The Law relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks

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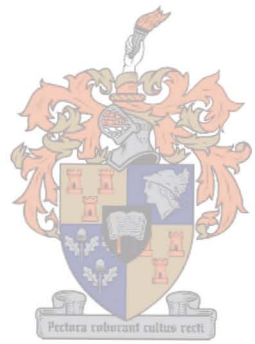

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Declaration

I, the undersigned, hereby declare that the work contained in this dissertation is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

Signature: 

Date: 1/10/96

Summary

The documentary credit is one of the most important methods of payment utilised in international trade. This versatile instrument is encountered in a variety of forms. In its simplest form it is an undertaking by a bank given on application by a buyer-importer (the bank's client) to pay the seller-exporter (the beneficiary) against delivery of stipulated documents. It has two essential characteristics: (i) the bank's undertaking to pay the beneficiary is independent of the contract of sale and the contract between the bank and its client; and (ii) the bank will pay only against the precise documents stipulated in the credit. In Chapter One the different relationships established between the parties involved are dealt with against this background, and the different types of credits are discussed.

Documentary credits are, comparatively speaking, modern instruments. Possible historical origins are explored briefly in Chapter Two. Documentary credits are virtually invariably applied for and issued subject to the *Uniform Customs and Practice for Documentary Credits* (the *UCP*). The *UCP* is a set of rules formulated by the International Chamber of Commerce. The modern history of documentary credits as reflected in the development of the *UCP* is discussed in Chapter Three. The legal nature of the *UCP* is analysed from a civilian, common-law and South African perspective in Chapter Four.

The legal nature of the relationship between the bank and the beneficiary is the focal point of Chapter Five. The question is approached from a civilian (especially German and Dutch), common-law (especially English and American) and South African point of view. Special attention is devoted to the ability (or inability) of the traditional law of contract of the different jurisdictions to provide a theoretical foundation for (i) the independence of the bank's obligation, and (ii) the irrevocability of the bank's undertaking. The conclusion arrived at is that the South African law of contract is able to provide an adequate basis for this relationship in general and these two matters in particular.

In the final chapter the defences available to the bank against the beneficiary's claim are scrutinised, as well as the possibility of the bank being interdicted from paying the beneficiary. Related issues such as anti-dissipation interdicts and attachments in the documentary-credit context are also dealt with. These questions are likewise investigated from a civilian, common-law and South African perspective. This investigation leads to the conclusion that the South African law is essentially in harmony with the law elsewhere and that our courts have been successful to date in protecting the integrity of documentary credits.

Opsomming

Die dokumentêre kredietbrief is een van die belangrikste betalingsmetodes wat in die internasionale handel aangewend word. Hierdie buigbare middel kan 'n verskeidenheid van vorms aanneem. In sy eenvoudigste vorm is dit 'n onderneming deur 'n bank wat op aansoek van 'n koper-invoerder (die bank se kliënt) aan die verkoper-uitvoerder (die begunstigde) gegee word. Dit het twee essensiële eienskappe: (i) die onderneming van die bank om die begunstigde te betaal is onafhanklik van die koopkontrak sowel as die kontrak tussen die bank en sy kliënt; en (ii) die bank sal slegs betaal teen lewering van die presiese dokumente vereis in die kredietbrief. In Hoofstuk Een word die verskillende verhoudinge tussen die partye betrokke teen hierdie agtergrond bespreek asook die verskillende tipes kredietbriewe.

Dokumentêre kredietbriewe is relatief gesproke moderne instrumente. Moontlike historiese oorspronge word kortliks in Hoofstuk Twee verken. Kredietbriewe word bykans sonder uitsondering aangevra en uitgereik onderworpe aan die *Uniform Customs and Practice for Documentary Credits* (die *UCP*). Die *UCP* is 'n stel reëls wat deur die Internasionale Kamer van Koophandel opgestel is. Die moderne geskiedenis van kredietbriewe soos in die ontwikkeling van die *UCP* weerspieël, is die hoofonderwerp van Hoofstuk Drie. In Hoofstuk Vier word die regsaard van die *UCP* vanuit die perspektief van die regstelsels baseer op die *ius civile*, die *common-law* stelsels en die Suid-Afrikaanse reg beskou.

In Hoofstuk Vyf word op die regsaard van die verhouding tussen die bank en die begunstigde gefokus. Die aangeleentheid word benader vanuit 'n *ius civile* (veral Duitse en Nederlandse) perspektief, 'n *common-law* (veral Engelse en Amerikaanse) perspektief, asook 'n Suid-Afrikaanse perspektief. Besondere aandag word verleen aan die vermoë (of onvermoë) van die tradisionele kontraktereg in die verskillende jurisdiksies om 'n teoretiese grondslag daar te stel vir: (i) die onafhanklikheid van die bank se verpligting; en (ii) die onherroepbaarheid van die bank se betalingsonderneming. Daar word tot die gevolgtrekking geraak dat die Suid-Afrikaanse kontraktereg wel in staat is om 'n bevredigende basis vir die verhouding in die algemeen, en hierdie twee aangeleenthede in die besonder, daar te stel.

In die laaste hoofstuk word aandag geskenk aan die verwere wat 'n bank teenoor die begunstigde se aanspraak kan opper, asook aan die moontlikheid dat die bank by wyse van interdik belet kan word om die begunstigde te betaal. Verwante aangeleenthede soos interdikte *in securitatem debiti* en beslagleggings in die konteks van kredietbriewe word ook bygehaal. Hierdie aangeleenthede word eweneens vanuit 'n *ius civile*, *common-law*, en Suid-Afrikaanse perspektief benader. Die ondersoek lei tot die gevolgtrekking dat die Suid-Afrikaanse reg breedweg beskou in harmonie is met ander stelsels en dat ons howe die integriteit van kredietbriewe tot dusver suksesvol beskerm het.

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Opgedra aan my geliefde vrou, seuns, moeder en oorlede vader.

Contents

Chapter One

Documentary Credits: Basic Concepts and Relationships

1 1 Introduction

The documentary credit is a method of payment widely used in international trade. It is of fundamental importance to stress from the outset two aspects of this method. It is, in the first place, *international*. Clearly, no international method of payment can enjoy the widespread use of the documentary credit without a broad consensus of opinion internationally as to its nature, uses and consequences. Such consensus does, without any doubt, exist.[1] Any lawyer commenting on documentary credits from the perspective of a specific national legal system should take account of and respect, as far as possible, the existing international consensus. Any substantial departure from this consensus may seriously harm the particular country's trade relations.[2]

Secondly, it is important to bear in mind that the documentary credit is essentially a *mercantile*, rather than a legal device. It was created by merchants and bankers to fulfil a specific mercantile need. Thus, any lawyer commenting on documentary credits will do well to heed the following words and implicit warning of Sir William Holdsworth:

> "In many different places, and at many different times, the lawyers have been slow to learn that their technical rules must, in the long run, accommodate themselves to business needs - that

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1 Much of this international consensus is contained in a document drafted by the International Chamber of Commerce (hereinafter referred to as the ICC) titled *The Uniform Customs and Practice for Documentary Credits* (1993) ICC Publication 500 ICC Publishing Paris (hereinafter referred to as the *UCP*). The nature and role of the *UCP* is considered in detail in chapter 4 below. In the United States the importance of harmonising national law with international practices was recently highlighted in the revision process of article 5 of the Uniform Commercial Code, which regulates documentary credits. The working group expressed itself as follows in this regard: "Not only should the rules be consistent within the United States, but they need to be substantively and procedurally consistent with international practices." In fact, this was regarded as the first goal of the revision. See American Law Institute *Uniform Commercial Code Revised Article 5 - Letters of Credit - Proposed Final Draft* (6 April 1995) Prefatory Note xvii.

2 See the comment by F R R "International Principles and the Documentary Credit" 1979 *Journal of Business Law* 364. The author discusses an unreported case in which an Angolan court ignored an aspect of this international consensus and concludes his discussion by remarking that "[a] country in which such judgments may be expected cannot look to participation in international trade".

> commercial law exists primarily to settle mercantile disputes, and not to dictate to the merchants the modes in which they shall carry on their business."[3]

South African courts have only recently been called upon to decide on the legal effect and consequences of documentary credits.[4] In the first South African case in point, *Phillips v Standard Bank of South Africa Ltd*, Goldstone J, relying on English and American precedents, echoed Holdsworth's warning by stressing that "the Courts should recognise and give effect to the *commercial purpose* for which the system of irrevocable documentary credits has been devised".[5]

This commercial purpose and background of the documentary credit, as well as the main elements of the international consensus relating to these instruments, form the subject-matter of this introductory chapter.

1 2 Payment in International Trade

Although the documentary credit has proved to be a most versatile device,[6] its primary use since its inception to the present day has been as an instrument of payment in international trade.

The principal parties in an international sale are the buyer or importer, the seller or exporter and the financier (normally a bank) of the buyer. Although an international sale is in legal principle no different from a domestic sale, the parties are subjected to additional risks not faced in the domestic arena. The major risks faced by the international seller[7] include not only the economic risk that the buyer,

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3 Holdsworth Sir William *A History of English Law* Vol VIII 2 ed (1937) Methuen & Co Ltd London 119. Although these words were written with reference to negotiable instruments, few would doubt their general applicability. Examples abound. See Chorley R S T "The Conflict of Law and Commerce" (1932) 48 *Law Quarterly Review* 51-72.

4 To date there have been only 4 reported South African decisions specifically concerned with letters of credit, namely: *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W); *Nedcor Bank Ltd v Hartzer* 1993 4 CLD 278 (W); *Ex Parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W); *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A).

5 1985 3 SA 301 (W) 304C (my italics).

6 See in general Joseph C E "Letters of Credit: the Developing Concepts and Financing Functions" (1977) 94 *Banking Law Journal* 816.

7 On the risks faced by international sellers in general see Huber E & Schäfer H *Dokumentengeschäft und Zahlungsverkehr im Außenhandel* (1985) Fritz Knapp Verlag Frankfurt am Main 30-32; Davis A G *The Law Relating to Commercial Letters of Credit* 3

due to a lack of funds, insolvency, or the fact that he has found a better bargain elsewhere, is unable or unwilling to comply with his contractual obligation to pay timeously,[8] but also the political risk that the buyer may be unable to comply with his obligations due to external factors such as war, revolution, blockage of funds, a moratorium or the cancellation of export or import licences.[9] The international seller furthermore faces risks such as the influence of exchange-rate fluctuations, the regulation of exchange control,[10] and the risk of having to litigate in the buyer's jurisdiction should the buyer default.

International buyers in turn face the risks arising out of the difficulty of effective quality control in far-away countries. They require assurance that they will receive the specific goods contracted for. The considerable time involved in shipment may also cause cash-flow problems for the buyer.[11]

The international aspect may further affect the security interests of the buyer's financier, who will be unwilling to part with money without acceptable security.[12]

It is against this background that payment must be arranged in international trade. There are several possible ways in which this can be done. In the first place the

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ed (1963) Pitman & Sons Ltd London 13; Cowan H R "Export Trade Finance" (1986) 65 *Canadian Bar Review* 368 369-371; Stassen J C "Die Dokumentêre Kredietbrief as Betalingsmetode in die Internasionale Handel" 1982 *Modern Business Law* 14; Berman H J & Kaufman C "The Law of International Commercial Transactions (*Lex Mercatoria*)" (1978) 19 *Harvard International Law Journal* 221 222.

8 Huber & Schäfer (*op cit* n 7) 30 use the term "wirtschaftliche Risiken", which are "Risiken ... die in der Person des Käufers liegen". Berman & Kaufman (*op cit* n 7) 222 use the term "commercial risks".

9 Huber & Schäfer (*op cit* n 7) 31 describe "politische Risiken" as "Risiken ... die nicht in der Person des Käufers, sondern im Land des Käufers liegen". Berman & Kaufman (*op cit* n 7) 222 use the term "risks of administrative action".

10 These risks are termed "Währungsrisiken" in the German literature. See Huber & Schäfer (*op cit* n 7) 30.

11 On the risks faced by international buyers see in general Stassen (*op cit* n 7) 14-16; Mijnsen F H "Documentair Krediet" in Bannier F A W, Boll J M, Mijnssen F H J & De Rooy R E *Betalingsverkeer* (1987) Tjeenk Willink Zwolle 64-65; McCurdy W E "Commercial Letters of Credit" (1921-1922) 35 *Harvard Law Review* 539 540-542; Anonymous "Letters of Credit under the Proposed Uniform Commercial Code: an Opportunity Missed" (1953) 62 *Yale Law Journal* 227 233.

12 Finkelstein H N "Performance of Conditions under a Letter of Credit" (1925) 25 *Columbia Law Review* 724 726; Anonymous (*op cit* n 11) 233; Schmitthoff C M assisted by Adams J *Schmitthoff's Export Trade* 9 ed (1990) Stevens & Sons London 401.

seller may simply insist on *payment in advance*.[13] The buyer, in other words, must pay the seller before receiving anything. This is the method of payment most advantageous to the seller. The risks inherent to such a sale are then absorbed by the buyer. This method of payment is therefore indicative of a seller in a very strong bargaining position.[14]

A second method of payment is the *open account*,[15] by which payment is due a specified number of days after the invoice date. The seller then relies on the ability and willingness of the buyer to pay. He relinquishes control of the goods prior to receiving payment. This method of payment is indicative of the buyer being in a strong bargaining position. It is often suitable in domestic trade where contracting parties may know one another well and legal redress against a defaulting buyer is relatively simple.[16] In the context of international trade though, this method is appropriate only where both the "[c]ountry and importer are known and reliable".[17]

A third possibility, which achieves a greater measure of equilibrium between the interests of the seller and buyer, is payment by means of *documentary bills*.[18] The seller forwards the shipping documents, invoices, insurance certificates, and any other necessary or agreed documentation to his agent, normally a bank, in the buyer's country. These documents are accompanied by a bill of exchange drawn by the seller in favour of himself on the buyer. The bill may be either a sight or a

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13 Stassen (*op cit* n 7) 14; Davis (*op cit* n 7) 13; McGivern T "International Letters of Credit and their Use in Agricultural Export Situations" (1983) 37 *Arkansas Law Review* 217 218; Cowan (*op cit* n 7) 371. On "Vorauskasse" in German practice see Huber & Schäfer (*op cit* n 7) 19.

14 Goode R *Commercial Law* 2 ed (1995) Penguin Harmondsworth 960; Cowan (*op cit* n 7) 371.

15 Stassen (*op cit* n 7) 14; Goode (*op cit* n 14) 960; Davis (*op cit* n 7) 13; McGivern (*op cit* n 13) 218; Cowan (*op cit* n 7) 371. On "Bezahlung gegen offene Rechnung" or "offenes Zahlungsziel" in German practice see Zahn J C D, Eberding E & Ehrlich D *Zahlung und Zahlungssicherung im Außenhandel* 6 ed (1986) Walter de Gruyter Berlin par 1/2; Huber & Schäfer (*op cit* n 7) 23.

16 McGivern (*op cit* n 13) 218.

17 Standard Bank of South Africa Ltd *Guide to Business Series - Documentary Credits* 29.

18 On payment by documentary bills (or drafts) in general see Stassen (*op cit* n 7) 15; Goode (*op cit* n 14) 961; Davis (*op cit* n 7) 14; McGivern (*op cit* n 13) 218-219; Cowan (*op cit* n 7) 372.

term bill.[19] In the case of a sight bill, the buyer can acquire the documentation only by paying the bill.[20] By this device the seller thus protects himself by effectively retaining control of the goods until payment of the bill. He still, however, faces the risk of the buyer being unable or unwilling to pay. This would leave the seller in the unenviable position of having to dispose of the goods in a foreign port in what may well be a falling market. In the case of a term bill, the documents are relinquished against acceptance of the bill by the buyer.[21] The seller in this instance relinquishes control of the goods in exchange for a claim based on a liquid document.[22] In the event of the buyer having a good credit standing the seller should be able to discount the bill, thereby acquiring payment prior to the due date of the bill. The seller, however, still faces the risk that the buyer may run into financial difficulties and the seller as a consequence may find it impossible to discount the bill. Furthermore, the possibility remains that the buyer may eventually dishonour the bill.[23]

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19 The terminology "cash draft" as against "term draft" or "usuance draft" is also encountered.

20 In German practice this method of payment is known as "Kasse gegen Dokumente". See Zahn, Eberding & Ehrlich (*op cit* n 15) par 1/3; Huber & Schäfer (*op cit* n 7) 20-21.

21 In German practice this is known as "Dokumente gegen Akzept". See Huber & Schäfer (*op cit* n 7) 21.

22 A claim based on a liquid document being easier to enforce than a claim on the contract of sale itself, the seller is in a better position than he would have been in the event of a sale on open account.

23 There are two variations of payment by documentary bill encountered especially in the American and Far Eastern trades. The *authority to purchase* indicates the willingness of the buyer's bank to buy the seller's bill in the belief that it will be honoured by the buyer. Should the bill, however, be dishonoured by the buyer, the bank would, in terms of the law of bills of exchange, have a right of recourse against the seller-drawer. (On the authority to purchase in general see Harfield H *Bank Credits and Acceptances* 5 ed (1974) Ronald Press Company New York 45; Schneider J *Akkreditive im gebundenen und freien Zahlungsverkehr mit dem Ausland* (1955) Dissertation Wirtshaftshochschule Mannheim 71-72; Stassen (*op cit* n 7) 24-25; Kozolchyk B *Letters of Credit* in Ziegel J S (chief editor) *International Encyclopedia of Comparative Law* Vol IX (1979) JCB Mohr (Paul Siebeck) Tübingen par 5; McCurdy (*op cit* n 11) 549-550.) The *authority to pay* allows the bill to be drawn on the buyer's bank itself, or on its correspondent in the seller's country. The bank, however, is not obliged to honour the seller's draft. (On the authority to pay in general see Harfield *supra* 45, 258-260; Stassen *supra* 25; Kozolchyk *supra* par 5. These authorities are considered by the business world as creating no binding obligations from the time of issue. They are regarded as revocable and subject to modification any time before presentation of the drafts. See in this regard Harfield *supra* 258-260; McCurdy *supra* 549-551; Stassen *supra* 24-25; Schneider *supra* 72.)

Payment by documentary bill (or draft) is therefore clearly not without its shortcomings. Kozolchyk[24] thus concludes:

> "[T]he documentary draft method of payment and its variants eliminated some of the risks inherent in the direct remittance of exchange.[25] However, it is also true that documentary drafts favored significantly the interests of buyers. By simply refusing to accept the documentary draft or instructing their banks not to pay the drafts drawn on them, buyers could exact more liberal terms from sellers. The sellers would then have been faced with the prospect of litigating in a foreign country without the material possession of goods that were either in transit, or, more likely, in the foreign customs house."

In the same vein Goode stresses that what the seller needs is "an assurance, before he makes the shipping arrangements, that he will be paid after shipment".[26]

Risks and insecurities such as these may prompt a seller to reinforce his position by exacting an undertaking to pay from a third party, for instance a bank. Such an undertaking can be either a primary undertaking (such as a documentary credit, independent guarantee or performance bond) or a secondary undertaking (in the case of suretyship). In the context of international contracts of sale, the documentary credit has become the most prevalent and important method of payment.[27] It is the method of payment which achieves the highest degree of equilibrium between the interests of the different parties.[28] As a consequence, English judges have gone so far as to term documentary credits the "life-blood of international commerce".[29]

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24 (*Op cit* n 23) par 5.

25 "Direct remittance of exchange" refers collectively to the payment methods "cash in advance" and "open account" discussed above.

26 (*Op cit* n 14) 962.

27 Schmitthoff & Adams (*op cit* n 12) 400. See also Anonymous (*op cit* n 11) 227; Gornall J "Negotiating and Drafting the International Sales Contract and Related Agreements" (1984) 14 *Georgia Journal of International and Comparative Law* 491 492.

28 "Ein Akkreditiv stellt eine optimale Möglichkeit dar, sowohl die Interessen des Verkäufers als auch die des Käufers gleichermaßen zu schützen" state Huber & Schäfer (*op cit* n 7) 20.

29 *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] 1 QB 146 (QB) 155G; *Intraco Ltd v Notis Shipping Corporation (The "Bhoja Trader")* [1981] 2 Lloyd's Rep 256 (CA) 257.

1 3 Definition and Operation of Documentary Credits

1 3 1 Possible Definitions

Courts and commentators tend to shy away from defining the documentary credit. Such an attempt, according to Davis, "would serve no good purpose, for a commercial letter of credit[30] as such, unlike, for example, a bill of exchange, is not clothed with particular attributes, the absence of any one of which would destroy its legal validity."[31] An accurate definition is very difficult due to the many different varieties in use. Documentary credits are accordingly best described in general terms. Goode, for example, offers the following definition:

> "A documentary credit is in essence a banker's assurance of payment against presentment of specified documents."[32]

This "assurance" can, however, take a number of forms. This is clearly evident in the following more comprehensive definition contained in the International Chamber of Commerce's *Uniform Customs and Practice for Documentary Credits* (*UCP*):[33]

> "For the purposes of these Articles, the expressions 'Documentary Credit(s)' and 'Standby Letter(s) of Credit'[34] .... mean any arrangement, however named or described, whereby a bank (the 'Issuing Bank'), acting at the request and on the instructions of a customer (the 'Applicant') or on its own behalf,
>
> **i.** is to make a payment to or to the order of a third party (the 'Beneficiary'), or is to accept and pay bills of exchange (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

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30 In the context used here the term "commercial letter of credit" is synonymous with "documentary credit". On the proper terminology see par 1 3 3 below.

31 Davis (*op cit* n 7) 12. See also McCurdy (*op cit* n 11) 542 who states as follows: "To attempt to define a commercial letter of credit would be more than futile. That the use of a definition as starting point serves to obscure analysis and is a source of legal error is nowhere more evident than in the subject of letters of credit. Their variations are almost infinite."

32 (*Op cit* n 14) 964.

33 On the development, legal nature and importance of the *UCP* see chapter 3 and 4 below.

34 Standby letters of credit have the same form as documentary credits, but serve a different function. See the discussion in par 1 6 5 below.

iii. authorises another bank to negotiate,

against stipulated document(s), provided that the terms and conditions of the Credit are complied with."[35]

1 3 2 The Documentary Credit in its Simplest Form

In its least complicated form the "banker's assurance" in the case of a documentary credit is simply an undertaking to pay the seller against presentation of certain documents. But how does this obligation to pay arise? This is best illustrated by means of an example.

A South African wine merchant wishes to buy and import a quantity of German wine. He accordingly enters into a contract of sale with a German seller. Typically this contract will stipulate that payment is to be effected by means of a documentary credit issued by a reputable South African bank in favour of the German seller. It may even specify the documents[36] against which payment will be made. This contract of sale can be regarded as the first stage[37] in the documentary-credit process.

The South African buyer will thereupon request his bank to issue such a credit. The request, made on the bank's standard application form, can be regarded as the second stage of the process. In his application the buyer (applicant) must give clear instructions to the bank. In this regard it is of fundamental importance to stipulate the precise documents against which the bank is instructed to pay. Depending upon its customer's creditworthiness the South

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35 A 2 of the 1993 revision. This definition, which has basically remained unaltered since 1962 (apart from minor changes), has generally met with approval. See Ellinger E P *Documentary Letters of Credit - A Comparative Study* (1970) University of Singapore Press Singapore 5. Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/3 n 5 point out that there is no reason why only banks should be able to issue letters of credit, as implied by the *UCP*'s definition, but add that as far as Germany is concerned this is merely a theoretical objection.

36 These would normally include the transport documents, commercial invoices and insurance documents.

37 The stages in the operation of documentary credits are discussed in many works. Especially instructive is the discussion of Hedley W *Bills of Exchange and Bankers' Documentary Credits* 2 ed (1994) Lloyds of London Press Ltd London 247-253. See further Ellinger (*op cit* n 35) 20-23; Davis (*op cit* n 7) 15-23; Kozolchyk (*op cit* n 23) par 8-13; Stassen (*op cit* n 7) 16; Schmitthoff & Adams (*op cit* n 12) 403-404. For the German practice see Zahn, Eberding & Ehrlich (*op cit* n 15) chapter 2; Huber & Schäfer (*op cit* n 7) 182-189.

African bank may require to be put in funds to the extent of the proposed commitment to the seller.

Once the South African bank has approved the application and decided to issue the documentary credit, this fact must be communicated to the German seller - the beneficiary of the credit. Although the issuing bank can, in principle, communicate directly with the beneficiary (for instance by mailing the credit to him) this is seldom done. The services of a correspondent bank in the seller's country are generally employed. The issuing bank requests this bank (referred to as the advising bank) to communicate (or advise) the particulars of the documentary credit to the beneficiary.[38] This can be regarded as the third step in the process.

The fourth step is the presentation of the stipulated documents by the beneficiary to the issuing bank, who, if the documents are in order, pays the beneficiary. The final step in the process is the presentation of the documents by the bank to the applicant who, if they are in order, pays the bank.

This method of payment serves the interests of all parties well. The seller's interests are protected in that he acquires the undertaking of a bank that he will be paid against delivery of the documents. The obligation to pay is therefore that of an institution with a high credit standing. This obligation, furthermore, is totally independent of the underlying contract of sale and cannot be countermanded by the buyer. The independence of the bank's obligation is one of the fundamental principles of documentary-credit law.[39]

As a general rule[40] the bank may only decline to pay if the conditions stipulated in the letter of credit have not been complied with, that is if the documents tendered do not conform with the requirements of the credit. This "doctrine of

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38 See the discussion in par 1 3 4 below. The advice of the credit is normally given by telex and confirmed by letter. See Goode (*op cit* n 14) 969.

39 The independence principle is discussed in detail in chapter 5 below. For authoritative renditions of the principle see a 3 of the *UCP* as well as *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 1 WLR 1233 (CA) 1241A-B. In South Africa the principle was accepted unambiguously in *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W) 304D-E.

40 Exceptions to the principle do exist, especially in the context of fraud. See chapter 6 below.

strict compliance"[41] is another fundamental principle of the law and practice of documentary credits.[42]

The interests of the buyer are served in that by prescribing the conditions of the credit he can ensure that the seller performs properly. If creditworthy he will furthermore only be required to pay against delivery of the documents of title to him.[43] Finally, the interests of the bank are also served in that it holds the documents, and therefore the effective control of the goods, as security until reimbursed by the buyer.[44]

The success of the documentary-credit system is due to the manner in which it manages to harmonise the conflicting interests of the different parties. As Wheble states:

> "[T]he realities of international trade continue to require documentary credits ... . Just as fifty years ago, sellers still hesitate to release their goods before receiving payment, while buyers prefer to have control over the goods before parting with their money. But matching payment with physical delivery is rarely possible, so a compromise is normally agreed - payment against 'constructive delivery', the handing over of documents transferring title to, or control over, the goods. Creditworthiness then becomes important, and bankers are required to intervene, giving their conditional undertaking to the seller to pay against presentation of documents and compliance with conditions stipulated by the buyer. Hence the continuing need for documentary credits."[45]

The above description of the operation of documentary credits, as has been indicated, relates to the documentary credit in its simplest form. The construction is generally, however, more complex due to (i) the involvement of

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41 Schmitthoff & Adams (*op cit* n 12) 406.

42 The *dictum* quoted in this regard with monotonous regularity is that of Lord Sumner in *Equitable Trust Co of New York v Dawson Partners Ltd* [1927] 27 Ll L Rep 49 (HL) 52: "There is no room for documents which are almost the same or which will do just as well." See also the *UCP* aa 4 & 15 and the discussion in chapter 6 below.

43 In England and the United States it is possible for the bank to release the documents under a trust receipt. The buyer then holds and deals with the documents and goods as trustee of the bank. This enables him to pay for goods after having sold them, thereby financing his purchase out of the proceeds of the goods themselves.

44 See the discussion in par 3 9 4 below.

45 International Chamber of Commerce *Uniform Customs and Practice for Documentary Credits* (1983) ICC Publication 400 Paris Foreword 5.

further banks in different capacities, or (ii) the coupling of a bill of exchange to the letter of credit. Before dealing with these matters, however, it is necessary to comment on the terminology encountered in this field.

1 3 3 Terminology: Documentary Credits, Letters of Credit, and Commercial Credits.

In the English and American legal literature the terms "documentary credit", "letter of credit" and "commercial credit" are often used indiscriminately. This is immediately evident from the titles of the major treatises on the subject: Jack,[46] Ellinger[47] and Hedley[48] have opted for "documentary credit"; Schmitthoff & Adams,[49] Sarna[50] and Dolan[51] have chosen "letters of credit"; Gutteridge & Megrah[52] have selected "bankers' commercial credits"; and Davis[53] prefers "commercial letters of credit". The statutory and quasi-statutory instruments are equally inconclusive in this regard. The *UCP* uses the term "documentary credit" in the first two articles and thereafter the abbreviation "credit". However, article 5 of the UCC (in both the current and proposed revisions)[54] consistently employs the term "letter of credit".

