appeal held that the deviation from a simple and literal interpretation of Article 20 (b) would defeat its purpose. The purpose of the article is to benefit banks by avoiding doubt regarding the acceptability of documents produced using modern technology.[71] The appeal was dismissed.

5.4.3 Terms as to issuers of documents

Terms such as "first class", "well known", "qualified", "independent", "official", "competent", "local", and the like, shall not be used to describe the issuers of any document to be presented under the credit. If such terms are used, they are to be ignored and the document presented will be accepted provided that it otherwise appears to meet the credit and is not issued by the beneficiary.[72]

5.5 Requirements as to particular documents

5.5.1 Commercial invoice

The commercial invoice is a primary document in the sense that it states the goods in respect of which the documents are presented.[73] It must appear on its face to be issued by the beneficiary named in the credit. It must be made out in the name of the applicant and need not be signed.[74] The description of the goods in the commercial invoice must

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71 At 153.

72 Article 20 (a).

73 See Jack *op cit* n 13 at 166.

74 Article 37 (a).

correspond with the description in the credit.[75] In all other documents the goods may be described in general terms not inconsistent with the description of the credit. There is authority to the effect that the description of the goods in the commercial invoice need not be in the same words as the description in the credit.[76] The difficulties in interpreting article 37 (c) shows the need of describing the goods in the credit in a simple form so that it may be in accordance with the description in the invoice.

The bank may refuse a commercial invoice which exceeds the amount of the credit. Even the tolerance allowed by Article 39 (b) cannot be used as a means of increasing the amount of the credit. If it accepts such invoice, its decision will be binding on all the parties against payment of the maximum amount of the credit.[77]

5.5.2 Transport documents

The function of a transport document is to evidence receipt of the goods by the carrier and the terms of contract of carriage.[78] A bill of lading used to be the usual form of transport document until the development of containerisation and other transport practices created new forms of transport documents. The growth of container transportation led to the appearance of container freight stations where containers are assembled and filled with goods of different shippers, and of container ports specialising

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[75] Article 37 (c). See also *Kydon Compania Naviera SA v National Westminister Bank Ltd and others* [1981] 1 Lloyd's Rep 68 at 76 where Parker J held "unless otherwise specified in the credit, the beneficiary must follow the words of the credit and this is so even where he uses an expression which, although different from the words of the credit, has, as between buyers and sellers, the same meaning as such words. It is important that this principle should be strictly adhered to".

[76] *Astro Exito Navegacion SA v Chase Manhattan Bank* NA [1986] 1 Lloyd's Rep 455.

[77] The total amount of the invoice will include the cost of freight and insurance if they are to paid by the buyer.

in the handling of containers and of container vessels. Container transport may also involve more than one mode of carriage, for example, carriage by air and road. There are different provisions for different types of documents in the UCP. The purpose of this section is to discuss the special requirements of those documents which are most frequently tendered under letter of credit transactions.

5.5.2.1 Marine/ ocean bills of lading

Article 23 of the UCP deals with marine/ocean bills of lading and applies where "a bill of lading covering port-to-port shipment is called for". This article only applies to sea transport from one port to another. It is a requirement that a bill of lading must indicate the name of the carrier.[79] It must also be signed or authenticated by the carrier or the master, or by an agent of one of them.[80] If a carrier is a company, the agent of the company must sign on its behalf.[81] The bill of lading must indicate that the goods have been shipped on a named vessel and that may be indicated by pre-printed wording on the bill of lading that the goods have been loaded on-board a named vessel or by notation which gives the date on which the goods have been loaded on-board.[82] The requirement of a signature or an initial on an board notation was abandoned.[83] Applicants are still free to require that such signatures or initials appear on an board notation, but the banks will

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78 See Jack *op cit* n 13 at 170.

79 Article 23 (a) (i).

80 *Ibid.*

81 *Ibid.* The agent may be an employee of the carrier or of another company which is acting as the agent of the issuer. Article 23 also provides that an agent signing or authenticating for the carrier or master must also indicate the name and capacity of the party, ie carrier or master, on whose behalf that agent is acting.

82 Article 23 (a) (ii).

83 See UCP 400 and 500 Compared *op cit* n 67 at 66.

have no duty, unless otherwise agreed, to check for the validity or genuineness of such signature or initials. Where the bill as originally drawn names the vessel as an intended vessel, the on-board notation must include the name of the vessel on which they are loaded even where it is the same as the intended vessel.[84] Thus, the on-board notation must show explicitly that it reflects the condition of carriage on board the actual ocean vessel of a port-to-port carrier. Where the bill of lading is pre-printed in the loaded board form, the date of issue of the bill is deemed to be the date of shipment. In an on-board notation the date of notation is deemed to be the date of shipment.

The bill of lading must show the port of loading and the port of discharge consistent with the letter of credit,[85] but it can show a place of receipt different from the port of loading or a place of final destination different from the port of discharge.[86] The reason is that if the goods are containerised, they are likely to be taken in charge prior to arrival at the port of loading and delivered up beyond the port of discharge. It is a requirement that documents must consist of the full set of original bills of lading or the sole original bill if only one bill was issued.[87] The bill must appear to contain all the terms and conditions of carriage, or some of such terms and conditions by reference to a source or document other than the bill of lading and banks are not required to examine the terms and conditions of the bill.[88]

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84 That removes the burden on the bank to decide whether the on-board notation in such a situation is related to the placing of the goods on board the intended vessel or to the actual vessel in which goods are to be transported from the port of loading to the port of discharge. See UCP 400 and 500 Compared *op cit* n 67 at 67.

85 Article 23 (a) (iii). It is no longer sufficient for the carriers to refer to "intended ports"

86 See Jack *op cit* n 13 at 176.

87 Article 23 (a) (iv).

The reason why the bill should contain all the terms and conditions of carriage is that the bill of lading is regarded as evidencing the contract of carriage only, whilst some other terms and conditions may be contained elsewhere, such as in the carrier's published tariff. A bill of lading must not indicate that it is subject to a charter party and must not indicate that only sail propels the carrying vessel.[89] A bill of lading which allows transshipment will be acceptable unless transshipment is specifically prohibited by the letter of credit stipulations, and provided that the entire ocean carriage is covered by one bill of lading.[90] Even where the credit prohibits transshipment, banks will accept a bill of lading which incorporates clauses stating that transshipment will take place so long as the cargo is shipped in containers, trailers or barges, provided the entire carriage is covered by one bill of lading.[91] A bill of lading which reserves the right to transship is acceptable.[92]

5.5.2.2 Non-negotiable sea waybill

The non-negotiable sea waybill was introduced by the transport industry to avoid delay in the handling of goods once they arrive at the port of discharge.[93] The sea waybill is not a traditional negotiable bill of lading nor a document of title, as the consignment and delivery of the goods are made to a nominated consignee upon proof of identity and not upon delivery of the original sea waybill. It is a receipt for goods which provides

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88 Article 23 (a) (v).

89 Article 23 (a) (vi).

90 Article 23 (c). Transshipment is defined in Article 23 (b) of the UCP as "unloading and reloading from one vessel to another vessel during the course of ocean carriage from the port of loading to the port of discharge stipulated in the credit".

91 Article 23 (d) (i).

92 Article 23 (d) (ii).

93 UCP 400 and 500 Compared *op cit* n 67 at 72.

evidence of the carriage under which the goods are carried, but it is not negotiable and cannot transfer title in the goods.[94] The shipper can assign its right of control to the consignee so that the latter becomes the only party who can give delivery instructions to the carrier.

The seller can by including a non-disposal clause in the waybill renounce the right to vary the identity of the consignee of the goods during transit. Such a clause can cause problems for the seller if the documents are rejected under the credit. The problem can be resolved by a clause providing for the seller to renounce his right to vary the identity of the consignee upon the acceptance of the waybill under a letter of credit and the confirmation of that acceptance by the accepting bank to the carrier.[95]

5.5.2.3 Charter party bills of lading

Charter party bills of lading are marine bills of lading issued subject to charter party.[96] It is an established fact that under charter party contracts the applicant and the beneficiary, or their agents, are the ones who arrange for the contract or the hiring of the vessel or part thereof, for a time or purpose, in order to have the cargo delivered according to their intent. Since both the applicant and the beneficiary are aware of the terms of the contract of carriage it would be logical for them to state explicitly in the instructions to issue the credit that shipment must be made under the charter party contract concluded and that the

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94 Non-negotiable sea waybills are regulated by Article 24. The provisions of Article 24 are the same as those in article 23 for marine bills of lading with the substitution of sea waybills for bills of lading.

95 See Jack *op cit* n 13 at 181.

96 The provisions of charter party bills of lading are similar to those in Article 23.

credit allows for the presentation of a charter party bill of lading.[97] If a charter party contract is presented, the banks will not be responsible for examining such charter party contract and will forward it without responsibility.[98]

5.5.2.4 Multimodal transport document

Multimodal transport documents are documents which cover at least two different modes of transport, for example road and rail.[99] The essential differences between a multimodal transport document and a bill of lading are the following.[100] Firstly, the multimodal transport document can be signed or otherwise authenticated by a multimodal transport operator or his agent as well as the carrier or his agent,[101] whereas a marine bill of lading must be issued by a carrier or his agent.[102] Secondly, a multimodal transport document need not evidence the dispatch or taking in charge of the goods by the carrier. It is sufficient if it indicates that the goods have been dispatched or taken in charge. Thirdly, a multimodal transport document can be issued by a freight forwarder acting as a principal. Finally, even where the credit prohibits transshipment, banks will accept a multimodal

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97 UCP 400 and 500 Compared *op cit* n 67 at 74.

98 Article 25 (b).

99 In drafting the new article on multimodal transport documents the term "multimodal transport document" was chosen in preference to "combined transport document" or "intermodal transport document" for the sake of consistency with the terminology of United Nations Commission on International Trade Law. They are governed by Article 26, which is similar to Article 23.

100 For the distinction see generally Guest AG *op cit* n 22 at para 23-205, Jack *op cit* n 13 at 185 Todd *op cit* n 54 at 144-145, Proctor C *The Legal Role of Bill of Lading, Sea Waybill and Multimodal Transport Document* (1997) at 140-141.

101 Article 25 (a) (i).

102 Article 23 (a) (i).

transport document, which indicates that transshipment may or will take place, provided that the entire carriage is covered by one and the same multimodal transport document.[103]

5.5.2.5 Air transport documents

Article 27 (a) provides that if a credit calls for an air transport document banks will, in the absence of stipulation to the contrary, accept the document, however named, provided certain requirements are satisfied. The requirements are, firstly, that the document has to be signed by the carrier or by a named agent acting on his behalf;[104] secondly, the documents must indicate that the goods have been accepted for carriage;[105] thirdly, where the credit calls for an actual date of dispatch, then a specific notation of the date is required, which is then deemed to be the date of shipment;[106] fourthly, the documents must indicate the airport of departure and of dispatch;[107] fifthly, the documents must appear to be original for the consignor or shipper even if the credit stipulates a full set of originals;[108] finally, the documents must appear to contain the terms and conditions of carriage and must in all respects meet the stipulations of the credit.[109]

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103 This provision is wider than Article 23 (d) (i) of the UCP which applies a comparable rule where cargo in containers, trailers, or "LASH" barges.

104 Article 27 (a) (i).

105 Article 27 9 (a) (ii).

106 Article 27 (a) (iii).

107 Article 27 (a) (iv).

108 Article 27 (a) (v).

109 Article 27 (a) (vi) and (vii). The provisions relating to transhipment are dealt with by article 27 b-c, which is similar to the provisions of Article 23.

5.5.2.6 Road, rail, and inland waterway transport documents

The provisions of Article 28 in relation to road, rail or inland waterway transport documents are similar to those in Article 27 which applies to air transport documents. The main difference is in respect of the number of documents to be tendered. Article 28 (b) of the UCP provides that in the absence of any indication on the transport document as to the numbers issued, banks will accept the transport documents presented as constituting a full set. Banks will also accept as original a transport document irrespective of whether or not it is marked original.

5.5.2.7 Courier and post receipts

In terms of Article 29 (a) of the UCP a post receipt or certificate of posting must comply with two basic requirements. First, it must appear on its face to have been stamped or otherwise authenticated and dated in the place from which the credit stipulates the goods to be dispatched.[110] Secondly, the documents must in all respects meet the stipulation of the credit.[111]

5.6 General provisions on transport documents

5.6.1 Transport documents issued by freight forwarders

Article 30 (i) of the UCP allows a bank to accept the transport document issued by a freight forwarder provided that the document indicates that the freight forwarder is acting as a carrier or a multimodal transport operator and that it is signed or authenticated by such freight forwarder as a carrier or multimodal transport operator. In the event that the freight forwarder is acting as a named agent on behalf of the carrier or the multimodal

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[110] Article 29 (a) (i).

[111] Article 29 (a) (ii).

transport operator, the document must indicate the name of the carrier or the multimodal transport operator and must be signed or authenticated by the freight forwarder as a named agent acting on behalf of the carrier or multimodal transport operator.[112] The document must also comply with all the conditions of the relevant UCP 500 transport article incorporated in those rules.

5.6.2 On deck, shipper's load and count, and name of the consignor

5.6.2.1 Carriage on deck

Unless otherwise stipulated in the credit, in the case of carriage by sea, the bank will not accept a document which indicates that the goods are or will be loaded on deck. Nevertheless, the bank will accept a transport document which contains a provision that the goods may be carried on deck provided that it does not specifically state that they will be loaded on deck.[113] Banks used to refuse bills showing stowage on deck because there is an additional likelihood of damage to goods so stowed. Today the situation is different because container vessels whereby containers are stacked several high on a low deck are used.[114] Jack correctly suggests that Gutteridge and Megrah's view that where the credit calls for shipment under deck, a bill of lading should state that it is carried under deck should be adopted.[115]

5.6.2.2 Shipper's load and count

A transport document which bears the clause "shipper's load and count" or "said by shipper to contain" or words of similar effect, is acceptable unless the credit provides

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112 Article 30 (ii).

113 Article 31 (i).

114 See Jack *op cit* n 13 at 191.

otherwise.[116] The effect of such a clause is that the carrier is not bound by the quantity or weight declared to him by the consignor and which he would otherwise acknowledge by the bill of lading.[117]

5.6.2.3 Name of the consignor

The transport document which indicates as a consignor of the goods a party other the beneficiary of the credit will be acceptable.[118] The reason is to safeguard the possibility that the beneficiary may be a buyer in a string or a third party who shipped the goods.

5.6.3 Clean transport document

A clean transport document is one which bears no clause or notation which expressly declares a defective condition of the goods and/or the packaging.[119] A bank will not accept a transport document bearing such clauses or notations unless otherwise authorised in the credit.[120] The transport document is regarded as being "clean on board" if it complies with Article 32, and Articles 23-28, or 30 of the UCP.[121] It is regarded as clean because it does not bear a notation rendering the document "foul" or "unclean". Oelofse

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115 *Ibid.*

116 Article 31 (ii).

117 See Jack *op cit* n 13 at 191.

118 Article 31 (iii).

119 Article 32 (a) In *British Imex Industries Ltd v Midland Bank Ltd* [1958] 1 QB 542 at 551 it was held that when a credit calls for a bill of lading it means a clean bill of lading.

120 Article 32 (b). Banks are only charged with the knowledge of the banking industry practice and therefore banks should not be placed in a position of interpreting market practice in other industries. If there are other industry practices which allow marginal clauses to be noted and which may mislead another party as to the acceptability, then the applicant should declare that marginal clauses are acceptable by clearly stating, in their application for the credit, the specific clauses allowed. See UCP 400 and 500 Compared *op cit* n 67 at 91.

121 Article 32 (c).

states that article 32 (a) literally read means that a notation regarding defects renders a transport document "unclean" even if it is clear from the notation itself that the defect arose only after shipment. He however suggests that it must not be read literally. It should be read to mean that a transport document is clean unless it contains a notation of a defect existing at the time of shipment.[122]

5.6.4 Freight

Banks will accept transport documents requiring that freight or transport charges remain to be paid.[123] If any words indicating that the seller has paid freight appear by stamp or by other means in the carriage documents they are to be accepted as evidence of such payment.[124] In relation to courier charges, Article 33 (b) of the UCP provides that if the credit is issued requiring courier charges to be paid or pre-paid or a similar designation, the courier document does not need to carry the traditional "freight pre-paid" notation. A bank will also accept an indication that the courier charges are for the account of a party other than the consignee as evidence that freight charges have been prepaid.

5.6.5 Partial Shipment

Transport documents which appear on their face to indicate that shipment has been made on the same means of conveyance and for the same journey, provided that they indicate the same destination, will not be regarded as covering partial shipment, even if the

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122 See Oelofse *op cit* n 11 at 210.

123 Article 33 (a). Additional transport charges other than freight charges may be incurred, such as for the cleansing of containers and their return. UCP 400 and 500 Compared *op cit* n 67 at 93.

124 Article 33 (b). Article 33 (c) states that the words "freight prepayable" or "freight to be pre-paid" do not constitute evidence that payment has taken place.

transport documents indicate different dates of shipment and/or different ports of loading, places taking in charge or dispatch.[125] Where partial shipments are made, the documents should be presented to the bank in a single presentation unless the credit permits drawings by instalments or shipments by instalments.[126]

5.6.6 Insurance documents

5.6.6.1 The documents to be issued

Insurance documents must appear on their face to be issued and signed by insurance companies or underwriters or their agents.[127] If the insurance document indicates that it has been issued in more than one original, all originals must be presented.[128] Banks must accept an insurance certificate or a declaration under an open cover pre-signed by insurers or underwriters or their agents.[129] An insurance document will be acceptable as a substitute for an insurance certificate. Insurance cover is considered effective if the insurance document bears a date of issuance not later than the date of loading, dispatch or taking in charge as indicated in the respective transport document.[130] The document should cover the entire voyage but need not describe the goods in detail.[131]

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125 Article 40 (b).

126 See Jack *op cit* n 13 at 196.

127 Article 34 (a).

128 Article 34 (b).

129 Article 34 (d). See also Jack *op cit* n 13 at 199. An open cover is a policy issued by an insurer which enables a named party, perhaps a broker or an underwriting agent, to make declarations under it of risks which fall within the risks permitted by the cover.

130 Article 34 (e). It is not the responsibility of the banks to interpret the extent of insurance cover or lack thereof. See UCP 400 and 500 Compared *op cit* n 67 at 96.

131 See Guest *op cit* n 22 at para 23-211.

5.6.6.2 Currency and amount

The insurance document must be expressed in the same currency as the letter of credit.[132] If different currencies are used there may be a problem in evaluating the cover provided, and fluctuation in exchange rate could cause devaluation of the policy.[133] The minimum amount for which the insurance must be effected is the Carriage Insurance Freight (CIF) or Carriage and Insurance paid to the named place (CIP- value of the goods plus 10 %). However, if the CIF or CIP value of the goods cannot be determined from the face of the documents, the amount covered must be equal to that of the draft or the commercial invoice, whichever is greater.[134] A policy, which indicates that cover is subject to a franchise or an excess (deductible) is, in the absence of stipulations to the contrary, good tender.[135] A franchise is an amount or percentage stated in a policy which must be reached before any claim is payable and if it is reached, then the claim is payable in full.[136]

5.6.6.3 Risks

Credits should stipulate the type of insurance required and, if any, additional risks which are to be covered.[137] Unless otherwise indicated in the credit, banks will accept insurance

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132 Article 34 (f) (i).

133 See Jack *op cit* n 13 at 201.

134 Article 34 (f) (ii).

135 Article 35 (c).

136 See Jack *op cit* n 13 at 202.

137 Article 35 (a). Imprecise terms such as "usual risks" or "customary risks" must not be used. If they are used, banks will accept insurance documents as presented, without responsibility for any risks being covered. Jack *op cit* n 13 at 198 suggests that Article 35 will not entitle a bank to accept an insurance document without examination of its content.

documents as presented without any responsibility for any risks covered.[138] When a letter of credit stipulates for an "all risks" cover, any insurance document which contains an "all risks" notation or clause is a good tender and the banker is not responsible if a specific risk is, in effect, not covered. This is so even if the policy does not have an "all risks" heading or indicates that certain risks are excluded. [139]

5.6.6.4 Other documents

Documents other than transport documents, insurance documents and commercial invoices can be called for in the credit. If they are called for, they should stipulate by whom such documents are to be issued and their wording or data content. If there is no stipulation, banks will accept such documents as presented, provided that their data content is not inconsistent with any other stipulated document presented.[140] There are also various other types of certificates that can be called for in the credit such as certificate of inspection, of origin, of weight, of analysis and of quality. If a credit calls for attestation or certification of weight in the case of transport other than by sea, banks will accept a weigh stamp or declaration of weight which appears to have been superimposed on the transport document by the carrier or his agent unless the credit specifically stipulates that the attestation or attestation of weight must be on the separate document.[141]

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138 Article 35 (b).

139 Article 36.

140 Article 21.

141 Article 38.

5.7 Conclusion

Banks must be very careful in accepting documents presented under the credit. They must examine the documents to ensure that they are in strict compliance with the requirements as set out in the credit. If the documents do not comply with the terms and conditions of the credit, banks must reject them. It is submitted that the banks must not reject the documents if the discrepancy is trivial and may be ignored. That will ensure the smooth running of letters of credit transaction without unnecessary delay. Banks must also ensure that the requirements of the UCP in relation to transport documents are adhered to.

CHAPTER SIX

THE PRINCIPLE OF INDEPENDENCE AND THE FRAUD EXCEPTION

6.1 Introduction

The issuing bank or the confirming bank, if there is any, has an obligation to pay the beneficiary in terms of a letter of credit irrespective of any dispute that may lie between the buyer and seller or between the bank and the buyer. Thus, the different contracts in a letter of credit transaction are independent from each other. The contract between the issuing bank and the seller is independent from the contract between buyer and the seller, and between the issuing bank and the buyer. This principle of independence has long been accepted as the basis of the letter of credit system. However, an exception to this principle has been recognised. If the bank identifies any fraud by the beneficiary in the documents, it may dishonour the demand to pay on the letter of credit. If the bank refuses to dishonour the letter of credit the buyer can approach the court for a grant of an interdict. The English and South African courts adopt a relatively inflexible and rigid approach on the fraud exception by requiring a high standard of proof of fraud to displace the independence principle. However, American appear to adopt a more flexible approach to the standard.

The scope of this chapter is to look at the principle of independence and a way in which the standard of proof of fraud can be developed in South Africa.

6.2 The principle of independence

The principle of independence was firmly established in the early development of letters of credits. In *Urquhart, Lindsay & Co v Eastern Bank Ltd*[1] the plaintiffs entered into contract with the buyers in Calcutta to manufacture and ship same machinery in instalments. The buyers opened a confirmed irrevocable credit covering all shipments through their bank. The letter of credit was to pay several drafts which were to be accompanied by invoices and shipping documents. The plaintiffs shipped two instalments under the contract and presented drafts which were honoured. The plaintiffs included in the drafts an increase in the purchase price as a result of costs of production. The defendants refused to accept a third draft drawn against the third shipment and the plaintiffs then cancelled the contract, claiming damages from the defendant. Rowlatt J held that the defendants committed breach of contract with the plaintiff when they refused to pay the drafts. He said:[2]

> "The answer to this is that the defendants undertook to pay the amount of invoices for machinery without qualification, the basis of this form of banking facility being that the buyer is taken for the purposes of all questions between himself and his banker or between his banker and the seller to be content to accept the invoices of the seller as correct. It seems to me that so far from the letter of credit being qualified by the contract of sale, the latter must accommodate itself to the letter of credit. The buyer having authorised his banker to undertake to pay the amount of the invoice as presented, it follows that any adjustment must be made by way of refund by the seller, and not by way of retention by the buyer."

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1 [1922] 1 KB 318.

2 At 322-323.

Rowlatt J is correct in the fist part of his opinion that an irrevocable credit is independent from the contract of sale but he is incorrect in saying that the contract of sale must accommodate itself to the letter of credit because the two contracts are independent from each other.

The principle is clearly illustrated by the decision of the Court of Appeal in *Hamzeh Malas & Sons v British Imex Industries Ltd.*[3] The plaintiffs, a Jordanian firm, agreed to buy from the defendants, a British company, a quantity of reinforced steel rods. The steel rods were delivered in two instalments and payment was to be effected by the opening of two confirmed letters of credit in favour of the defendants with Midland Bank in London. Each letter of credit was in respect of an instalment. The letters of credit were duly opened and the defendants' vendors realised the first one and were on the point of realising the second payment. The plaintiffs, on receiving the first consignment of steel rods, considered that they were not of the quality specified in the contract and therefore applied for an injunction restraining the sellers from dealing with the second letter of credit. The application was refused. The plaintiffs appealed and the appeal was dismissed. It was held that the opening of a confirmed letter of credit constitutes a contract between the bank and the buyer which imposed on the bank an absolute obligation to pay irrespective of any dispute between the parties on whether the goods are up to standard or not. It was also held that the operation of letter of credit system will be broken completely if the dispute of the parties under the underlying contract were to stop payment under the letter of credit.[4]

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[3] [1958] 1 QB 127. See also *Power Curber v National Bank of Kuwait SAK* [1981] 1 WLR 1233, *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159, *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 WLR 315.

The principle was also applied in the South African case of *Phillips and another v Standard Bank of South Africa Ltd and others*[5] where the applicants contracted to purchase a quantity of shoes from the third respondent, an Italian firm. Payment was to be made by means of an irrevocable letter of credit issued by the first respondent, Standard Bank of South Africa. A letter of credit was issued in terms of which Standard Bank undertook to pay 30 days after the presentation of certain documents. After the presentation of the documents, which were strictly in compliance with the credit, but before payment, the shoes arrived. When unpacking the shoes which had been delivered by the third respondent pursuant to the aforesaid contract, the applicant found that a substantial number of the shoes were defective. The applicant then sought a court order interdicting Standard Bank from honouring its obligation in terms of the credit. The application was dismissed. Goldstone J held:[6]

> "In my opinion the documentary credit issued in this case does indeed constitute a contract independent of the contract of purchase and sale between the applicants and the third respondent. The courts should recognise and give effect to the commercial purpose for which the system of irrevocable documentary credits has been devised, viz to facilitate international trade by giving the seller, before he parts with his goods, the assurance that he will be paid and that no dispute as to the performance by him of the contract with the purchaser will constitute a ground for non payment or delayed payment."

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4 At 129.

5 1985 (3) SA 301 (W).

6 At 304.

He also held that an irrevocable letter of credit constitutes an independent contract between the issuing bank and the beneficiary and the buyer may not stop payment because of the alleged breach of contract with the seller. This was confirmed in the case of *Ex Parte Sapan Trading (Pty) Ltd*[7] where it was held that an irrevocable letter of credit gives rise to a contract between the issuing bank and the seller, which is the result of the contract between the buyer and the seller which establishes the credit, and of a contract between the buyer and issuing bank, but is separate and independent from such underlying contracts.[8]

In the USA the principle of independence is provided for in section 5-114 (1) of the UCC.[9] It provides:

> " An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract of sale or other contract between the customer and the beneficiary."

The court in *Lamborn v Lake Shore Banking & Trust Co*[10] said:[11]

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7 1995 (1) SA 218 (W).

8 At 223-224.

9 Revised section 5-103 (d) states "Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or non-performance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary".

10 188 NYS 162 (1921). See also *Kingdom of Sweden v New York Trust Co* 96 NYS 2d 779 (1949), *Centrifugal Casting Machine Co Inc v American Bank & Trust Co* 966 F 2d 1348 (1992), *Global Network Technologies Inc v Regional Airport Authority of Louisville and Jefferson Country* 122 F 3d 661 (1997), *Banco del Estado v Navistar International Transportation Corporation* 954 F Supp 1275 (1997), *Ganz v Lyons Partnership* 961 F Supp 981 (1997).

"The authorities are uniform to the effect that this letter of credit constitutes the sole contract with the shipper [seller], and that the bank issuing the letter of credit has no concern with any question which may arise between the vendor and vendee of the merchandise for the purchase price for which the letter of credit was issued."