It possible to make three observations from this terminology. First, as a general rule it would appear that the term "letter of credit" is the more popular in the United States whilst "documentary credit" is favoured in the recent English sources. Secondly, these terms are synonymous. Finally, they are all used in two distinct senses: (i) to designate the instrument setting out the bank's

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46 Jack R *Documentary Credits* 2 ed (1993) Butterworths London.

47 Ellinger E P "Documentary Credits and Finance by Mercantile Houses" in Guest A G (general editor) *Benjamin's Sale of Goods* 3 ed (1987) Sweet & Maxwell London. But see also Ellinger (*op cit* n 35) where the term "documentary letters of credit" is used.

48 (*Op cit* n 37).

49 (*Op cit* n 12) 400.

50 Sarna L *Letters of Credit* 3 ed (1989) (loose-leaf edition) Carswell Toronto.

51 Dolan J F *The Law of Letters of Credit - Commercial and Standby Credits* 2 ed (1991) Warren, Gorham & Lamont Boston.

52 Gutteridge H C & Megrah M *The Law of Bankers' Commercial Credits* 7 ed (1984) Europa Publications London.

53 (*Op cit* n 7).

54 On Article 5 of the UCC in general see par 3 10 1 and 3 10 2 below.

payment obligation (the narrow sense); and (ii) to designate the entire documentary-credit transaction, that is not only the bank-beneficiary relationship, but all other relationships associated with the documentary-credit transaction (the broad sense).

The situation is somewhat different on the European continent. As Stassen[55] points out the German terms "Akkreditiv" or "Dokumentenakkreditiv", and their Dutch counterpart "accreditief" are reserved for the narrow meaning described above. For the wider meaning the Germans employ the term "Akkreditivgeschäft" and the Dutch the term "documentair crediet". With reference to the terminological confusion in the English literature Van Delden motivates this distinction as follows:

> "Uit deze terminologie blijkt reeds een zekere verwarring omtrent de juridische constellatie, welke met de term documentair krediet aangeduid wordt. Er is niet slechts één rechtsfiguur, welke met documentair krediet kan worden aangeduid. Documentair krediet is een aanduiding van een maatschappelijk of economisch verschijnsel ... waarbij juridisch *tenminste* drie zelfstandige rechtsverhoudingen betrokken zijn, te weten 1. tussen de partijen bij een basisovereenkomst; 2. uit lastgeving tussen de bank en de opdrachtgever... ; 3. tussen de bank en de begunstigde ... . In het navolgende zal ik deze rechtsverhouding met accreditief aanduiden."[56]

A dominant trend in the terminology has not as yet emerged from the South African sources. Both "documentary credit"[57] and "letter of credit"[58] are often used. The term "commercial credit" is seldom encountered. Stassen takes the view that the continental approach of distinguishing clearly between the instrument containing the bank's obligation, and the entire transaction embracing at least three relationships is to be preferred from both a legal and a practical point of view. For the former he suggests the term "documentary letter of credit" (Afrikaans: *dokumentêre kredietbrief*) and for the latter "documentary

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55 Stassen (*op cit* n 7) 22-23.

56 Van Delden R *Betalingsverkeer (Documentair Krediet/Documenten)* (1990) Kluwer Deventer 4.

57 See for instance *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W); Standard Bank Guide (*op cit* n 17); Standard Bank of South Africa Ltd *Irrevocable Documentary Credit Application*.

58 *Ex Parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W); *Nedcor Bank Ltd v Hartzer* 1993 4 CLD 278 (W); Malan F R "Letters of Credit and Attachment ad Fundandam Jurisdictionem" 1994 *Tydskrif vir die Suid Afrikaanse Reg* 150.

letter of credit transaction" (Afrikaans: *dokumentêre kredietbrieftransaksie*).[59] Whilst the point made by Stassen and Van Delden is appreciated, it must not be overemphasised. It is suggested that the context in which either the term "letter of credit" or "documentary credit" appears, invariably clarifies whether it is used in the narrow or broad sense. The English terminological confusion, in other words, does not as a rule lead to conceptual confusion. Furthermore, the English terminology is well settled, and unlikely to change. Thus, in recognition of the international aspect of documentary credits the following approach is adopted in this thesis: (i) the term "documentary credit" is used rather than "letter of credit" as this allows for the often encountered abbreviation "credit";[60] (ii) the term "documentary-credit transaction" or "documentary-credit process" is used where it is important to stress that it is used in its wider meaning; (iii) the term "commercial credit" is avoided except in the specific instance of differentiating between the traditional (commercial) documentary credit described above and the more recent innovation of the functionally different standby letter of credit.[61]

1 3 4 The Involvement of other Banks

Apart from the "issuing bank"[62] and "advising bank",[63] the roles of which have already been touched upon, further banks may become involved in other capacities in the operation of the documentary credit. The most important of these are the confirming bank,[64] nominated bank,[65] and negotiating bank,[66] each of which has a significant impact upon the relatively simple construction described above. Banks may further be involved as reimbursing bank, claiming bank and collecting bank.

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59 (*Op cit* n 7) 23.

60 This is the most sensible choice as it reflects the practice adopted in the *UCP*.

61 See par 1 6 5 below.

62 Aa 2, 9(a) of the *UCP*.

63 A 7 of the *UCP*.

64 A 9(b) of the *UCP*.

65 A 10 of the *UCP*.

66 A 10 of the *UCP*.

As stated above the issuing bank seldom communicates the fact that a credit has been issued (and its terms) directly to the beneficiary. Instead, it employs the services of its correspondent (the advising bank) in the beneficiary's country. In advising the credit the advising bank acts as the mandatary of the issuing bank.[67] The role of the advising bank is defined as follows in the *UCP*:

> "A Credit may be advised to a Beneficiary through another bank (the 'Advising Bank') *without engagement on the part of the Advising Bank*, but that bank, if it elects to advise the Credit, shall take reasonable care to check the apparent authenticity of the Credit which it advises."[68]

The advising bank accordingly does not make any undertaking to the beneficiary. Its sole obligation to the beneficiary is to verify the authenticity of the credit.[69] However, the beneficiary may not be satisfied with the undertaking of only the (foreign) issuing bank. Typically this will be the case where the creditworthiness of the issuing bank, for whatever reason, is suspect. In such a situation the seller may require that the credit be confirmed by a local bank. Such a confirmation, in terms of the *UCP* "constitutes a definite undertaking of the Confirming Bank, in addition to that of the Issuing Bank" in exactly the same terms as those of the issuing bank.[70] The seller therefore has an undertaking, not only of a (foreign) issuing bank, but also of a (local) *confirming bank*. The confirming bank's undertaking amounts to a primary (as opposed to a secondary) liability,[71] and, as in the case of the issuing bank, the confirming bank's undertaking is independent of any of the other relationships surrounding the documentary credit. The advising and confirming bank is often, but not necessarily, the same bank.[72]

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67 See the discussion of this relationship in par 1 5 5 below.

68 A 7(a) (my italics).

69 A 7(a) of the *UCP*.

70 A 9(b).

71 Del Busto C *Documentary Credits - UCP 500 & 400 Compared* 1993 ICC Publication 511 Paris 24.

72 Hedley (*op cit* n 37) 248-249.

As noted above[73] a documentary credit furthermore includes any arrangement whereby an issuing bank "authorises another bank" to effect payment. Just as the issuing bank does not normally communicate the credit directly to the beneficiary, it may also prefer not to pay the beneficiary directly but rather to authorise or "nominate" another bank (often the advising bank) to pay on its behalf. This implies that the documents must likewise be tendered to the *nominated bank*. The matter is regulated in article 10 of the *UCP* which provides as follows:

> "**b i.** 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. Presentation of documents must be made to the Issuing Bank or the Confirming Bank, if any, or any other Nominated Bank. ...
>
> **d** By nominating another bank ... or by authorising or requesting another bank to add its confirmation, the Issuing Bank authorises such bank to pay, accept Draft(s) or negotiate as the case may be, against documents which appear on their face to be in compliance with the terms and conditions of the Credit and undertakes to reimburse such bank... ."

The nominated bank acting as the mandatary of the issuing bank[74] receives the documents from the beneficiary and pays him. The nominated bank does not therefore acquire the documents in its own right but on behalf of the issuing bank.[75] In one instance, however, the nominated bank, or any bank, may acquire the documents in its own right. This occurs in the case of a negotiation credit. A negotiation credit is defined as follows by Jack:

> "With a negotiation credit the undertakings [of the issuing and confirming banks] are directed to any bank, or to any bank of a description stated in the credit... . The purpose of making a credit a negotiation credit is that it enables a bank to negotiate (or buy) the documents from the beneficiary and then to present them under the credit and to receive payment in due course. In this way the beneficiary gets his money immediately from the

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73 Par 1 3 1.

74 See the discussion of this relationship in par 1 5 5 below.

75 Jack (*op cit* n 46) 120.

> negotiating bank, and the negotiating bank has the undertakings given by the credit available to it... ."[76]

Thus, a bank purchasing the documents under a negotiation credit (the *negotiating bank*), does not merely do so as the mandatary of the issuing bank, but in its own right.[77] The negotiating bank discounts the credit, thus it purchases the documents as a short-term investment.

The *UCP* also refers to a *reimbursing bank* and a *claiming bank*. However, these provisions in no way affect the legal relationships between the seller and any banks liable to him in terms of the credit, nor the relationship between the buyer (applicant for the credit) and the issuing bank. They are solely concerned with inter-bank reimbursement arrangements.[78] In this respect the salient provisions of the *UCP* are the following:

> "a If an Issuing Bank intends that the reimbursement to which a paying, accepting or negotiating bank is entitled, shall be obtained by such bank (the 'Claiming Bank'), claiming on another party (the 'Reimbursing Bank'), it shall provide such Reimbursing Bank in good time with the proper instructions or authorisation to honour such reimbursement claims. ...
>
> c An Issuing Bank shall not be relieved from any of its obligations to provide reimbursement if and when reimbursement is not received by the Claiming Bank from the Reimbursing Bank."[79]

Finally, the beneficiary may decide to make use of a *collecting bank*.[80] The collecting bank, on request of the beneficiary presents the documents on behalf of the beneficiary. Typically the collecting bank will be the beneficiary's own bank. This arrangement has the advantage that the beneficiary can avail himself of the expertise of his bank in determining beforehand whether the documents tendered comply strictly with the requirements of the credit. Insofar as this bank may have financed the beneficiary (for instance to acquire the goods sold) the collecting bank may have a very real interest that nothing should go wrong

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76 (*Op cit* n 46) 27. See also the discussion of straight as opposed to negotiation credits in par 1 6 6 below.

77 Jack (*op cit* n 46) 27, 135.

78 See the Standard Bank Guide (*op cit* n 17) 4, 35.

79 A 19.

80 See in general on the collecting bank Jack (*op cit* n 46) 134-135.

with the transaction. The collecting bank acts as the agent of the beneficiary in this regard. Thus, if it makes an advance to the beneficiary in anticipation of successful collection, it does so at its own risk.[81]

1 3 5 Documentary Credits in Conjunction with Bills of Exchange

The undertaking of the issuing (and confirming) bank need not simply be to pay against delivery of the stipulated documents; it may be to *accept a bill of exchange* against delivery of the documents and to pay the bill on maturity.[82] In this instance the bill is typically a time draft (also referred to as a usuance draft) drawn by the beneficiary of the credit in favour of himself. Due to the fact that the bill has been accepted by a bank it can readily be discounted in the money market. This enables the beneficiary of the credit (payee of the bill of exchange) to acquire the money before the bill is due. The buyer of the bill can either retain it and present it to the acceptor on maturity, or may in turn sell (negotiate) it in the money market.[83]

This construction holds benefits for both the buyer and seller. The benefit for the seller is that it enables him in effect to be paid as soon as he can discount the accepted bill (banker's acceptance). The benefit for the buyer, on the other hand, is that he acquires credit; he will only be required to put the accepting bank in funds to meet the bill on maturity.

Instead of accepting the bill itself, the issuing bank may also nominate another bank who, as mandatary of the issuing bank, will accept the beneficiary's bill against delivery of the documents and pay it upon maturity and subsequently be reimbursed by the issuing bank.[84]

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81 The line between making an advance in anticipation of collection and purchasing the documents as negotiating bank, can be very fine. It may, however, be a vital line. The beneficiary's fraud will not, for instance, affect the right of a negotiating bank to recover under the credit, but will defeat any such claim from the collecting bank. See Jack (*op cit* n 46) 135. See also *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168 (HL); *European Asian Bank AG v Punjab and Sind Bank* [1983] 1 Lloyd's Rep 611 (CA) 618, 619.

82 See a 2(i) and 9(a)(iii) of the *UCP*. Note that the issuing bank's letter of credit undertaking is not limited to acceptance of the bill but also to payment thereof. Thus, if the accepted bill is dishonoured the beneficiary could institute action on either the bill or the credit. See also Del Busto (*op cit* n 71) 23.

83 Hedley (*op cit* n 37) 252, 259-261.

84 A 2(ii) of the *UCP*.

It is also possible that the seller, instead of drawing the bill in favour of himself draws it in favour of the buyer. The bill is then presented to the buyer who endorses it specially to the seller and presents it to the issuing bank (or nominated bank) for acceptance. Thereafter it is returned to the seller who discounts it in the manner described above. The advantage of this method is that not only the acceptor but also the buyer is liable on the bill. On the other hand the procedure is more cumbersome and time consuming.[85]

In the examples considered above the seller gets his money by selling (discounting) an accepted bill of exchange. It is also possible, however, in the case of a negotiation credit for the seller to get his money by the *negotiation of an unaccepted bill of exchange*. In this instance the bill is utilised in the following fashion. The seller draws a bill on the buyer in favour of himself. The seller endorses the bill and sells it as well as the documents stipulated in the credit to the negotiating bank. The negotiating bank then presents the bill and documents to the issuing bank who reimburses the negotiating bank. The issuing bank obtains the acceptance of its client (the buyer) on the bill. If the client is in good standing, the bank will probably release the documents to the client against acceptance. Otherwise, the bank may only be willing to release the documents against payment.[86]

It must be stressed, however, that a bill of exchange brings with it a separate group of rights and obligations arising from the drawing, acceptance or negotiation thereof. Therefore, the introduction of a bill of exchange, as one commentator puts it, "adds a complication which requires to be thought through: what is the function of the bill; what obligations are intended to and will result from it?"[87] Thus, unless there is a good reason for its inclusion, a bill of exchange should be avoided.

1 4 The Functions of Documentary Credits

From the aforegoing it is possible to discern three different functions that can be fulfilled by documentary credits. In the first place the documentary credit, from

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85 Hedley (*op cit* n 37) 259.

86 Hedley (*op cit* n 37) 261-262.

87 Jack (*op cit* n 46) 8.

the perspective of the seller as well as that of the buyer, clearly has an important *security function*.[88] The seller needs the security that he will not part with the goods without being paid for them, while the buyer needs the security that he will not pay for the goods without receiving them. The opening of a documentary credit in favour of the seller serves his security interests in that he acquires an independent claim against the bank. The security interest of the buyer is served in that he may designate the documents against which the bank will be entitled to pay. The extent to which he is secured is therefore dependent upon which documents he designates.

The documentary credit, in the second place, has a *payment function*.[89] In terms of the underlying contract, the buyer is required to pay by means of a documentary credit. As a general rule, however, the mere arranging for the issue of a documentary credit in favour of the seller does not amount to payment. The payment obligation of the buyer under the contract of sale is merely suspended, and not discharged by the issue of the credit.[90] Thus, in the event of the bank not paying, the buyer may still be liable under the contract of sale.

Documentary credits may, in the final instance, also have a *credit function*.[91] The documentary credit itself is no credit instrument,[92] but in many instances it stands in a close economic relationship to credit. By opening a documentary credit the bank undertakes to pay the beneficiary against the delivery of the proper

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88 The importance of the security function of the documentary credit has led to it being described as "Kind des Mißtrauens" in the German literature. See Angersbach U *Beiträge zum Institut des Dokumenten-Akkreditivs* (1965) Dissertation Julius-Maximilians-Universität Würzburg 46-47. On the security function in general see further Schärrer H *Die Rechtsstellung des Begünstigten im Dokumenten-Akkreditiv* (1980) Dissertation Universität Bern Stämpfli & Cie Bern 23-24; Nielsen J *Aktuelle Rechtsfragen zum Dokumenten-Akkreditiv* (1984) RWS Skript 138 Köln 1; Ulrich C M *Rechtsprobleme des Dokumentenakkreditivs* (1989) Schweizer Schriften zum Handels- und Wirtschaftsrecht Band 126 Schulthess Polygraphisher Verlag Zürich 13-21; Eisemann F & Schütze R A *Das Dokumentenakkreditiv im internationalen Handelsverkehr* 3 ed (1989) Verlag Recht und Wirtschaft GmbH Heidelberg 61.

89 On the payment function in general see Angersbach (*op cit* n 88) 47-48; Schärrer (*op cit* n 88) 24-25; Nielsen (*op cit* n 88) 1; Ulrich (*op cit* n 88) 22-23.

90 See the discussion in par 1 5 2 below.

91 On the credit function in general see Angersbach (*op cit* n 88) 49-51; Schärrer (*op cit* n 88) 25-27; Nielsen (*op cit* n 88) 2; Ulrich (*op cit* n 88) 24-25.

92 In this respect both the English term "documentary credit" and the French "crédit documentaire" are somewhat confusing. The German "Dokumentenakkreditiv" is better. See Ulrich (*op cit* n 88) 24.

documents. The bank therefore requires cover from the moment of the opening of the credit. Thus, before opening the credit, the bank may require the buyer to pay the full amount of money into a special account. In this case there is no credit function: the credit function arises only insofar as the bank is willing to issue the credit prior to receiving the money from its client. The bank can thereby enable an importer to finance the import out of the sale of the goods he has imported.

1 5 The Relationships between the Different Parties Involved in the Documentary-Credit Transaction

1 5 1 Introduction

It is possible to identify up to five different relationships in the typical documentary-credit transaction. In the first place there is the relationship between the buyer and seller, in other words that between the applicant for and the beneficiary of the credit. In the second place there is the relationship between the buyer and the issuing bank. In the third place there is the relationship between the issuing bank and the seller. These three relationships are essential to every documentary-credit transaction. If, as is normally the case, the issuing bank employs the services of a correspondent,[93] two further relationships arise, namely that between the issuing bank and its correspondent, and that between the correspondent and the seller.

From a legal perspective the relationship between the issuing bank and the beneficiary is arguably the most problematic. It forms the main thrust of this thesis and is considered in detail below.[94] A detailed examination of the other relationships falls outside the scope of this thesis. What follows is a brief consideration of the salient aspects and some of the problems associated with these relationships.

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93 The term "correspondent" in this context includes an advising, confirming and nominated bank.

94 See chapters 5 and 6.

1 5 2 The Relationship between the Buyer (Applicant) and the Seller (Beneficiary)

Introduction

The contract between the applicant for and beneficiary of the credit is typically but not necessarily a contract of sale.[95] As such it is governed by the normal principles relating to contracts of sale. In the documentary-credit context it is the "root contract from which all others stem".[96] The beneficiary's right to demand a letter of credit, and the nature[97] and terms[98] of the credit are all derived from the so-called "documentary-credit clause"[99] of the contract of sale. Insofar as the contract of sale does not expressly stipulate the terms of the credit fully, such terms may clearly be incorporated either tacitly or *ex lege*[100] where applicable.[101] If the terms of the credit are not stipulated expressly in the

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95 See for instance Canaris C-W *HGB Staub Großkommentar - Bankvertragsrecht* Erster Teil 4 ed (1988) Walter de Gruyter Berlin 639 (par 924) who with reference to this relationship termed the *Valutaverhältnis* in German literature, says: "Das Valutaverhältnis ... kann durch jeden beliebigen Schuldvertrag gebildet werden, doch liegt typischerweise ein *Kaufvertrag* vor."

96 Goode (*op cit* n 14) 995. See also Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/16 who stress that for this reason the *Valutaverhältnis*, the independence principle notwithstanding, deserves attention: "Sie bildet jedoch nicht nur die notwendige Voraussetzung für das Zustandekommen eines Akkreditivs, sondern enthält auch die für seine spätere Ausgestaltung wesentlichen Elemente".

97 For instance whether the credit must be confirmed or not. If the seller requires a confirmed credit, this must be stipulated in the contract. See Jack (*op cit* n 46) 39.

98 For instance the documents to be presented in terms of the credit and its expiry date.

99 Ellinger (*op cit* n 47) 1394 (par 2191). The German term is *Akkreditivklausel*. See Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/16.

100 On tacit and *ex lege* incorporation of terms in the South African law of contract see Van der Merwe S, Van Huyssteen L F, Reinecke M F B, Lubbe G F & Lotz J G *Contract - General Principles* (1993) Juta Cape Town 196-200; Christie R H *The Law of Contact in South Africa* 2 ed (1991) Butterworths Durban 184-202.

101 In this respect the following remarks of Goff J in *Ficom SA v Sociedad Cadex Limitada* [1980] 2 Lloyd's Rep 118 (QB) 131-132 are instructive: "In the present case, I am concerned with a contract of sale in which the terms of the letter of credit ... were undefined... . Now, in such a case, it is a commonplace that a letter of credit will be opened thereafter - sometimes preceded by a pre-advice by the buyer of the terms of the proposed credit followed by detailed negotiations of the terms so proposed - resulting in a letter of credit being issued in precise terms acceptable to both parties. Often the letter of credit so agreed will take the form which is usually employed in the particular trade. ... Now what happened in the present case? First of all, we have a sale contract which was silent on the terms upon which the letter of credit was to be opened. It is possible that this gap in the sale contract could, if necessary, have been filled, by implication, by reference

contract of sale, and cannot be imported by means of tacit or *ex lege* terms, there is no agreement.[102]

In general the relationship between the buyer and the seller is not overly complicated. The problems stemming from this relationship have in the main centred on the situations in which the buyer can be said to be in breach of the documentary-credit clause, and the question whether the buyer's payment obligation is discharged by the issue of the credit. These are the topics considered immediately below.

The Buyer's Breach

As regards breach of the contract of sale, the normal principles of our law of contract should apply. Thus, in the event of the credit received by the seller not conforming to the requirements stipulated in the contract of sale, the buyer will be in breach of this contract either through repudiation[103] or positive malperformance.[104] On the other hand, if the issue of such a credit objectively becomes impossible (for instance due to the passing of a law prohibiting imports from the seller's country and any credits issued in support of such

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to the custom of the trade... . But, be that as it may, I am satisfied, on the special case and the documents exhibited to the case, that the parties by agreement filled the gap in the sale contract." See also *Shamsher Jute Mills Ltd v Sethia (London) Ltd* [1987] 1 Lloyd's Rep 388 (QB) 392.

102 *Schijveschuurder v Canon (Export) Ltd* [1952] 2 Lloyd's Rep 196 (QB). But see also Jack (*op cit* n 46) 40-41 who points out that there is authority in English law, that where parties to a commercial transaction have intended to bind themselves, courts will lean over backwards to find a contract by reasonable implication. See in this respect *G Scammell and Nephew Ltd v Ouston* [1941] AC 251 (HL).

103 According to Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 257 the tender of "defective performance as complete and proper performance" before the final date stipulated for performance amounts to repudiation of the contract if, from the tender, "it is reasonable to conclude that malperformance will take place in the future". See also De Wet J C & Van Wyk A H *Die Suid-Afrikaanse Kontraktereg en Handelsreg* 5 ed (1992) Butterworths Durban 169; Lubbe G F & Murray C M *Farlam & Hathaway - Contract - Cases, Materials, Commentary* 3 ed (1988) Juta Cape Town 471; *Celliers v Papenfus & Rooth* 1904 TS 73; *Janowsky v Payne* 1989 2 SA 562 (C). In the documentary-credit context this can be illustrated by means of the following example. The contract of sale calls for a credit to be issued to the beneficiary by June the 30th. The contract further provides that a sea waybill will suffice as transport document. On June the 20th a credit calling for a marine bill of lading is issued to the beneficiary.

104 Positive malperformance occurs where a contractant "render[s] performance which does not comply with the terms of the contract". See Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 250. An example in the documentary-credit context would be where the contract of sale calls for a credit, requiring as transport document a sea waybill, to be issued to the beneficiary by June the 30th, and on June the 30th a credit requiring a marine bill of lading is issued.

imports), the obligation is extinguished and there is no breach.[105] Supervening subjective impossibility (for instance the inability of the buyer due to his financial position to persuade a bank to provide the credit), will not, on the other hand, extinguish the obligation.[106]

Probably the most problematical matter in this regard is that of *mora debitoris*.[107] In the event of the contract of sale stipulating a specific date by which the credit must be provided, there is no problem; if the seller has not received the credit by that date, the buyer is in breach (*mora ex re*).[108] The situation is, however, more complicated where, as is often the case,[109] there is no specific provision as to the latest date upon which the credit must be provided. The general rule in the South African law of contract is that the debtor must be placed in *mora* by a demand.[110] There is, however, important English case law pertaining to this issue. In *Pavia & Co SpA v Thurmann-Nielsen* Denning LJ in the context of documentary credits stated:

> "In 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 obligations he must make the credit available to the seller at the very first date when the goods may be lawfully shipped in compliance with the contract."[111]

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105 Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 384. See also Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/22, and Canaris (*op cit* n 94) 716 (par 1054) who cites "divisenrechtliche Hindernisse" as an example.

106 Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 384; Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/22; Canaris (*op cit* n 95) 716 (par 1054).

107 See in general Boon M N *Het Documentair Akkreditief - De Rechtspositie van de Opdrachtgever ingevolge de UCP* (1988) Nederlands Instituut voor het Bank- en Effectenbedrijf Publikatiereeks 66 195-204.

108 Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 243-244.

109 According to Ellinger (*op cit* n 47) 1396 (par 2195) this is the situation in most cases.

110 Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 244. This is also the situation in Germany. See Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/22 and par 284 *BGB*.

111 [1952] 2 QB 84 (CA) 88-89.

This *dictum* has subsequently been interpreted both in case law[112] and by commentators as meaning that the seller must have the credit "at the very latest a reasonable time before the first date upon which shipments may take place".[113] However, in *Ian Stach Ltd v Baker Bosley Ltd* Diplock J expressed the view that the introduction of the "reasonable time before" concept would lead to uncertainties; he favoured the view that the credit must be issued, at the latest, on the first day of the shipping period.[114] The situation is accordingly not quite clear in English law.

The question to be considered against this background is whether, in the same circumstances, South African law will require a demand to place the buyer in *mora*. It is suggested that this is an interpretation question in the sense that it depends upon whether a tacit term exists stipulating the latest possible date for the receipt of the credit. If there is no such term a demand is necessary to place the buyer in *mora*.[115] Should the contract stipulate a shipment period, however, it seems likely that there is an unexpressed consensus between the buyer and seller that the seller must, at the very latest, be in possession of the credit on the first day of this period. A demand would then be unnecessary. This would also be in accordance with German law which does not require a demand (*Manung*) "wenn sich aus dem Kaufvertrag ... ein Zeitpunkt ergibt, nach welchem die Akkreditivstellung keinen Sinn mehr hat (Verschiffungsfrist oder Laufzeit des Akkreditivs o. ä.)".[116]

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112 *Sinason-Teicher Inter-American Grain Corporation v Oilcakes and Oilseeds Trading Co Ltd* [1954] 1 WLR 1394 (CA) 1400.

113 Ellinger (*op cit* n 47) 1397 (par 2195). See also Goode (*op cit* n 14) 997 n117: "a shipper cannot make instantaneous shipping arrangements and if he does not receive the letter of credit until the day before the commencement of the shipping period he will almost certainly be deprived of the benefit of at least the first few days of that period". See further Jack (*op cit* n 46) 42-44; Boon (*op cit* n 107) 198.

114 [1958] 2 QB 130 (QB) 142. Diplock J regarded the remarks of Denning LJ in the *Sinason* case (see n 112 above) as *obiter*. It may also be possible to distinguish the *Pavia* (see n 111 above) and *Sinason* cases on the basis that they were concerned with CIF contracts whilst the *Ian Stach* case dealt with a FOB contract.

115 Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 249-250.

116 Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/22.