In *Dulien Steel Products Inc of New York v Bankers Trust*[12] the plaintiffs contracted to sell steel scrap to European Iron and Steel Community. The transactions were arranged by Messrs Marco Polo Company who were to receive commission from the plaintiffs. The plaintiffs opened an irrevocable credit with Seattle First National Bank for payment of the commission and Marco Polo instructed them to issue the letter of credit in favour of Sica. Subsequently, the plaintiffs and the purchasers agreed to reduce the purchase price of the goods but Sica, the beneficiary of the credit, demanded full payment. Seattle bank informed the defendants about the alteration regarding the underlying contract and requested them not to make any payment. Sica however demanded full payment and the defendants finally paid him. The plaintiff brought an action against the defendants for the recovery of money paid to Sica. They argued that as the defendants were informed of the amendments of the contract of sale, they should have refused payment. Bryan J said:[13]

"When a bank confirms a letter of credit the letter evidences its irrevocable obligation to honor the drafts presented by the beneficiary upon compliance with the terms of the credit. The letter is quite independent of the primary agreement

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11 At 163.

12 189 F Supp 922 (1960).

13 At 927.

between the party for whose account it is issued and the beneficiary, or of any underlying transactions. Neither the issuing nor the confirming bank has any obligation, and is not permitted, to go behind the terms of the letter and the documents which are required to be presented, and to enter controversies between the beneficiary and the party for whose account the letter was opened concerning other agreements or transactions."

The second argument of the plaintiff was that Sica was a mere nominee and that Marco Polo agreed to the amendments and therefore payment should have been refused. The court held that it was not the defendants concern whether Sica was a principal or a collecting agent. The defendants were only concerned with making the payment to the beneficiary.

The principle of independence is embodied in Articles 3 (a) and 4 of the UCP. Article 3 (a) provides:

"Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the Credit. Consequently, the undertaking of a bank to pay, accept and pay Draft (s) or negotiate the undertaking of a bank to pay, accept and pay Draft (s) or negotiate and/or to fulfil any other obligation under the credit, is not subject to claims or defences by the Applicant resulting from his relationships with the Issuing Bank or the Beneficiary".

Article 4 states that in credit operations banks deal with documents and not with goods and services or other performances to which the documents may relate.

The effect of the principle of independence is multi-edged. It delineates the scope of the issuing bank to pay by providing that it is not required to investigate the underlying contract which is financed by a letter of credit. From the buyer's side, it increases the risks if the seller does not perform because the issuing bank's payment is independent from the contract of the buyer and the seller. The buyer can stop payment by the issuing bank under the credit only where the documents are not in compliance with the terms and conditions of the letter of credit. In so far as the beneficiary is concerned, the credit provides a solvent paymaster who will not go beyond the documentary evidence into the underlying contract in making preparation for payment.[14]

6.3 The fraud exception[15]

Although the principle of independence is firmly established, it is not absolute.[16] An exception to the principle occurs in case of fraud.[17] Thus, where the seller has committed fraud such as the tendering of forged documents, the bank may dishonour the letter of credit.

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14 See Sarna L *The Law and Current Practice* 2 ed (1989) at para 5-2-5-3.

15 For a discussion of other exceptions to the principle of independence see Oelofse AN *The Law of Documentary Letters of Credit in Comparative Perspective* (1997) at 357-376.

16 See Hugo CF "Documentary Letters of Credit: Reflections on Recent Developments" (1993) *Annual Banking Law Update* 181 at 185.

17 In *Phillips and another v Standard Bank of South Africa and others op cit* n 5 at 34 Goldstone J refers to the fraud exception but finds it inapplicable in the case. The UCP does not have any provision dealing the fraud exception. According to the ICC Banking Commission (ICC Publication No 399) at 27, it is the intention of the UCP to leave questions of fraud to the relevant municipal law but the existence of the exception is not denied.

The American case of *Sztejn v J Henry Schroder Corporation*[18] is a landmark decision in so far as the fraud exception is concerned. The plaintiff Chester Sztejn, based in the United States, wished to purchase a number of hog bristles from Transea Traders Ltd, a corporation based in Lucknow, India. The defendant, Schroder Bank, issued an irrevocable letter of credit in favour of Transea Traders. Transea placed fifty cases of material on board a steamship and thus acquired a bill of lading and customary invoices. Chartered Bank of India acted as the correspondent bank. When Transea delivered to Chartered Bank the documents called for in the credit, Charted Bank sought payment from Schroder on behalf of Transea. Transea's fifty creates were allegedly filled "with cow hair, other worthless material, rubbish rather than with hog bristles". Prior to Schroder making payment to Chartered, Sztejn applied for declaratory and injunctive relief. He asked that the letter of credit and draft be declared void and that an injunction be issued to prevent payment of the draft. Chartered Bank applied for the dismissal of the claim on the ground that there was no cause of action. For the purposes of hearing the motion the court assumed the allegations by the buyers to be true. In other words it assumed that Transea had committed a deliberate fraud upon Sztejn.

Shientag J refused to strike out the action. He firstly referred to the principle of independence and noted that the application of the principle "presupposes that the documents accompanying the draft are genuine and conform in terms to the requirements of the letter of credit".[19] He, however, held that the principle would not apply if the seller's fraud has been called before the drafts and documents are presented for payment

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18 31 NYS 2d 631 (1941).

19 At 634.

because it is not intended to protect an unscrupulous seller. He also held that if the issuing bank paid before receiving the notice of the seller's fraud it will be protected if it exercised reasonable diligence before making payment. The court also held that Transea has not merely committed a breach of warranty but rather an active fraud. The court held:[20]

> "No hardship will be caused by permitting the bank to refuse payment where fraud is claimed, where the merchandise is not merely inferior in quality but consists of worthless rubbish, where the draft and the accompanying documents are in the hands of one who stands in the same position as the fraudulent seller, where the bank was given notice of fraud before being presented with the drafts and documents for payment, and where the bank itself does not wish to pay pending an adjudication of the rights and obligations of the other parties."

This lack of hardship arises from the fact that only the fraudulent seller is denied access to payment from the credit while the innocent buyer and issuing bank are protected, and the confirming bank is not largely inconvenienced since it is presenting documents as an intermediary between the issuing bank and the beneficiary.

The fraud exception was echoed by the House of Lords in *United City Merchants v Royal Bank of Canada.*[21] Vitrorefuerzos SA (the buyers), a Peruvian company, entered into a contract of sale with the English sellers, for the purchase of glass fibres free on board London by means of a confirmed irrevocable letter of credit which was transferable. The letter of credit was issued by a Peruvian Bank, Banco Continental SA, and was confirmed

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[20] At 635.

by the Royal Bank of Canada. The letter of credit was expressed to be subject to the UCP. The buyer and seller agreed on the so-called "over invoicing" in order to circumvent the Peruvian exchange control measures and to enable the Peruvian buyer to export capital to the United States. The sellers invoiced the plant to the buyer at double the real sale price in US dollars and the excess was to be made available at the account of an American corporation controlled by the buyer in Miami, Florida. The credit was to be available by sight draft on the issuing bank against delivery of, amongst others, a full set of on-board bills of lading evidencing receipt for payment of goods from London to Dallas on or before a date in October, which was subsequently extended to 15 December 1976. The banks were not aware of the circumvention of the Peruvian exchange control when issuing and confirming the credit.

The goods were ready for shipment by the beginning of December 1976 but the actual shipment took place on 16 December 1976. The agent of the carriers ante-dated the bill by writing that the goods were shipped on 15 December in order to create the impression that shipment had taken place within the period for shipment stipulated in the credit. Neither the seller nor the confirming bank was aware of any fraud by the agent of the carrier. On presentation of the shipping documents the confirming bank rejected them and was sued under the letter of credit.

Two defences were raised against the claim under the letter of credit.[22] The first defence was based on the fraud exception. It concerned the fraud of the agent of the carrier by

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21 [1983] 1 AC 168 (HL).

22 This case was disposed of by two separate judgments. The first judgment dealt with the fraud defence and the second with the illegality defence.

inserting a wrong shipment date in the bill of lading. The trial judge, Mocatta J, held on the first defence that the bank should not make payment in terms of the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances where there is no right to payment. He nevertheless held that as fraud in the bill of lading cannot be blamed on the seller, it did not entitle the bank to reject the documents. Accordingly, the defence failed.[23]

The second defence was on illegality. The defence was that the transaction, if carried out, would be against the Peruvian exchange control measures. The second defence is considered in this discussion because it raises the possibility of another exception to the principle of independence. Mocatta J held that the transaction would, if carried out as a whole, amount to a contravention of Peruvian exchange control measures.[24] Britain and Peru are parties to the Bretton Woods Agreement. Article VIII 2 (b) of the Agreement (the relevant part) provides:

> "Exchange contract which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this agreement shall be enforced in the territories of any member. ..."

For Article VIII 2 (b) to apply the contract concerned must be an exchange contract. The Court of Appeal in *Wilson, Smithett & Cope Ltd v Jeruzzi*[25] gave a narrow interpretation

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23 [1979] 1 Lloyd's Rep 267.

24 [1979] 2 Lloyd's Rep 498.

25 [1976] 1 QB 683.

of the expression "exchange contract". The meaning is restricted to contracts to exchange the currency of one country for the currency of another and does not include contracts entered into in connection with the sale of goods which require the conversion by the buyer of one currency into the other in order to enable him to pay the purchase price. It was also held that in considering the application of the provision a court should look at the substance and not the form. It should not enforce a contract that is merely a monetary transaction in disguise.

Mocatta J held that the contract of sale between the buyer and the seller at the inflated price was a monetary transaction in disguise and therefore cannot be enforced. That was so despite the fact that the contract is independent under the letter of credit. Thus, although the underlying contract cannot be regarded as an exchange contract because there was no exchange of currencies, the contract is an exchange contract in disguise and cannot be enforced. Mocatta J also had to consider whether the fact that the underlying contract is unenforceable affects the confirming bank's undertaking to pay under the letter of credit. He held a court should not enable the Bretton Woods Agreement to be avoided when enforcing the credit.[26]

This decision may at face value suggest that it recognised illegality as another exception to the principle of independence. However, it is not authority for the general preposition that if illegality is established under the underlying contract, the contract will be regarded as void and can be a defence against any claim under the letter of credit.[27] It only holds

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[26] At 505.

that illegality in this case, apparently because of Britain's obligation under the Bretton Woods Agreement, is an exception to the principle of independence. This view is supported by Staughton LJ in the Court of Appeal in *Deutsche Ruckversichierung AG v Walbrook Insurance Co Ltd and others, Group Josi Re (Formerly known as Group Josi Reassurance SA) v Walbrook Insurance Co Ltd and others*[28] where he said (*obiter*) that the illegality exception recognised by the House of Lords in the *United City Merchants* case may well be one of its kind and not an indication that illegality in the underlying contract is generally a defence under a letter of credit. He also stated that there might be cases when illegality in the underlying contract can affect the letter of credit, but did not attempt to formulate any general principle. In sum, it is safe to say that illegality of an underlying contract is not necessarily an exception to the principle of independence.

It was argued in *United City Merchants* that in applying severability the sellers could recover that half of the invoice price which represented the true sale of the goods, even if they could not claim the other half of the invoice price. In rejecting this submission, which he referred to as "rather remarkable", Mocatta J held that it was impossible to sever the contract constituted by the documentary credits. It is either enforceable or not at all.

In the Court of Appeal[29] Stephenson LJ stated that the letter of credit contract between the seller and the confirming bank was not an exchange contract but an exchange contract

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27 See Oelofse AN "Developments in the Law of Documentary Letters of Credit" 1996 *South African Mercantile Law Journal* 56 at 63 *op cit* n 38.

28 [1996] 1 ALL ER 791.

29 [1982] 2 QB 208.

in disguise.[30] However it is submitted that this statement is incorrect because the letter of credit contract did not purport to be anything other than an agreement to pay against presentation of documents. Stephenson LJ further held that the sale contract was an exchange contract in disguise. He said that the courts of a country which is party to the Bretton Woods Agreement should do their best to promote international trade and comity. That could be done by enforcing the part of the sale contract which is not against the law of Peru and refusing to enforce the part of the contract which is a disguised monetary transaction.[31] Ackner LJ and Griffiths LJ agreed that this was possible.

On the fraud exception the Court of Appeal held that because the bill of lading had been fraudulently completed, the bank was entitled to refuse to pay even if the sellers were not aware of the fraud.[32] Stephenson LJ said:[33]

> "If a document false in the sense that it is forged by a person other than the beneficiary can entitle a bank to refuse payment, I see no reason why a document in any way false to the knowledge of a person other than the beneficiary should not have the same effect."

Ackner LJ asked "How can there be a difference between a document forged by the third party and a document fraudulently completed by the third party?[34] Griffiths LJ held[35] "if

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30 At 219-220.

31 At 227.

32 At 239.

33 *Ibid.*

34 At 247.

the documents presented are fraudulently false, they are not genuine documents and the bank has no obligation to pay". The court seemed to hold that an untrue statement in the document makes it non-conforming, but it is submitted that such a view is incorrect. The fact that a document contains a factually untrue statement does not make it non-conforming. A forged document is of course a non-conforming document.

The House of Lords reversed the decision of the Court of Appeal and restored Moccata J's decision in so far as the fraud exception was concerned. Lord Diplock held that the fraud exception applies where the seller fraudulently presents to the confirming bank documents that contain, expressly or impliedly, material representations which to his knowledge are untrue.[36] He therefore rejected the proposition in the Court of Appeal that a fraudulent statement in a document will make the exception apply even if the seller was not aware of the false statement. He therefore held that that the case did not fall within the fraud exception.

Lord Diplock left open the question whether the beneficiary can enforce the letter of credit when a document presented by him is a nullity because unknown to him it was forged by the third party.[37] Oelofse correctly suggests that it was material for Lord Diplock to consider that.[38] A forged document is not a conforming document even though it appears to be and the bank should not be obliged to pay on non-conforming

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35 At 254.

36 At 183.

37 At 188.

38 See Oelofse *op cit* n 15 at 393.

documents because the beneficiary was not aware of the fraud.[39] The fact that the court did not address the question will lead to difficulties because in future there would be a strong argument that the position in respect of forgeries which the beneficiary was not aware of is on the same footing as established fraud and therefore the bank has to pay on forged document.

In so far as the Bretton Woods Agreement was concerned, the House of Lords agreed with the Court of Appeal with the exception of indicating that the issue did not concern severability but to give effect to the Bretton Woods Agreement. The House of the Lords held that severability applies where the court construes the language that the parties used in their written contract and the question in this case does not deal with the construction of the contract.[40] The House of Lords did not formulate illegality as another general exception to the principle of independence but gave a specific Bretton Woods Agreement exception to the principle.[41]

The *United City Merchants* case adopted a narrow approach in relation to fraud. Lord Diplock provided that fraud must relate to the documents tendered in terms of the credit.[42] This approach is also followed in South Africa.[43] However in America a wider or

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39 See Goode R *Commercial Law* 2 ed at 1009.