Discharge of the Payment Obligation

In terms of the documentary-credit clause of the contract of sale the buyer must effect payment by procuring a documentary credit. One of the questions which has attracted much attention in this regard is whether, by procuring the credit, the buyer is discharged from his contractual obligation to pay for the goods.[117] In this regard much can be learnt from English law. In English legal terminology the answer depends upon whether the opening of the credit amounts to *absolute* or *conditional payment*. Jack regards this as "an area where caution is necessary in the making of general statements".[118] In *W J Alan & Co Ltd v El Nasr Export and Import Co*, a decision regarded by Jack as "probably the leading authority",[119] Lord Denning stated:

> "In my opinion a letter of credit is not to be regarded as absolute payment, unless the seller stipulates, expressly or impliedly, that it should be so. He may do it impliedly if he stipulates for the credit to be issued by a particular banker in such circumstances that it is to be inferred that the seller looks to that particular banker to the exclusion of the buyer."[120]

Whether payment is absolute or conditional is therefore a question of construction of the contract (hence Jack's warning against generalisation). In the absence of a clear indication to the contrary it would, however, appear that the credit is likely to be regarded as conditional payment. Thus, the buyer is discharged from his debt only if the bank honours the credit.[121] But this does not mean that the seller can disregard the credit and present the documents

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117 For a detailed comparative analysis of this question see Boon (*op cit* n 107) 215-242. For a good review from a common-law perspective see Zohrab P S "Significant Developments in Letter of Credit Law" May 1994 *New Zealand Law Journal* 170.

118 (*Op cit* n 46) 54.

119 (*Op cit* n 46) 56.

120 [1972] 2 QB 189 (CA) 210A. See also *Maran Road Saw Mill v Austin Taylor & Co Ltd* [1975] 1 Lloyd's Rep 156 (QB) 159; *E D & F Man Ltd v Nigerian Sweets and Confectionery Co Ltd* [1977] 2 Lloyd's Rep 50 (QB) 56.

121 *W J Alan & Co Ltd v El Nasr Export & Import Co* [1972] 2 QB 189 (CA) 212B-C. For support of this view see Goode (*op cit* n 14) 996; Ellinger (*op cit* n 47) 1401 (par 2205). Ellinger also refers to *Saffron v Société Minière Cafrika* (1958) 100 CLR 231 243-244 in which the Australian High Court suggested that although an unconfirmed credit should not be construed as absolute payment, the opposite is true of a confirmed credit. Ellinger points out, however, that there is no theoretical basis for such a distinction.

directly to the buyer.[122] As stated by Goode, the credit (as is the case with a bill of exchange or cheque)[123] "is considered to be taken as conditional payment ... and during the currency of the credit [the seller's] right to sue for the price is suspended".[124] It follows that, were the seller to ship the goods contracted for but tender non-complying documents which are properly rejected[125] by the bank, he would not be able to claim payment directly from the buyer on the original contract of sale. The case *Shamsher Jute Mills Ltd v Sethia (London) Ltd*[126] provides a good example. The contract of sale incorporated by reference the following clause from the Bangladesh Jute Mills Association standard contract:

> "Irrespective of the method of payment, the Buyer shall remain responsible for payment of the full value of all goods shipped in accordance with this contract... ."[127]

The contract of sale stipulated that payment was to be effected by confirmed documentary credit. The terms of the credit were not stipulated in the contract of sale. An unconfirmed letter of credit was issued to the seller stipulating the documents against which the issuing bank would pay. The seller accepted the credit and shipped the goods contracted for. However, the documents tendered did not conform and were properly rejected by the bank. Bingham J found that "by accepting the credit terms the sellers must be taken to have varied the contract [of sale] in accordance with the terms of the credit they have accepted, or at least to have waived any right to rely on the earlier contract terms".[128]

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122 *Soproma SpA v Marine & Animal By-Products Corporation* [1966] 1 Lloyd's Rep 367 (QB). See also Goode (*op cit* n 14) 996: "A term in the contract of sale providing for payment by letter of credit is for the benefit of both parties. Accordingly, [the seller] is not entitled to demand payment in any other way... ."

123 *W J Alan & Co Ltd v El Nasr Export and Import Co* [1972] 2 QB 189 (CA) 212B; *Maran Road Saw Mill v Austin Taylor & Co Ltd* [1975] 1 Lloyd's Rep 156 (QB) 159.

124 (*Op cit* n 14) 996.

125 Were the bank wrongfully to reject proper documents the seller would of course be able to sue the bank. Whether he would also be able to sue the buyer is unclear in English law. See Jack (*op cit* n 46) 59-60.

126 [1987] 1 Lloyd's Rep 388 (QB).

127 Quoted at 388 of the judgment.

128 392.

Likewise, unless otherwise stated in the contract, the buyer in the case of an acceptance credit is not discharged by the bank's acceptance, but by its eventual payment of the bill. Thus, for instance, were the bank to become insolvent during the currency of the bill and as a consequence be unable to pay on maturity, the seller would be entitled to turn to the buyer for payment.[129] This would be the case irrespective of whether the buyer had already put the bank in funds to meet the credit.[130]

In Germany the position is very much the same. The buyer's obligation is not discharged as a consequence of the issue of the credit; it is merely suspended. The buyer is discharged when the bank pays. Zahn, Eberding and Ehrlich explain as follows:

> "Die Vereinbarung eines Akkreditivs besagt aber nicht, daß der Käufer bereits mit dessen Eröffnung durch die Bank seine kaufvertragliche Pflicht zur Zahlung des Kaufpreises erfüllt habe. ... Die Eröffnung des Akkreditivs ... geschieht *erfüllungshalber*, also nicht an Erfüllungs Statt. Daraus ergibt sich, daß der Kaufpreisanspruch des Verkäufers gegen den Käufer erst erlischt, wenn der Verkäufer durch die Bank aufgrund des gestellten Akkreditivs tatsächlich Zahlung erhält."[131]

As is the case in English law, the seller must, however, attempt to receive payment by means of the documentary credit, prior to which he cannot seek payment in any other manner.[132] In general terms this would also appear to be the position in the Netherlands.[133]

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129 *Maran Road Saw Mill v Austin Taylor & Co Ltd* [1975] 1 Lloyd's Rep 156 (QB) 159; *E D & F Man Ltd v Nigerian Sweets and Confectionery Co Ltd* [1977] 2 Lloyd's Rep 50 (QB) 56. See also Jack (*op cit* n 46) 59; Ellinger (*op cit* n 47) 1401-1402 (par 2206).

130 *Maran Road Saw Mill v Austin Taylor & Co Ltd* [1975] 1 Lloyd's Rep 156 (QB) 159. The reasoning of the court is that the buyer's undertaking is "*to pay* by letter of credit; not to provide by letter of credit a source of payment which *[does] not* pay". See also Ellinger (*op cit* n 47) 1404 (par 2209); Jack (*op cit* n 46) 59.

131 (*Op cit* n 15) par 2/17. See also Schärrer (*op cit* n 88) 25: "Die Akkreditivverpflichtung der Bank is zwar dazu bestimmt, die direkte Zahlungspflicht des Käufers zu ersetzen, lebt aber wieder auf, sobald sich erweist, dass das neue Schuldverhältnis nicht zum Ziel führte. Die Akkreditivverpflichtung kommt somit nur der Begründung einer zusätzlichen Sicherheit gleich, welche mit dem Fortbestand der alten Schuld nicht unvereinbar ist. Aus dem Gesagten ergibt sich, dass der Käufer nicht mit, sondern im Wege des Dokumenten-Akkreditivs bezahlt." See further Canaris (*op cit* n 95) 716-717 (par 1055); Boon (*op cit* n 107) 219 especially n 1.

132 Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/17: "Die Akkreditivklausel begründet eine Pflicht der Parteien, den vorgesehenen Weg der Zahlungsabwicklung über das Akkreditiv auch tatsächlich zu beschreiten. Der Verkäufer muß die Kaufpreiszahlung durch Benutzung

It would accordingly appear that in England, Germany and the Netherlands the law on these matters has crystallised to a large degree, and is materially the same. It is suggested that South African courts are likely to reach similar conclusions this regard.

1 5 3 The Relationship between the Buyer (Applicant) and the Issuing Bank

Although certain commentators prefer to treat the relationship between the applicant and the issuing bank as an agreement *sui generis*,[134] it can essentially be regarded as a contract of mandate, with the bank being the applicant's mandatary.[135] It is, however, also possible to identify aspects of a loan agreement. Stassen explains as follows:

> "[Daar kan] ook 'n leenkontrak tussen koper en bank bestaan, waarby òf die koper òf die bank as uitlener figureer afhangende daarvan of die koper 'n lopende rekening met 'n kredietbalans by die bank het en of die bank die bedrag wat hy uitbetaal aan die koper voorskiet."[136]

In essence the relationship between the issuing bank and applicant corresponds in a large degree to the bank-customer relationship in the case of a cheque

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des gestellten Akkreditivs hereinholen...; er darf den Käufer nich unmittelbar oder auf einem anderen Weg auf Zahlung des Kaufpreises in Anspruch nehmen, solange er nicht den ernsthaften Versuch gemacht hat, aus dem Akkreditiv Zahlung zu erhalten."

133 Van Delden (*op cit* n 56) 34-36 uses the term "non-exclusiviteit van het accreditiefbeding". See also Boon (*op cit* n 107) 234-5.

134 Davis (*op cit* n 7) 58-61; Ellinger (*op cit* n 35) 152.

135 Stassen J C "Die Regsaard van die Verhouding tussen Bank en Kliënt" 1980 *Modern Business Law* 77 86. In *Midland Bank Ltd v Seymour* [1955] 2 Lloyd's Rep 147 (QB) 168-169 Devlin J, in the context of this relationship, speaks of the buyer "ratifying" unauthorised acts of the bank. This creates the impression that the relationship is one of principal and agent. However, as Ellinger (*op cit* n 47) 1406 (par 2215) points out this is clearly not the case for "the issuing banker does not contract on the buyer's behalf" but "at the buyer's request, the issuing banker enters into an independent contractual relationship with the seller". See also Ellinger E P "The Relationship between Banker and Buyer under Documentary Letters of Credit" (1965-6) 7 *Law Review University of Western Australia* 40 43-45. The German literature regards the relationship as one of mandate (*ein Werkvertrag auf eine Geschäftsbesorgung gerichtet*). See Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/29; Eisemann & Schütze (*op cit* n 88) 83; Canaris (*op cit* n 95) 639 (par 923). Similarly in the Netherlands the relationship is regarded as one of *lastgeving*. See in this regard Van Delden (*op cit* n 56) 39-40. For a detailed analysis of this relationship see Boon (*op cit* n 107) 243-525.

136 (*Op cit* n 135) 86. See also Van Delden (*op cit* n 56) 39.

account.[137] In principle therefore, much of the law pertaining to the bank-customer relationship in the case of a cheque may also be applicable to documentary credits.[138] In the case of documentary credits, however, the bank-customer relationship is expressly regulated to a far greater degree than in the case of cheques.[139] The terms are to be found mainly in the application form for the issue of the credit as well as in the *UCP*.[140] A further difference is that whilst a cheque is normally a specific mandate arising from a general mandate relationship,[141] such a general relationship does not necessarily exist in the case of a documentary credit; each credit contains its own specific provisions and conditions.[142]

In the normal situation the contract comes into being by the applicant completing and submitting a standard application form to the bank which can be regarded as an offer.[143] The bank typically either rejects the offer by refusing to issue the credit applied for, or accepts it by simply proceeding to issue the credit as requested.[144] The most important provisions of the contract such as the nature of the credit to be issued, details of shipment and insurance, an accurate description of the goods and the documents to be tendered are expressly

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137 See Malan F R with Pretorius J T & De Beer C R *Malan on Bills of Exchange, Cheques and Promissory Notes in South African Law* 2 ed (1994) Butterworths Durban 331-332 (par 203): "[I]n essence the contract between bank and customer obliges the bank to render certain services ... to the customer on his instructions and for this reason it can be classified as a contract of mandatum."

138 Stassen (*op cit* n 135) 86.

139 Goode (*op cit* n 14) 998.

140 Stassen (*op cit* n 135) 86.

141 Malan, Pretorius & De Beer (*op cit* n 137) 332 (par 203) distinguish between the cheque itself "a dependent order" and the "internal law of cheques". See also Stassen (*op cit* n 135) 86.

142 Stassen (*op cit* n 135) 86. In the case of a revolving credit, however, one has to do with a relationship which more closely approximates the cheque account in this respect. See par 1 6 8 below.

143 Goode (*op cit* n 14) 998. However, it is possible to establish a relationship with a bank in terms of which the client is entitled to open credits with the bank to a given value at any one time. This is advisable where the client frequently requires credits as, by so doing, it will not be necessary in each instance to submit the lengthy standard application form. See Jack (*op cit* n 46) 64. The position is similar both in the Netherlands and Germany. See Van Delden (*op cit* n 56) 43-44; Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/29.

144 Goode (*op cit* n 14) 998; Zahn, Eberding & Ehrlich (*op cit* n 15) 2/29; Van Delden (*op cit* n 56) 44.

stipulated in the application.[145] The application, in addition, invariably contains a term incorporating the provisions of the *UCP*. The *UCP*, for instance, contains provisions relating to the instructions for the issue of a credit,[146] the examination of the documents presented under the credit,[147] and various disclaimers.[148]

The primary duty of the bank arising from this contract is to observe the terms of its client's mandate. It is on this principle that the important[149] doctrine of strict compliance is founded.[150] Hence, should the bank pay against discrepant documents without the buyer's permission, such payment cannot be for the account of the buyer.[151] The bank, as a provider of professional services, is required to act with the care and skill expected of a *bonus argentarius*, that is without negligence.[152] Van Delden[153] identifies the following specific duties of

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145 Stassen (*op cit* n 135) 86; Ellinger (*op cit* n 47) 1405 (par 2212); Jack (*op cit* n 46) 65.

146 In terms of a 5 instructions must be "complete and precise" and "excessive detail" must be "discouraged" by the bank. See in this regard Jack (*op cit* n 46) 65-68; Ellinger (*op cit* n 47) 1407 (par 2216).

147 A 13 deals with the standard for the examination of the documents and a 14 with what should be done in the event of discrepant documents being presented. See further the discussion in chapter 6 below.

148 A 15 (exclusion of responsibility for "form, sufficiency, accuracy, genuineness, falsification, or legal standard"); a 16 (exclusion of liability for the consequences of "delay and/or loss in transit of any message(s), letter(s) or document(s)"); a 17 (exclusion of liability for the consequences of "Acts of God, riots, civil commotions, insurrections, wars or any other causes beyond ... [the bank's] control"); and a 18 (disclaimer for acts of an instructed party). The last-mentioned disclaimer is highly controversial and in English law may fall foul of the Unfair Contract Terms Act 1977. The problem with this disclaimer is described by Goode (*op cit* n 14) 1000 as follows: "[It amounts] to a disclaimer by IB [the issuing bank] of responsibility for the acts and omissions of its own agents, with the result that whilst IB would be liable ... if it were itself to accept nonconforming documents, it can ... shuffle off all responsibility by delegation to AB [the advising bank], thereby depriving B [the buyer] of all remedy." It would however appear that English banks tend not to invoke this disclaimer. See also Jack (*op cit* n 46) 72-74; Ellinger (*op cit* n 47) 1408 (par 2218).

149 Regarded by Schmitthoff & Adams (*op cit* n 12) 404 as one of the "two fundamental principles" of documentary-credit law.

150 Ellinger (*op cit* n 47) 1405-1406 (par 2214); Jack (*op cit* n 46) 68-70; Van Delden (*op cit* n 56) 44. See further the discussion in chapter 6 below.

151 Goode (*op cit* n 14) 998-999.

152 Goode (*op cit* n 14) 998. In the Netherlands "de zorg van een goed lasthebber" is required of the bank. See in this regard Van Delden (*op cit* n 56) 49. See also in relation to the

the respective parties. The bank undertakes to issue the credit timeously in accordance with the client's instructions, to receive and inspect the documents tendered by the beneficiary, to reject non-conforming documents, to accept and to pay against conforming documents, and to present the received documents to the client against payment by the client. The client in turn undertakes to accept conforming documents and to pay against delivery thereof (the amount of the credit as well as bank charges).

Finally, it must be noted that although the contract between the applicant and the bank arises from the contract between the buyer and beneficiary, in law it is totally independent of this contract.[154] The validity of the contract between the applicant and the bank will therefore remain unaffected by anything which may go wrong with the contract of sale.

1 5 4 The Relationship between the Issuing Bank and the Seller (Beneficiary)

The relationship between the issuing bank and the beneficiary is considered in detail below.[155] The most important aspects of this relationship are the following. First, the issuing bank is bound[156] to the terms of the documentary credit as against the beneficiary from the time of its issue.[157] Secondly, barring certain extreme exceptions,[158] the bank's undertaking is totally independent of any of the other relationships.[159] Finally, the undertaking is conditional in the sense that the bank is only obliged to perform against presentation of conforming documents.[160]

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bank's duty in the case of a cheque account Malan, Pretorius & De Beer (*op cit* n 137) 344-345 (par 206) n 69.

153 (*Op cit* n 56) 46.

154 *United City Merchants (Investments) Ltd v Royal Bank of Canada* 1983 AC 168 (HL) 182H-183F. See also Ellinger (*op cit* n 47) 1405 (par 2213); Jack (*op cit* n 46) 63; Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/29.

155 See chapters 5 and 6 below.

156 Whether the obligation is contractual is a matter of uncertainty. See chapter 5 below.

157 Whatever "the moment of issue" might be. See par 5 2 3 below.

158 Especially fraud and illegality. See chapter 6 below.

159 See chapter 5.

160 See chapter 6 (especially par 6 2 3 and 6 3 5).

1 5 5 The Relationship between the Issuing Bank and its Correspondent

As noted above[161] the issuing bank may employ the services of another bank in various different capacities. The correspondent may be employed merely to advise the beneficiary of the credit, or to confirm it. Furthermore, the issuing bank may nominate another bank to receive the documents and to pay on its behalf. Finally, the issuing bank may also employ the services of a correspondent to reimburse the paying bank.

The continental sources have no hesitation in classifying the contract between the issuing bank and its correspondent, be it in the capacity of advising, confirming, nominated or reimbursing bank, as a contract of mandate (German: *Werkvertrag auf eine Geschäftsbesorgung gerichtet*; Dutch: *lastgeving*) in which the correspondent acts as the mandatary of the issuing bank.[162] The English sources, on the other hand, tend to regard the relationship between the issuing bank and its correspondent as one of principal and agent.[163] There is a broad consensus that this is true of the relationship between the issuing and advising banks.[164] The same is probably true of the relationship between the issuing and nominated banks.[165] In *Bank Melli Iran v Barclays Bank (Dominion, Colonial & Overseas)*[166] the relationship between an instructing and confirming bank was likewise regarded as one of principal and agent. It has, however, been pointed out by several commentators that in the case of a confirming bank it is necessary to distinguish between different functions of the bank. Jack explains as follows:

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161 Par 1 3 4.

162 For the German point of view see Eisemann & Schütze (*op cit* n 88) 138, 143, 149, 153; Canaris (*op cit* n 95) 675 (par 972); Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/150-156. For the Dutch law see Van Delden (*op cit* n 56) 132.

163 In *Bank Melli Iran v Barclays Bank (Dominion, Colonial & Overseas)* [1951] 2 Lloyd's Rep 367 (KB) 376 McNair J cited the view presented in Gutteridge & Megrah (*op cit* n 52) 77 with approval: "As between the issuing bank and the intermediary bank the relationship is, unless otherwise agreed, that of principal and agent..." (The citation was from an earlier edition but has remained virtually unchanged.)

164 Jack (*op cit* n 46) 115; Gutteridge & Megrah (*op cit* n 52) 77-78; Ellinger (*op cit* n 47) 1431 (par 2252). See also *Bank Melli Iran v Barclays Bank (Dominion, Colonial & Overseas)* [1951] 2 Lloyd's Rep 367 (KB) 376.

165 Jack (*op cit* n 46) 120.

166 [1951] 2 Lloyd's Rep 367 (KB) 376.

> "The obligation of a confirming bank to pay ... is an obligation which it gives as a principal. This does not prevent it from acting in other respects as the agent of the issuing bank. ... The position is that in carrying out its functions, where appropriate, it will act in a dual capacity. In so far as its interests as a confirming bank are concerned, it acts as a principal: at the same time as regards the issuing bank it acts as agent. Thus in accepting documents and paying against documents it acts as a principal in relation to its obligations as confirming bank, and it acts as agent for the issuing bank with regard to the obligations of the issuing bank."[167]

It would, however, be fallacious to hold on English authority that in South African law the correspondent bank necessarily acts as the agent of the issuing bank. The terms "agent" and "agency" have been criticised by South African commentators for being somewhat confusing.[168] In *Totalisator Agency Board, OFS v Livanos* Van Zyl J explained the terms as follows:

> "[I]t would appear that 'agency' is referred to, for the most part, in the sense of representation pursuant to authorisation granted by the principal to the agent by virtue of which the agent performs a juristic act on behalf of or in the name of the principal. Should such juristic act be a contract entered into between the agent, on behalf of the principal, and a third person, the rights and obligations arising therefrom accrue to the principal and not to the agent, who acts merely and solely in a representative capacity."[169]

In this sense an agent is therefore a representative whose representative capacity arises from an authorisation. The authorisation will typically arise from a contract of mandate. Thus, the correspondent bank (mandatary) can only be regarded as the agent of the issuing bank (the mandator) insofar as the mandate can be regarded as an authorisation to perform a juristic act on the issuing bank's behalf. In this respect it is important to note that not every mandate gives rise to an authorisation. De Wet and Van Wyk state the principle thus:

> "In die praktyk word dit soms voorgehou of mense wat sekere take te verrig het ... outomaties met volmag toegerus is. Hierdie

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167 (*Op cit* n 46) 121. See also Ellinger (*op cit* n 47) 1431 (par 2252) as well as Van Delden's discussion of the English law in this regard (*op cit* n 56) 134-135.

168 De Wet J C (Revised by Du Plessis A G) "Agency and Representation" in Harms L T C, Pienaar G J & Rabie P J (editorial panel) *The Law of South Africa* First Reissue Vol I (1993) Butterworths Durban 97 (par 100); Kahn E (general editor) *Contract and Mercantile Law - A Source Book* Vol I 2 ed (1988) Juta Cape Town 848-849; Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 176.

169 1987 3 SA 283 (W) 291B.

> benadering kan net nie onderskryf word nie. Daar bestaan geen regsreëls wat voorskryf dat wadrywers, huurmotorbestuurders, winkelbestuurders of welke ander soort werknemer of lashebber eenvoudig as sodanig met verteenwoordigingsbevoegdheid beklee is nie. In elke spesifieke geval moet uitgemaak word of iemand met volmag beklee is."[170]

So viewed it is suggested that the advising and confirming banks, although mandataries are not agents in the sense described above.[171] They are not authorised to perform any juristic act on behalf of the issuing bank. Their mandate is to act as messengers.[172] On the other hand it is submitted that the bank nominated (authorised) to pay the beneficiary on behalf of the issuing bank, as well as the bank instructed (authorised) to reimburse the paying bank on behalf of the issuing bank, may well act as the agents of the issuing bank.[173] However, in the context of the relationship between the issuing bank and its correspondent, the question whether the correspondent is an agent must not be over-emphasised. This question is material to a different relationship, namely that between the issuing bank and the third party, particularly in relation to the question whether the issuing bank will be bound by the acts of its correspondent. As Zimmermann explains:

> "Whilst the mandate relates to the (internal) relationship between principal and agent, the grant of authority determines the (external) relationship between the principal and the other party with whom the agent concludes the contract. Both acts are independent of each other: there can be a mandate without grant of authority, just as it is possible to have a grant of authority without mandate."[174]

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170 (*Op cit* n 103) 112-113.

171 The word "agent" is, however, sometimes used in a wider sense to denote "persons who have been instructed to perform some task, regardless of whether they have been clothed with authority to conclude a juristic act." (Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 176.)

172 Eisemann & Schütze (*op cit* n 88) 139: "Die avisierende Bank hat nur Botenstellung für die Akkreditivbank, ist 'technische Durchleitungstelle'". On the distinction between an agent and messenger in general see De Wet (*op cit* n 168) 101 (par 103).

173 Eisemann & Schütze (*op cit* n 88) 150: "Die Zahlstelle is bevollmächtigt ... die Dokumenten zu prufen, bei Ordnungsmäßigkeit (Akkreditivkonformität) aufzunehmen und zu Lasten der Akkreditivbank Zahlung zu leisten." See also Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/90.

174 Zimmermann R *The Law of Obligations - Roman Foundations of the Civilian Tradition* (1990) Juta Cape Town 58. See also Silke J M *The Law of Agency in South Africa* 3 ed (1981) Juta Cape Town 11.

Thus, whether the correspondent bank is the issuing bank's agent or not, *vis à vis* the issuing bank it is a mandatary. As such the correspondent's legal position as against the issuing bank is similar to that of the issuing bank as against its client.[175] Therefore, the correspondent's right to rêmuneration is dependent upon it having complied strictly with the mandate, and, in the event of the correspondent paying out against non-conforming documents, it will not be entitled to reimbursement.[176]

In conclusion it may be pointed out that in certain instances the correspondent bank is in fact the issuing bank. This occurs where the applicant's bank does not itself issue the credit but instructs its correspondent to do so.[177] In this situation the relationship between the applicant's bank (the instructing bank) and the correspondent issuer is clearly one of mandate, and the correspondent issuer is obviously not the agent of the applicant's bank. It is submitted that the relationship correlates exactly with that between an applicant and the issuing bank.

1 5 6 The Relationship between the Correspondent Bank and the Beneficiary

The relationship between the correspondent bank and the beneficiary depends upon the role assumed by the correspondent bank. The beneficiary's relationship with the confirming bank is essentially the same as that with the issuing bank. This relationship is considered in detail below.[178]

There is no relationship whatsoever between the beneficiary and the reimbursing bank.[179] The bank nominated by the issuing bank to receive the documents and to pay the beneficiary is also, *vis à vis* the beneficiary, in no way bound to do so.[180] This is an obligation as against the issuing bank. Thus, the relationship between the beneficiary and the nominated or paying bank can be likened to that between the payee of a cheque and the drawee bank. In the event of cheque being dishonoured the payee has no remedy against the drawee

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175 See par 1 5 3 above.

176 See, for a typical example, the facts of *Nedcor Bank Ltd v Hartzer* 1993 4 CLD 278 (W).

177 Ellinger (*op cit* n 47) 1430 (par 2251); Jack (*op cit* n 46) 123.

178 See chapter 5.

179 On the reimbursing bank see par 1 3 4 above.

180 Eisemann & Schütze (*op cit* n 88) 151 ("keine vertraglichen Beziehungen").

bank and must look to the drawer for payment.[181] In the same way, should the nominated bank refuse to pay the beneficiary of a documentary credit, the beneficiary's remedy is not against the nominated bank but against the issuing bank.

The position of an advising bank may be more complex. On the one hand, the credit is advised "without engagement on the part of the Advising Bank".[182] There is accordingly no contractual relationship between the advising bank and the beneficiary. On the other hand, in terms of the *UCP* the advising bank is expected to "take reasonable care to check the apparent authenticity of the credit".[183] But does the duty of the advising bank stop here? The beneficiary clearly relies on the information supplied by the advising bank. This raises the difficult question whether, in the event of the advising bank incorrectly advising the terms of the credit to the beneficiary thereby causing him to present non-complying documents, the beneficiary can on rejection of the documents claim damages from the advising bank.

It would appear that this question is answered in the affirmative in both Germany and the Netherlands.[184] There is also support for this view from the English commentators. Ellinger[185] suggests that such a claim may well lie on the principle established in *Hedley Byrne & Co v Heller and Partners*[186] that a professional is liable for negligent misrepresentation. Jack, on the other hand, points out that the question is unlikely to arise. The advice of the credit falls within the ostensible authority of the advising bank and therefore "the advising

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181 See in general Malan, Pretorius & De Beer (*op cit* n 137) 221 (par 142), 345 (par 207), 362 (par 211).

182 A 7 of the *UCP*.

183 A 7.

184 According to Canaris (*op cit* n 95) 678 (par 978) "Schadensersatzansprüche wegen Schutspflichtverletzung ... z. B. wegen einer falschen Mitteilung" can arise. See also Eisemann & Schütze (*op cit* n 88) 140; Eberth R "Die Revision von 1983 der Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive" Sonderbeilage 4 1984 *Wertpapier Mitteilungen* 3 9. The Dutch commentator Van Delden (*op cit* n 56) 136 likewise takes the view that the the advising bank may be liable "uit onrechtmatige daad terzake van onjuiste mededelingen".

185 (*Op cit* n 47) 1435 (par 2260).

186 [1964] AC 465 (HL). The decision is described as "momentous" by Malan F R "Professional Responsibility and the Payment and Collection of Cheques" 1978 *De Jure* 326, 1979 *De Jure* 31 32.

bank's advice of the credit will have bound the issuing bank". He then continues as follows:

> "But if ... the issuing bank was in some way not bound by the credit as advised, under English law the advising bank would be liable to the beneficiary for damages for breach of warranty of authority, that is, for breach of the warranty which English law implies that every agent gives that he has the authority of his principal to act as he does."[187]

In South African law, however, the advising bank is not the agent of the issuing bank, and no such warranty can be construed. However, it is suggested that Ellinger's argument based on the professional liability established in the *Hedley Byrne* case is a distinct possibility in South Africa. The recognition of a duty of care on the advising bank (the breach of which may in principle lead to delictual liability) would bring our law on a par with that of England,[188] Germany and the Netherlands. It would also be consistent with the recognition of such a duty on the collecting bank in the collection of cheques.[189]

1 6 Basic Types of Documentary Credits

1 6 1 Introduction

The documentary credit is an extremely adaptable instrument. Many different types have been identified and distinguished in the legal literature. This has led to a rather daunting array of terminology, not always used consistently.[190]

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187 (*Op cit* n 46) 116.

188 In so far as the question of liability of the advising bank may arise in England.

189 See in this regard especially *Indac Electronics (Pty) Ltd v Volkskas Bank Ltd* 1992 1 SA 783 (A); *KwaMashu Bakery Ltd v Standard Bank of South Africa Ltd* 1995 1 SA 377 (D). Much has been written on the development of this action. See *inter alia* Malan (*op cit* n 186) *passim*; Hugo C F "The Negligent Collecting Bank: Recent Decisions Introduce a New Era" (1992) 4 *Stellenbosch Law Review* 115; Malan F R & Pretorius J T "Negligence and the Collecting Bank: Liability at Last?" (1993) 5 *South African Mercantile Law Journal* 206, "Questions of Negligence and the Collecting Bank: A Brief History of the *Bonitas* Trilogy" (1994) 6 *South African Mercantile Law Journal* 116, and "Liability of the Collecting Bank: More Clarity?" (1994) 6 *South African Mercantile Law Journal* 218; Malan, Pretorius & De Beer (*op cit* n 137) 413-433 (par 237-252).

190 For an extensive discussion of the terminology, for which Afrikaans translations are suggested, see Stassen (*op cit* n 7) 19-25. On the Anglo-American terminology see further Ellinger (*op cit* n 35) 5-20; Kozolchyk (*op cit* n 23) par 37-67; McCurdy (*op cit* n 11) 542-562; Megrah M, Ryder F R & Bueno A *Paget's Law of Banking* 9 ed (1982) Butterworths London 532-535; Schmitthoff & Adams (*op cit* n 12) 421-437; Penn G A, Shea A M & Arora A *Banking Law Vol II - The Law and Practice of International*

Against this background it is important to note the following warning of Megrah, Ryder and Bueno:

> "Credits are of many types, but their labels are not necessarily a proper indication of the contract they represent. Their terms establish the contract and its effect. It is accordingly to some extent useless to describe credits; only an understanding of the terms in which they are couched will provide an understanding of the contract... ."[191]

There are, however, certain distinctions which contribute to a systematic understanding of these instruments, and as such deserve attention. Especially important are the distinctions between revocable and irrevocable documentary credits, confirmed and unconfirmed credits, payment and usuance credits, commercial and standby credits, straight and negotiation credits, and transferable and non-transferable credits. Apart from these distinctions there are further specific types of credits which fulfill specific functions. Of these the most important are the back-to-back credit and the revolving credit.

1 6 2 Revocable and Irrevocable Credits

The most prominent distinction acknowledged in the *UCP* is that between revocable and irrevocable credits.[192] This is a very important distinction for it goes to the heart of the liability of the bank issuing the credit. By issuing a credit as "revocable" the bank gives notice to the beneficiary, as well as to any third party who may have negotiated in terms of the credit, that it can be "amended or cancelled by the Issuing Bank at any moment and without prior notice to the Beneficiary".[193] The practice to give notice of an intention to amend or cancel a revocable credit, is regarded as a matter of courtesy with no

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Banking (1987) Sweet & Maxwell London 303-306. For German terms see Eisemann & Schütze (*op cit* n 88) 67-81; Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/1-14. For Dutch terms see Cahn E M *Het Accreditief* (1935) H J Paris Amsterdam 12-24; De Rooy F P *Documentair Kredieten* (1980) Kluwer Deventer 24-54.

191 (*Op cit* n 190) 532. This warning is echoed by Kozolchyk (*op cit* n 23) par 67. See also Harfield (*op cit* n 23) 33.

192 Aa 6, 8 and 9.

193 A 8(a) of the *UCP*. See also Jack (*op cit* n 46) 20-23; Ellinger (*op cit* n 47) 1381 (par 2168) and (*op cit* n 35) 8-13; Kozolchyk (*op cit* n 23) par 38-41; Gutteridge & Megrah (*op cit* n 52) 17-21; Stassen (*op cit* n 7) 20; Megrah, Ryder & Bueno (*op cit* n 190) 533-535; Schmitthoff & Adams (*op cit* n 12) 423-425; Penn, Shea & Arora (*op cit* n 190) 305; McCurdy (*op cit* n 11) 556. On the "widerrufliche" and "unwiderrufliche Akkreditiv" in German law see Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/139-147; Eisemann & Schütze (*op cit* n 88) 67-73.

bearing on legal liability.[194] Unless stated clearly on the documentary credit that it is revocable, it is deemed to be irrevocable.[195] An irrevocable credit "constitutes a definite undertaking of the Issuing Bank, provided that the stipulated documents are presented to the Nominated Bank or to the Issuing Bank and that the terms and conditions of the Credit are complied with".[196]

Although uncommon, revocable credits may still be utilised especially in situations where the beneficiary is in a country with an unstable currency or political situation and disturbances could affect the performance of the contract.[197] From the point of view of the beneficiary, such credits have been termed "practically worthless".[198] The issuing bank is, for instance, entitled to revoke even after conforming documents have been tendered as long as they have not yet been accepted.[199] However, once the bank has accepted the documents without paying (for instance under a deferred payment credit or by accepting a term bill) the bank can no longer escape its obligation to pay.[200] The very limited protection offered by revocable credits is indicative of the buyer being in a very strong bargaining position. One commentator takes the view that the certainty of the bank's obligation is so central a principle in documentary-credit practice that the revocable credit cannot be regarded as a true documentary credit.[201]

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194 This principle was clearly established in *Cape Asbestos Co Ltd v Lloyds Bank Ltd* [1921] WN 274. See also Jack (*op cit* n 46) 22-23; Gutteridge & Megrah (*op cit* n 52) 18-19; Kozolchyk (*op cit* n 23) par 38.

195 A 6(b) and (c) of the *UCP*. This is a reversal of the position under previous revisions of the *UCP*. See, for instance, a 7 of the 1983 Revision. See also par 3 9 2 below.

196 A 9(a) of the *UCP*. On the nature of this undertaking see chapter 5 below.

197 Kozolchyk (*op cit* n 23) par 39.

198 *Cape Asbestos Co Ltd v Lloyds Bank Ltd* [1921] WN 274.

199 Del Busto (*op cit* n 71) 19 remarks on the fact that in the revision process of a 8 of the *UCP* several national committees of the International Chamber of Commerce argued for a provision disallowing revocation after presentation of conforming documents. This suggestion was rejected. See also Jack (*op cit* n 46) 22.

200 Jack (*op cit* n 46) 22.

201 McGivern (*op cit* n 13) 223-224.

1 6 3 Confirmed and Unconfirmed Credits

A further distinction found in the *UCP* is that between confirmed[202] and unconfirmed credits.[203] This distinction relates to the role of the intermediary bank. As noted above the intermediary bank may be requested merely to transmit or advise the undertaking of the issuing bank to the beneficiary. The documentary credit is in this instance unconfirmed, and the advising bank has no contractual liability to the beneficiary.[204] In terms of the *UCP* its sole obligation towards the beneficiary is to verify "the apparent authenticity of the Credit which it advises".[205]

The intermediary bank may, however, be requested to add its own undertaking to that of the issuing bank. By so *confirming* the undertaking of the issuing bank the intermediary bank becomes obligated towards the beneficiary.[206]

The confirmation may take one of the following different forms: (i) the beneficiary may be promised cash against delivery of the documents,[207] or on a

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202 In the earlier literature on documentary credits there is much confusion relating to the term "confirmed credit". This term was sometimes used to denote what has been described above as an irrevocable credit. This confusion has subsequently been cleared up. See Gutteridge & Megrah (*op cit* n 52) 17-18, and especially n 2; De Rooy (*op cit* n 190) 34-35; Ebertsheim H "Das Akkreditiv-Regulativ der Berliner Stempelvereinigung" 21/22 (1923) *Juristische Wochenschrift* 915.

203 A 7(a) and 9(b) of the *UCP*.

204 Jack (*op cit* n 46) 24-25; Ellinger (*op cit* n 47) 1383 (par 2170); Ellinger (*op cit* n 35) 13-15; Gutteridge & Megrah (*op cit* n 52) 81-82; Stassen (*op cit* n 7) 19, 20; Schmitthoff & Adams (*op cit* n 12) 426-429; Megrah, Ryder & Bueno (*op cit* n 190) 534; Mead C A "Documentary Letters of Credit" (1922) 22 *Columbia Law Review* 297 299; McGivern (*op cit* n 13) 224; De Rooy (*op cit* n 190) 34-38. On the "unbestätigte Akkreditiv" in German law see Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/160-165; Eisemann & Schütze (*op cit* n 88) 73.

205 A 7(a) of the *UCP*.

206 The main aspects of this relationship are considered in detail in chapters 5 and 6 below. See in general also Ellinger (*op cit* n 47) 1383 (par 2170); Ellinger (*op cit* n 35) 13-15; Gutteridge & Megrah (*op cit* n 52) 82-83; Stassen (*op cit* n 7) 20; Megrah, Ryder & Bueno (*op cit* n 190) 533-535, 546; Mead (*op cit* n 204) 299; McGivern (*op cit* n 13) 224; De Rooy (*op cit* n 190) 34-38. On the "bestätigte Akkreditiv" in German law see Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/166-177; Eisemann & Schütze (*op cit* n 88) 73.

207 A 9(b)(i) of the *UCP*. This will be the case where the credit is a sight payment credit. See par 1 6 4 below.

specified date after delivery of the documents,[208] to the confirming or nominated bank; (ii) the beneficiary may be requested to draw a bill on the confirming bank who undertakes to accept it against delivery of the documents;[209] and (iii) the confirming bank may undertake to negotiate the beneficiary's draft and/or other documents presented in terms of the credit.[210]

1 6 4 Payment Credits (Sight and Deferred Payment) and Usuance Credits (Available by Acceptance or Negotiation)

The *UCP* also distinguishes between different types of credits with reference to the nature of the bank's payment obligation.[211] In the event of the issuing or confirming bank's obligation towards the beneficiary of the credit being to pay cash against the delivery of the documents, the credit is termed a *sight or cash credit*.[212] A sight draft may be used in this instance, but is generally an unnecessary complication.[213]

Instead of undertaking to pay cash, the issuing (and confirming bank) may undertake to accept the beneficiary's time draft against delivery of the stipulated documents. This type of credit is called an *acceptance credit*. Once accepted, the bill can be discounted in the money market by the beneficiary which enables him to acquire his money shortly after shipment of the goods. The accepting bank, on the other hand, will only have to pay on maturity of the bill.

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208 A 9(b)(ii) of the *UCP*. This will be the case where the credit is a deferred payment credit. See par 1 6 4 below.

209 A 9(b)(iii) of the *UCP*. This will be the case where the credit is an acceptance credit. See par 1 6 4 below.

210 A 9(b)(iii) of the *UCP*. This will be the case where the credit is a negotiation credit. See par 1 6 4 below. See further Ellinger (*op cit* n 35) 14.

211 A 2. In this case the *UCP* only distinguishes between the different possible natures of the bank's obligation. The different credits implicit in this distinction are not named.

212 See De Rooy (*op cit* n 190) 52 who regards this type of documentary credit ("het payment credit") as the purest form of the documentary credit. This is the form most often encountered in Germany. See Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/106-107. See further Ellinger (*op cit* n 35) 15; Stassen (*op cit* n 7) 20; McCurdy (*op cit* n 11) 543.

213 Draftless credits may be used for different reasons. In certain Western nations draftless credits have been used to avoid the payment of stamp duty on the bill of exchange (also the main reason for the increasing popularity of the deferred payment credit discussed at nn 218-224 below). In socialist countries this form of credit has been used in order to control generally the credit extension mechanism that would become available through the discount and negotiation of drafts. See Kozolchyk (*op cit* n 23) par 43; Stassen (*op cit* n 7) 20.

A further possibility is that the issuing (and confirming) bank may undertake to negotiate, rather than accept, the beneficiary's time draft against delivery of the proper documents. The money acquired by the negotiation (selling) of the bill is then passed on to the beneficiary. This type of credit (*credit available by negotiation*),[214] as in the case of the acceptance credit, enables the beneficiary to acquire payment before maturity of the bill. As such both it and the acceptance credit are *usuance credits*.[215]

One of the main consequences of usuance credits is that, by making use of a term bill, the bank does not in fact pay against delivery of the documents, but payment is deferred to the date of maturity of the bill. This generally enables the buyer to acquire the documents before payment needs to take place.[216] Coupling bills of exchange to documentary credits has, however, never been popular in continental Europe, and although at first prevalent in English and American practice,[217] is now also being questioned in these regions. Jack explains as follows:

> "In the past deferred payment has commonly been provided for by the use of a time draft, on the maturity of which payment is due. More recently the practice has developed of dispensing with a draft and *having the credit provide that payment under it shall be due after the required period from, for example, the date of presentation of documents* ... or from the date of the transport document."[218]

The development of this type of credit, the *deferred payment credit*, which originated in Japan,[219] was first acknowledged in the 1983 revision of the

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214 Not to be confused with the *negotiation credit* discussed in par 1 6 6 below.

215 See Ellinger (*op cit* n 35) 15-16; Stassen (*op cit* n 7) 20; McCurdy (*op cit* n 11) 543. De Rooy (*op cit* n 190) 52-53 simply distinguishes between "niet-wisseltrekkredieten" and "wisseltrekkredieten". See also Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/107.

216 Stassen (*op cit* n 7) 20, 21; Eberth (*op cit* n 184) 6.

217 De Rooy (*op cit* n 190) 52; McCurdy (*op cit* n 11) 543; Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/107.

218 (*Op cit* n 46) 26 (my italics). See also Wheble B *UCP 1974/1983 Revisions Compared and Explained* (1984) ICC Publication 411 ICC Publishing Paris 23; Gutteridge & Megrah (*op cit* n 52) 14; Stassen (*op cit* n 7) 21; Eberth (*op cit* n 184) 6.

219 Gutteridge & Megrah (*op cit* n 52) 14.

UCP.[220] As in the case of the usuance credit the deferred payment credit generally enables the buyer to obtain the documents at a date prior to payment. The difference is merely that whereas in the case of the usuance credit the payment obligation is secured by a bill of exchange, in the case of the deferred payment credit it is secured by the letter of credit itself.[221] The deferred payment credit has the advantage of avoiding not only the unnecessary complexity of bills of exchange, but often also the stamp duty payable on bills.[222] It must be stressed however that the intention of the deferred payment credit is simply to extend the date of payment and not to alter the conditions for payment. The independence of the payment obligation and the principle of strict compliance are equally applicable to deferred payment credits.[223] Thus, if for instance the documents are in order but prior to the date of payment the goods are found to be defective, the buyer will nevertheless be obliged to pay.[224]

1 6 5 Commercial and Standby Credits

The *UCP*, since the 1983 revision, has, in defining its area of application, expressly included the so-called "standby letter of credit".[225] The term "commercial credit" is often employed to distinguish the traditional

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220 See aa 10(a)(ii), 11(a), 16(a), 19, and 41(b). See also Wheble (*op cit* n 218) 21-23, and in general the discussion in par 3 8 2 below.

221 Wheble (*op cit* n 218) 23; Eberth (*op cit* n 184) 6-7.

222 In accordance with s 3 of the Stamp Duties Act 77 of 1968 read with Schedule 1 Item 5 bills of exchange are subject to stamp duty of 5c for every R100. Bank drafts used solely for settling or clearing accounts between bankers are exempted. See also Barlow L Untitled Address *ICC/Lloyd's of London Press Ltd Seminar on Documentary Credits* (11 June 1984) 4. The *Irrevocable Documentary Credit Application* of Standard Bank of South Africa Ltd contains the following note: "To avoid possible heavy stamp duties, dispense with the draft stipulation (if possible)".

223 See aa 9(a)(ii) and 14(a) of the *UCP*. See further Barlow (*op cit* n 222) 4; Meier-Boeschenstein O C "Current Developments: Switzerland" *International Bar Association Seminar on Problems of Letters of Credit and Bankers' Guarantees* (8-9 May 1984) Amsterdam 388-390; Eberth (*op cit* n 184) 7.

224 This principle was clearly illustrated in *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W).

225 Aa 1 and 2 of both the 1983 and 1993 revisions. The earlier revisions contained no reference to standby credits. Their inclusion has met with some criticism. See in this respect Schmitthoff C M "The New Uniform Customs for Letters of Credit" 1983 *Journal of Business Law* 193 195, who is of the opinion that standby letters of credit "are such a different institution from ordinary documentary credits" that it is "unwise and potentially leading to confusion" that the *UCP* should be applicable to them. See also par 3 8 2 below.

documentary credit utilised in international trade from this recent and innovative creation.

The background against which standby credits originated is that, in contrast to banks in most other countries, banks in the United States are not entitled to issue guarantees.[226] Since the landmark decision in *Border National Bank of Eagle Pass Texas v American National Bank of San Francisco*,[227] it has, however, been accepted that this prohibition does not extend to the issuing of documentary credits.[228] This decision enabled the American banks to issue instruments clothed as documentary credits, but serving the function of a guarantee or performance bond. These instruments have become known as *standby letters of credit* or *standby credits*. Bearing in mind the guarantee function of the standby credit it is clear that whereas the commercial credit contemplates payment upon performance, "the standby letter of credit ... contemplates payment upon failure to perform".[229] It has thus been termed the "psychological opposite" of the commercial credit.[230]

Standby credits are used in a very wide range of situations.[231] They are, however, especially common in the construction industry. Typically, in terms

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226 Harfield (*op cit* n 23) 54 and "The National Bank Act and Foreign Trade Practices" (1947-1948) 61 *Harvard Law Review* 782 788; Ellinger E P "Standby Letters of Credit" (1978) 6 *International Business Lawyer* 604 611; Twenhafel M A Comment (1980) 11 *Texas Tech Law Review* 703-716. This has been well established in case law. See for instance *Seligman v Charlottesville Nat Bank* (1879) 21 Fed Cas 12642 (Circuit Court WD Virginia); *Commercial Nat Bank v Pirie* (1879) 82 F 799 (Circuit Court of Appeals 8th Circuit); *Barron v McKinnon* (1910) 179 F 759 (Circuit Court D Massachusetts); *Farmers' & Miners' Bank v Bluefield Nat Bank* (1926) 11 F 2d 83 (Circuit Court of Appeals 4th Circuit).

227 (1922) 282 F 73 (Circuit Court of Appeals 5th Circuit).

228 The power of banks to accept bills of exchange drawn at a usuance, granted by the Federal Reserve Act of 1913, was interpreted as encompassing the issuing of letters of credit.

229 Wheble (*op cit* n 218) 10-11; Katskee M R "The Standby Letter of Credit Debate - The Case for Congressional Resolution" (1975) 92 *Banking Law Journal* 697 699.

230 Getz H A "Enjoining the International Standby Letter of Credit: the Iranian Letter of Credit Cases" (1980) 21 *Harvard International Law Journal* 192.

231 For a recent overview of the main uses of standby letters of credit in the United States see Del Busto C "Are Standby Letters of Credit a Viable Alternative to Documentary Credits?" 1991 *Journal of International Banking Law* 72 73. See further Joseph (*op cit* n 6) 820-850; Anonymous "Recent Extensions in the Use of Commercial Letters of Credit" (1957) 66 *Yale Law Journal* 902-921; Jones G W "Letters of Credit in the United States Construction Industry" Feb 1986 *International Business Lawyer* 17-22.

of a construction contract, the contractor will demand part payment of, for instance, one tenth of the contract price before starting work. The developer may then desire some assurance that this money will be paid back in the case of non-performance. A standby credit can provide such assurance. The developer consequently agrees to such down payment subject to a standby credit, in an amount equal to the down payment, being issued in his favour. In terms of the credit the issuing bank undertakes to pay the amount to the beneficiary against certain documents substantiating that the contractor has failed to perform. In the event of the construction contract being performed properly, no payment is made in terms of the credit. Thus, by means of a standby credit, the bank has in effect guaranteed that the contractor will perform.

In form there is no difference between a standby and a commercial credit. Both are documentary in the sense that the issuing bank pays only against specified documents.[232] The legal principles applying to both are materially the same.[233] Thus, the doctrine of strict compliance applies equally to both forms. Both can be revocable or irrevocable, confirmed or unconfirmed. In both instances the bank's obligation is independent of the underlying contract.[234]

Standby credits are used mainly, but not exclusively,[235] in the United States. In other parts of the world, the same end is achieved by first-demand bank guarantees.

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232 Typically, however, the nature and purpose of the documents differ substantially. In the case of commercial credits the presentation of third party documents such as a bill of lading is required. In the case of the majority of standby credits the only document required is a *pro forma* declaration by the beneficiary that the other party has failed to perform. The document serves simply to trigger performance by the bank. See Getz (*op cit* n 230) 195. Such letters of credit have thus been labelled "suicide letters of credit". See Jones (*op cit* n 231) 17.

233 For a brief rendition of the major legal principles applicable to standby letters of credit see Ellinger (*op cit* n 226) 614-621.

234 This independence is seen as the factor distinguishing the standby letter of credit from a guarantee, thereby legalising it. Ellinger (*op cit* n 226) 619 states: "The finding, that - unlike a guarantee - a standby credit is a primary and autonomous undertaking of the issuing bank, constitutes the basis for regarding the issuing of a standby credit as being within the powers of American banks." See also Twenhafel (*op cit* n 226) 703-716. See further *Barclays Bank DCO v Mercantile National Bank* (1972) 339 F Supp 457 (US District Court ND Georgia), affirmed (1973) 481 F Supp 2d 1224 (US Court of Appeals 5th Circuit) 1236; *National Surety Corporation v Midland Bank & Trust Co* (1976) 408 F Supp 684 (US District Court D New Jersey) 692.

235 Ellinger (*op cit* n 226) 614.

1 6 6 Straight and Negotiation Credits

If the undertaking of the issuing bank (supplemented by that of a confirming bank where applicable) is directed to a named beneficiary alone, the credit is termed a *straight credit*. Should the undertaking, however, be directed not only to the beneficiary but to all *bona fide* holders of the documents, or to banks generally or of a particular description who have purchased the documents, the credit is termed a *negotiation credit*.[236] Whether a credit in a particular case amounts to a straight or negotiation credit depends on the interpretation of the wording on the credit.[237]

"Negotiation" in this context, according to the *UCP*, means "the giving of value for Draft(s) and/or document(s) by the bank authorised to negotiate".[238] It is clear from this definition that a negotiation credit need not necessarily be accompanied by a bill of exchange.[239] If there is a bill, though, the negotiating bank as the buyer thereof will become the holder[240] - normally the holder in due course.[241]

By negotiating the documents the negotiating bank acquires its rights against the issuing and confirming banks in its own right and not as the agent or mandatary of the issuing bank. The negotiating bank can accordingly sue in its own

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236 On straight and negotiation credits in general see Jack (*op cit* n 46) 27-28, 135-138; Hedley (*op cit* n 37) 253; Dolan (*op cit* n 51) par 1.02[3]; Ellinger (*op cit* n 47) 1384-1385 (par 2172).

237 This can be a problematic question. See Jack (*op cit* n 46) 28-30 who reviews the following cases in point: *In re the Agra and Masterman's Bank (Limited), Ex parte the Asiatic Banking Corporation (Limited)* [1867] 36 LJNS (Ch) 222; *M A Sassoon & Sons Ltd v International Banking Corporation* [1927] AC 711 (PC); and *European Asian Bank AG v Punjab and Sind Bank* [1983] 1 Lloyd's Rep 611 (CA). See also Ellinger (*op cit* n 47) 1384-1385 (par 2172).

238 A 10(b)(ii).

239 Hedley (*op cit* n 37) 253 incorrectly presupposes the use of a bill of exchange. The similar statement in Dolan (*op cit* n 51) par 1.02[3] can be ascribed to the fact that his book was written prior to the 1993 revision of the *UCP*. Jack (*op cit* n 46) 27, 135 adopts the correct approach.

240 As the "indorsee in possession". See s 1 of the Bills of Exchange Act, 34 of 1964.

241 Provided it meets the requirements for holding in due course as proscribed in s 27(1) of the Bills of Exchange Act, 34 of 1964. This should normally be the case.

name.[242] By selling the documents to the negotiating bank the beneficiary acquires his money immediately. Negotiation in this sense is likely only to occur where the credit does not provide for immediate payment. If the credit provides for immediate payment the beneficiary may as well present the documents directly to the issuing bank.[243]

1 6 7 Transferable Credits, Assignment of Proceeds and Back-to-Back Credits

In order to be transferable, a credit must expressly be designated "transferable". In terms of the *UCP* the designation of a credit as "divisible", "fractionable", "assignable" or "transmissible" does not render it transferable and shall be ignored.[244] A *transferable credit*[245] confers upon the beneficiary the right to request the appropriate bank (the transferring bank) to make the credit available in whole or in part to another party or parties (the second or further beneficiaries). The word "transfer" in this context is misleading. The credit itself is not transferred. The beneficiary returns it to the issuing bank who then issues a new credit in favour of the new beneficiary.[246] It is important to note that the (first) beneficiary's right to request the bank to transfer the credit does not mean that the bank is obliged to accede to the request.[247] However, it has been suggested that it would be contrary to the spirit of the *UCP* provisions, if

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242 Jack (*op cit* n 46) 27, 135.

243 Jack (*op cit* n 46) 27.

244 A 48(b).

245 For a comprehensive recent discussion of the transferable credit in general see Jack (*op cit* n 46) 233-246. See further Goode (*op cit* n 14) 1015-1022; Ellinger (*op cit* n 47) 1387-1394 (par 2178-2190); Gutteridge & Megrah (*op cit* n 52) 99-105. On the *übertragbares Akkreditiv* in German law see Eisemann & Schütze (*op cit* n 88) 156-165; Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/178-189; Canaris (*op cit* n 95) 709-712 (par 1034-1041).

246 Goode (*op cit* n 14) 1016; Ellinger (*op cit* n 47) 1389 (par 2181).

247 This principle was first recognised expressly in the 1983 revision of the *UCP* (a 54(c)) and thereafter reiterated in the 1993 revision (a 48(c)). In *Bank Negara Indonesia 1946 v Lariza (Singapore) Pte Ltd* [1988] 1 AC 583 (PC) 599D, a case in which the credits were governed by the 1974 revision, a similar interpretation was adopted. See also Jack (*op cit* n 46) 234-235; Eisemann & Schütze (*op cit* n 88) 160.

this entitled the bank to refuse to transfer without good reason.[248] Unless otherwise stated in the credit, it can be transferred once only.[249]

Which bank is to be the transferring bank? The *UCP* distinguishes two situations. If the credit is not freely negotiable the transferring bank is "the bank authorised to pay, incur a deferred payment undertaking, accept or negotiate". Typically the transferring bank will therefore be the correspondent of the issuing bank. If, however, the credit is freely negotiable, the credit must specifically nominate a transferring bank.[250] In the event of no such bank being nominated the credit must either be regarded as non-transferable or non-negotiable. The latter option is favoured by Jack.[251]

The function of a transferable credit is that it enables the seller (first beneficiary) to pay his supplier by effecting a transfer of the credit to the supplier (second beneficiary). The second beneficiary presents documents under the credit, including his own invoice, and receives payment from the transferring bank. Typically, he will receive less than the amount designated in the original credit. The first beneficiary acquires this difference, which reflects his profit, by presenting his own invoice to the bank in question. The bank substitutes the first beneficiary's invoice for that of the supplier before passing on the documents. Thus, although the buyer will know that the seller was being supplied by a third party,[252] the identity of the third party can be kept from him, thereby preventing the buyer from by-passing the seller and dealing with the supplier directly.[253]

The precise effect of the transfer of the credit upon the relationships between the parties is neither dealt with in the *UCP*, nor has it as yet been considered in English or South African case law. This matter is generally regarded as

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248 Ellinger (*op cit* n 47) 1391-1392 (par 2186).

249 A 48(g). See also Jack (*op cit* n 46) 238. The proviso was not included in the previous revision which prohibited further transfers in absolute terms. See a 54(e) of the 1983 revision and Eisemann & Schütze (*op cit* n 88) 158.

250 A 48(a).

251 (*Op cit* n 46) 237.