40 At 189.

41 See Oelofse *op cit* n 15 at 394.

42 At 183. See also Hugo *op cit* n 16 at 185. Although English law supports the narrow approach, it is interesting to note that two recent English cases, *Deutsche Ruckversichierung AG v Walbrook Insurance Co Ltd and others; Group Josi Re (Formerly known as Group Josi Reassurance SA) v Walbrook Insurance Co Ltd and others* [1994] 4 ALL ER 181 and *Themehelp Ltd v West and others* [1995] 3 WLR 751 supported, the "wider view".

broader approach, "fraud in the transaction", is followed. The original version of Article 5 of the Uniform Commercial Code (UCC) eventually codified the *Sztejn* case. Article 5-114 (2) provided:

> "Unless otherwise agreed when documents appear on their face to comply with the terms of the credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7-507) or of a certified security (Section 8-036) or *is forged or fraudulent or there is fraud in the transaction.*
>
> (a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiation bank or other holder of the draft or demand which has taken the draft or demand under the credit and under such circumstances which would make it a holder in due course (Section 3-302) and in appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a certified security (Section 8-302); and
>
> (b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor."[44]

It was not clear initially whether the clause "fraud in the transaction" meant fraud in the letter of credit transaction with the presentation of documents or fraud in underlying

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[43] See *Loomcraft Fabrics CC v Nedbank Ltd and another* 1996 (1) SA 812. *Union Carriage and Wagon Company Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) supported the "wider approach".

[44] The italics are mine.

transaction. The broad or wider view was supported in *United Bank Ltd v Cambridge Sporting Goods Corp*[45] where the court said:[46]

> "The drafters of section 5-114, in their attempt to codify the Sztejn case and in utilising the term 'fraud in the transaction', have eschewed a dogmatic approach and adopted a flexible standard to be applied as the circumstances of a particular situation mandate."

The court in *Intraworld Industries Inc v Girard Trust Bank*[47] supported a narrow view of the fraud exception. The plaintiff, the lessee of a Swiss hotel, sought to enjoin the issuer of the credit from paying drafts drawn under a standby letter of credit. A promise was made in the letter of credit that payment would be made upon presentation of a draft accompanied by the beneficiary's signed statement to the effect that the bank's customer had not paid an instalment of rent due under the lease. A draft was presented by the beneficiary accompanied by a statement that conformed to the terms of the letter of credit. The customer alleged fraud, in that no rent was due because the beneficiary, the lessor, had terminated the lease and that the beneficiary's claim was not for rent, but for a stipulated penalty under the lease.

The Pennsylvanian Supreme Court affirmed the trial court's denial of the customer's application for injunction. It stated:[48]

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45 360 NE 2d 943 (1976).

46 At 949.

47 336 A 2d 316 (1975). See also *Xantech Corp v Ramco Industries Inc* 643 NE 2d 918 (1994).

"In the light of the basic rule of independence of the issuer's engagement and the importance of this rule to the effectuation of the purposes of the letter of credit, we think that the circumstances which will justify an injunction against honor must be narrowly limited to situations of fraud in which wrongdoing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served...."

The new Article 5 is clear and it supports the broad view. It provides for relief where fraud is in the underlying transaction and where the beneficiary has committed fraud. Section 5-109 of the new Article 5 provides:

"(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, *but a required document is forged or materially fraudulent*, or honor of presentation would facilitate *material fraud by the beneficiary* on the issuer or applicant: (1) the issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which has taken place after acceptance by the issuer or nominated person, (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated

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[48] At 324-325.

person.(2) the issuer, acting in good faith, may honor or dishonor the presentation in any other case."[49]

The new revision omits the ambiguous standard of "fraud in the transaction", which was in section 5-114, and replaces it with a "material fraud standard". Article 5 does not attempt to define material fraud but comment 4 states that the burden is on the applicant to show by evidence and not mere allegation that relief must be granted. It appears that the new section 5-109 by providing the material fraud standard tightens the possibility of relief for fraud.

Section 5-109 (b) of the new Article 5 provides that a court may temporarily or permanently enjoin the issuer of the credit from honouring a presentation against an issuer or other persons if the court finds that: (1) the relief is not prohibited; (2) a beneficiary, issuer, or nominated bank who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted; (3) all of the conditions which entitle a person to the relief under the law of this state have been met; (4) on the basis of the information submitted to court, the applicant is more likely than not to succeed under its claim of forgery or material fraud. By providing that the court will grant an injunction if all of the conditions which entitle a person to the relief the law of the state have been met, section 5-109 (b) (3) recognises that injunctions based on the fraud exception are subject to the ordinary principles applicable to injunctions. The applicant has to show the following in order to obtain a preliminary injunction: (1) that he

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[49] The italics are mine.

suffered irreparable harm or (2) that there is a probability of success on the merits or (3) that the balance of hardship weighs in his favour. [50] In the last requirement the question will be whether the granting of an injunction will cause greater harm to the beneficiary than its refusal will cause to the account party.[51]

The American courts have been prepared to grant interim injunctions on the basis of strong suspicion of fraud under standby credits opened in favour of Iranian beneficiaries just before the revolution.[52] As a result of the revolution in Iran, there was a disruption of performance of many contracts by American businesses. The American contract parties sought injunctions against payment because they believed that the new Iranian government would make unwarranted calls on the standby credits.[53] As a result of the Iranian crisis the American courts developed a new doctrine used to decide whether to grant relief or not. In *Warner v Central Trust Co*[54] the Sixth Court of Appeals summarises the new doctrine as follows:

> "[T]he factors to be considered by a district court in exercising its discretion to grant a preliminary injunction are: (1) Whether the plaintiff (viz, the buyer) has shown strong or substantial likelihood or probabilities of success on the merits;

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50 See Oelofse *op cit* n 15 at 426.

51 See *Friendship Materials v Michigan Brick Inc* 679 F 2d 100 (1982).

52 See *Dynamics Corp of America v Citizens and Southern National Bank* 356 F Supp 991 (1973), *Harris Corp v National Iranian Radio and Television* 691 F 2d 1344 (1982), *Itek Corp v The First National Bank of Boston* 566 F Supp 1210 (1983). The strict rule of fraud was applied in *KMW International v Chase Manhattan* 606 F 2d 10 (1979), *American Bell International Inc v The Islamic Republic of Iran* 474 F Supp 420 (1979), *Werner Lehara International Inc v Harris Trust and Savings Bank* 484 F Supp 65 (1980).

53 See Oelofse *op cit* n 15 at 426-427.

54 715 F 2d 1121 (1983) at 1123.

(2) Whether the plaintiff has shown irreparable injuries; (3) Whether the issuance of a preliminary injunction would cause substantial harm to others; (4) Whether the public interest would be served by issuing a preliminary injunction."

In some cases the courts granted an interim injunction where the account party brought strong evidence that a demand was unjustified and the enforcement of the facility would cause irreparable harm because it will be difficult for the account party to recover the amount paid by proceedings in Iran.[55]

In England the court in *United City Merchants* did not determine the extent to which fraud must be proven before the bank may be interdicted from honouring the credit. Subsequent English case law dealt with the standard of proof required, providing that fraud must be established before an interdict can be granted. In other words, a mere allegation of fraud communicated by the buyer to the bank is not sufficient.[56]

The approach of courts with regard to the granting of interdicts was dealt with in *RD Harbottle (Mercantile) Ltd v National Westminister Bank*[57] where the plaintiffs entered into a contract with Egyptian buyers for the sale of a quantity of goods under three

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[55] CF Guest A G (Gen Ed) *Benjamin's Sale of Goods* 2 ed (1997 at para 23-127. See also *Harris Corp v National Iranian Radio and Television op cit* n 48, *Rockwell International v Citibank* 719 F 2d 583 (1983).

[56] The cases are discussed below.

[57] [1978] QB 146. The case dealt with a performance guarantee but, as Lord Denning MR held in *Edward Owen Engineering v Barclays Bank International* [1978] QB 159 at 171, a performance guarantee stands on the same footing as a letter of credit. Lord Denning held that the exception applies where there is a clear fraud of which the bank had notice. Brown LJ held, "But it is certainly not enough to allege fraud, it must be 'established' and in such circumstances I should say very clearly established."

separate contracts. Each of the contracts provided that the plaintiff was to be paid by means of an irrevocable confirmed letter of credit and that any dispute was to be resolved by arbitration. According to the contracts the plaintiffs were to establish guarantees of 5 percent confirmed by a bank in favour of the buyers. The guarantees were performance bonds, which provided security to the buyers for the fulfilment by the plaintiffs of their obligations under the contracts. The plaintiffs instructed their own bank to confirm the guarantees to the Egyptian banks, which in turn confirmed them to the buyers. A dispute arose between the plaintiffs and the buyers and in each case the buyer demanded payment under the guarantees. The issuing bank intended to pay once the demand had been made but the plaintiffs instituted proceedings against the bank, the Egyptian bank and the buyers to prevent them from obtaining payment under the guarantees. The bank applied for the discharge of the injunctions issued against it. In holding that the injunctions against all the defendants should be discharged, Kerr J held that the courts will interfere with the irrevocable obligation assumed by the banks only in exceptional circumstances of fraud. Frequent interference by the courts will irreparably damage international commerce.[58]

In *Bolivinter Oil SA v Chase Manhattan Bank NA*[59] the plaintiffs, Bolivinter Oil SA, entered into a contract of affreightment to transport a cargo of crude oil from Iran to Syria for the third defendant, the General Company of Homs refinery. It was also agreed that the plaintiffs would furnish the third defendant with a bank guarantee for US $ 1 million. The plaintiffs requested the first defendant, Chase Manhattan Bank, to arrange the

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58 At 155.

59 [1984] 1 WLR 392.

guarantee. As a consequence the second defendant, the Commercial Bank of Syria, gave a guarantee for the agreed sum to the third defendant. Chase Manhattan opened an irrevocable letter of credit in favour of the Commercial Bank of Syria. Dispute arose between the plaintiffs and the third defendant over the performance of the contract. Before the issuing of the writ the plaintiffs obtained ex parte injunctions, (1) restraining the General Company of Homs from claiming on the guarantee, (2) restraining Commercial Bank of Syria from paying under the guarantee or claiming on the letter of credit and (3) restraining Chase Manhattan from paying under the letter of credit.

Staughton J discharged the injunctions against the first and the second defendants. The plaintiff appealed and the appeal was dismissed. Donaldson MR held that the granting of an interdict against a bank because a customer is dissatisfied would undermine the value of irrevocable credits and the reputation of the bank. He held that an injunction could be granted only where the bank has been informed before making payment that the documents are fraudulent. The evidence must be clear that there is fraud and that the bank was aware of the fraud.[60]

Ackner J warned in *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd and others*[61] that a requirement of excessive strictness with respect to the proof of fraud would make it impossible for the courts to apply the exception. He held:[62]

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60 At 393.

61 [1985] 2 Lloyd's Rep 554.

62 At 561.

"We would expect the court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. In general, for the evidence of fraud to be clear, we would expect the buyer to have been given an opportunity to answer in circumstances where one could properly be expected. If the court considers that on the material before it, the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case for fraud."

Ackner J also concluded that that a more liberal approach on the standard of proof of fraud will not lead to commercial dislocation. He also referred to American cases where temporary restraining orders were granted on the basis of suspicion of fraud.[63]

It is interesting to note that in all the English cases quoted above the plaintiffs did not succeed in establishing fraud to the satisfaction of the court. The case of *Tukan Timber Ltd v Barclays plc*[64] is the first one in which the applicant succeeded in establishing fraud. An injunction in this case was however refused on the ground that the bank already declined to pay against the documents presented under the credit, and an injunction was unnecessary.

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[63] See *Dynamics Corp of America v Citizens and Southern National Bank supra* n 52, *Harris Corp v National Iranian Radio and Television supra* n 52, *Itek Corp v First National Bank of Boston supra* n 52.

[64] [1987] 1 Lloyd's Rep 171. See also *Rafsanjan Pistacho Producers Co-Operative v Bank Leumi (UK) plc* [1992] Lloyd's Rep 513. and *Deutsche Ruckersisheirung AG v Walbrook Insurance Co Ltd and others, Group Josi Re (Formely known as Group Josi Reassurance SA) v Walbrook Insurance Co Ltd and others op cit* n 28 where the injunction sought was against the beneficiary and not the bank.

South African courts have also adopted the standard of proof as applied in English law. In *Loomcraft Fabrics CC v Nedbank Ltd and another*[65] the appellant, Loomcraft Fabrics CC, a textile manufacturing company, entered into a contract of sale with the second respondent, Perfel, who carried on business in South Africa as a distributor of fabric, for the purchase of a quantity of fabric. Payment was to be made by means of an irrevocable letter of credit in favour of Perfel. Nedbank transmitted the credit to Perfel's bank in Lisbon, which acted as an advising bank and did not confirm the credit. The credit provided for deferred payment 90 days after the date of the bills of lading and for two bills, out of three, to be included in the documents which had to be presented as a precondition of payment. The latest date for shipment of goods was to be 20 April 1992 and the expiry date was 30 April 1992. Perfel indicated to the appellant that it would be unable to manufacture the fabric in time and the appellant agreed to extent the expiry date from 30 of April to 18 May 1992. The latest date of shipment was extended from 20 April to 8 May 1992. The goods arrived late on the 18 of June 1992 and the appellant was not satisfied with their quality.

On 4 August 1992 the appellant launched an urgent application in the Witwatersrand Local Division for an interdict restraining Nedbank from making payment in terms of the letter of credit as well as for other ancillary relief. It alleged that the bills of lading presented to Nedbank contained a fraudulent misrepresentation as to the date of payment. Perfel opposed the application but the interim relief was granted pending the finalisation of the matter. Perfel then filed opposing papers together with a counter-application in

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[65] 1996 (1) SA 812 (A). See also *ZZ Enterprises v Standard Bank of South Africa* 1995 (CLD) 769 (W). Although the case was concerned with documentary collections the court referred to the principle of independence and the fraud exception. The court said that fraud must be clearly established.

which it sought an order directing Nedbank to make payment in terms of the letter of credit.