252 As a consequence of the request that the credit be designated "transferable".

253 Eisemann & Schütze (*op cit* n 88) 156; Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/178; Jack (*op cit* n 46) 234; Ellinger (*op cit* n 47) 1388-1389 (par 2180).

somewhat vexing.[254] The most recent, comprehensive discussion is that of Jack who summarises his views in this regard as follows:

> "A transferable credit embodies a contract or contracts with the first beneficiary which the credit foresees may be varied on transfer. On transfer variation of the contract or contracts with the first beneficiary takes place, and contracts also then come into being between the issuing bank and any confirming bank with the second beneficiary."[255]

Jack accordingly distinguishes two aspects. The transfer of the credit, in the first place, impacts upon the relationship between the issuing (and confirming) bank and the original beneficiary of the credit; "variation of the contract" occurs. The contract is varied, not in its nature, but in its performance. Jack puts it thus: "by asking for the transfer the first beneficiary accepts that he will only be able to collect the difference between the value of his invoice and the second beneficiary's invoice."[256]

Secondly, the transfer of the credit may give rise to new obligations between the banks and beneficiaries involved. In this respect Jack distinguishes between two situations: (i) where the transferring bank is a bank involved with the original credit, that is "the correspondent or advising bank which is also the paying bank (and which may or may not also confirm the credit)"; and (ii) where the transferring bank is a third party bank under a negotiation credit.[257] With reference to the first situation Jack states:

> "It is suggested that the relationships of the banks with the second beneficiary are exactly the same as those between them and the first beneficiary save that the terms of the credit as transferred, in particular as to amount, are likely to be different... . [T]hus, the

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254 Jack (*op cit* n 46) 241-243; Goode (*op cit* n 14) 1021-1022; Ellinger (*op cit* n 47) 1392 (par 2187); Eisemann & Schütze (*op cit* n 88) 163-165.

255 Jack (*op cit* n 46) 243. In substance this view, as further analysed below, is also in accordance with the German literature in this regard. See Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/185-187; Eisemann & Schütze (*op cit* n 88) 160, 163-165.

256 (*Op cit* n 46) 242. The fact that the first beneficiary retains this right as against the issuing (and confirming) bank prevents the transfer of the credit being regarded as a novation as suggested by Dolan (*op cit* n 51) par 10.03[1] and Goode R M "Reflections on Letters of Credit - V" 1981 *Journal of Business Law* 150 151. See also Ellinger (*op cit* n 47) 1392 (par 2187) who argues that "the transfer of a documentary credit may be described as an assignment of some of the seller's rights to the second beneficiary, who can enforce them only against the tender of certain documents."

257 (*Op cit* n 46) 241.

> second beneficiary has the issuing bank's undertaking that payment will be made (if the credit provides for payment) and it has a confirming bank's undertaking to pay."[258]

If, however, the transferring bank is merely the advising bank (as opposed to the confirming bank), the second beneficiary has no right as against the transferring bank.[259]

With regard to the situation where the transferring bank is a bank entitled under a negotiation credit to negotiate, a different consideration applies. Although, prior to acceding to the beneficiary's request for transfer the bank is under no obligation to negotiate the documents, an agreement to transfer the credit must carry with it an agreement to negotiate conforming documents presented under the credit. To hold otherwise would mean that "the negotiating bank could subsequently decline to negotiate documents from the second beneficiary and decline to pay the first beneficiary on substitution of its invoice and draft".[260] In order to prevent being placed in a position akin to that of the issuing bank, the negotiating bank, in these circumstances, is likely to make it a term of the transfer that it does so without engagement, in other words it will negotiate with recourse.[261]

The transfer of a credit must be distinguished from, to adopt the language of the *UCP*, the *assignment of proceeds* of the credit.[262] In this regard article 49 of the *UCP* provides as follows:

> "The fact that a Credit is not stated to be transferable shall not affect the Beneficiary's right to assign any proceeds to which he

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258 (*Op cit* n 46) 241. See also Eisemann & Schütze (*op cit* n 88) 160-161.

259 Eisemann & Schütze (*op cit* n 88) 160-161 state the principle thus: "Die Übertragungserklärung der zwischengeschalteten Bank, die nur als avisierende Bank oder Zahlstelle tätig ist, begründet keine rechtliche Verpflichtung dieser Bank. In ihrer Eigenschaft als Bestätigungsbank haftet sie dem Zweitbegünstigten auf Grund der Übertragung dagegen in demselben Umfang wie die akkreditiveröffnende Bank." See also Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/185-187.

260 Jack (*op cit* n 46) 242.

261 Jack (*op cit* n 46) 242-243.

262 See in general Jack (*op cit* n 46) 246-249; Gutteridge & Megrah (*op cit* n 52) 105-110; Ellinger (*op cit* n 47) 1387-1388 (par 2178-2179). On the *Abtretung des Zahlungsanspruchs des Begünstigten* in German law see Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/190-195; Eisemann & Schütze (*op cit* n 88) 165-169; Canaris (*op cit* n 95) 706-709 (par 1029-1033).

> may be, or may become, entitled under such Credit, in accordance with the provisions of the applicable law."

This article is concerned with the assignment, or to employ South African legal terminology, the cession[263] by the beneficiary of his right to payment in terms of the credit. The cession can take place either after the beneficiary has delivered conforming documents (for instance in the case of a deferred payment credit) or before delivery of the documents. In the latter instance the right ceded will be subject to the condition that the beneficiary (cedent) delivers conforming documents within the time stipulated in the credit.[264] Although the assignment of a contingent right may be problematic in English law,[265] it is well established that such rights are capable of being ceded in South African law.[266]

The proceeds of the credit may well be ceded *in securitatem debiti*, for instance to the bank discounting the beneficiary's draft, or to the bank financing the transaction.[267]

Finally, the transferable credit must be distinguished from the functionally related but juristically very different *back-to-back* or *subsidiary credit*.[268] In the case of a back-to-back credit a bank at the seller's request issues a letter of

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263 See also Canaris (*op cit* n 95) 706 (par 1029) who regards this as "gewönliche Zession".

264 Goode (*op cit* n 14) 1023 states the rule thus: "to claim under the credit the assignee must present the beneficiary's documents *as agent of the beneficiary*, or get the beneficiary to present them". See also Ellinger (*op cit* n 47) 1388 (par 2179). There is a (somewhat controversial) Austrian decision, *Singer & Friedlander v Creditanstalt-Bankverein*, to the effect that, in the event of the cessionary tendering the beneficiary's documents, he must do so on behalf of the beneficiary. For a discussion of the case see Gutteridge & Megrah (*op cit* n 52) 108-110; Wilson N "The Singer & Friedlander/Creditanstalt Bankverein Litigation" Oct 1983 *International Business Lawyer* 33.

265 Jack (*op cit* n 46) 247. But see also Ellinger (*op cit* n 47) 1388 (par 2179) and Gutteridge & Megrah (*op cit* n 52) 107-108 who have no problem accepting the assignability of such a right.

266 Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 100) 336; De Wet & Van Wyk (*op cit* n 103) 254; Scott S *The Law of Cession* 2 ed (1991) Juta Cape Town 170. This is also the position in German law. See Canaris (*op cit* n 95) 707 (par 1031).

267 Ellinger (*op cit* n 47) 1388 (par 2179).

268 See, on back-to-back credits in general Ellinger (*op cit* n 47) 1392 (par 2188); Goode (*op cit* n 14) 1023-1025; Jack (*op cit* n 46) 30-32; Gutteridge & Megrah (*op cit* n 52) 14. On the German *Gegenakkreditiv* or *Unterakkreditiv* see Eisemann & Schütze (*op cit* n 88) 169-171; Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/189, 7/1-8; Canaris (*op cit* n 95) 712-713 (par 1042-1043).

credit to the seller's supplier in reliance on a letter of credit procured by the buyer in favour of the seller. The bank, on agreeing to issue a back-to-back credit, takes possession of the credit issued to the seller and issues the countervailing credit to the supplier. This second credit is entirely distinct from the first. However, the documents specified in the back-to-back credit must be capable of being tendered on behalf of the seller in terms of the first credit. Thus, the specifications must be identical and the documents must relate to the same goods. When the documents have been tendered by the supplier to the seller's bank, the bank simply substitutes the seller's invoice for that of the supplier and presents the documents in terms of the first credit. Jack offers the following concise definition:

> "A credit may be described as back-to-back when it is intended that the documents which are received through the operation of it may be presented, with substitution of invoices (and possibly other documents), to obtain payment under another credit."[269]

From the bank's point of view a back-to-back credit is a risky instrument. Due to the independence of the two credits, the bank will have to pay if conforming documents are tendered regardless of whether its client is able to obtain payment under the backing credit. For this reason banks generally prefer making use of a transferable credit.[270] If, however, the seller wishes not only to conceal the identity of the supplier from the buyer, but the very fact that he is being supplied (and not delivering his own goods), this cannot be achieved by requesting a transferable credit. It is for this situation that the back-to-back credit is required.[271]

1 6 8 Revolving Credits

A credit need not necessarily be for a fixed amount or time, but may revolve around value or time.[272] In terms of a *value revolving credit* the beneficiary

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269 (*Op cit* n 46) 30-31.

270 Jack (*op cit* n 46) 31; Goode (*op cit* n 14) 1025; Gutteridge & Megrah (*op cit* n 52) 14. See also Zahn, Eberding & Ehrlich (*op cit* n 15) par 2/189: "Gegenakkreditive bergen sowohl für den Exporteur als auch für die Banken erheblich höhere Risiken in sich als übertragbare Akkreditive."

271 Ellinger (*op cit* n 47) 1392 (par 2188).

272 Goode (*op cit* n 14) 983-984. On revolving credits in general see further Jack (*op cit* n 46) 32; Ellinger (*op cit* n 47) 1387 (par 2177); Gutteridge & Megrah (*op cit* n 52) 15; Dolan (*op cit* n 51) par 1.09. It would appear that the revolving credit is not part of German

may present documents as often as he wishes during the credit period provided an overall limit is not exceeded. The credit is accordingly reduced by payments made by the bank in terms of the credit, and is replenished by payments received from the buyer. A *time revolving credit* allows the beneficiary to draw, for example, up to a specified amount per month for the duration of the credit. The credit may be cumulative in the sense that it allows the beneficiary to carry forward any amount not utilised to the next month.[273] However, a credit is only cumulative if it is expressly so stipulated.[274]

Revolving credits are appropriate where the sale envisages delivery in instalments. They are especially common in the petroleum industry.[275]

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practice. Zahn, Eberding & Ehrlich (*op cit* n 15) par 8/3 refer to it briefly as one of the "anglo-amerikanische Rechtsformen dokumentärer Geschäfte".

273 Jack (*op cit* n 46) 32; Goode (*op cit* n 14) 984.

274 A 41 of the *UCP*.

275 Ellinger (*op cit* n 47) 1387 (par 2177).

Chapter Two

The History of Documentary Credits: Early Analogous Instruments

2 1 Introduction

Most commentators agree that the documentary credit is, comparatively speaking, a modern instrument created by nineteenth century merchants and bankers.[1] However, trade and the financing of trade are very old, and as Bewes has stated, "it is almost impossible to conceive of caravan traffic after the age of barter had passed without some commerce in documentary credits,[2] the distance to be travelled and the dangers of the routes making bills of some sort imperative".[3]

Not surprisingly therefore, history reveals several analogous devices to which commentators have pointed as possible roots of the modern documentary credit. In this respect three different classes of instruments can be identified. In chronological sequence they are: (i) certain early clay tablets originating in the Middle East; (ii) the *receptum argentarii* of classical Roman law; and (iii) certain institutes of the European *lex mercatoria* such as the letter of payment and mercantile letter of credit.

However, as has been stressed by Holdsworth,[4] one must bear in mind that argument from analogy is dangerous. Methods of solving similar commercial problems through the ages will often possess a superficial similarity. The existence of such similarity is not conclusive proof of a derivative relationship.

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1 See for example Kozolchyk B "The Legal Nature of the Irrevocable Commercial Letter of Credit" (1965-1966) 14 *American Journal of Comparative Law* 395 398; Ellinger E P *Documentary Letters of Credit* (1970) University of Singapore Press Singapore 26-27; Finkelstein H N "Performance of Conditions under a Letter of Credit" (1925) 25 *Columbia Law Review* 724-725; Stassen J C "Die Dokumentêre Kredietbrief as Betalingsmetode in die Internasionale Handel" 1982 *Modern Business Law* 14 16-17.

2 It would appear that the term "documentary credit" is used by Bewes in a very wide sense, i e any form of credit reflected in a document, and not in the sense in which the term is generally understood today.

3 Bewes W A *The Romance of the Law Merchant* (1923) Sweet & Maxwell Ltd London 48.

4 Holdsworth W S "The Origins and Early History of Negotiable Instruments II" (1915) 31 *Law Quarterly Review* 173 174.

2 2 Early Middle Eastern Clay Tablets

Archaeological evidence indicates that the Babylonian and Phoenician civilisations used sophisticated methods of payment from very early times. Trimble[5] refers to a Babylonian clay "promissory note" of the third millennium BC in which provision is made for repayment of the principal debt as well as interest. He also refers to a clay tablet constituting an instrument payable to bearer and promising repayment in produce of a loan of money. The most important archaeological evidence, however, is probably certain plaques found during excavations at the ancient Assyrian city of Karkhemish. Several plaques were found on which different types of obligations were inscribed.[6] One of these is reminiscent of a bill of exchange, at least in the sense of it being an instruction in writing by one person to another to pay a certain sum of money on a certain date to a third person:

> "Four minae fifteen shekels of silver (credit) of Ardu-Nana, son of Yakin, on Mardukabalasur, son of Mardukbalatirib in the town of Orchoé, Mardukbalatirib will pay in the month of tebet four minae fifteen shekels of silver to Belabaliddin, son of Sinnaïd, Our the fourteenth Arakhsamna, Second year of Nabu-nâhid, King of Babylon."[7]

Bewes actually goes as far as to call this a "fully developed bill of exchange".[8] This does not, however, seem to be justified. We simply do not know what the mercantile functions and legal consequences of instruments such as these were. The history of early Middle Eastern trade is unfortunately to a large degree "lost history".[9] This can be ascribed not only to the repeated destruction of the great commercial centres of the Middle East through the ages,[10] but also to the fact that

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5 Trimble R J "The Law Merchant and the Letter of Credit" (1947-1948) 61 *Harvard Law Review* 981 982. See also the comment of Twenhafel M A in (1980) 11 *Texas Tech Law Review* 703 705; Stern M "The Independence Rule in Standby Letters of Credit" in Hillman W C (ed) *Letters of Credit - Current Thinking in America* (1987) Butterworths Boston 29 38 n 50.

6 Bewes (*op cit* n 3) 48-50 quotes translations of five of these plaques, each reflecting a different obligation.

7 Translation quoted in Bewes (*op cit* n 3) 50.

8 (*Op cit* n 3) 50.

9 Bewes (*op cit* n 3) 48; Trimble (*op cit* n 5) 982.

10 Bewes (*op cit* n 3) 48. A related problem is the absence of adequate archaeological research by persons trained in law. See Trimble (*op cit* n 5) 982.

mercantile matters were regulated more by custom than by law.[11] But, bearing in mind the importance of Karkhemish as a trade centre,[12] one cannot deny the probability of instruments such as these having been used to finance trade. Clearly, however, there is insufficient authority for the assertion that the modern documentary credit can be traced back to these civilisations.[13]

2 3 The Receptum Argentarii[14]

Inevitably civil lawyers have sought to trace the documentary credit back to Roman law. Thus Cahn, in an early thesis on the subject,[15] suggested that the origin of the documentary credit could be the Roman-law concept of the *receptum argentarii*. This *receptum* was one of the *pacta praetoria*[16] enforceable by an *actio in factum*, the *actio recepticia*.[17] It was an informal promise in terms of which an *argentarius* undertook to discharge the obligation of another.[18] Of special significance was the fact that the *argentarius* was liable even in the event of the underlying obligation being invalid or unenforceable. The obligation of the

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11 Trakman L E *The Law Merchant: The Evolution of Commercial Law* (1983) Fred B Rothman & Co Littleton Colorado 7-8; Trimble (*op cit* n 5) 981.

12 Kharkemish was the most important trade centre on the northern caravan route, and trade from the Persian Gulf also passed through it. See Bewes (*op cit* n 3) 49 n (g).

13 See Ellinger (*op cit* n 1) 24; Kozolchyk B *Letters of Credit* in Ziegel J F (ed) *International Encyclopedia of Comparative Law* Vol IX (1979) J C B Mohr (Paul Siebeck) Tübingen par 1; Stassen (*op cit* n 1) 16.

14 On the *receptum argentarii* in general see Kaser M *Das Römische Privatrecht* Vol I (1971) C H Beck München 585, and Vol II (1975) 383; Zimmermann R *The Law of Obligations - Roman Foundations of the Civilian Tradition* (1990) Juta Cape Town 514; Lee R W *The Elements of Roman Law* (1956) Sweet & Maxwell London 343-344; Thomas J A C *Textbook of Roman Law* (1976) North Holland Publishing Amsterdam 319. The most comprehensive research on the subject is, however, that of Bürge A "Fiktion und Wirklichkeit: Soziale und rechtliche Strukturen des römischen Bankwezen" (1987) 104 *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte (romanistische Abteilung)* 465 527-536.

15 Cahn E M *Het Accreditief* (1935) HJ Paris Amsterdam 8.

16 I e an agreement which although not conforming to any of the nominate or innominate contracts, was nevertheless regarded as binding by the praetor. See Zimmermann (*op cit* n 14) 508-514; Lee (*op cit* n 14) 343; Thomas (*op cit* n 14) 318.

17 Kaser (*op cit* n 14) Vol I 585; Thomas (*op cit* n 14) 319.

18 Kaser (*op cit* n 14) Vol I 585; Zimmermann (*op cit* n 14) 514; Thomas (*op cit* n 14) 319; Lee (*op cit* n 14) 343.

argentarius was therefore regarded as abstract or independent.[19] It is in this respect that the *receptum argentarii* differed from the otherwise similar *constitutum debiti alieni*.[20] Justinian, however, abolished the *receptum argentarii* as a separate institution and it was fused with the *constitutum debiti alieni*.[21] This fusion resulted in the *receptum argentarii* losing its abstract quality.[22]

Roman sources contain little information on the use of the *receptum argentarii*.[23] It is, however, generally accepted that this *receptum* was available only to the *argentarii*.[24] *Argentarius* is often translated simply as "banker".[25] This translation is misleading. The term is best left untranslated. Rome knew no banks or bankers as we do today. Several different professions conducted different forms of business, aspects of which would today be regarded as banking business.[26] The main province of the *argentarius* was to act as middleman in market transactions,

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19 Cahn (*op cit* n 15) 8; Zimmermann (*op cit* n 14) 514; Thomas (*op cit* n 14) 319; Lee (*op cit* n 14) 343.

20 Zimmermann (*op cit* n 14) 514. The *constitutum debiti alieni* was an informal promise by any person to pay the debt of another. This promise was enforceable by the praetorian *actio de pecunia constituta*. See Thomas (*op cit* n 14) 319; Zimmermann (*op cit* n 14) 511-512. A further difference between the two actions was that the creditor in the case of a *constitutum debiti* had the advantage of a penal *sponsio* of half as much again of the original debt under the *actio de pecunia constituta*. No such penal element was attached to the *actio recepticia*.

21 See Cahn (*op cit* n 15) 8; Kaser (*op cit* n 14) Vol II 383; Zimmermann (*op cit* n 14) 514; and Thomas (*op cit* n 14) 319 who also points out that the penal element of the *actio de pecunia constituta* (see n 20 above) was simultaneously abolished.

22 Kaser (*op cit* n 14) Vol II 383.

23 See Bürge (*op cit* n 14) 527.

24 Bürge (*op cit* n 14) 527. See especially the commentary of Theophilus A on Gaius's *Inst* 4 68 in *Institutionum Graeca Paraphrasis Pars Posterior* (1967) Neudruck der Ausgabe Berlin 1897 Scientia Verlag Aalen 422.

25 Zimmermann (*op cit* n 14) 514; Thomas (*op cit* n 14) 319; Lee (*op cit* n 14) 343; Cahn (*op cit* n 15) 8; De Rooy F P *Documentair Kredieten* (1980) Kluwer Deventer 5.

26 In this regard Bürge (*op cit* n 14) 567-508 identifies, apart from the *argentarii*, the *nummularii* whose main business was to exchange coins of different regions, and the *feneratores* who lent money. Whilst the *nummularii* were members of a specific profession, the *feneratores* were not. Anyone who lent money was a *fenerator*. On 508 he concludes: "In Rom gab es keine Banken. Das römische Bankwesen ist eine moderne Fiktion; die Wirklichkeit sieht anders aus. Was wir beobachten können, sind personale Beziehungen, die über ein Netz van abhängigen Mittelsmännern verlaufen." See also Finley M I *The Ancient Economy* (1973) University of California Press Berkeley 141-142.

especially as auctioneer.[27] Secondary roles were to provide short-term liquidity and to function as a point of payment.[28] In this context claims were set off against one another. The difference between the *argentarii* and the bankers of today is highlighted by the fact that not only money claims were so set off, but also claims in *naturalia* such as wine against wine, and wheat against wheat.[29] The *receptum argentarii* was likewise not limited to monetary obligations. The sources indicate that any obligation could be secured by it.[30]

The only real similarities between the *receptum argentarii* and the modern documentary credit are therefore that in both instances the creditor looks to someone other than the original debtor to pay a debt, and that the third party's undertaking to do so was independent of the original debt. But this is as much as can be said. The area of application differed widely from that of the modern documentary credit. Furthermore, as has been indicated, once fused by Justinian with the *constitutum debiti alieni*, the *receptum argentarii* lost its abstract quality. It is therefore highly unlikely that the *receptum argentarii* in later years could have inspired merchants and bankers in their search for new financial instruments akin to the modern documentary credit.[31]

2 4 Instruments of the European Lex Mercatoria

2 4 1 The European *Lex Mercatoria*

The commercial law of the civil-law and common-law countries is considerably more uniform than is the case in other areas of law. This is due to the fact that both share the same roots, being founded on what is most often termed the *lex*

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27 Bürge (*op cit* n 14) 480-483, 528.

28 Bürge (*op cit* n 14) 480-483, 528.

29 Bürge (*op cit* n 14) 480. This is especially clear in the discussion by Gaius *Inst* 4 64-68 of set-off in the context of the work of the *argentarius*. (I used the text: Whittuck E A *Gai Institutiones or Institutes of Roman Law by Gaius* Translation and Commentary by Poste E 4ed (1904) Oxford University Press London.)

30 Bürge (*op cit* n 14) 527-528. See especially the commentary of Theophilus on Gaius's *Inst* 4 68 (*op cit* n 24) 422.

31 De Rooy's conclusion (*op cit* n 25) 6 is therefore probably correct: "[H]et receptum argentarii heeft zich ... buiten het Romeinse Recht niet verder ontwikkeld. Wanneer de schaduw over Rome valt, wordt dit instituut niet elders aangetroffen en wanneer in later tijden kooplieden nieuwe financiële technieken voor de afwikkeling van hun transacties ontwikkelen, lijken niet zozeer de constructies van de Romeinse juristen als wel de behoeften van de handelspraktijk aan die nieuwe technieken ten grondslag te liggen."

mercatoria.[32] The *lex mercatoria* was not, however, a specific supranational legal system applicable to mercantile matters. Fundamentally it was custom of a generally[33] universal nature. As Bärmann states:

> "[D]as Handelsrecht des Mittelalters [ist] keineswegs ein nationales Recht eines Staates und auch nicht das uniforme Recht mehrerer Staaten... , sondern [wird] allein gebildet... durch die Gewohnheiten und Praktiken einer sozialen Klasse, nämlich der Kaufleute, wie sie in allen Ländern und Städten existiert mit der gleichen Mentalität, den gleichen Gewohnheiten und den gleichen Notwendigkeiten. Insofern allerdings kann man von einem gemeinen Recht aller Kaufleute verschiedener Nationalität und verschiedener juristischer Systeme sprechen, das in jedem Land neben dem nationalen Zivilrecht besteht."[34]

Whatever the earliest sources of the *lex mercatoria* may have been,[35] it is clear that from the eleventh century onward it developed at first mainly in the Italian

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32 Also termed *ius mercatorum* or *stilus mercatorum*. See Von Caemmerer E "The Influence of the Law of International Trade on the Development and Character of the Commercial Law in the Civil Law Countries" in Leser H G (ed) *Ernst von Caemmerer gesammelte Schriften* Vol I (1968) J C B Mohr (Paul Siebeck) Tübingen 11. Malynes G *Consuetudo vel Lex Mercatoria or the Ancient Law Merchant* (1622) Adam Islip London in his introduction opts for *lex mercatoria* instead of *ius mercatorum* "because it is a Customary Law approued by the authoritie of all Kingdomes and Commonweales, and not a Law established by the Soveraigntie of any Prince". See further Bärmann J "Ist internationales Recht kodifizierbar" in Flume W (ed) *Internationales Recht und Wirtschaftsordnung, Festschrift für F A Mann* (1977) C H Beck München 547 548.

33 Differences, especially in the earlier stages of the development of the *lex mercatoria* in the European cities and fairs, did exist. See in this regard Mitchell W *An Essay on the Early History of the Law Merchant* (1904) Cambridge University Press Cambridge 7, who nevertheless concludes that "in spite of minor differences, the international character of the Law Merchant ... cannot be denied."

34 (*Op cit* n 32) 559.

35 With reference to early sources Bewes (*op cit* n 3) 1-2, for example, argues as follows: "It has been too confidently assumed by most writers that the law merchants [sic] arose in Italy in the central part of the Middle Ages ... . International trade is in some measure a constant thing. Although a great revival took place after the new contact with the East which was made by the Crusades, commerce at that time simply changed hands, leaving the Arabs ... and being undertaken by the Italians ... . But before the Arabs came the Romans, and before the Romans the Greeks, and before the Greeks the Phoenicians." He also points out that in Europe at the time of the trade revival, canon law was the prevailing authority and must have extended its influence over the law merchant, especially as the Church was a considerable trader during the Middle Ages. Egyptian, Babylonian, Assyrian, Phoenician, Greek, Roman and Arabian sources are also discussed in the major treatise of Goldschmidt L *Universalgeschichte des Handelsrechts* (1891) Ferdinand Ente Stuttgart 48-100. On the history of the *lex mercatoria* prior to the 11th century, see further Mitchell (*op cit* n 33) 22-26; Trakman (*op cit* n 11) 8.

cities and spread from there to Spain, France, Germany and England.[36] It had the character of a universal customary law, based specifically on the customs of the social class of international merchants.[37] Several factors contributed to the universal nature of this *lex mercatoria*.[38] Much can be ascribed to the uniform manner in which the great international fairs were regulated,[39] as well as the general similarity of the rules of ocean traffic.[40] Very important, furthermore, was the creation of special mercantile courts throughout Europe, where cases were decided according to the customs of merchants.[41]

This special law for the merchant class existed side by side with the different national legal systems throughout Europe for several centuries. It was not until the eighteenth century that the *lex mercatoria* was incorporated into the different national legal systems.[42] On the continent this nationalisation of the *lex mercatoria* took the form of the adoption of national codifications.[43] In England, at first, the special mercantile courts had to give way to those of the

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36 See for example Mitchell (*op cit* n 33) 29-38; Von Caemmerer (*op cit* n 32) 11; Goldschmidt (*op cit* n 35) 142-200; Kellenbenz H *Handelsrecht* in Erler A & Kaufmann E (editors) *Handwörterbuch zur deutschen Rechtsgeschichte* Vol 1 (1971) Erich Schmidt Verlag Berlin 1943.

37 On the customary nature of the *lex mercatoria* see Mitchell (*op cit* n 33) 9-12 who regards it as "by far the most decisive factor in its development". See also Trakman (*op cit* n 11) 1-2, 9-11; Bärmann (*op cit* n 32) 555-560; Schmitthoff C M "Das Neue Recht des Welthandels" (1964) 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 48-49.

38 See generally on the universal nature of the *lex mercatoria* Mitchell (*op cit* n 33) 20-21; Bärmann (*op cit* n 32) 555-560; Schmitthoff (*op cit* n 37) 49.

39 Mitchell (*op cit* n 33) 5-8; Schmitthoff (*op cit* n 37) 49. Amongst the well known international fairs were those of Champagne, Lyon, Frankfurt am Main, Leipzig and Bruges. See Von Caemmerer (*op cit* n 32) 11; Bärmann (*op cit* n 32) 556.

40 Schmitthoff (*op cit* n 37) 49.

41 Schmitthoff (*op cit* n 37) 49. Mitchell (*op cit* n 33) 39-78 contains a detailed discussion of the role of the special mercantile courts. A feature of these courts which was often encountered was the so-called "half tongue jury", i e a jury of which half the members were local merchants, and the other half foreign merchants.