The court a quo dismissed the application and set aside the interim relief. The appellant appealed against the dismissal. Scott AJA referred to English decisions and held that a court will grant an interdict restraining the bank from paying the beneficiary in terms of the credit if it is established that the beneficiary was a party to a fraud in relation to the documents presented to the bank for payment. He further held that fraud by the beneficiary has to be clearly established on the balance of probabilities and as in any case where fraud is alleged, it will not be inferred.[66] In order for the appellant to succeed on the ground of fraud he must have proven that Perfel presented the bills of lading to the bank while aware that they contained a material misrepresentation of fact which the bank would rely on and which Perfel knew were untrue. He held that "mere error, misunderstanding or oversight, however unreasonable, cannot amount to fraud".[67] It was further held that if Nedbank was prepared to pay the credit there was no reason why the appellant should try to obtain an interdict against the bank restraining it from doing so. In terms of South African law an applicant for a final interdict must establish that there is no other remedy available to him. If Nedbank erred in paying, the appellant had another remedy of breach of contract.[68]

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66 At 817.

67 At 822.

68 At 823.

It is submitted that the standard of proof of fraud in South Africa is too high. It is also submitted that the approach by the American courts of granting temporary restraining orders on the basis of strong suspicion of fraud in standby credits should be adopted by South Africa in letters of credit. The rule that the court will not interfere with payment by the issuing bank unless fraud is established, even at an interlocutory stage, is in contrast with the ordinary rules of procedure. In South Africa an interim interdict is granted if the applicant shows (1) that he has a *prima facie* right (the right can be *prima facie* established even if it is open to some doubt); (2) that he will suffer a well-grounded apprehension of irreparable harm if the interim relief is not granted and the ultimate relief is eventually granted; (3) that the balance of convenience favours the granting of an interim interdict; (4) and that the applicant has no other satisfactory remedies. An interim interdict is granted to preserve or restore the *status quo* pending the final determination. A final interdict is only granted once the applicant brings convincing evidence to the court. It is a final determination of the rights of the parties. The requisites are (1) a clear right; (2) an injury actually committed or reasonably apprehended; (3) and the absence of similar protection by any other ordinary remedy.[69]

It is submitted that in letters of credit the courts should grant a temporary interdict when fraud is alleged and supported by a *prima facie* evidence.[70] A final interdict should be granted upon provision of concrete evidence of fraud. The court should not deviate from its normal procedure of granting temporary interdicts upon *prima facie* proof when

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[69] See Harms LTC *Civil Procedure in the Supreme Court* Issue 20 April (2000) at 500-508 and cases quoted there.

[70] In Canada *prima facie* case of fraud is sufficient for the court to grant an interlocutory injunction. See *Bank of Nova Scotia v Angelica-Whitewear* 36 DLR (4 th) 161 (1987).

dealing with international credit transactions. By providing that the fraud must be established the courts require more than *prima facie* proof. The granting of an interim interdict will give the applicant the opportunity of investigating the letter of credit transaction in order to prove fraud by the beneficiary. This will fly in the face of the principle of independence and great care will be needed. The principle of independence should, however, not be allowed to become a cause of injustice.

The argument that if the courts continually interdict banks from making payment to the beneficiary guilty of fraudulent practices it will erode trust in international commerce is unacceptable. The innocent buyer must not be penalized as against the fraudulent beneficiary. The fact that the buyer can allege fraud without proof is best resolved by the fact that he will be responsible for the cost of litigation including security for costs. That will ensure that only buyers who have justifiable complaints would go to the extraordinary expense and effort to get involved in litigation. It is fallacious to hold that parties will take the matter to court merely to cause confusion because of the costs involved.

6.4 Conclusion

The principle of independence, which is regarded as foundational to the letter of credit transaction, is clear and well established. It is also clear that the exception to this principle applies in the case of fraud by the beneficiary. The only difficulty is the standard of proof of the fraud exception. The standard as it stands now in South Africa and England is too high and will make it difficult for the courts to apply it. This is also illustrated by the fact that in many English cases the plaintiff failed to establish fraud to

the satisfaction of court. The question then becomes why should we have the fraud exception in the first place if the standard of proof, which triggers its application, is too difficult for the applicant to meet? The proposed standard that the courts should grant a temporary interdict where fraud is alleged and accompanied by *prima facie* proof of fraud should be adopted. Our courts should indeed develop the standard of proof in these instances.

CHAPTER SEVEN

CONFLICT OF LAWS IN LETTERS OF CREDIT

7.1 Introduction

There are usually at least four parties involved in a letter of credit transaction namely the applicant, the issuing bank, the beneficiary and the correspondent bank. The parties are often situated in different jurisdictions having different laws. In case of a dispute between the parties, and in the absence of choice of law, the court will be faced with a problem of whether to apply the domestic or foreign legal system. The Uniform Customs and Practice for Documentary Credits (UCP) does not have rules which govern conflict of laws. As a result, most jurisdictions have developed their own rules to be applied in cases of conflict of laws. The purpose of the rules is to provide the court with principles to apply in resolving conflicts of laws and thus choose the appropriate law to govern transactions.

The purpose of this chapter is to look at conflict of law rules as developed and practised by different jurisdictions and the relevance of the rules to letters of credit.

7.2 South African rules

Various theories have been propounded in South Africa as to the correct way for determining the proper law for the intrinsic validity, interpretation and effect of a contract. The preferred theory is the so-called localizing theory which does not depend on a rigid formula, but which seeks to find a natural "seat" for the juristic act in each

particular case, taking into account the relevant facts.[1] In other words, the parties may themselves choose the legal system, which is to be applied.[2] Generally the intrinsic validity, interpretation and effect of the contract are regulated by the *lex loci contractus*.[3] But where a contract has been entered into in one place and it is to be performed in another, the validity of the contract, and the nature and extent of the obligations created by it, are to be governed by the law of place of performance.[4] The foundation of the rule is that the parties are presumed to have intended to substitute the *lex loci solutionis* for the *lex loci contractus* and the contract is presumed to be entered into with the view that the law of the country where it is performed will govern it.[5] The place of performance is therefore construed as a fictional *lex loci contractus*. The choice of proper law is, however, not limited to the two laws. Other legal systems could also be considered.

The question is whether the parties' freedom of choice of law should be restricted. At face value it seems that South African cases allow unrestricted choice of law,[6] but South African courts have not addressed this question. It is submitted that the freedom of choice of law can indeed be restricted where the parties are unable to choose the foreign law which is not against South African *ordre public* and therefore would not be applied by a

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1 See De Vos W "Freedom of Choice of Law for Contracts in Private International Law" 1961 *Acta Juridica* 1 at 1.

2 South Africa recognised party autonomy.

3 See De Vos *op cit* n 1 at 1.

4 See *Hulser v Voorschotkas voor Zuid-Afrika* 1908 TS 542.

5 *Ibid* at 545-546.

6 De Vos *op cit* n 1 at 11-12.

South African court.[7] The parties also cannot choose a legal system which is not *bona fide* or legal.

In the absence of a valid choice of law, a contract is governed by the *lex loci contractus.* If it differs from the *lex loci solutions,* the latter governs. The leading case on this subject is *Standard Bank of South Africa v Efroiken and Newman*[8] where the respondents from South Africa entered into a contract for the purchase of flour from a seller in the United States of America. Each respondent contracted in Cape Town with the appellant bank where under the bank undertook to establish a credit for them with its branch in New York and to honour the seller's drafts upon presenting them at that branch, provided that the drafts were accompanied, in the case of Efroiken, "by a bill of lading and insurance policy" for certain flour, CIF Cape Town, and in the case of Newman, "by a full set of shipping documents including marine and war risk policies for merchandise shipped to Cape Town". The respondents on their part undertook to accept the drafts on presentation and to pay them at maturity provided they were accompanied by the above-mentioned documents.

The sellers, when presenting their drafts in New York, attached to each a thorough bill of lading and an insurance certificate. These documents were accepted by the bank and the drafts honoured, but on presentation of the drafts in Cape Town the respondents refused to accept them. The bank instituted an action for the difference between the amount of the drafts and the price realised from the sale of the flour bought by the respondents.

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[7] See Oelofse AN *The Law of Documentary Letters of Credit in Comparative Perspective* (1997) at 533.

Only the contract between Efroiken and the bank needs to be considered here. The respondent raised the defence that the documents which accompanied the drafts were not the documents which were stipulated. The question was whether the bills of lading and the insurance policy had to be interpreted in terms of South African law or in terms of American law. In the court a quo it was held that as the credit was negotiated in South Africa and the acceptance and payment of the bills were to be made within the South Africa, it was the law of South Africa and not that of the United States of America which governed the construction of the contract. In the Appellate Division (as it then was) it was held that the dispute between the parties should be decided in accordance with the principles of American law and not in accordance with South African law because the contract was made and to be performed wholly in America.[9] It was assumed that under American law, as under South African law, the usual meaning of the expression "bill of lading" is an ocean bill of lading.[10] The buyer was therefore entitled to reject the documents.

Although the Appellate Division in the *Standard Bank* case applied the intention of the parties test to determine the proper law of the contract, subsequent case law supports the "closest and most real connection" test as used under Rome Convention.[11] However the courts feel bound by the *Efroiken* case.

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8 1924 AD 171.

9 At 188. The parties were deemed to have intended that the law of place of performance of the contract should govern the contract.

10 At 176-177.

11 The intention theory is regarded as fictitious. According to De Vos *op cit* n 1 at 3, "What happens in fact is that all the relevant facts are examined in order to determine where the natural seat of the juristic act is, but it is presented as if the intention of the parties is deduced from the facts and that the intention thus determined is decisive of the question".

In *Improvair Cape Pty Ltd v Establissements Neu*[12] the plaintiff, a South African company, and the defendant, a French company, had decided to make a joint tender for the installation of air-conditioning in a nuclear power station to be built at Koeberg, Cape Town. Each company was a specialist in the work. They had concluded an agreement in which they, *inter alia*, specified their respective obligations and responsibilities for the tender and for the work to be done if their tender were successful. Members of the consortium accepted their tenders and separate contracts were concluded with each. A dispute arose between the parties in regard to their contract with one of the construction companies and the plaintiff sued the defendants for relief pursuant to their agreement. There was no express choice of law in the contract and there was no evidence that a tacit choice has been made.

Grosskopf J explained the term "proper law" to mean the system of law which governs the interpretation, validity and mode of performance of the contract. He held that if the parties have agreed on the law of a particular place to govern their contract, that law will be the proper law of the contract. Where there is no express agreement the court may in certain cases conclude that the contract contains a tacit term of the proper law of the contract. In this instance the parties did not agree on the proper law of the contract and a term could not be implied from the contract. The judge held that it is established in South African law that the intention of the parties should be looked at. He found that the modern tendency is to adopt an objective approach that the law which has the closest and

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[12] 1983 (2) SA 138 (C). See also *Laconean Maritime Enterprises Ltd v Agromar Lineas Ltd* 1986 (3) SA 509 (D) where Booysen J held "[T]he fact remains that the 'intention theory' has not been laid to rest in South Africa", *Ex Parte Spinazze and another NNO* 1985 (3) SA 650 (A), *Henry v Brainfield* 1996 (1) SA 244 (D).

most real connection should apply. He further held that the two formulations do not often lead to different conclusions, but felt bound by the *Efroiken* case.[13]

In principle South African courts still follow the "intention test" as applied in the case of *Efroiken.* The onus is therefore on the Supreme Court of Appeal to get rid of the vague "intention test" and follow the "closest and most real connection" test as applied by English courts. The Appeal Decision had an opportunity to do so in the case of *Ex parte Spinazze and Another NNO*[14] case but failed to seize it.[15]

There must be a system which governs the formation and validity of the choice of law provision itself. There are suggestions that the legal system which governs is the law that would have been the proper law of the contract in the absence of a choice of law by the parties. However, the general support is on the *lex fori* to decide the law governing the formation and validity.[16]

7.3 Canadian rules

Before the Civil Code of Quebec of 1994 came into effect, Quebec and the common law provinces of Canada followed the principle that parties have a right to make a choice of law, provided that the choice *is bona fide*, legal and not contrary to public order.[17] Article

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13 At 145-147.

14 *Supra* n 12.

15 See Kahn E "International Contracts - V" (1991) 20 *Businessman's Law* 126 at 127.

16 De Vos *op cit* n 1 at 261.

17 See Gozan A Y *International Letters of Credit: Resolving Conflict of Laws Disputes* (1999) at 16-17.

3111 of the Civil Code of Quebec of 1994 states a general rule on freedom as to choice of law.[18] It states:

> "A juridical act, whether or not it contains any foreign element, is governed by the law expressly designated in the act or the designation of which may be inferred with certainty from the terms of the act.
>
> A juridical act containing no foreign elements remains, nevertheless, subject to the mandatory provisions of the law of the country, which would apply if none were designated. The law of a country may be expressly designated as applicable to the whole or a part only of a juridical act".

The last part of Article 3111 admits "de`pecage", where the parties are free to choose a law for the whole or part of the contract. Such choice, however, is not to be exercised capriciously. At common law, if the parties have not made an express choice of law, the courts will imply a choice of law.[19] The courts might imply from the language and/or the terms of the contract between the parties, such as the form and style of the documents concerning the transaction, the currency used, the legal terminology, the site of the subject matter of the transaction, the residence or head office of a corporate party.[20]

If the choice cannot be inferred from the surrounding circumstances, the courts will apply the system of law of the site with which the transaction has the closest and most real

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18 Article 3111 of the Civil Code of Quebec of 1994 replaced Article 8 of the previous Civil Code of Lower Canada.

19 See Castel GJ *Canadian Conflict of Laws* 3 ed (1994) at 556.

20 See Castel *op cit* n 19 at 557-558.

connection. In rendering its decision on which law applies, a court will also consider applying the law of the site where the parties contracted and/or the law of the site of performance of the transaction.[21] In Quebec, however, if the parties did not make a choice of law, reference will be made to Article 3112 of the Civil Code of Quebec which provides that "if no law is designated in the act or if the law designated invalidated the juridical act, the courts apply the law of the country with which the act is most closely connected, in view of its nature and the attendant circumstances".[22]

The courts in Quebec will assume, while trying to determine the intention of the parties, that the act is valid, unless the designated law renders the juridical act invalid. Even if the designated law invalidates the juridical act, Article 3112 of CCQ suggests that the law with the closest connection to the act must apply. When no law has been designated, the courts of Quebec will assume that the contract has the closest and most real connection to the law governing the residence or place of business of the party performing the central obligation. The only dilemna which a Quebec court will be faced with is the interpretation of the central obligation performed, in favour of either the law of the issuing or performing bank. The Canadian courts have not to date had the opportunity of dealing with conflicts of law in matters of letters of credit. However, they would be expected to do so in future, given the rise of international business in Canada and Quebec.[23]

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21 See Castel *op cit* n 19 at 560-561.

22 Article 3112 of the CCQ should be read together with article 3113 of the CCQ which defines the law with the closest connection as follows "A juridical act is presumed to be most closely connected with the law of the country where the party who is to perform the presentation which is characteristic of the act has his residence or, if the act is made in the ordinary course of business of an enterprise, his establishment."

23 See Gozlan *op cit* n 17 at 42.

7.4 Austrian rules

The Austrian Rules on Private International Law were codified as the Federal Statute on Private International Law of 1978. It adhere to the application of the law chosen by the parties, either expressly or impliedly, if this could be determined by the circumstances at hand.[24] In the absence of a choice of law by the parties, the law of the state of the characteristic performance of a debtor applies.[25] The special rules governing banking transactions are provided by Article 38 (1) of the Austrian Code:

> "Banking transactions shall be judged according to the law of the state in which the bank has its particular permanent business establishment, for banking transactions between banks, the particular permanent business establishment of the bank employed to initiate the transaction shall be determinative."

Thus, when deciding on which law applies to a letter of credit transaction, the court will analyse only those facts where the strongest connection exists with the characteristic performing bank.[26] Article 3 of the Code provides that if foreign law is determinative, it shall be applied *ex officio* and as it would be in its original jurisdiction. However, a provision of that foreign law shall not be applied when its application would lead to a

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[24] Section 35 (1) of the Austrian Federal Statute on Private International Law.

[25] Section 36 of the Austrian Federal Statute on Private International Law provides: "Bilateral monetary debt on the part of one party shall be judged according to the law of the state in which the other party has his habitual residence. If this party concludes the contract as an entrepreneur the particular permanent business establishment (s 361) involved in the execution of the contract shall be determinative instead of the habitual residence."

[26] Article 1 (1) reads "factual situations with foreign contracts shall be judged, in regard to private law, according to the legal order to which the strongest connection exists."

result irreconcilable with the basic tenets of the Austrian legal order. In its place, if necessary, the corresponding provision of Austrian law shall be applied.[27]

7.5 Swiss rules

The Swiss Rules on Private International Law were codified as the Federal Statute on Private International Law of 1987. In general, the Swiss rules favour the application of the law chosen by the parties provided that it is express, or that it results with certainty from the provisions of the contract or from the circumstances surrounding the particular transaction.[28] In the absence of a choice of law, the contract is governed by the law of the state which has the closest connection with the contract. The contract is deemed to have its closest connection with the state where the party who is to render the performance that is characteristic of the contract has his habitual residence, or, if the contract is entered into in the course of that party's commercial or professional activities, his place of business.[29]

Article 117 (3) gives factors in determining characteristic performance. It provides that the following performances are considered characteristic: the performance of the alienator in contracts of alienation, the performance of the party conferring the use in contracts for the use of a thing or of a right, the rendering of service in contracts of mandate, enterprise contracts, and other contracts for the rendering of services, the performance of the depositary in the contracts of deposit, the performance of the

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27 Article 6 of the Austrian Federal Statue on Private International Law.

28 Article 116 of the Swiss Federal Statute on Private International Law.

29 Article 117 of the Swiss Federal Statute on Private International Law.

guarantor or of the surety in the contracts of guarantee and suretyship. A foreign law will be inapplicable if it is inconsistent with Swiss public policy.[30]

The Swiss mandatory rules override conflict of laws rules in the statute. But foreign mandatory rules can be used if the situation at hand has a close connection to that law. In determining whether such a provision is to be taken into consideration, the purpose of the provision and the consequences of its application should be taken into consideration so as to reach a decision compatible with the Swiss conception of law.[31]

In *Esteve Hermanos v Banque Hoffman SA*[32] the plaintiff, Esteve Hermanos, had sold 600 bales of cotton to a German corporation located in Bremen. A letter of credit was opened by the buyer in favour of the seller. Banque Hoffman issued the letter of credit in Zurich, through the intermediary Bank of America. The letter of credit was subject to the UCP. The loading of the cotton was to take place approximately in mid-September. The cotton had to be loaded on September 22, 1958, and during the same period the German buyer became bankrupt. The bank of America refused to pay the beneficiary, since the documents were not satisfactory. The court held that the law of Switzerland had to be applied in interpreting the letter of credit, since Banque Hoffman had an office there.[33]

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30 Article 117 of the Swiss Federal Statute on Private International Law.

31 Article 19 of the Swiss Federal Statute on Private International Law.

32 ATF 87 II 344, journal des Tribunax 1962 I 206 JDI 1965 at 940-941. See also Gozlan *op cit* n 17 at 50.

33 See Gozlan *op cit* n 17 at 50.

7.6 American rules

The rules for the governing law are set out in the Restatement of the Law of Conflict of Laws and the UCC. Article 1-105 (1) of the UCC provides:

> " ... when a transaction bears a reasonable relation to the state and also to another state or nation the parties may agree that the law either of this state or of such state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state."

Article 186 of the Restatement on Conflict of Laws provides that issues in contract are determined by the law chosen by the parties in accordance with the rule in Article 187 and otherwise by the law selected in accordance with Article 188. The parties to a contract may choose their applicable law provided that the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.[34] However, the chosen law can be applied even if the particular issue is one which the parties could not have resolved by an explicit mention in their agreement directed to that issue, unless either the chosen state has no substantial relationship with the parties and no other reasonable basis exists for the parties' choice or it will be contrary to the fundamental policy of the state having the greatest interest to the transaction.[35]

If the parties did not make an effective choice of law, the governing law will be the law having the significant relationship to the transaction.[36] Although one can say that

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34 Article 187 (1) of the Restatement of the Law of Conflict of Laws.

35 Article 187 (2) of the Restatement of the Law of Conflict of Laws.

36 Article 188 (1) of the Restatement of the Law of Conflict of Laws.

American courts strongly favour the site of payment as the place of performance, the appeal court recently stated that the site of the issuing bank is the place where the central performance under the letter of credit is executed.[37] However, even in instances where the place of payment is supported as the place which has the most significant relationship to the transaction, the cases conflict.[38]

In *J Zeevi and Sons Ltd v Grindlays Bank (Uganda) Ltd*[39] Hiram Zeevi and Company (Uganda) Ltd, an Israeli corporation, had deposited with the defendants, Grindlays Bank (Uganda) Ltd, on 24 March 1972 local currency valued at approximately $ 406, 946,80 for the purposes of establishing a fund upon which the plaintiff, J Zeevi and Sons, an Israeli co-partnership, could draw money. On the same date, the defendant opened its irrevocable credit for $406, 846,80 in favour of the partnership. The credit stated that the credit was valid until 31 January 1973 for presentation of drafts in Kampala. The letter of credit further stipulated: "We guarantee the payment of drafts drawn in conformity with the terms and conditions stated. The negotiating bank must send drafts direct to us by air-mail". While the letter of credit was opened by the Ugandan issuing bank, Grindlays Bank, it was to be paid by the correspondent bank, First National City Bank, in New York. Citibank acted as an extension of the issuing bank without undertaking any independent obligations towards the beneficiary. A third bank was Chemical Bank from New York, which was to negotiate the letter of credit and claim reimbursement from Citibank. The negotiating bank was authorised to claim payment on the due date from

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37 See Gozlan *op cit* n 17 at 94-95.

38 See Oelofse *op cit* n 7 at 526.

39 37 NYS 2d 892 (1975).

Citibank, to the debit of the account with Citibank, together with a certificate to the effect that all terms of the credit have been complied with and the relative drafts have been airmailed. Citibank was to reimburse the negotiating bank, Chemical Bank, upon presentation of the drafts under the letter of credit. In March 1972, officials of the Bank of Uganda, acting under the orders from the government of Uganda, notified Grindlays Bank not to make any foreign exchange payment in favour of the Israeli company.

Grindlays then requested its agent Citibank to cancel the letter of credit and not to effect payment against drawings US $40, 684,68 due to be paid on or after 15 April 1972. On the 28 December 1972, Chemical Bank presented to Citibank drafts in the amount of the letter of credit for reimbursement. On 19 January 1973, Citibank returned the drafts, refusing to honour its obligations. An action was instituted by the plaintiff, the beneficiary, for an order attaching the funds due by the defendant bank at Citibank, the agent of the defendant. The defendant contended that the complaint must be dismissed because the court lacked subject-matter jurisdiction in that the law of Republic of Uganda applied and under it the complaint must be dismissed. In the Court of Appeal Cooke J held that the applicable law was that of the state of New York, because it is the law of the jurisdiction having the greatest interest in the litigation and not because of the locality of the performance.

In *Chuidian v Philippine National Bank,*[40] an issuing bank, Philippine National Bank located in Manila, opened a letter of credit in favour of Chuidian. The Los Angeles branch of PNB acted as an advising bank. The advising bank was to pay the beneficiary

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[40] 970 F 2d 561 (1992).

in Los Angeles. The letter of credit was issued, payable in US dollars, and no choice of law was stipulated, with the exception of a reference to the 1983 Revision of the UCP. Shortly, thereafter, the Philippine government was overthrown. The new government prohibited PNB Manila from making payment under the letter of credit. When PNB refused to pay under the letter of credit, Chuidian sued it in a Los Angeles court, which removed the matter to the appropriate federal district court. The court upheld the Philippine government's instruction to PNB, and refused to enforce the letter of credit.

The Appeal Court affirmed the decision of the district court of California. It held that performance took place in Manila, Philippines, the site of issuance, and not in Los Angeles. The majority of the court continued by said:[41]

> "Designation of a place of payment under a letter of credit does not alter or amplify that result unless the paying bank also serves as a confirming bank or otherwise acts in a manner indicating that its role with respect to the letter of credit is more than merely mechanical."

It was also held that the Philippines was also the jurisdiction with the most significant relationship to the issue and the parties in the case.[42] Fernandez J dissented and held that the site of payment should be looked at as the place of performance, notwithstanding the role or lack of commitment of the paying bank in Los Angeles.

The revised section 5-116 of the Uniform Commercial Code (UCC) contains a codification of private international law (conflict of laws) rules. However, it has not yet

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41 At 563.

been adopted by most American legislatures. According to the revised section 5-116 (a), the parties may enter into an agreement regarding whose law will determine the liability of the issuer, nominated person, or adviser of the letter of credit. The chosen jurisdiction need not bear any relation to the transaction. To be effective, there must be an agreement by the affected parties, who either must have incorporated the provision in their letter of credit, confirmation, or other undertaking, or must have incorporated their agreement in a record that they have authenticated in the same manner that a letter of credit must be authenticated. This choice of law provision can only apply to the applicant to the extent that his rights may be related to the liability of an issuer, nominated person, or adviser.[43]

If the parties did not make a valid choice of law in terms of the revised section 5-116 (a), then the liability of an issuer, nominated person or adviser is governed by the law of the jurisdiction in which that person is located. The person is considered to be located at the address shown in the undertaking, with the address from which the person's undertaking was issued being the location in cases where more than one address has been indicated. When a bank is involved, each branch may be treated as a separate entity.[44] If the issuer, nominated, person or adviser's liability is expressly made subject to any rules of custom or practice, such as the UCP, and the revised Article 5 applies, such incorporated rules of custom or practice have preference, except to the extent that they conflict with non-

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[42] At 564.

[43] It is possible that the law of more than one jurisdiction applies, because each of the affected parties must enter into the choice of law provision. The parties can escape the application of Article 5 entirely by choosing a jurisdiction that has not adopted the UCC.

[44] The rule in article 5-116 (b) states: "For the purposes of jurisdiction, choice of law, and recognition of inter branch letters of credit but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection."

variable provisions set out in revised section 5-103 (c).[45] Section 5-116 (e) provides that the forum for settling disputes arising from an undertaking within the revised Article 5 may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with the revised section 5-116 (a).

7.7 English rules before the adoption of the Rome Convention

English courts had, before the Rome Convention, always respected the choice of law agreed upon by the parties. In *Vita Food Products Inc v Unus Shipping Co*[46] it was held that where the parties expressed their choice of law no qualification is necessary provided the intention expressed is *bona fide* and legal, and not against public policy. It is not essential for the choice to have a close connection with the country and as Lord Wright put it, "connection with English law is not as a matter of principle essential".[47] Thus in solving problems of conflict of laws courts will take into consideration the proper law, which is defined as the "law which the parties intended to apply" or, where the intention is neither expressed nor presumed from the terms of the contract and the surrounding circumstances, the system of law of the closest connection.

The decisions in the cases of *Offshore International SA v Banco Central SA*[48] and *Power Curber International Ltd v National Bank of Kuwait SAK*[49] can be used to illustrate that

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45 Revised section 5-116 (c).

46 [1939] AC 277.

47 At 290.

48 [1977] WLR 399. This case is regarded as the leading case regarding choice of laws in letters of credit.

49 [1981] 1 WLR 1233.

before the Rome Convention, where a credit provided for documents to be presented to a bank and for payment to be made by that bank, the proper law of the credit was the law of the place where the payment was made. In *Offshore International SA v Banco Central SA*[50] a Spanish Construction Company agreed to build an oil-drilling vessel for the plaintiffs, Offshore, an oil rig operator incorporated in Panama but operating out of Houston, Texas. Banco Central issued an irrevocable letter of credit for the benefit of Offshore. By the letter of credit the Spanish bank committed itself to pay Offshore, in the event of cancellation subject to certain conditions, US $3,000,000 plus six percent interest. The correspondent bank, where payment had to be made, was a New York branch of the Chase Manhattan Bank. Chase Manhattan did not confirm the credit. The credit was payable in US dollars by Chase Manhattan on production of documents including sight drafts on that bank. Offshore cancelled the contract and claimed under the letter of credit against the bank, Banco Central. The judge had to consider as a preliminary point which system of law governed the contract between the defendant Spanish bank and the plaintiff rig operators. In holding that New York law has the closest connection with the transaction, Ackner J said:[51]

> "The contest here is between New York law and Spanish law. What are the relevant factors in favour of each? As regards New York law, the credit was opened through a New York bank; payment was to be made in US dollars. Further, such payment was only to be made against documents presented in New York. In favour of Spanish law being the proper law, is the fact that the letter of credit was opened by a Spanish bank.... Thus, on the side of New York law are all

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50 *Spura* n 48.