42 Von Caemmerer (*op cit* n 32) 12-17; Schmitthoff (*op cit* n 37) 49-55.

43 The Napoleonic *Code de Commerce* of 1807 was the first major commercial code. In Germany commercial law was first codified in 1861 in the *Allgemeines Deutsches Handelsgesetzbuch*. The law of bills of exchange had by then already been codified in the *Allgemeine Deutsche Wechsel-Ordnung* of 1848. See in general on the codification of commercial law in continental Europe Schmitthoff (*op cit* n 37) 50-54; Von Caemmerer (*op cit* n 32) 13-14.

common law. Especially under Lord Mansfield the rules of the *lex mercatoria* were then incorporated into the common law,[44] but, eventually, in the latter half of the nineteenth century, the most important parts of commercial law were also codified in England.[45] However, in spite of this nationalisation of commercial law throughout Europe, the common foundation remains clearly visible today.

Two instruments known to the European *lex mercatoria* are of special historical interest in the context of documentary credits. These are the medieval letter of payment and the mercantile letter of credit. Due to the universal character of the *lex mercatoria* these instruments were encountered throughout Europe as well as in England.

2 4 2 The Medieval European Letter of Payment

Although, from a historical point of view, the medieval letter of payment was especially important in the development of bills of exchange,[46] it is also sometimes referred to as the historical foundation of the modern documentary credit.[47] The letter of payment developed from the contract of *cambium*. This contract was a special variety of the contract of exchange or barter (*permutatio*).[48] Whilst *permutatio* was the exchange of a species of one *genus* for a species of another *genus*, *cambium* referred to the exchange of a species

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44 At first the common-law courts treated the rules of the *lex mercatoria* simply as commercial usage, which had to be proved. In Lord Mansfield's time, the *lex mercatoria*, however, acquired the status of law, and was incorporated into the common law. See Von Caemmerer (*op cit* n 32) 12; Schmitthoff (*op cit* n 37) 52-53. On Lord Mansfield's role in this respect see especially Fifoot C H S *Lord Mansfield* (1977) Scientia Verlag Aalen 82-157.

45 The law on sale of goods, bills of exchange, carriers, marine insurance, merchant shipping, bills of lading, partnership and companies was so codified. See Von Caemmerer (*op cit* n 32) 12-13; Schmitthoff (*op cit* n 37) 50-53.

46 See Malan F R *Die Reëlmatige Houer in die Wisselreg* (1975) Unpublished LL D dissertation University of Pretoria 15-18; Malan F R, Pretorius J T & De Beer C R *Malan on Bills of Exchange, Cheques and Promissory Notes in South African Law* 2 ed (1994) Butterworths Durban 39 (par 25); Cowen D V & Gering L *Cowen on the Law of Negotiable Instruments in South Africa* 4 ed (1966) Juta Cape Town 2 n 6.

47 Stassen (*op cit* n 1) 16; Kozolchyk (*op cit* n 13) par 1, and (*op cit* n 1) 395-396; Trimble (*op cit* n 5) 982-986; De Rooy (*op cit* n 25) 7.

48 I e one of the innominate contracts actionable in Justinian law by the *actio praescriptis verbis*. In the pre-Justinian era *permutatio* was an unenforceable *pactum*. See Zimmermann (*op cit* n 14) 250-251; Thomas (*op cit* n 14) 313.

of one *genus* for a different species of the same *genus*.[49] The relevant *genus* was money. Thus, in its most simple form, *cambium* was a contract by which A agreed to give B coins of one denomination in exchange for coins of another denomination (*cambium minutum*, *permutatio pecuniae*).[50]

Early trade required the rather risky transportation of large amounts of coins. Merchants soon realised that the contract of *cambium* could be adapted to obviate the physical transportation of money by making use of foreign correspondents and the adjustment of accounts. For example, if A needed to pay B (a foreign creditor), A would enter into a contract of exchange with X. In terms of this contract X undertook to deliver the money received from A to B. Instead of physically transporting the money X instructed his correspondent in B's country to pay B. This instruction was contained in a letter of payment (*lettera/littera di pagamento*).[51] These letters were first utilised, in any event as far as Western civilisation is concerned, by the merchants in Northern Italy.[52]

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49 Holdsworth W S "The Origins and Early History of Negotiable Instruments IV" (1916) 32 *Law Quarterly Review* 20 24-25.

50 The exchange of old coins for current coins, or gold for silver, also passed as *cambium minutum*. This was a perfectly legal contract, also in the event of the moneychanger taking a small profit. In the event of it being entered into in order to circumvent the usury prohibition, the contract, under these circumstances called *cambium siccum*, was unlawful. See De Roover R *Gresham on Foreign Exchange* (1949) Harvard University Press Cambridge 94-96; Holdsworth (*op cit* n 49) 25-26; Endemann W *Studien in der Romanisch-Kanonistischen Wirtschafts- und Rechtslehre* Vol I (1874) Guttentag (D Collin) Berlin 81-115.

51 Endemann (*op cit* n 50) 98; Holdsworth (*op cit* n 49) 26-29. Typically the exchanger's undertaking was to pay in a different place and denomination. Whether "Ortsverschiedenheit" or "Münzverschiedenheit" was the dominant feature of the letter of payment, has been debated in German legal literature. Whilst Goldschmidt (*op cit* n 35) 424-425 argues "[ü]berall findet sich Ortsverschiedenheit, mit seltenen Ausnahmen auch Münzverschiedenheit", Schaube A "Studien zur Geschichte und Natur des ältesten Cambium" (1895) 65 *Jahrbücher für Nationalökonomie und Statistik* 153 162, having examined several examples and stressing the cambial background of the letter, concludes that Goldschmidt's statement should rather have read: "Überall wo die Wechselklausel angewandt ist, findet sich Münzverschiedenheit, in der Mehrzahl der Fälle auch Ortsverschiedenheit."

52 Holdsworth (*op cit* n 4) 173. They may, however, have been influenced by Eastern civilisations. In this respect two theories have been advanced. De Rooy (*op cit* n 25) 6 mentions that the Italian merchants may well have found some inspiration in China. He describes an instrument, the *fei k'iuan*, in common use from approximately the 9th century, which enabled a trader to take up money to his credit in his own country, in a different region. Marco Polo reported on these instruments during his travels in China between 1271 and 1295. It seems probable that the Italian merchants were aware of these instruments. The second theory, raised by Bewes (*op cit* n 3) 45-46, is that the instrument was taken over from the Arab civilisation by the crusaders. In support of this argument he

From there the letter of payment, as instrument of the *lex mercatoria*, spread throughout Europe. The following is one of the earlier[53] examples:

> "Avignon, October 5, 1339
> In the name of God, amen. To Bartolo [Casini] and partners, Barna of Lucca and partners [send] greetings from Avignon. You shall pay by this letter on November 20, [1]339, to Landuccio Busdraghi and partners, of Lucca, gold florins three hundred twelve and three fourths for the exchange [*per cambio*] of gold florins three hundred, because I have received such money today from Tancredi Bonagiunta and partners at the rate of 4½ per 100 to their advantage. And charge it to our account. Done on October 5, [1]339....
> To Bartolo Casini and partners, in Pisa.
> [Mark of Barna of Lucca]"[54]

Four parties can be identified in this instrument. They are a remitter or *datore* (Tancredi Bonagiunta), a drawer or *prenditore* (Barna of Lucca), a drawee (Bartolo Cassini in Pisa), and a payee (Landuccio Busdraghi).[55] The instrument accordingly embraces several different relationships.

The relationship between the remitter and payee is a simple debtor-creditor relationship. The remitter would typically have purchased goods from the payee. The relationship between the remitter and drawer is regulated by the exchange contract. In terms of this contract the drawer undertakes to pay the debt of the remitter. This is therefore an example of a *constitutum debiti alieni*.[56] The relationship between drawer and drawee could take different forms. The drawee was often the agent or partner of the drawer, in which case

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shows that the word "aval", which is part of the commercial codes of several European states (as well as part of South African law), is derived from the Arabic word *hawâla*. With reference to the possible Arab influence see also Holdsworth *supra* 174.

53 Holdsworth (*op cit* n 4) 173 refers to this instrument as the earliest example available to him. An earlier example, dated March 24, 1290/1, is referred to by Usher A P *The Early History of Deposit Banking in Mediterranean Europe* (1943) Russell & Russell New York 79.

54 The English translation is taken from Trakman (*op cit* n 11) 109. The original Italian of this instrument is quoted by Holdsworth (*op cit* n 4) 176 n 4.

55 See in general De Roover R "Money, Banking and Credit in Medieval Bruges" (1942) 2 *Journal of Economic History* 52 55-56.

56 See nn 20 and 21 above. On the extension of the *actio de pecunia constituta* to the remitter against the drawer in the event of the drawee not paying in terms of the letter of payment, see Holdsworth (*op cit* n 4) 178; Usher (*op cit* n 53) 88.

their relationship was governed by the agency or partnership agreement.[57] This was not, however, necessarily the case. It would appear from certain letters of payment that a merchant was sometimes simply provided with funds to meet bills to be drawn on him at some future date.[58] The relationship between the drawee and payee depended on whether the drawee had accepted the instrument. To be liable as against the payee, the drawee must have accepted the instrument.[59] With reference to the relationship between the drawer and the payee, it would appear that the payee had no right of recourse against the drawer in the event of the drawee not paying. The payee was simply a *solutionis causa adjectus*.[60]

So viewed the letter of payment, and especially its four-party structure, shows some resemblance to the modern documentary credit. As Stassen points out, however, the resemblance is superficial and limited to one common feature: in both instances the buyer and seller make use of intermediaries in the payment process.[61] There are two fundamental differences. First, as noted above, the payee of the letter of payment did not acquire a right against the drawer of the letter. In contrast, the very essence of the documentary credit is that the beneficiary acquires a right against the issuing bank. Secondly, the abstract quality of the modern confirmed credit was absent from the medieval letter of payment. Holdsworth explains:

> "[T]he rights of the payee [against the drawee] depended upon the fact that value had been given by the person who wished to remit the money to the drawer, and that this value had been passed over to the drawee for the benefit of the payee. It followed that if the drawer had never received this value he could not have passed it to the drawee; and that the drawee, even if he had

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57 Malan (*op cit* n 46) 15; Usher (*op cit* n 53) 87; Holdsworth (*op cit* n 4) 178.

58 An example provided in Trakman (*op cit* n 11) 110 contains the following endorsement by the drawee: "We do not pay them because we do not have the funds in your [account]." See also Usher (*op cit* n 53) 87; Holdsworth (*op cit* n 4) 178-179.

59 Failure to protest was at first construed as acceptance, but by the end of the 14th century written acceptance was generally required by mercantile custom or statute. Acceptance later became so much the rule that it was left to the payee to make this protest in the event of non-acceptance or non-payment. See Holdsworth (*op cit* n 4) 179; Usher (*op cit* n 53) 87-88.

60 Malan (*op cit* n 46) 30; Stassen (*op cit* n 1) 16-17; Kozolchyk (*op cit* n 13) par 1. The contrary view of Holdsworth (*op cit* n 4) 179-180 and Usher (*op cit* n 53) 88-89 is based upon a misinterpretation of Baldus. See in this regard Malan (*op cit* n 46) 21 n 12.

61 (*Op cit* n 1) 16.

accepted, could plead this fact as a defence to any action by the payee."[62]

2 4 3 The Mercantile (Open) Letter of Credit

The Generalkreditbrief

Instruments referred to in legal literature as "letters of credit" can be traced back to at least the middle of the twelfth century.[63] These early instruments were typically issued by kings, popes or other rulers to loyal servants named in the letters, in order to enable such servants to procure advances for the account of the issuer.[64] As was the case with the early *cambium* contracts, these instruments originated from the desire to avoid the risky transportation of large amounts of coins.[65] Goldschmidt gives the following example of such an instrument issued by King John:

> "John, by the grace of God. Greetings to all merchants who shall inspect these letters. May you all know that we have destined the bearers of the present [i e these letters], Hugo de Feritate and Robertus de Sablenc', to the Roman court for the promotion of our affairs, and that we shall be held liable to pay back, to merchants from whom they may have accepted money up to five hundred marks of silver as a loan, the same amount, and foremostly regarding this matter, we by these letters constitute ourselves as debtors, and on the date of expiry [of the loan] according to the convention entered into between our chosen clerics and the merchants, we shall be made to discharge the full amount of money to those who return our present letters to us or to our representative, together with open letters of the chosen

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62 Holdsworth (*op cit* n 4) 181.

63 Goldschmidt (*op cit* n 35) 398; Davis A G *The Law relating to Commercial Letters of Credit* (1963) Pitman London 2; Ellinger (*op cit* n 1) 24; Thayer P W "Irrevocable Credits in International Commerce: Their Legal Nature" (1936) 36 *Columbia Law Review* 1031 1032.

64 According to Goldschmidt (*op cit* n 35) 398 these letters were used in the crusades as well as by English medieval kings, and very often by Louis IX of France. See also Bewes (*op cit* n 3) 55-6; Davis (*op cit* n 63) 2; Ellinger (*op cit* n 1) 24. De Roover (*op cit* n 55) 56-57 mentions that part of the business of the Italian merchants was to make loans to such rulers. He makes the point that these loans were dangerous because they tied the lender to the political fortunes of the borrower. This could be disastrous, as evidenced by the liquidation of the Bruges agency of the Medici due to excessive loans to Charles the Bold and Maximilian of Austria.

65 Davis (*op cit* n 63) 2.

> clerics bearing witness to the sum of money accepted as a loan. Under my own hand -. 1202"[66]

This *Generalkreditbrief*, as it is termed by Goldschmidt, is clearly far removed from the modern documentary credit. It had little, if anything at all, to do with trade. It was simply an instrument which enabled the servants of a king or the crusaders of a pope, to acquire loans they may have needed, in their furtherance of the affairs of the issuer. It was far easier for these servants to acquire the loans, because of the issuer's good credit standing and because the issuer, by the letter, constituted himself as the debtor for any loan made in accordance with the letter.

The Development of the Mercantile (or Open) Letter of Credit in England

Merchants, inspired in all probability by the *Generalkreditbrief*, eventually started issuing letters of credit of their own to facilitate trade. These letters of credit may have been used by Italian merchants as early as the fourteenth century,[67] but the evidence in this respect is inconclusive.[68] It is clear, however, that they were known to the English merchants of the early seventeenth century. Malynes devotes a chapter of his treatise on the *lex mercatoria* to "Letters of Credit and Blankes signed" in which he describes the letter of credit as follows:

> "A Merchant doth send his friend or his servant (either within the Land or beyond the Seas) to buy some commodities, or to take up money for some purpose, and doth deliver unto him an open Letter, directed to another Merchant, requiring him that if his friend such a one, the Bearer of that Letter (being either his

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66 The translation is my own (with the kind assistance of Reinhard Zimmermann). The original Latin, quoted by Goldschmidt (*op cit* n 35) 399, is as follows: "Johannes Dei gratia etc. Universis mercatoribus has litteras inspecturis Salutem. Noverit universitas vestra, quod nos latores praesentium, Hugonem de Feritate et Robertum de Sablenc', pro negotiis nostris promovendis ad Romanam curiam destinamus et mercatoribus a quibus pecuniam usque ad D marcas argenti pro ipsis negotiis promovendis mutuo acceperint, ipsam pecuniam persolvere tenebimur: et nos per praesentes litteras principaliter super hoc constituimus debitores et termino statuto secundum conventionem inter praedictos clericos nostros et mercatores factam illis qui praesentes litteras nostras nobis vel mandato nostro reddent, una cum litteris praedictorum clericorum patentibus summam pecuniae mutuo acceptae protestantibus, pecuniam ex integro faciemus persolvi. Teste me ipso -. 1202."

67 Trimble (*op cit* n 5) 982-985; Ellinger (*op cit* n 1) 24.

68 I could find no satisfactory example. That quoted by Trakman (*op cit* n 11) 110 as a letter of credit appears to me to be a letter of payment. Trimble (*op cit* n 5) 985 n 15 claims, without quoting an example, to have copies of "letters of credit" used by the Italians and the Medici Bank in Bruges during the late fourteenth century. He does not, however, attempt to distinguish between a letter of payment and a letter of credit, and the provisions in these letters referred to by him could also relate to letters of payment.

> friend or servant) have occasion to buy commodities, or to take up moneys to the value of so many hundreths, or so many thousand pounds in that place or thereabouts; that hee will either procure him the fame, or passe his promise, Bill, or Bond for it, and hee will provide him the money, or pay him by exchange, or give him such satisfaction as hee shall require: the partie to whom this Letter is directed will accordingly doe his endevour and performe the request of the other, and keepe the Letter for his assurance or securitie, and what hee doth thereupon undertake, is made apparant by such Writings or Evidences as hee taketh of the said Bearer of the Letter, that thereupon hee may bee well dealt withall accordingly."[69]

Malynes's description envisages a letter addressed to a specific merchant (for example a business partner or correspondent of the issuer). However, it is clear from Marius, another seventeenth century commentator on English law, that a letter of credit could be either special (when addressed to a specific merchant) or general (when not addressed to any person in particular but to whomsoever would choose to act on it).[70] The letter of credit of this period, which is generally referred to as an *open*[71] *(or traveller's*[72]*) letter of credit* in contemporary legal literature, continued to be used in England during the eighteenth and nineteenth centuries.[73] However, until well into the nineteenth century there was very little case law on these instruments. The paucity of decisions led Davis to conclude that letters of credit may not have been in common use.[74] However, Malynes ascribes a "reputation" to letters of credit, which implies that they must have been well known.[75] Furthermore, Ellinger's

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69 Malynes (*op cit* n 32) 104.

70 See Davis (*op cit* n 63) 1. See also Story J *Commentaries on the Law of Bills of Exchange, Foreign and Inland as Administered in England and America* 4ed (1860) Boston 577-578.

71 Ellinger (*op cit* n 1) 5-7, 24-26; Story (*op cit* n 70) 574; Stassen (*op cit* n 1) 17.

72 Davis (*op cit* n 63) 1.

73 This is clear from the textbooks of Giles Jacob. See in this regard Davis (*op cit* n 63) 4-5 who quotes from Jacob G *A New Law Dictionary* (1782) and from *Comyns Digest V* (1822). The following definition from Comyns shows that Malynes's letter of credit had remained very much the same for 2 centuries: "A bill of credit is, when a merchant sends a letter by a servant or agent to another merchant, within the realm, or in foreign parts, whereby he desires him to give credit to the bearer for goods or money, to such a value. So he may give a general letter of credit to all merchants or others, for all monies delivered to such a one, within such a time: and thereupon shall be liable for all monies advanced to such agent." See also Ellinger (*op cit* n 1) 25 who cites Jacob G *Lex Mercatoria, or the Merchant's Companion* (1729) London.

74 (*Op cit* n 63) 5-6.

75 (*Op cit* n 32) 104.

argument that letters of credit would not have been discussed in Jacobs's *Lex Mercatoria or the Merchant's Companion* had they been scarce, due to the fact that this book was intended as an everyday reference book for merchants, is persuasive.[76] According to Story, also, letters of credit were "in common use in our [i e American] commerce with foreign countries".[77] It would therefore appear that the reason for the dearth of case law during this period must be sought elsewhere. A possible explanation may well be the importance to merchants, so stressed by Malynes,[78] of having a good credit standing. Hence, merchants simply adhered meticulously to their undertakings in letters of credit and did not litigate.

There were, however, a few cases which deserve mention. In the case law prior to the nineteenth century specific references to letters of credit by name were scarce and, where encountered, insignificant.[79] Nevertheless, there were some early decisions which dealt with something very similar, namely an undertaking by a merchant to accept bills of exchange to be drawn on him. *Pillans v Van Mierop*[80] provides an apt point of departure. The plaintiffs, merchants in Rotterdam, had promised White, an Irish merchant, that they would accept a bill of exchange drawn by him for £800, if White would give them as reimbursement a "confirmed credit upon a house of rank in London".[81] White named the defendants whereupon the plaintiffs honoured White's draft. The

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76 (*Op cit* n 1) 25.

77 (*Op cit* n 70) 573.

78 "The Credit of Merchants is so delicate and tender, that it must be cared for as the apple of a mans eye: Hence it doth proceed that Letters of Credit are had in such reputation, that the giver of them will bee well advised before he doth make them; and the partie to whom they are directed will bee carefull to accomplish them, for it doth concern both their credits ((*op cit* n 32) 104).

79 See *Pillans v Van Mierop* (1765) 3 Burr 1663 (97 ER 1035 1037); *Pierson v Dunlop* (1777) 2 Cowp 571 (98 ER 1246 1247); *Russel v Langstaffe* (1780) 2 Doug 514 (99 ER 328 329). In the last-mentioned case Lord Mansfield remarked that "[t]he endorsement on a blank note is a letter of credit for an indefinite sum". That signed blank notes were so viewed and used by merchants is also borne out by Malynes' treatment of letters of credit and "blankes signed" in the same chapter ((*op cit* n 32) 104-106). Having concluded his discussion of letters of credit the discussion of signed blank notes is introduced as follows: "The Signing of Blankes, is also a Custome among Merchants, whereby they strengthen the credit of their Factors or Servants in the like occasions."

80 (1765) 3 Burr 1663 (97 ER 1035).

81 1035 (ER). The term "confirmed credit" as used here must clearly not be understood in its modern meaning explained in par 1 6 3 above.

plaintiffs subsequently wrote to the defendants inquiring "whether they will honour their drafts for £800 in about a month's time".[82] The defendants replied that they would. However, when plaintiffs subsequently drew on them, they refused to pay due to White's insolvency. The question to be decided was accordingly whether the defendants were, under these circumstances, bound by their undertaking.

The defendants' undertaking in this case had one peculiar feature. The plaintiffs had already honoured White's draft before the defendants had undertaken to accept plaintiffs' draft. Thus, according to the defendants, there was no consideration for their promise. They were nevertheless held liable. "In commercial cases amongst merchants", said Lord Mansfield, "the want of consideration is not an objection".[83] Judge Wilmot, on the other hand, was prepared to find consideration in the fact that once the defendants had undertaken to accept plaintiff's draft, White's obligation as against the plaintiffs was discharged.[84]

This case stressed the general importance of merchants complying with their undertakings. Thus, the undertaking to accept had to be regarded as a "virtual acceptance",[85] that is as tantamount to an acceptance itself.[86]

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82 1037 (ER).

83 1038 (ER). This contention of Lord Mansfield was later rejected in *Rann v Hughes* (1778) IV Brown 27 (2 ER 18 21). The common law had thereby triumphed over the *lex mercatoria* - a development not favourably received by all. See for example Schmitthoff (*op cit* n 37) 55-56: "Diese Rechtsprechung des höchsten englischen Gerichtshofs stellte einen Sieg des Nationalrechts über die Denkweise des Kaufmannsstandes dar, der bis zum heutigen Tage seine nachteiligen Folgen behalten hat. ... Es ist indessen bemerkenswert, daß am Ende sich die Bedürfnisse des Welthandels doch als stärker erwiesen haben als der nationalrechtliche Begriff der consideration, und zwar im Bankrecht: der englische Bills of Exchange Act, 1882, sieht bereits vor, daß eine schon bestehende Schuld oder Verbindlichkeit ... wirksame consideration für ein Wechselversprechen sein kann. Noch klarer ist dieser Sieg des handelsrechtlichen Denkens über nas nationalrechtliche Dogma indessen auf dem Gebiete des ... Dokumenten-Akkreditivs."

84 1039 (ER).

85 On the doctrine of virtual acceptance in general see Anonymous "When a Promise Contained in a Letter of Credit is a Virtual Acceptance" (1925) 25 *Columbia Law Review* 819.

86 In Lord Mansfield's words: "'I will give the bill due honour,' is, in effect, accepting it. If a man agrees that he will do the formal part, the law looks upon it (in the case of an acceptance of a bill) as if actually done." (1038 (ER)). See also Judge Yates's rendition: "This agreement 'to honour their bill' was a virtual acceptance of the bill." (1041 (ER)).

This doctrine that a person who has made a parol[87] promise to accept a bill, has made a "virtual acceptance" was followed in several subsequent cases.[88] Of special interest, if this matter is viewed from the perspective of letters of credit, are the following remarks of Parke B in *The Bank of Ireland v Archer and Daly*:

> "The case of *Pillans v. Van Mierop* appears to be the authority on which the doctrine, that a person can be bound by a promise to accept a future bill, is rested. It is not quite clear from the report of that case, on what ground the defendant was held liable to the plaintiffs, the drawers; whether on his special contract with them to accept, or as actual acceptor. ... In Beawes' Lex Mercatoria ... a promise to accept is apparently put on the ground of a contract, for a breach of which an action lies, and not as being an actual acceptance."[89]

These remarks reveal the relationship between a parol acceptance and a letter of credit. The special contract, referred to here, is, it is submitted, essentially a letter of credit.[90] However, the cases concerned with the undertaking by a merchant to accept bills drawn on him, were at first mainly argued on the basis of the merchant being liable as an acceptor. One such case which deserves special attention is *Mason v Hunt*.[91] The defendants had agreed in writing to accept bills of exchange drawn on them by Vance subject to certain conditions. The conditions were *inter alia* that the bills of exchange would be drawn at a rate of £80 per hogshead of tobacco shipped by Vance, that orders for insurance of the cargo were to be given to the defendants and that the bills of lading consigned to the defendants, were to be sent to them. The bills of exchange were subsequently drawn by Vance in favour of himself and endorsed to the plaintiff. The defendants, however, refused to accept the bills, due to the fact that the tobacco was found to be much below the stipulated value.

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87 "Parol" is clearly used here, not in the usual sense of "oral" but in the sense of writing extrinsic to the bill of exchange.

88 *Wilkinson v Lutwidge* 1 Strange 648 (93 ER 758); *Pierson v Dunlop* (1777) 2 Cowp 571 (98 ER 1246); *Wynne v Raikes* (1804) 5 East 514 (102 ER 1167).

89 (1843) 11 M&W 383 (152 ER 852 855).

90 See Anonymous (*op cit* n 85) 819 where the following is stated: "A virtual acceptance is a species of letter of credit. The letter of credit and the virtual acceptance have at least this much in common; they both contain a promise to pay or accept a draft". See also Davis (*op cit* n 63) 6-7; Ellinger (*op cit* n 1) 26.

91 (1779) 1 Doug 297 (99 ER 192).

Lord Mansfield, in considering the liability of the defendants, held:

> "If one man, to give credit to another, makes an absolute promise to accept his bill, the drawer or any other person, may shew such promise upon the exchange, to get credit, and a third person, who should advance his money upon it, would have nothing to do with the equitable circumstances which might subsist between the drawer and acceptor. But an agreement to accept is still but an agreement, and if it is conditional and a third person takes the bill knowing of the conditions annexed to the agreement, he takes it subject to such conditions."[92]

However, as the condition relating to the value of the tobacco had not been met, the plaintiffs' claim was rejected.

The special significance of this case is that the merchant's (defendants') undertaking was made subject *inter alia* to the delivery to him of the bills of lading. This case therefore provides an early example of a letter of credit in which a merchant undertakes to accept bills drawn on him against delivery to him of the documents of title. Thus, in this case, the parol acceptance (letter of credit) was "documentary" in the same sense as the modern documentary credit.

However, the doctrine of virtual acceptance was not destined to survive long in England.[93] In 1800, in *Johnson v Collings*, it was clearly laid down that the promise to accept an undrawn bill could not amount to an acceptance.[94] The parol acceptance of a bill already drawn was furthermore rendered ineffective by the legislature, for inland bills in 1821,[95] and for all other bills in 1856.[96] In the United States, however, until the introduction of the Uniform Commercial Code (UCC) in 1958,[97] the doctrine of virtual acceptance survived[98] and continued to be applied also in the context of letters of credit.[99]

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92 194 (ER).

93 On the rise and demise of this doctrine in England see Holden J M *The History of Negotiable Instruments in English Law* (1955) University of London Athlone Press 137-138, 149-153.

94 (1800) 1 East 98 (102 ER 40). See also *Bank of Ireland v Archer and Daly* (1843) 11 M&W 383 (152 ER 852).

95 S 2 of the Regulation of Acceptances Act, 1821 (1 & 2 Geo 4 c 78).

96 S 6 of the Mercantile Law Amendment Act, 1856 (19 & 20 Vict c 97).

97 § 3-409(a). On the UCC in general see par 3 10 2 below.

Clearly, as noted by Holden, the demise of the doctrine of virtual acceptance in England "brought with it certain difficulties in connection with the law and practice relating to [open] letters of credit".[100] A new basis had to be found for holding the issuer liable. This matter came to the fore in *In re The Agra and Masterman's Bank (Limited), ex parte The Asiatic Banking Corporation (Limited)*.[101] The Agra and Masterman's Bank had given D an open letter of credit authorising D to draw bills of exchange on them. The last passage in the letter was: "parties negotiating bills under it are requested to indorse particulars on the back hereof."[102] D subsequently drew bills on the Agra Bank. In reliance on the letter of credit the bills were discounted by the Asiatic Banking Corporation. The Agra and Masterman's Bank refused to pay the bills on the ground that it in turn had a claim against D exceeding the amount of the bills. Dismissing submissions by which the Asiatic Banking Corporation attempted to re-establish the doctrine of virtual acceptance Lord Justices Turner and Cairns found that the Agra and Masterman's Bank was contractually bound to the Asiatic Banking Corporation to honour the bills. The nature of the letter was explained as follows by Cairns LJ:

> "It is a general invitation issued by the Agra & Masterman's Bank (Limited), through Dickson, Tatham & Co. [D], to all persons to whom the letter might be shewn, to take bills drawn by Dickson, Tatham & Co. on the Agra & Masterman's Bank (Limited) with reference to the letter, and to alter their position by paying for such bills, and an assurance that, if they or any of them would do so, the Agra & Masterman's Bank (Limited) would accept such bills on presentation.

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98 See in this regard Story (*op cit* n 70) 288-296. See also Holden (*op cit* n 93) 153. The doctrine also formed part of the Negotiable Instruments Law (NIL). § 134 provides: "Where an acceptance is written on paper other than the bill itself, it does not bind the acceptor except in favor of a person to whom it is shown and who, on the faith thereof, receives the bill for value." S 135 extends the doctrine also to undrawn bills in certain circumstances: "An unconditional promise in writing to accept a bill before it is drawn is deemed an actual acceptance in favor of every person who, upon the faith thereof, receives the bill for value." The NIL governed most American states until eventually replaced by the UCC.

99 See Beutel F K *Beutel's Brannan - Negotiable Instruments Law* 7 ed (1948) Greenwood Press Westport 1239-1241.

100 (*Op cit* n 93) 151.

101 (1867) 36 LJNS 222 (Ch).

102 225.

> If it be necessary to determine the question of the legal liability of the Agra & Masterman's Bank (Limited), I am of opinion that, upon the offer in this letter being accepted and acted on by the Asiatic Banking Corporation, there was constituted a valid and binding legal contract against the Agra & Masterman's Bank (Limited) in favour of the Asiatic Banking Corporation."[103]

Thus, by the end of the nineteenth century, it was firmly established in English law that the issuer of a open letter of credit was contractually liable as against a third party who acted on the faith of it. It is also clear from the *Agra* case that the liability was abstract in the sense of being free from equities between the issuer and its client. Cairns LJ expressed this principle thus:

> "The essence of this letter is, as it seems to me, that the person taking bills on the faith of it is to have the *absolute* benefit of the undertakings in the letter, and to have it in order to obtain the acceptance of his bills ... *without reference to any collateral or cross claims*. Unless this is done, the letter is useless... ."[104]

The Roman-Dutch Law relating to Open Letters of Credit

The Roman-Dutch sources contain very little information on these instruments. Van der Linden briefly refers to the letter of credit as one of the commercial instruments resembling but differing materially from a bill of exchange.[105] In so doing he refers to Pothier's treatise on bills of exchange, which Van der Linden himself had translated into Dutch, and in which *Credit-Brieven* are dealt with more comprehensively:

> "'Er is eene zoort van Assignatie, welke men Crediet-Brief noemt, waar bij een Koopman of Banquier aan zijnen Correspondent op eene andere plaats verzoekt, om aan den persoon, in den Brief genoemd, zoo veel geld toe te tellen, als hij opgeven zal benoodigd te hebben.
>
> Men geeft deeze zoorten van Crediet-Brieven aan reizende lieden, op dat zij ontlast zouden zijn van de moeite, om te veel geld met zig mede te voeren. Deeze Brieven zijn zomtijds onbepaald, zomtijds bepaald tot eene zekere somme toe.

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103 225.

104 226 (my italics).

105 Van der Linden J *Institutes of Holland, or Manual of Law, Practice, and Mercantile Law, for the Use of Judges, Lawyers, Merchants, and All who Wish to Have a General View of the Law* (translated by Juta Sir Henry) 3ed (1897) Juta Cape Town 471, 473: "*Letters of credit*: by which a merchant or a banker requests his correspondent at another place to pay the person mentioned in the letter as much money as he states he requires."

> Zij bevatten niets meer, dan ééne enkele lastgeving, waar bij de Schrijver van den Brief den geen, aan wien die Brief houdt, belast, zekere somme aan den genoemden persoon uit te tellen.
>
> De Houder van den Brief wordt niet geöordeeld zig met den ontfangst te belasten: hij maakt van den Brief alleenlijk gebruik naar maate van zijne behoefte, en naar zijn goedvinden; en hy gaat geene verbintenis aan, dan door het ontfangen van het geld, welke verbintenis nederkoomt op een Contract van geld-leening, uit hoofde der aan hem gedaane aantelling van het geld."[106]

Although Pothier was, strictly speaking, a French and not a Roman-Dutch writer, the Roman-Dutch law of bills of exchange was modelled to a large degree on that of France,[107] and Pothier's treatise was regarded by Van der Linden as the most authoritative also for Holland.[108] In any event, neither Heineccius nor Phoonsen (the two other foremost Roman-Dutch authorities in the field of bills of exchange),[109] nor as far as I could ascertain any other Roman-Dutch authority, dealt with letters of credit. It would appear from Pothier's description, however, that the *Credit-Brief* did not differ materially from Malynes's *letter of credit*. Although, according to the Roman-Dutch law of Pothier's time, an acceptance need not necessarily have been on the bill

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106 Pothier R J *Verhandeling van het Wissel-Recht* (translated by Van der Linden J) (1801) A & J Honkoop Leyden 2 30.

107 Malan (*op cit* n 46) 56.

108 Van der Linden was unstinting in his praise of this work. He terms it a "keurlijk zamenstel van 't Wissel-recht ... waar in men, behalven den doorzichtigsten Rechtsgeleerden, ook te gelijk den Man opmerkt, die de gebruiken van den Koophandel, en de wel doorgedachte begrippen van ervaarene Kooplieden, eerbiedigde". See Pothier (*op cit* n 106) x (Voorbericht van den Vertaaler).

109 See Heineccius J G *Grondbeginselen van het Wisselrecht (naar de zevende uitgaaf vertaald, en met de noodige aanmerkingen verrykt en opgehelderd door Karel Koenraad Reitz)* (1774) Middelburg; Phoonsen J *Wissel-Styl tot Amsterdam (en daarna vervolgt en tot op dezen tyd verbeterd door I. le Long)* (1755) Rotterdam. Van der Linden did not think much of either of these works. With reference to Heineccius he remarks: "Zonder te kort te doen aan de verdiensten van HEINECCIUS, mogen wij met reden zeggen, dat, welk een groot en onvergelijkelijk Man hij ook in Letterkunde, in Oudheden, en in't Romeinsche Recht geweest moge zijn, het schrijven van een Werk, dat in den Koophandel een waar nut moet aanbrengen, de paalen van zijn vak scheen te buiten te gaan. Phoonsen is dismissed in the following terms: "... behalven den duisteren en verveelenden stijl, die de leezing van dit Werk alleronaangenaamst maakt, ziet men 'er, ja wel, den Koopman in, maar men derft den Rechtsgeleerden." See Pothier (*op cit* n 106) vii-viii (Voorbericht van den Vertaaler). In fairness though it must be remarked that Phoonsen was held in high regard by others as borne out by the fact that his work was subsequently translated into German and French. See Asser W D J "Bills of Exchange and Agency in the 18th Century Law of Holland and Zeeland" in Piergiovanni V (ed) *The Courts and the Development of Commercial Law* (1987) Berlin 107 who terms him "[a]n outstanding authority on the exchange law of Amsterdam".

itself,[110] it is further clear that Pothier did not regard the letter of credit as a (virtual) acceptance. Finally, it is probably fair to conclude from the dearth of authority on the topic that letters of credit did not give rise to many problems in practice.

Conclusion

As appears from the descriptions of both Malynes and Pothier, the purpose of the open letter of credit was to enable a travelling merchant to raise funds abroad. Due to the fact that the letter of credit contained the promise of the issuer to reimburse those who made advances on the strength of it, the letter strengthened the credit of its bearer or beneficiary. As such, the open letter of credit clearly differs in function from the modern documentary credit. Whilst the function of the open letter of credit was to raise funds abroad, the main function of the documentary credit is to constitute security for payment for goods.[111] The two instruments also differ in form: whereas the documentary credit is issued to the seller the open letter of credit is issued to the applicant (buyer), to enable him to discount bills drawn in terms of it. In this sense it is indeed the applicant himself who is the beneficiary of the open letter of credit. Ellinger concludes:

> "Documentary credits ... differ from open credits in object, scope and mechanism. One should therefore carefully distinguish authorities given in respect of open credits from those given in respect of documentary credits."[112]

2 5 The Emergence of the Modern Documentary Credit

The most thorough research on the emergence of the modern documentary credit has been that of Ellinger.[113] Hindered by the fact that most of the archives of the

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110 Phoonsen (*op cit* n 109) 10 8-11; Van der Keessel D G *Praelectiones Iuris Hodierni ad Hugonis Grotii Introductionem as Iurisprudentiam Hollandicam* (edited and translated into Afrikaans by Van Warmelo P, Coertze L I, Gonin H L) Vol IV (1966) Balkena Amsterdam Th 618; Heineccius (*op cit* n 109) 4 26 (Reitz's n 34). These authors all acknowledged the existence of a general rule to the effect that an acceptance need not be written on the bill itself, but also point out that a variety of Keuren require an acceptance to be written on the bill itself. It would appear that by Van der Linden's time an acceptance had to be written on the bill itself (*op cit* n 105) 4 7 8.

111 On the functions of documentary credits in general see par 1 4 above.

112 (*Op cit* n 1) 6-7.

113 (*Op cit* n 1) 26-37.

merchant bankers relevant to the nineteenth century had been destroyed, Ellinger nevertheless came to a reasoned (albeit somewhat speculative) conclusion that "documentary credits slowly developed from open credits during the first half of the nineteenth century".[114] It has already been noted that important elements such as the independence principle and documentary nature of the modern documentary credit can also be identified in the open letter of credit.[115] Furthermore, it is clearly evident from English and American case law discussed by Ellinger,[116] that during the course of the nineteenth century merchants progressively recognised the versatility of letters of credit and, in specific instances, adapted them to resemble closely the documentary credit of today.

The most significant case in this regard is that of *Gurney v Behrend*[117] in 1854. Although it does not deal specifically with issues relating to letters of credit, the payment arrangement between parties to the case shows a remarkable resemblance to the modern documentary credit. The headnote describes the arrangement as follows:

> "B., a Dantzick merchant, sold wheat to W., an Amsterdam merchant, to be paid for by drafts, to be drawn by B. on C., a London merchant, against bills of lading. W. was in fact ... acting for P., another London merchant. W. wrote to C. opening a credit, on account of P., in favour of B., to be drawn on against bills of lading, P. to be debited with the amount."[118]

The nature of the relationship between B, W and C is further clarified in the letter written by W to C:

> "By order and for account of ... [P], I beg to inform you that *I have opened a credit with your house in favour of ... [B]* in Dantzig for 10,000l.: Ten thousand pounds.

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114 (*Op cit* n 1) 27.

115 See the discussion of *In re The Agra and Masterman's Bank (Limited), ex parte The Asiatic Banking Corporation (Limited)* [1867] 36 LJNS 222 (Ch) and *Mason v Hunt* (1779) 1 Doug 297 (99 ER 192) in par 2 4 above.

116 (*Op cit* n 1) 28-36.

117 (1854) 3 El & Bl 622 (118 ER 1275).

118 1275 (ER).

> I therefore request you to honor the drafts at 2 m. d. of said Dantzig friends for this amount, *against bills of lading of wheat*, at the rate of 40s. per quarter, and to debit ... [P] for them."[119]

This arrangement differed from the typical open letter of credit of the period in that it was opened, not in favour of the applicant (or buyer), but in favour of a third party (the seller). The payment for the goods was thus effected by a letter of credit in terms of which the seller was entitled to acceptance of bills of exchange drawn on the issuer of the credit against the delivery of the bills of lading. Essentially, this is a documentary credit in its most basic form.[120] There are two minor differences: (i) the issuer of the *Gurney* credit was not a banker but a merchant; and (ii) it appears that the beneficiary was notified of the credit not by the issuer or his correspondent (as is the case with the modern documentary credit),[121] but by the applicant.[122] It is submitted, however, that these differences did not materially affect the nature of the relationships.

It must be pointed out that, although uncommon today, the issuing of letters of credit by merchants was typical of the period. During the first half of the nineteenth century the financing of international trade became an important part of the business of the large import and export merchants in England. It would appear that they often utilised letters of credit.[123] Biro states:

> "Für einen englischen Kaufmann, der Waren in ferne Länder verschiffen ließ, war damals die Erstellung eines Akkreditivs zu seinen Gunsten bei einem der großen Handelshäuser die beste Gewähr dafür, daß er auch pünktlich und ordnungsgemäß Bezahlung für seine Waren erhalten würde."[124]

The natural development from this point was that many of the large import and export merchants became merchant bankers. Thus, during the course of the latter half of the nineteenth century, letters of credit became the particular province of

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119 1276 (ER) (my italics).

120 See par 1 3 2 above.

121 See par 1 3 2 and 1 3 4 above.

122 See the letter of Behrend & Co to Collmann & Stolterfoht quoted on 1276 (ER).

123 Biro M "Das Akkreditivgeschäft der Merchant Bankers" (1959) 7 *Oestereichische Bank Archiv* 408-409. See also Ellinger (*op cit* n 1) 30.

124 (*Op cit* n 123) 409.

the merchant bankers. According to Biro their outstanding contribution in this regard was a major reason for London's later dominance in the world economy.[125]

Letter-of-credit (and documentary-credit) business remained mainly within the field of activity of the English merchant bankers until the end of the First World War after which it became part of the regular business of the commercial banks in London.[126] It was during this period, also, that documentary credits were first commonly issued by European bankers.[127]

It must be noted in conclusion that the earliest text book in which I encountered the term "documentary credit" was Hart's *Law of Banking* (1914). He does not, however, use the term in its modern meaning but rather in the sense of an open documentary credit.[128] The first legal writing dealing specifically with the documentary credit in the modern sense is post First World War.[129] This is probably an indication that documentary credits were not all that common earlier.[130] In any event, it is generally acknowledged that it was during the course of the twentieth century that the documentary credit attained its status as the most important instrument of payment in international trade, and was refined to its current format.[131] These developments form the subject-matter of the next chapter.

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125 (*Op cit* n 123) 409. See also Ellinger (*op cit* n 1) 34-35.

126 Ellinger (*op cit* n 1) 36-37; Biro (*op cit* n 123) 409-410.

127 Ritter C "Vom Akkreditiv" (1921) 4 *Hanseatische Rechts-Zeitscrift* 609 611-613 discusses certain earlier examples but states that prior to the First World War these were exceptions: "Die eigentliche 'Blüte' des Akkreditivs beginnt met dem Ende des Krieges." See also Reichardt H "Das Akkreditiv" (1926) 88 *Zeitschrift für Handelsrecht* 1. The position was similar in France. See Ellinger (*op cit* n 1) 37.

128 Hart H L *The Law of Banking* (1914) Stevens & Sons London 618 624.

129 In both the common-law and civil-law jurisdictions the first legal writing in this regard was in the form of substantial groundbreaking articles in law journals. See, for example, Hershey O F "Letters of Credit" (1918-1919) 32 *Harvard Law Journal* 1-39; McCurdy W E "Commercial Letters of Credit" (1921-1922) 35 *Harvard Law Review* 539-592, 715-742; Mead C A "Documentary Letters of Credit" 22 (1922) *Columbia Law Review* 297-331; Kalbfleisch F "Das 'Dokumenten-Akkreditiv'" (1921) 15 *Zeitschrift für Handelswissenschaftliche Forschung* 141-151; Ritter (*op cit* n 127) 609-629; Boes W & Hartenfels E "Das Waren- oder Dokumenten-Akkreditiv" 1922 *Die Bank* 657-664, 721-729; Reichardt (*op cit* n 127) 1-79.

130 See Hershey (*op cit* n 129) 1.

131 See chapter 3.

Chapter Three

The Development of the Uniform Customs and Practice for Documentary Credits[1]

3 1 Introduction

By the beginning of the twentieth century the documentary letter of credit, with all its essential features, was known to the Anglo-American mercantile world.[2] It was, however, especially after the First World War that documentary credits became very popular.[3] This was also the period in which they first came to be used extensively on the European continent.[4] This can be ascribed to the fact that whilst trade prior to the war was mostly conducted between concerns knowing and trusting one another, these links were severed during the war. New and unknown trading partners had to be sought.[5] Furthermore, this was a period of economic instability. Many merchants prospered or became insolvent in a very short time. Against this background traders relied on the documentary credit for security.[6] The technical achievements of this century, especially in the fields of transport and communication, also created better conditions for the development of this form of trade financing.[7]

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1 Much of the contents of this chapter has been published in the form of an article. See Hugo C "The Development of Documentary Letters of Credit as Reflected in the Uniform Customs and Practice of Documentary Credits" (1993) 5 *South African Mercantile Law Journal* 44-77.

2 See par 2 5 above.

3 See Regling W "Die Bedeutung des dokumentären Akkreditivgeschäftes in der Nachkriegszeit" (1963) 3 *Bank-Betrieb* 238-240.

4 See with reference to Germany Ritter C "Vom Akkreditiv" (1921) 4 *Hanseatische Rechts-Zeitschrift* 609 611-613; Wolff "Das Akkreditiv" (1922) 51 *Juristische Wochenschrift* 770; Reichardt H "Das Akkreditiv" (1926) 88 *Zeitschrift für Handelsrecht* 1. With reference to the Netherlands see Cahn E M *Het Accreditief* (1935) H J Paris Amsterdam 6, 9.

5 Ritter (*op cit* n 4) 613; De Rooy F P *Documentair Kredieten* (1980) Kluwer Deventer 9.

6 Ritter (*op cit* n 4) 613; Ellinger E P *Documentary Letters of Credit* (1970) University of Singapore Press Singapore 37. De Rooy (*op cit* n 5) 9.

7 Regling (*op cit* n 3) 239 having related in this regard the developments in sea, rail, road and air transport, concludes as follows: "Aber erst als es möglich wurde, Zahlungsanweisungen auf drahtlichem oder luftpostlichem Wege zu erteilen, insbesondere aber mittels häufig verkehrender Flugzeuge auch Dokumente in kürzester Frist an fast jeden Ort zu versenden, konnte das Dokumenten-Akkreditiv die Bedeutung erlangen, die diesem Zahlungsinstrument zuzusprechen ist."

There was however at this stage no standard form for documentary credits, or standard regulations surrounding the issue of such credits. Each bank conducting documentary-credit business issued its own form of documentary credit on the conditions it saw fit.[8] It became apparent that some form of standardisation of documentary credits was in the interests of merchants, bankers and trade as a whole.[9] Thus the era after the First World War was dominated by the quest to standardise or unify the regulation of documentary credits. The earliest efforts in this regard came from banks organised on a national or regional basis in several different countries agreeing on certain standard forms and interpretations. Most important, however, was the work of the International Chamber of Commerce (ICC). The uniformity which has today been attained, mainly through the efforts of the ICC, is impressive. This uniformity stems from the adherence of banks to the ICC's *Uniform Customs and Practice for Documentary Credits* (*UCP*). Adherence can be on a collective national basis in which case the banks in a specific country collectively signify their adherence, or on a individual basis in which case certain or all the banks in a specific country individually signify their adherence. As from 5 April 1990 the banks of 81 countries throughout the world have signified their adherence on a collective basis. Banks in 67 further countries have signified their adherence on an individual basis.[10]

The *UCP* is of special importance in the twentieth century history of documentary credits. It is, in the first place, the vehicle by which the ideal of standardisation of documentary credits has, to a large extent, been attained. But, secondly, having been reviewed and adapted several times, the changing face of the *UCP* reflects

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8 Harfield H *Bank Credits and Acceptances* (1974) Ronald Press Company New York 196-197.

9 Ebertsheim H "Das Akkreditiv-Regulativ der Berliner Stempelvereinigung" (1923) 21/22 *Juristische Wochenschrift* 915, for instance, states as follows: "Das Dokumentenakkreditiv hat trotz der großen wirtschaftlichen Bedeutung, die es in den letzten Jahren erlangt hat, keine einheitliche Behandlung erfahren. Es fehlt an einer speziellen gesetzlichen Regelung, aber auch an einem allgemeinen Handelsbrauch ... Die Folge ... war eine bedauerliche Unsicherheit, die zu zahlreichen Rechtsstreitigheiten führte." See also Ellinger (*op cit* n 6) 37-38; Kozolchyk B *Letters of Credit* in Ziegel J F (ed) *International Encyclopedia of Comparative Law IX* (1979) J C B Mohr (Paul Siebeck) Tübingen par 21-25.

10 A list, issued by the ICC itself, of the different countries where the banks have adhered collectively, as well as the countries where banks have adhered on a individual basis (including the specific banks in these countries which have adhered on an individual basis), was published in December 1990 *Letter of Credit Update* 29. These statistics referring to the 1983 revision are the most recent I have been able to find. Very much the same trend is likely to occur regarding the current 1993 revision.

developments in the law and practice of documentary credits. It is with these aspects that this chapter is primarily concerned.

3 2 The First Moves towards Unification

The first moves towards standardising documentary-credit practice came from the United States. After the enactment of the American Federal Reserve Act[11] in 1913, New York bankers established study groups to look into the standardisation of existing banking practices. One of these study groups was the New York Bankers Commercial Credit Conference.[12] In 1920 this group published the *Regulations Affecting Export Commercial Credits* (*RAECC*).[13] The *RAECC* was subscribed to by 34 banking institutions,[14] each of which informed its correspondent banks abroad that the *RAECC* would in future govern the treatment of export credits.

The *RAECC* clarified certain vague terms encountered in documentary credits such as "documents" or "shipping documents",[15] "prompt shipment" or "immediate shipment",[16] and with reference to time, the words "to", "until" and "on".[17] The form of bills of lading was also dealt with.[18] It was furthermore provided that "[i]nstructions shall be interpreted according to our laws and customs".[19] Export

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11 38 Stat 263 (1913).

12 See Taylor D "U.S. Council on Int'l Banking and the UCP, A Brief History" June 1990 *Letter of Credit Update* 12. See also Ellinger E P "The Uniform Customs - Their Nature and the 1983 Revision" 1984 *Lloyd's Maritime and Commercial Law Quarterly* 578 who refers to this conference as the "New American Commercial Credits Conference".

13 The full text of the 1920 *RAECC* is published in June 1990 *Letter of Credit Update* 40-42. See also Taylor (*op cit* n 12) 12; De Rooy (*op cit* n 5) 9-10; Cahn (*op cit* n 4) 10.

14 Amongst the subscribers were the National Bank of South Africa Ltd and the Standard Bank of South Africa Ltd. See June 1990 *Letter of Credit Update* 41.

15 A 2. These terms were understood to comprise only "ocean bills of lading ... and marine and war insurance, in negotiable form, with invoices".

16 A 5F. This meant "shipment within thirty days from the date of our credit advice".

17 A 5D. These words were interpreted as "to include the date mentioned". A 5E provides that "[w]hen the indicated expiration date ... falls upon a Sunday or legal holiday here, the expiration is extended to the next succeeding business day".

18 See A 3, 4, 5A and 5B.

19 A 5.

terms drafted and accepted in 1919 by a conference in which the interests of industry, trade and commerce were well represented, were expressly incorporated.[20] These export terms were later to become known as the *American Foreign Trade Definitions*. The legal relationships between the different parties were not dealt with in the *RAECC*, with the single exception of article 1 in which the subscribing banks described their own position as follows:

> "We assume no liability or responsibility for the form, sufficiency, correctness, genuineness or legal effect of any documents, or for the description, quantity, quality, condition, delivery or value of the merchandise represented thereby, or for the good faith or acts of the shipper or any other person whomsoever; but documents will be examined with care sufficient to ascertain whether on their face they appear to be regular in general form."

Similar developments were soon to follow on the European continent. In 1922 the Berliner Stempelvereinigung decided to compile uniform rules for the treatment of documentary credits.[21] Their effort, the *Regulativ des Akkreditivgeschäfts der Berliner Stempelvereinigung*,[22] came into force on 1 January 1923.[23] Commenting on the importance of this document, Ebertsheim writes as follows:

> "Dieses Regulativ ist lediglich eine Vereinbarung privater Natur; doch wird es voraussichtlich große Bedeutung erlangen, da der genannten Vereinigung die bedeutendsten Finanzinstitute Berlins angehören und anzunehmen ist, daß auch die Bankinstitute außerhalb Berlins mit der Zeit das Regulativ in ihre Geschäftsbedingungen aufnehmen werden."[24]

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20 A 5J. The conference was attended by the National Foreign Trade Council, Chamber of Commerce of the USA, National Association of Manufacturers, American Manufacturers' Export Association, Philadelphia Commercial Museum, American Exporters' and Importers' Association, Chamber of Commerce of the State of New York, New York Produce Exchange and the New York Merchants' Association.

21 See Ebertsheim (*op cit* n 9) 915; Ellinger (*op cit* n 12) 578.

22 Hereinafter referred to as the *Regulativ*.

23 Ebertsheim (*op cit* n 9) 915; Eisemann F and Schütze R A *Das Dokumentenakkreditiv im Internationalen Handelsverkehr* 3 ed (1989) Verlag Recht und Wirtschaft Heidelberg 47; Zahn J C D, Eberding E and Ehrlich D *Zahlung und Zahlungssicherung im Außenhandel* (1986) Walter de Gruyter Berlin par 1/11.

24 (1923) 21/22 *JW* 915. In 1926 an identical *Regulativ* was adopted by the Hamburg bankers. See in this regard Cahn (*op cit* n 4) 10. In time virtually all the German banks adopted this *Regulativ*. See Angersbach U *Beiträge zum Institut des Dokumenten-Akkreditivs* (1965) Julius-Maximilians-Universität Würzburg 11.

The *Regulativ*[25] contained more substantive provisions than the *RAECC*. It was indeed an attempt to regulate all matters pertaining to documentary credits.[26] With reference to the purpose of the *Regulativ*, Jacoby states:

> "Das Regulativ soll der theoretischen Unsicherheit in der juristischen Beurteilung des Akkreditivgeschäfts und der Verschiedenartigkeit in der praktischen Handhabung ein Ende machen. Es soll gleichzeitig den Kaufleuten, die Akkreditive stellen, Richtlinien für das geben, was sie hierbei zu beachten haben. ... Es wird als Basis der Rechtsverhältnisse zwischen den Parteien dienen und damit Rechtschaffend wirken."[27]

The *Regulativ* had three subdivisions. The first established the difference between revocable and irrevocable letters of credit (*widerrufliche und unwiderrufliche Akkreditiv*). In this context it is interesting to note that the *Regulativ* displayed the same confusion between irrevocable and confirmed credits apparent in the Anglo-American literature of the time,[28] by equating the *unwiderrufliche* and *bestätigte Akkreditiv*.[29] The second subdivision was concerned with particularities relating to the documents encountered in documentary-credit business, while the third subdivision contained directives as to the interpretation of the instructions to the bank to issue a documentary credit.

The bankers in other European centres soon followed suit. In 1924 uniform rules were adopted in Norway and France as well as by the banks of Vienna, and thereafter by Italy, Sweden and Czechoslovakia in 1925, and Copenhagen in

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25 The full text is quoted as "Anlage 1" to the article of Jacoby A "Das Regulativ des Akkreditivgeschäfts der Berliner Stempelvereinigung" (1922/1923) 22 *Bankarchiv* 101 108-109.

26 As stated by Ebertsheim (*op cit* n 9) 916: "Mit Absicht hat das Regulativ eine vollständige Regelung aller das Akkreditiv betreffenden Fragen getroffen."

27 (*Op cit* n 25) 101.

28 See Gutteridge H C & Megrah M *The Law of Bankers' Commercial Credits* 7 ed (1984) Europa Publications Ltd London 17; Hershey O F "Letters of Credit" (1918-1919) 32 *Harvard Law Review* 1 20; Mead C A "Documentary Letters of Credit" (1922) 22 *Columbia Law Review* 297 299.

29 Jacoby (*op cit* n 25) 102; Ebertsheim (*op cit* n 9) 915. On the *widerrufliche, unwiderrufliche, bestätigte und unbestätigte Akkreditiv* as viewed at this time, see in general the articles of Boes W & Hartenfels E "Das Waren- oder Dokumenten-Akkreditiv" 1922 *Die Bank* 657-664, 721-729; "Die verschiedenen Formen der Dokumentar-Akkreditive" 1923 *Die Bank* 81-88.