51 At 401-402.

matters of performance, whereas, in relation to Spanish law, Spain and a Spanish bank was the source of the obligation. In my judgment, it is with New York law that the transaction has its closest and most real connection.... Very great inconvenience would arise, if the law of the issuing bank were to be considered as the proper law. The advising bank would have constantly to be seeking to apply a whole variety of foreign law."

Another case which applied the system of the law of the closest connection is *Power Curber International Ltd v National Bank of Kuwait SAK*[52] where the plaintiffs, Power Curber International, a corporation incorporated in the United States of America and carrying business in North Carolina, agreed to export goods on CIF terms to buyers in Kuwait. Payment was to be made by a letter of credit, 25 percent to be paid on presentation of documents and the remaining seventy-five percent by bills of exchange to be due one year after the date of shipment. The letter of credit was opened and advised by the National Bank of Kuwait to the Bank of America in Miami, Florida. The National Bank's letter asked the Bank of America to advise the credit through the North Carolina National Bank at Charlotte, North Carolina. The National Bank of Kuwait made the letter of credit irrevocable, but the correspondent bank did not confirm it. The machinery was delivered to the buyers in Kuwaiti, but they were not satisfied with it. The buyers applied for an order of provisional attachment of the sums due to the plaintiffs payable by the National Bank of Kuwait under the letter of credit. A provisional attachment was ordered, which prevented the bank from making any further payment under the credit in Kuwait and outside it and made the bank accountable to the court for the amount involved. The Kuwait court refused an application by the National Bank of Kuwait to set

aside the order and the Court of Appeal in Kuwait confirmed the refusal. The sellers, Power Curber, then discontinued the proceedings in North Carolina and began proceedings for payment of the credit in London against the National Bank of Kuwait, which had a branch in London.

Parker J gave judgment in favour of Power Curber, against National Bank of Kuwait for the amount claimed but imposed a stay of execution of the judgment pending a further order. Power Curber appealed against the stay and the National Bank against the judgment. It was argued for the bank that the proper law of the contract was Kuwaiti law and that as payment by that law was unlawful, the bank had a defence. It was argued alternatively that the site of the debt was Kuwait and it was that country's law which governs the effect of attachment. Lord Denning held:

> "The proper law of the contract is to be found by asking: with what law has the contract its closest and most real connection? In my opinion it was the law of North Carolina where payment was to be made (on behalf of the issuing bank) against presentation of documents.... Nor can I agree that the lex situs of the debt was Kuwait. It was in North Carolina. A debt under a letter of credit is different from ordinary debts. They may be situated where the debt is resident. But a debt under a letter of credit is situated in the place where it is in fact payable against documents." [53]

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[52] *Supra* n 49.

[53] At 1240. Griffiths LJ (at 1242) agreed with Lord Denning and based his conclusion on the fact that under the letter of credit the bank accepted the obligation of paying or arranging the payment sums due in American dollars against presentation of documents at the seller's bank in North Carolina. He further held that the bank undertook to reimburse the advising bank if they paid on their behalf in dollars in America. See also *European Asian Bank v Punjab and Sind Bank* [1982] 2 Lloyd's Rep 356 CA, *Attock Cement Co v Romanian Bank of Foreign Trade* [1989] 1 WLR 1147, *Turkiye Is Bankasi AS v Bank of China* [1993] 1 Lloyd's Rep 132.

The majority in the Court of Appeal, as it has already been observed, approved the decision of Ackner J in the case of *Offshore* that the proper law of the credit is the law of the correspondent bank which advised the credit. In sum, it is safe to say that English case law before the Rome Convention gave effect to the choice of law by the parties and in the absence of a choice of law by the parties, the law with the closest and most real connection to the transaction will apply.

7.7.1 The Rome Convention

The conflict of laws rules applicable to contracts of most members of the European Economic Union are now governed by the Convention on the Law Applicable to Contractual Obligations, otherwise known as the Rome Convention.[54] It came into force on 1 April 1991.[55] Article 1 (1) of the Convention provides that the rules contained in it shall apply to contractual obligations in any situation involving a choice between the laws of different countries.[56] Therefore there need not be an EEC connection. In other words, the different countries which could have conflict of laws do not have to be either parties

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[54] It is known as the Rome Convention because it was opened for signature in Rome. It was signed on the 19 June 1980 by the Kingdom of Belgium, the Federal Republic of Germany, the French Republic, Ireland, the Italian Republic, the Grand Duchy of Luxembourg, the Kingdom of the Netherlands, and the United Kingdom of Great Britain and Northern Ireland. Since then, it came into force in Spain, the Netherlands and Finland. It is expected that Portugal, Austria, Switzerland and Norway will sign it in the future.

[55] The Convention was ratified by the UK and implemented in UK law in Contracts (Applicable Law) Act 1990. The provision of the Act which brought the Rome Convention into force entered into force on 1 April 1991.

[56] The Guiliano–Lagarde Report OJ 1980 No C 282/1, 31.10.80 (a report by Professors Mario Guiliano and Paul Lagarde which accompanied the Convention) is considered in determining the effect of the provisions of the Convention. It states at p10 that the rules of the Convention shall apply in cases where the dispute would give use to a conflict between two or more legal systems despite the fact that the words of Article 1 (1) refer to the laws of different countries, which may not be the same thing. Article 19 (1) of the Convention confirms the Guiliano–Lagarde Report by stating "Where a state comprises several territorial units each of which has its own rules of law in respect of contractual obligations, each territorial unit shall be considered as a country for the purposes of identifying then law applicable under this Convention." Article 19 (2) is also worth quoting. It provides: "A state within which different territorial units have their own rules in respect of contractual obligations shall not be bound to apply this Convention to conflicts solely between the laws of such units."

to the Convention or members of the European Community for the Convention to apply. The Convention can also apply if the case is brought before a member state's court. The Convention applies where the issue in question is not excluded subject matter of Article 1 (2). Article 1 (2) excludes the following contracts and obligations some of which are relevant to letters of credit:

" 2. [The Rules] shall not apply to

(a) ... ;

(b) ... ;

(c) obligations arising under bills of exchange, cheques, promissory notes and other negotiable instruments to the extent that the obligations under such other negotiable instruments arise out of negotiable character;[57]

(d) arbitration agreements and agreements on the choice of court;[58]

(e) ... ;

(f) the question whether an agent is able to bind a principal, or an organ to bind a company or body corporate or unincorporated, to a third party;[59]

(g) the constitution of trusts and the relationship between settlors, trustees and beneficiaries; ..."[60]

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[57] The reason for this exclusion is that all jurisdictions classify such obligations as contractual. Classification of an issue as arising from negotiable instruments is done by the *lex fori*. See The Giuliano–Lagarde Report at 11.

[58] The matter was excluded because it lies within the procedure and because it is dealt with by the Brussels Convention. See the Giuliano–Lagarde Report at 11-12.

[59] It was excluded because there is no freedom of contract on this point. See the Giuliano–Lagarde Report at 13.

[60] It was excluded because trusts exist only in common law countries without a counterpart in civil law. Similar constructions in civil law countries fall within the provisions of the Convention. See the Giuliano–Lagarde Report at 13.

Article 15 excludes the doctrine of renvoi by providing that private international law rules of the country specified in the Convention are disregarded. Article 2 of the Convention states that any law specified in the Convention shall be applied whether or not it is the law of the contracting state. This means that the rules of the Convention must be applied by a court of a country which is a member of the Convention even if the law the application of which they dictate is neither the law of a contracting state nor the law of a member of the European Community. Thus the Convention will apply if the choice of law is between the law of South Africa and the law of England, as it will if the choice is between the law of Belgium and the law of France. Article 3 of the Convention provides for express choice of law by the parties in a particular transaction. It provides:

> "A contract shall be governed by the law chosen by the parties. The choice must be express or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or part only of the contract."

The application form which the issuing bank requires the applicant to complete may contain an express governing law clause but otherwise the contracts in a letter of credit transaction do not normally expressly state what the governing law is.[61] The UCP does not offer any help in conflict of laws issues. The Working Group of the ICC Commission

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[61] See Jack R *Documentary Credits The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees* 2 ed (1993) at 295.

on Banking Technique and Practice held, during the revision of UCP 400 leading to the UCP 500, that such matters should best be left to national courts to hear and resolve.[62]

The existence and validity of the consent of the parties as to the choice of the applicable law is determined in terms of Articles 8, 9 and 11 of the Rome Convention. Article 8 (1) provides that the existence and validity of a contract is determined by the law which would govern it under the Convention if the contract or term were valid.[63] Article 9 deals with formal validity and it provides that a contract concluded between persons who are in the same country is formally valid if it satisfies the formal requirements of the law which governs it under the Convention, or of the law of the country where it is concluded.[64] Article 11 states that if a contract is concluded between two persons who are in the same country, a natural person who would have the capacity to contract under the law of that country may invoke his incapacity resulting from another law only if the other party was aware of this incapacity at the time of the conclusion of the contract, or was not aware thereof as a result of negligence. By providing that "the choice must be *express or demonstrated* with reasonable certainty"[65] Article 3 shows that there must be strong evidence of the intention of the parties.

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62 ICC Publication 511.

63 Article 8 (2) qualifies Article 8 (1) and states: "Nevertheless a party may rely upon the law of the country in which he has habitual residence to establish that he did not consent if it appears from the circumstances that it would not be reasonable to determine the effect of his conduct in accordance with the law specified in the preceding paragraph (which is paragraph 8 (1))."

64 If a contract is concluded by persons who are in different countries, it will be formally valid if it satisfies the formal requirements of the law which governs it under the Rome Convention or the law of one of those countries (Article 9 (2) of the Rome Convention).

65 The italics are mine.

The Guiliano-Lagarde Report points out that the relevant words require a demonstration that the parties have made a real choice of law in the sense that there must be a clear intention to choose. The report goes on to identify factors which might indicate that such choice might have been made. It states: [66]

> "[T]he contract may be a standard form which is known to be governed by a particular system of law, even though there is no express statement to this effect such as the Lloyd's policy of marine insurance. In other cases a previous course of dealings between the parties under contracts containing an express choice of law may leave the court in no doubt that the contract in question is to be governed by the law previously chosen where the choice of law clause has been omitted in circumstances which do not indicate a deliberate change of policy by the parties. In some cases the choice of a particular forum may show in no uncertain manner that the parties intend the contract to be governed by the law of that forum, but this must always be subject to the other terms of the contract and all circumstances of the case. Similarly references in a contract to specific articles of the French Civil Code may leave the court in no doubt that the parties have chosen French law, although there is no expressly stated choice of law. Other matters may impel the court to the conclusion that a real choice in related transactions between the same parties, or the choice of a place where disputes are to be settled by arbitration in circumstances indicating that the arbitrator should be the law of that place."

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[66] The Giuliano-Lagarde Report at 17.

Be that as it may, it will be difficult to determine whether a case falling within the Convention is a case governed by Article 3 because there is a choice of law by parties, or article 4 since there is no choice.[67] The phrase "demonstrated with reasonable certainty by the terms of the contract or circumstances of the case" in Article 3 can also lead to disagreement as to whether the choice of law has been made or not. The fact that the parties can choose the law applicable to the whole or part only of the contract, indicates that the Convention accepts severability. For the provision to apply, obviously, the contract must consist of several parts, which are separable and independent of each other from a legal and economic point of view. When the contract is severable the choice must relate to elements, which can be governed by different laws without giving rise to contradictions.[68] If the chosen law is not reconcilable then the choice of law is not effective and the law applicable to the contract will have to be determined according to article 4 (a).

Article 3 (2) of the Convention addresses the question of what law determines whether the parties might change the law which governed the contract to a new and different governing law. It provides:

> "The parties may at any time agree to subject the contract to a law other than that which previously governed it, whether as a result of an earlier choice under this article or of other provisions of this Convention. Any variation by the parties of the law to be applied made after the conclusion of the contract shall not prejudice its formal validity under Article 9 or adversely affect the rights of third parties."

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67 Article 4 is discussed below.

68 See Guest A G *Benjamin's Sale of Goods* 2 ed (1997) at para 25-031.

The parties may change the applicable law when the law was expressly chosen by them or applicable because of the absence of a choice of law according to Article 4. The choice of law which changes the original law must satisfy the requirements of Article 3 (1).

In the absence of a choice of law by the parties the contract shall be governed by the law of the country with which it is most closely connected.[69] Article 4 (1) includes the possibility of severability by stating that a severable part of the contract which has a closer connection with another country may by way of an exception be governed by the law of that other country though the remaining part or parts will be governed by the law of the country with which they are most closely connected.[70] Article 4 (2) contains a presumption, which applies to determine the law of the country with which the contract is most closely connected. It provides:

> "Subject to the provisions of paragraph 5 of this Article, it shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a body corporate or unincorporate, its central administration. However, if the contract is entered into in the course of that party's trade or profession, that country shall be the country in which the principal place of business is situated or, where under the terms of the contract the performance is to be effected through a place of business

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[69] Article 4 (1) of the Rome Convention.

[70] According to the Giuliano-Lagarde Report at 23 the words "by way of exception" are to be interpreted in the sense that the courts must have regard to severance as seldom as possible.

other than the principal place of business, the country in which that other place of business is situated."

In order to apply the test in Article 4 (2) to the facts of a given contract it is necessary to identify the party who is to effect the performance which is characteristic of the contract. The Convention, however, does not provide any help on how to determine what is the characteristic performance of any particular contract. The Giuliano-Lagarde Report gives guidance by providing: [71]

> "[I]t is possible to relate the concept of characteristic performance to an even more general idea, namely the idea that his performance refers to the function which the legal relationship involved fulfils in the economic and social life of any country. The concept of characteristic performance essentially links the contract to the social and economic environment of which it will form part."

The Report points out that the characteristic performance in a unilateral contract presents no difficulty but in cases of bilateral contract it provides: [72]

> "[T]he counter performance by one of the parties in a modern economy usually takes the form of payment of money. This is not, of course, the characteristic performance of the contract. It is the performance for which payment is due, i.e. depending on the type of contract, the delivery of the goods, the granting of the right to make use of an item of property, the provision of a service, transport, insurance, banking operations, security, etc., which usually constitutes the centre of gravity and the socio-economic function of the contractual transaction."

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[71] At 20.

In relation to letters of credit the Report states that in a banking establishment the law of the country of the banking establishment with which the transaction is made will normally govern the contract.

If the characteristic performance of the contract cannot be determined, then the presumption in Article 4 (2) shall not apply. In such situations the law of the country with which the contract is most closely connected will have to be determined without the assistance of any presumption. The presumptions are, according to Article 4 (5), to be disregarded if it appears from the circumstances as a whole that the contract is more closely connected with another country than it is with the country whose law is indicated as applicable pursuant to the presumption.[73] In such circumstances the law of the more closely connected country will serve as the applicable law.

7.7.2 The effect of the Rome Convention on letters of credit

7.7.2.1 <u>The contract between the applicant and the issuing bank</u>

The contract between the applicant and the issuing bank is unlikely to raise any conflict of law problems because normally the parties carry on business in the same country and are governed by the same law. However, occasionally, the position may be different. The applicant can instruct a bank in another country to issue a letter of credit on his behalf and therefore in such instances there can be conflict of laws. The characteristic performance in this contract will obviously be that of the issuing bank. Therefore, it will

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[72] *Ibid.*

[73] According to the Giuliano–Lagarde Report at 22 Article 4 (5) gives the judge discretion in a particular case to determine whether a set of circumstances exists which justifies the application of the presumption.

be the law of the country in which the bank's place of business is situated which will be the governing law. Where the contract was made through a branch the governing law will be the law of the country in which the branch of the bank with which the contract is made is situated. The presumption in favour of the issuing bank's law may be rebutted by reference to Article 4 (5) of the Rome Convention. But since the contract of the issuing bank and the buyer has no real link with the contract between the seller and banks, there will be no reason to displace the issuing bank's law, as it might be in the contract between the issuing bank and the seller.[74] To solve this problem the issuing bank may in its standard form for the issuance of the credit, include an express governing law clause.

7.7.2.2 The contract between the confirming bank or other intermediary bank with the seller

As in the contract between the applicant and the issuing bank, the contract between the seller and the confirming bank is unlikely to give rise to conflict of laws problems because the latter will be carrying on business in the same jurisdiction with the seller and therefore the law of that country will govern. A problem may arise if the obligation of the bank to pay is at a foreign place. In such circumstances it is the confirming bank which has the characteristic performance of the contract. The law which governs will be the law of the country of the confirming bank or its branch as the case may be.

In some instances the intermediary bank is not a confirming bank but is merely an accepting or a negotiating bank. In case of a negotiating bank the governing law will be

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[74] See Morse CJJ "Letters of Credit of Credit and the Rome Convention" *Lloyd's Maritime*

the law of the place where the bank to which presentation of documents is to be made by the negotiating bank is situated. If the negotiation takes place in the same country as the bank to which presentation of documents is to be made under the credit, the law of that country will apply. If the negotiation takes place in another country, the governing law will be the law of the place where the negotiating or advising bank is situated.[75] If the intermediary bank accepts or negotiates a bill of exchange, that bill will contain a contract. The Rome Convention does not deal with bills of exchange, therefore the governing law of the contract in the bill of exchange itself is not governed by the Convention.[76]

7.7.2.3 The contract between the issuing bank and the confirming/correspondent bank

If a correspondent bank is employed it will certainly be in a different country from that of the issuing bank. According to Davenport and Smith:[77]

> "The most likely decision is that the party who has the performance characteristic of the contract is the intermediary bank performing the contract with the beneficiary which the issuing bank has asked it to perform ... the governing law of the contract between the issuing bank and the intermediary bank will be that of the place where the intermediary bank has the relevant branch or, as the case may be, its principal place of business."

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and Commercial Law Quarterly (1994) 560 at 570.

[75] See Jack *op cit* n 61 at 303.

[76] In the UK the applicable law in bills of exchange in cases of conflict of laws is determined by section 72 of the Bills of Exchange Act 1882.

The view of the two writers is acceptable because the functions of the confirming or correspondent bank, namely to confirm the credit, to examine the documents and make payment in terms of the credit, are all carried out in the country which it is situated. Therefore the characteristic performance of the contract is affected by it.

7.7.2.4 The contract between the issuing bank and the seller

In the contract between the issuing bank and the seller the governing law will be that of a country in which the bank or its branch is situated, which is to be the first to examine the documents and to determine acceptance or rejection. The party which has the performance which is characteristic of the contract is the issuing bank. The governing law will be the law of the issuing bank's country because it is the company's place of business through which performance is to be effected.

7.7.2.5 Transferable credits

If the place of presentation of documents is unchanged by the transfer of the credit to the second beneficiary, the proper law should govern the undertakings given to the second beneficiary as it governed those given to the first. If the credit is transferred to another place in another country, which means that the second beneficiary can present documents in his own country, it is suggested that the law governing the whole operation of the credit is the law of the place where the bank is situated to which documents are to be presented by the first beneficiary.[78] In other words, the governing law of the issuing

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[77] Brian Davenport and Michael Smith "The Governing Law of Letters of Credit Transactions" *Butterworths Journal of International Banking Finance* (1994) 3 at 3.

[78] See Jack *op cit* n 61 at 304.

bank's obligation towards the beneficiary should be determined as if there was no transfer.

Bank of Boroda v The Vysya Bank Ltd[79] is the first reported case which concerns the application of the Rome Convention in the United Kingdom in the field of letters of credit. It concerned the dispute between an issuing bank and the confirming bank. Indian buyers instructed Vysya Bank Ltd, India's largest private bank, to issue a letter of credit in favour of the seller, Granada Worldwide Industries Ltd, an Irish company with an office in London. After several amendments the ultimate form of the credit provided that it should be advised to the seller through the Bank of Baroda at the Indian Bank's London office with that bank adding its confirmation to the credit. Baroda duly paid the seller under the letter of credit and was subsequently informed by Vysya that reimbursement instructions had been given authorising Baroda to claim reimbursement on the due date, 10 February 1993. In November 1992, Vysya withdrew the authorisation. Baroda issued a writ alleging anticipatory and/or actual breach by Vysya as the issuing bank, of the contract which it had with Baroda, as confirming bank.

In a situation such as the one described above there are four different relationships which can be identified: the contract between the buyer and the issuing bank (Vysya), the contract between the issuing bank and the confirming bank (Baroda), the contract between the confirming bank and the seller and the contract between the issuing bank and the seller. The relevant contract which had to be considered in the proceedings was the contract between the Bank of Baroda as the confirming bank and Vysya Bank as the

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[79] [1994] 2 Lloyd's Rep 87. See also *Bank of Credit and Commerce Hong Kong Ltd v Somali Bank* [1995] 1 Lloyd's Rep 227.

issuing bank. Mance J identified the contract between the issuing bank and the correspondent as one of agency. He continued:[80]

> "Under a contract between an issuing bank and a confirming bank the performance which is characteristic of the contract is the adding of its confirmation by the latter and its honouring of the obligations accepted thereby in relation to the beneficiary [i.e., the seller]. The liability on the part of the issuing bank to reimburse or indemnify the confirming bank is consequential on the character of the contract, it does not itself characterise the contract."

Thus, the characteristic performance was that of the Bank of Baroda. That performance was to be effected through the London office of the Bank of Baroda, which was a place of business other than Bank of Baroda's place of business. If one applies the presumption contained in Article 4 (2), it will lead to the conclusion that English law governs the contract between the two banks.[81] Mance J then considered the contract between the confirming bank (Bank of Baroda) and the beneficiary (Granada). There was no dispute between the parties that the contract was governed by English law. The judge held that English law governed the contract when applying Article 4.

Vysya Bank contended that an application of the Rome Convention led to the applicability of Indian law as law governing the contract between the issuing bank and the beneficiary. Mance J held that it is undesirable to have two different legal systems governing the relationship of the two banks that are the issuing bank and the confirming bank with the beneficiary and therefore the presumption of Article 4 (2) must give way to

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[80] At 91.

the rule in Article (4) 5. Therefore, if a credit provides for a confirming bank situated in England the credit as a whole has its closest and most real connection with English law, with the result that English law also governs the contract between the beneficiary and the non-English issuing bank.

7.8 Conclusions on the effect of the conflict of laws rules on letters of credit

The rules of conflict of laws in different jurisdictions adhere to the party autonomy or express choice of law by parties to a letter of credit transaction, provided that it is not in conflict with public policy, is not illegal and is not intended to evade the law. American rules provide that party autonomy is limited to a choice of law having significant relationship to the state. If the parties did not provide for a choice of law in the credit and that cannot be implied from the credit itself, the applicable law will be that to which the contract has the closest and most real connection. In South Africa the "intention test" is followed. It is submitted that the closest and most real connection should apply in South Africa.

Courts differ in their interpretation of the law of the closest and most real connection. In Quebec, Austria and under the Rome Convention, courts interpret the closest and most real connection as the law of country where the party performing the central obligation or performance characteristic of a contract resides or, in case of a company, where its central administration is situated. Austrian code provides specifically for banking transactions and it provides that the applicable law is the law of where the bank is situated. In Canadian common law the courts look at all surrounding circumstances and

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[81] The conclusion is correct because the characteristic performance is that of the

relevant facts connected to the transaction. In the United States the determination of the law which has significant relationship is paramount.[82]

In letters of credit it will be difficult for the court to apply these broad rules because of the principle of independence which is regarded as foundational to the letter of credit operation. The court hearing a dispute over a letter of credit should make a judgment call on the facts connected to the letter of credit separate from the underlying contract. It is proposed that in letters of credit the courts should apply the law of domicile and place of business of the bank as the law of closest and most real connection. That will not be against the principle of independence because stipulations of the governing law in the underlying contract will not affect the letter of credit unless stipulated in the letter of credit contract itself. The parties and the relationships and obligations involved in the underlying contract are not the same as those in letters of credit. Thus the banks as the main role players in letters of credit transactions are not affected by the provisions of the underlying contract. The contract between the applicant and the issuing bank will be governed by the law of the country of the issuing bank because that is where the instructions to open the credit were given and the contract between the beneficiary and the issuing bank will be governed by the law of the country of the issuing bank because the documents are presented to it and the seller makes payment to it.

Difficulties arise where other banks are involved. In such instances the applicable law might be the law of the country of the issuing bank or the law of the country of the bank which pays the beneficiary. In order to determine which law is applicable the central obligation performed by the banks has to be identified. Gozlan suggest that the following

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confirming bank.

questions have to be asked to resolve the dispute between banks as to which law of the country of the bank applies:[83]

> "Which bank has made commitments to whom for the performance of specific obligations? What are the respective roles of the banks? Was the paying bank simply an advising bank which was prevailed upon to take this charge in order to facilitate the transaction, without assuming any obligations or commitments towards the beneficiary? At this stage, it will be useful to depict the connecting factors relevant to the letter of credit transaction in order to locate the factors having the closest connection to the transaction. Where was the letter of credit engagement issued? Where is payment to be made? Where is tender and inspection of documents to take place? Where was the bank incorporated? What language and what currency was used in the transaction? Following these steps it should make it possible in deciding which bank(s) has assumed central obligation in the letter of credit engagement."

It is submitted that Gozlan's view is convincing. It is difficult to pinpoint the central obligation of the bank in a letter of credit transaction. If one suggests that the central obligation takes place where the issuing of letter of credit takes place, the problem might be that the economic function of letters of credit is the payment of the beneficiary and therefore the law of the bank of the country which pays the beneficiary should apply. If it is suggested that the central obligation is the place of performance, the argument against it might be that the correspondent bank only acts as an agent of the issuing bank without any commitment to the beneficiary. Therefore determination of the central obligation

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82 Article 188 (2) of the Restatement of the Laws of Conflict of laws.

should depend on the circumstances of each and every letter of credit transaction. It submitted that in order to avoid conflicts of law in letters of credit transactions, parties should not only incorporate the UCP rules in their transaction but must also incorporate a choice of law clause applicable in cases of disputes and a choice of jurisdiction to settle the matter.

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[83] Gozlan *op cit* n 17 at 96-97.

CHAPTER EIGHT

POSTSCRIPT

A letter of credit is a highly convenient method of financing an international contract. The rules to be applied in letters of credit transactions are standardised in the Uniform Customs and Practice for Documentary Credits (UCP).[1] Although the UCP takes note of the communication revolution by providing for the opening of letter of credit by telecommunication, it does not provide for a fully computerised letters of credit operation. It is proposed that as the fast growing technology of computers and telecommunications is rapidly changing the methods of transacting business, the ICC should amend UCP and provide new rules which will provide for fully computerised letter of credit transactions.

The UCP provides for the principle of independence which allows the issuing or confirming bank to pay the beneficiary in terms of the credit irrespective of any dispute that may be between the buyer and the seller in an underlying contract or other contracts. An exception occurs in cases of fraud. In South Africa the buyer has to establish fraud before the court can grant an interdict restraining the issuing or confirming bank to make payment in terms of the credit. This standard of proof of fraud is too high. It is proposed that the court should grant a temporary interdict if the buyer gives *prima facie* proof of fraud. That will give the buyer time to investigate fraud in the documents and produces enough evidence of fraud to enable the court to grant a final interdict.

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1 America has its own rules relating to letters of credit in the form of Article 5 of the UCC.

The UCP also provides for the doctrine of strict compliance. In terms of the doctrine documents presented by the seller should comply strictly with the terms of the credit. It is proposed that the doctrine of strict compliance should not be applied strictly. Thus, banks should accept documents where there are trivial errors in the documents such as typographical errors.

In a letter of credit transaction the parties are often situated in different jurisdictions having different laws. In cases of a dispute between the parties, and in the absence of choice of law, the court will be faced with a problem of whether to apply the domestic or foreign legal system. As the UCP does not have conflict of laws rules, different jurisdictions have developed their own rules to apply in conflict of laws. If the parties did not make the choice of law in the credit, the law of the closest and most real connection is applied. However, in South Africa the courts apply "the intention of the parties" test. It is proposed that South Africa should follow the modern tendency in other jurisdictions to apply the closest and most real connection test when the parties did not make a choice of law and do away with the intention test. However, even in jurisdictions which adopted the closest and most real connection test, the courts differ in their interpretation of the phrase "closest and most real connection". It is proposed that in such instances the courts should apply the law of the place of the business of the bank.