1926.[30] In the Netherlands it was at first feared that rules for documentary credits would cause these instruments to stagnate.[31] Although standard formulas were drafted in 1923, they were merely available for use by bankers on a purely voluntary basis.[32] Uniform rules were nevertheless eventually accepted in the Netherlands in 1930.[33] The English and Commonwealth banks, however, were not in favour of written rules relating to letters of credit.[34] Their reluctance in this regard was to continue for several decades.[35]

In the meanwhile, in 1924, what is now known as the United States Council on International Banking was founded in New York under the name of the Junior Committee.[36] The New York Bankers Commercial Credit Conference no longer existed and the task of revising the *RAECC* fell to the Junior Committee.[37] Its revision was adopted and subscribed to by 38 banks[38] in 1926.[39] The form of the revised *RAECC* remained very much the same. The most noteworthy change was that the banks, in addition to the provisions of the 1920 version, also made clear that they assumed no liability for the "solvency, standing etc., of the carriers or

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30 Harfield (*op cit* n 8) 201-202; Ellinger (*op cit* n 6) 37, and (*op cit* n 12) 578; Lücke G *Das Dokumentenakkreditiv in Deutschland, Frankreich und der Schweiz: Eine rechtsvergleichende Darstellung* (1976) Christian Albrechts Universität Kiel 12-14.

31 De Rooy (*op cit* n 5) 10.

32 De Rooy (*op cit* n 5) 10.

33 De Rooy (*op cit* n 5) 10; Cahn (*op cit* n 4) 10. These rules had the rather cumbersome name of the *Reglement van de Amsterdamsche Bankiersvereeniging te Amsterdam, Rotterdamsche Bankiersvereeniging te Rotterdam en den Bond Voor den Geld- en Effectenhandel in de Provincie te 's-Gravenhage, betreffende Documentair Credieten*. See also Ellinger (*op cit* n 12) 578.

34 Eisemann & Schütze (*op cit* n 23) 47.

35 See par 3 6 1 and 3 6 2 below.

36 Taylor (*op cit* n 12) 13.

37 Taylor (*op cit* n 12) 13.

38 It is interesting to note that the two South African banks who subscribed to the 1920 version (see n 14 above), did not subscribe to the revised version. Their acceptance of the 1920 *RAECC* was in all probability at a stage before the English banks had formulated an attitude towards uniform regulation of documentary credits.

39 The 1926 version of the *RAECC* is quoted in August 1990 *Letter of Credit Update* 26-28. See also Taylor (*op cit* n 12) 13.

insurers of the merchandise",[40] as well as for "consequences arising out of delay or loss in transit of letters and/or documents, or for delay, mutilation or other errors in the transmission of telegrams or cables".[41] The *American Foreign Trade Definitions* were still expressly incorporated.

These various national regulations undoubtedly helped to clarify certain issues in documentary-credit practice.[42] However, as documentary credits were used mainly in international transactions, the different national regulations fell short of providing a universal standard practice.[43] This could only be achieved through concerted action by the bankers and merchants of all the chief trading nations. The importance of the various national regulations was that they opened the way for international standardisation. The initiative for this "monumental task of almost biblical proportions"[44] came from the ICC.[45]

3 3 The ICC and UCP (1926-1933)

The first moves towards international unification of documentary credits came once again from the United States. It was on the initiative of the American Chamber of Commerce[46] that the ICC instructed its Committee on Bills of

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40 A 1.

41 A 2.

42 Harfield (*op cit* n 8) 201.

43 "Aan al deze regelingen kleefde echter de beperking dat zij niet boven het eigen nationale niveau konden uitstijgen", states De Rooy (*op cit* n 5) 10. See also Harfield (*op cit* n 8) 201; Eisemann & Schütze (*op cit* n 23) 47.

44 David E A "Irrevocable or Revocable? Let's Break with Tradition to End Problem" December 1989 *Letter of Credit Update* 15.

45 Eisemann & Schütze (*op cit* n 23) 47: "Die fehlende Einheitlichkeit der Richtlinien mußte sich als ein wesentliches Hindernis bei der Entwicklung des internationalen Handelsverkehrs erweisen. Da es zu den wichtigsten Aufgaben der IHK gehört, an der Förderung des internationalen Handels und des Zustandekommens eines einheitlichen Handelsrechts mitzuwirken, war es nicht erstaunlich, daß sie sich vom Zeitpunkt ihrer Gründung an vorgenommen hat, insbesondere auf dem gebiet des Dokumentenakkreditivs einen Beitrag zur internationalen Vereinheitlichung und Normalisierung zu leisten."

46 De Rooy (*op cit* n 5) 10.

Exchange and Cheques, with an appropriate extension of its terms of reference, to investigate the problem and report back.[47]

The committee saw[48] as the logical conclusion of its mission the preparation of "uniform regulations on export commercial credits". A draft was thus prepared dealing with "the various kinds of credits and undertakings they imply, with the responsibilities which banks decline to assume, with documents which the banks accept (bills of lading, insurance policies and underwriters' certificates, invoices, etc.) and with the meaning of certain banking terms and the definition of certain banking customs". This draft was subsequently circulated to the various national committees of the ICC for their comments and "inviting them to consult their national banking associations in preparing their replies". The draft was accompanied by comparative tables showing the regulations already adopted in various countries. The replies evidenced "the strong interest taken in the question", as well as "a great diversity of views".

The committee submitted a report, which it did not regard as final, to the 1927 ICC congress held in Stockholm, and invited the congress to extend its mission.[49] This interim report was in the form of "Draft uniform regulations on export commercial credits".[50] The final report of the committee was eventually presented to the 1929 congress of the ICC held in Amsterdam.[51] The report was accepted and published in 1930 as the *Uniform Regulations for Commercial Documentary*

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47 See the 1927 "Report of the ICC Committee on Bills of Exchange, Cheques and Export Commercial Credits" published in ICC Brochure 48. The full report is contained in December 1990 *Letter of Credit Update* 37-39. See also Cahn (*op cit* n 4) 10; De Rooy (*op cit* n 5) 10; David (*op cit* n 44) 15; Kalson D J "The International Monetary Fund Agreement and Letters of Credit: a Balancing of Purposes" (1983) 44 *University of Pittsburg Law Review* 1061 1066.

48 For what follows see the 1927 "Report of the ICC Committee on Bills of Exchange, Cheques and Export Commercial Credits" December 1990 *Letter of Credit Update* 37-39.

49 See Taylor D "New Notes to Credit Rules History" October 1990 *Letter of Credit Update* 14; Holländer A "Vereinheitlichung der Dokumentarakkreditive" *Blätter für internationales Privatrecht* (Beilage) (1928) 22 *Leipziger Zeitschrift für deutsches Recht* 137.

50 The full text of this document is contained in October 1990 *Letter of Credit Update* 48-53. For a German analysis see Holländer (*op cit* n 49) 137-146.

51 Ellinger (*op cit* n 12) 579 regards this as the "first genuine drive for international standardization".

Credits.[52] These regulations met with very little success, being accepted only by France and Belgium.[53] At the 1931 Congress of the ICC in Washington the Banking Committee for Documentary Credits[54] was given the task of revising the regulations. Its version, the first named the *Uniform Customs and Practice for Documentary Credits*,[55] was accepted at the 1933 congress of the ICC held in Vienna.[56]

The 1933 *UCP* met with considerably more success. It was immediately adopted by the banks of Germany, France, Italy, Rumania, Switzerland, Belgium and the Netherlands.[57] Conspicuously absent from this list is the United States of America. The American banks at first opted rather for a revision of the *RAECC*. This task fell to the Committee on Foreign Banking in 1932.[58] Significantly, as part of its effort, the Committee sent a copy of the *RAECC* to the ICC stating that the *RAECC* accurately reflected the American practice "and should be used as a model for the development of international rules".[59] In 1934 the revised *RAECC* was adopted and subscribed to by 44 American banks.[60] The form of the 1934 version of the *RAECC*[61] corresponded to that of the earlier versions. The indemnity provisions were however once again extended, the banks this time making clear

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52 Cahn (*op cit* n 4) 10; De Rooy (*op cit* n 5) 10; Eisemann & Schütze (*op cit* n 23) 47; David (*op cit* n 44) 15.

53 Cahn (*op cit* n 4) 10; De Rooy (*op cit* n 5) 10 n 5; Eisemann & Schütze (*op cit* n 23) 47.

54 I e the "Comité bancaire pour les Crédits documentaires".

55 The French text, i e the "Règles et Usances Uniformes relatives aux Crédits Documentaires" was, however, considered the original. See De Rooy (*op cit* n 5) 10.

56 Cahn (*op cit* n 4) 10; De Rooy (*op cit* n 5) 10; Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/11; Eisemann & Schütze (*op cit* n 23) 47; Ellinger (*op cit* n 6) 37-38; Harfield (*op cit* n 8) 226; David (*op cit* n 44) 15; Regling W "Die Vorschläge für eine zweite Revision der Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive" (1961) 1 *Bank-Betrieb* 13.

57 Cahn (*op cit* n 4) 10; Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/11; Eisemann & Schütze (*op cit* n 23) 47.

58 Taylor D "US Council on Int'l Banking and the UCP, a Brief History, Part II" July 1990 *Letter of Credit Update* 12 13.

59 Taylor (*op cit* n 58) 13.

60 Taylor (*op cit* n 58) 13.

61 The full text of the 1934 *RAECC* is published in September 1990 *Letter of Credit Update* 33-36.

that they also assumed no liability or responsibility for "errors of translation or interpretation of technical terms",[62] or for "consequences arising out of the interruption of our business either by a decision of a public authority, or by strikes, lockouts, riots, wars, Acts of God, or other causes beyond our control".[63] Certain other terms encountered in credits were also clarified, and the *American Foreign Trade Definitions* were once again expressly incorporated.

In 1934 the Committee on Foreign Banking seriously investigated the differences between the *UCP* and the *RAECC*, and in 1938 eventually agreed to the adoption of the *UCP*.[64] At that time 128 American banks were willing to adopt the *UCP*,[65] but only with reference to export credits, and subject to certain reservations.[66] These reservations were annotated as "Guiding Provisions" on the version of the *UCP* printed and distributed by the Committee on Foreign Banking in the United States.[67] Amongst the "Guiding Provisions" was once again the incorporation of the *American Foreign Trade Definitions*.[68] Thus, by 1938, with the exception of the British Commonwealth, most of the important Western trading nations had adopted the 1933 revision of the *UCP*.

3 4 Basic Structure and Central Provisions of the 1933 UCP[69]

The ICC committee responsible for the drafting of uniform regulations, as part of its preparatory work, distributed to the various national committees of the ICC a

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62 A 2.

63 A 3.

64 Taylor (*op cit* n 58) 13.

65 The full text of the document in which these banks announced their adherence to the *UCP*, is published in September 1990 *Letter of Credit Update* 36-39. These banks, in their own words, "conduct[ed] substantially all the Letter of Credit business of the United States". This document furthermore discloses that adherence of the American banks to the *UCP* was, at that stage, on an individual basis.

66 Harfield (*op cit* n 8) 226; Taylor (*op cit* n 58) 13; Eisemann & Schütze (*op cit* n 23) 47.

67 Taylor (*op cit* n 58) 13. The full text of this version of the 1933 *UCP* together with the "Guiding Provisions" is published in March 1991 *Letter of Credit Update* 41-48.

68 Guiding provision 6.

69 An in depth discussion of the provisions of the *UCP* falls beyond the scope of this thesis. In this section the intention is merely to trace the development of the documentary credit as evidenced by the *UCP*. In later sections relevant articles of the *UCP* will be discussed in more depth.

draft of the proposed uniform regulations together with comparative tables showing the regulations already adopted in various countries. The various national regulations were therefore certainly considered by the committee in the formulation of its own regulations, but it cannot be said that the 1933 *UCP* was modelled on any one set of the national regulations. Elements of different national regulations are however visible in the 1933 *UCP*.[70]

The 1933 *UCP* was introduced by three "General Provisions". The first related to the nature of the *UCP* which was understood as "uniform directions in regard to Commercial Documentary Credits, applicable exclusively when other express and previously agreed arrangements between parties do not intervene".[71] The second emphasised the importance of "instructions regarding papers and documents ... be[ing] complete and precise" and "that use of technical terms ...[should] not give rise to confusion".[72] The abstract nature of the documentary credit was emphasised in the final general provision which stated that "the beneficiary of a credit can in no case avail himself of the legal relations existing between Banks, or between the Bank of the principal (purchaser) and the latter".[73]

The general provisions were followed by the 49 articles of the *UCP*, subdivided into five parts. The heading of Part A was "Form of Credits". The prominent article 1 was, however, more concerned with the nature of the documentary credit, emphasising its independence of any contract of sale on which it might be based. The form of credits did, nevertheless, feature in articles 2 to 7 in which revocable and irrevocable credits were defined and distinguished, and the difference between notification and confirmation of credits was explained. In this respect the *UCP* followed the basic structure of the *Regulativ* of the Berliner Stempelvereinigung.[74] The *RAECC* contained no comparable articles. Unlike the *Regulativ*,[75] however,

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70 Taylor (*op cit* n 58) 13 argues that the *RAECC* "was, in part, the model for the first *UCP*". The same can however be said of other national regulations.

71 General provision (a).

72 General provision (b).

73 General provision (c).

74 See par 3 2 above.

75 See the text at n 29 above.

the *UCP* clearly distinguished the concepts "irrevocable credit" and "confirmed credit".[76]

Part B was headed "Liability". This part was strongly influenced by the *RAECC*.[77] Articles 11, 12 and 13 of the *UCP* echoed the indemnity provisions of the *RAECC* as first formulated in the 1920 version and then expanded in the later revisions.[78] More emphasis was, however, placed on the bank's obligation to examine the documents.[79]

Part C ("Documents"), provided in detail which documents could be accepted by the bank. The following were dealt with: "bills of lading";[80] "railway or inland waterway consignment notes, counterfoil waybills, postal receipts";[81] "insurance";[82] "invoices";[83] and "other documents".[84]

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76 Aa 5-7 of the *UCP* read as follows: "Irrevocable credits are definite undertakings by an opening Bank in favour of the beneficiary. Such undertaking can neither be modified nor cancelled without the agreement of all concerned. Irrevocable credits may be notified to the beneficiary through an advising Bank without responsibility on the latter's part when it has merely been asked to notify the beneficiary. An advising Bank may be called upon by the opening Bank to confirm an irrevocable credit. In this case, the advising Bank makes itself responsible to the beneficiary as from the date on which it gives confirmation." Regarding the last two sentences it may be noted that the nature of the confirmed credit had received considerable attention at the influential International Congress of Comparative Law in 1932. See Colvin H M "The International Congress of Comparative Law" (1932-1933) 7 *Tulane Law Review* 53 66.

77 Taylor (*op cit* n 58) 13.

78 Aa 1, 2 and 3 of the 1934 *RAECC*. See par 3 2 above.

79 A 10 of the *UCP* reads as follows: "Banks must examine all documents and papers with care so as to ascertain that on their face they appear to be in order." This is a more definite statement than that contained in a 1 of the *RAECC*: "We assume no liability ... for the form, sufficiency, correctness, genuineness or legal effect of any documents ... but documents will be examined with care sufficient to ascertain whether on their face they appear to be regular in general form."

80 Aa 19-24.

81 Aa 25-27.

82 Aa 28-31.

83 Aa 32-33.

84 A 34.

Part D, headed "Interpretation of Terms", was also strongly influenced by the *RAECC*. The terminology which was thought to require definition was very much the same and was defined in virtually identical terms.[85]

In conclusion, Part E ("Transfer") both accepted and limited the transferability of credits. Transfer was possible but only "on the express authority of the principal", and then "once only" and "on the terms and conditions specified in the original credit, with the exception of the amount of the credit and of the time of validity, which both may be reduced".[86]

3 5 The Revision of 1951

After the Second World War the ICC decided that the *UCP* required revision.[87] The task fell to the ICC Commission on Banking Technique and Practice.[88] In 1949 suggestions were called for from the different countries for consideration.[89] The revision was finally adopted by a resolution at the 1951 congress of the ICC held in Lisbon and became effective as from the beginning of 1952.[90] The French text[91] was once again considered the original.[92] At the same conference the supporting *Standard Forms for Issuing Documentary Credits* were adopted for the first time.[93]

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85 The following terms were interpreted in the same way in the *UCP* and the *RAECC*: "about" and "circa"; "to", "until" and "till"; "prompt", "immediately" and "as soon as possible"; "departure", "dispatch" and "loading"; "first half" and "second half" of a month, as well as "beginning", "middle" or "end" of a month.

86 A 49 of the *UCP*.

87 Harfield (*op cit* n 8) 226.

88 Roesle E "Entwicklungen im Dokumentarkredit" (1957) 9 *Wirtschaft und Recht* 225 226.

89 See Taylor (*op cit* n 58) 13-14 who, in this respect writing from an American perspective, emphasises the role of the American Committee on Foreign Banking. Most of the committees' suggestions were eventually adopted.

90 Harfield (*op cit* n 8) 226; Taylor (*op cit* n 58) 14; Anonymous "Neue Richtlinien für Dokumenten-Akkreditive" (1951) 4 *Zeitschrift für das gesamte Kreditwesen* 591; Roesle (*op cit* n 88) 226.

91 I e the "Règles et Usances Uniformes relatives aux Crédits Documentaires".

92 De Rooy (*op cit* n 5) 11.

93 Roesle (*op cit* n 88) 226.

The main purpose of the new revision, as specifically stated in the resolution adopting it, was simply to adapt the *UCP* to reflect the current customs and practice.[94] Therefore, no revolutionary changes were made. The outward form remained identical, that is introductory "General Provisions" followed by the 49 articles grouped under the five headings "Form of Credits", "Liability", "Documents", "Interpretation of Terms", and "Transfer".[95] From a historical point of view the most important aspect of the new revision was that it was more acceptable to the American banks.[96] As to the effect of this revision Harfield states as follows:

> "[It] was to produce a greater area of accord as well as to conform the regulations to the then existing practice. In consequence, it was possible for the United States banks to adhere ... *without the necessity of the reservations which had theretofore appeared as 'guiding provisions'*."[97]

In spite of this "greater area of accord" the adoption of the 1951 *UCP* by American banks was nevertheless at first limited to export letters of credit, and the *American Foreign Trade Definitions* were still referred to.[98] In 1956, however, it was adopted as applying also to import letters of credit.[99] The *American Foreign Trade Definitions* had also become redundant by that stage due to the general acceptance of *Incoterms*, a set of standard international contract terms sponsored

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94 The resolution reads as follows: "The Uniform Customs and Practice for Documentary Credits were codified in 1933 ... and received formal acceptance by many countries. During the intervening years, however, there have been many new developments, and some practices, either new or variations of the old, have appeared... . The purpose of this revision of the Uniform Customs and Practice is to codify the customs and practice as they now exist". See further Harfield (*op cit* n 8) 226 and n 7 at 227; Anonymous (*op cit* n 90) 591; Roesle (*op cit* n 88) 226.

95 Anonymous (*op cit* n 90) 591.

96 Anonymous (*op cit* n 90) 591: "Was bei den Diskussionen über die Neufassung herausgekommen ist, scheint in der Hauptsache der Versuch eines Kompromisses zwischen amerikanische Anschauungen auf der einen und europäischen auf der anderen zu sein". See also Eisemann & Schütze (*op cit* n 23) 48: "Die Notwendigkeit, der amerikanischen Praxis ... Rechnung zu tragen, führte 1951 auf dem 13. Kongreß der IHK in Lissabon zur ersten Revision der Einheitliche Richtlinien".

97 (*Op cit* n 8) 226 (my italics).

98 Taylor (*op cit* n 58) 14.

99 Taylor (*op cit* n 58) 14.

and periodically revised by the ICC.[100] By the beginning of the sixties the *UCP* had been adopted by the banks of 28 countries on a collective basis and by the banks of a further 49 countries on an individual basis.[101] This represents a substantial growth in support.[102] However, the absence of the banks of the United Kingdom remained the major stumbling block in extending the influence of the *UCP*.[103] The South African banks, modelled to a large degree on their British counterparts, also did not adopt the 1951 *UCP*.

3 6 The Revision of 1962

3 6 1 Introduction

In 1962 the council of the ICC accepted a new revision of the *UCP* and recommended that it should be brought into operation, as far as possible, on 1 July 1963.[104] The purpose of the revision, as expressed in the introductory resolution of the council, was to "review the existing text with a view to securing the adherence of countries which had not hitherto accepted the Uniform Customs and Practice". In April 1963 the congress of the ICC held in Mexico formally endorsed the decision of its council. From a historical point of view, this revision was probably the most important. Especially important was that for the first time the British banks accepted the *UCP*.[105] The banks of the Commonwealth countries, and of many other countries, followed in their wake.

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100 Taylor (*op cit* n 58) 14. On *Incoterms* in general see Schmitthoff C M & Adams J *Schmitthoff's Export Trade* 9 ed (1990) Stevens & Sons London 9-10, 66-67; Von Westphalen F *Rechtsprobleme der Exportfinanzierung* 3 ed (1987) Verlag Recht und Wirtschaft Heidelberg 164-173.

101 Anonymous "Erweiterte Länderliste für den Akkreditivverkehr" (1964) 4 *Bank-Betrieb* 289 290; Regling (*op cit* n 3) 238.

102 De Rooy (*op cit* n 5) 10.

103 Noteworthy as a possible indication of a change of attitude, is that the meetings of the Commission of Banking Technique and Practice were also attended by a British delegation. See Roesle (*op cit* n 88) 226 n 1.

104 Regling W "Die neue Revision der Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive" (1962) 2 *Bank-Betrieb* 142; Megrah M "Documentary Credits - A Common Code" (1963) 113 *The Banker* 470.

105 Regling (*op cit* n 104) 142: "Die jetzige Revision ist ohne Zweifel - und alle, die im Akkreditivgeschäft arbeiten, werden zustimmen - als besonders wichtig zu betrachten. Sie bringt nämlich etwas, was wir seit Jahrzehnten erstrebt haben: das Zusammengehen der Engländer und der Länder, die sich schon seit langem der Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive bedienen." See also Megrah (*op cit* n 104) 470.

The South African banks adhered on a collective basis from 1 July 1963.[106] Thus, by the end of 1963 Regling could state:

> "Es kann mit Fug und Recht gesagt werden, daß die Anwendung der Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive jetzt weltweiten Umfang erreicht hat; schätzungsweise sind nunmehr mindestens 90% aller Dokumenten-Akkreditive gemäß diesen Richtlinien abzuwickeln."[107]

The revision had succeeded in its stated purpose.

3 6 2 The Change of Attitude of the British Banks

What then was the cause of this "unsung revolution in British banking"?[108] The previous reluctance of the British banks to adhere to the *UCP*, has been ascribed to scepticism in the sense of an acute awareness of the difficulties of devising a uniform code capable of uniform interpretation throughout the world,[109] as well as to a measure of chauvinism resulting from the *UCP* not being completely consistent with the practice which had been developed and established in London.[110] It is however probably fairer to state that many British bankers were simply of the opinion that the wishes and requirements of customers could be satisfied better if the banks retained complete freedom of

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106 Regling (*op cit* n 3) 238.

107 (*Op cit* n 3) 238. See also De Rooy (*op cit* n 5) 11: "De Uniforme Regelinge krijgen nu ook een waarlijk wereldwijde werkingssfeer". The banks of 78 countries adhered collectively (as against 28 countries in the case of the 1951 revision), and banks in a further 35 countries adhered individually (as against 49 in the case of the previous revision). Thus the banks of 113 countries signified their adherence to the *UCP* in 1963. This number had grown to 175 by 1971. See in this respect De Rooy *supra*.

108 Megrah (*op cit* n 104) 470. A mere four years before the acceptance of the *UCP* by the British banks, Megrah M "A Uniform Code for Documentary Credit Practice" (1959) 8 *International and Comparative Law Quarterly* 41 58 argued that "the British banks' desire for freedom of action is a permanent barrier" to such an acceptance.

109 Megrah (*op cit* n 104) 470-471.

110 Megrah (*op cit* n 104) 470-471. See also Megrah (*op cit* n 108) 53 where the same author states that "United Kingdom banks have always been willing to go their own ways, depending for the success of their operations on a deep and thorough knowledge of what they were doing and on the free play of competition *inter se*." For specific examples of differences between the "more rigid" British practice and that accepted in the *UCP*, see Ellinger (*op cit* n 12) 579-580. See further Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/11.

action.[111] Even after the acceptance of the *UCP* by British banks, Megrah stated that there was "undeniably much to be said for this attitude" and that "there will be many credit men who will regret been tied down by a code".[112]

The British banks' change of attitude can be ascribed to two factors. In the first place, as mentioned above, the meetings of the ICC Commission of Banking Technique and Practice, even at the stage of the 1951 revision, were also attended by a British delegation.[113] The work of this commission may well have convinced British bankers that it was not impossible to devise a uniform code. In any event it is clear that their scepticism as to the possibility of this venture receded.[114] The most important factor was however something completely different. At the 1961 congress of the ICC held in Stockholm, the meeting was informed by the British delegation that the British banks were considering the possibility of accepting the *UCP* "mindful of the value of a published code to bankers in the developing countries".[115] Although British banks, with their expertise and years of experience, were quite able to conduct documentary credit business without the aid of the *UCP*, the same experience and expertise was absent in many of the developing countries of the Commonwealth. There is no doubt that this detrimentally affected their trade.

3 6 3 Preparatory Work[116]

In 1957 the ICC Commission on Banking Technique and Practice, on American initiative, decided that a new revision of the *UCP* was required. With this in mind a working group was formed. The main purpose was to eliminate difficulties which could arise from the 1951 revision. The commission was, however, unanimous that the fundamental principles on which the *UCP* was

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111 Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/11 state as follows: "Die englischen Banken wollten sich im Interesse ihrer Kunden eine größere Handlungsfreiheit bewahren, um im Einzelfall die am geeignetsten erscheinende Form der Geschäftsabwicklung wählen zu können." See also Eisemann & Schütze (*op cit* n 23) 48; Megrah (*op cit* n 104) 470.

112 (*Op cit* n 104) 471.

113 See n 103 above.

114 See Regling (*op cit* n 104) 143.

115 The decision is quoted by Megrah (*op cit* n 104) 470. See further Anonymous "Die britischen Banken diskutieren Akkreditiv-Richtlinien" (1961) 1 *Bank-Betrieb* 70; Regling (*op cit* n 104) 143-144.

116 For what follows see especially Regling (*op cit* n 104) 142-144.

based, should not be tampered with. The different national branches of the ICC were requested to indicate which articles led to problems and to suggest solutions. It was furthermore decided that suggested changes would, without exception, only be considered in the following instances: (i) where the latest commercial practices necessitated adaptations; (ii) where compliance with the 1951 revision had led to difficulties; or (iii) where the meaning of the 1951 revision was not clear.[117]

On the basis of these criteria and the returns from the different national committees, the working group reported back to the Commission on Banking Technique and Practice in 1960. The matter was referred back to the working group with the comments of the commission. At the same time, however, it became apparent that the American delegation had wanted many changes which were subsequently rejected by the working group. This led to the Americans submitting a second report to the ICC in 1961. This was also the year in which the British banks decided to support the work on the new revision.[118] Thus a British report suggesting certain changes, which would enable the British banks to accept the *UCP*, was also submitted. The working group was consequently faced with the task of once again revising the *UCP* on the basis of the Commission on Banking Technique and Practice's comments on the working group's 1960 report, the 1961 American suggestions, and the 1961 British suggestions. At the same time the British banker Bernard Wheble, who has subsequently been termed one of the most important *auctores intellectuales* of the *UCP*,[119] joined the working group. In October 1962 the Commission of Banking Technique and Practice accepted the working group's proposed draft, as did the council of the ICC in November 1962. The final formal step was its acceptance by the ICC congress held in Mexico in April 1963.

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117 Schinnerer E "Neufassung der Einheitlichen Richtlinien und Gebräuche für das Dokumentenakkreditiv" (1962) 10 *Oesterreichisches Bank-Archiv* 245-246.

118 See par 3 6 2 above.

119 De Rooy (*op cit* n 5) 11. Commentators are unstinting in their praise for this man. See for instance Eisemann F "Die Reform der Einheitlichen Richtlinien und Gebräuche der Internationalen Handelskammer für Dokumenten-Akkreditive" *Tagungsvortrag* (27 bis 29 Februar 1976) Institut für internationales Recht des Spar-, Giro- und Kreditwesens Johannes Gutenberg Universität Mainz 9 ("ein hervorragende und brillante Führer"); Eisemann & Schütze (*op cit* n 23) 49.

3 6 4 The Material Changes

The outward form or appearance of the *UCP*[120] was changed for the first time. The changes, however, were not dramatic. The basic layout of the previous revisions was still recognisable. The "General Provisions" by which the previous revisions had been introduced, were replaced by "General Provisions and Definitions" in order to include, for the first time, a definition of the term "documentary credit". This definition was widely phrased and avoided any specification which could result in diminishing the area of application of the *UCP*.[121] The general provisions and definitions were followed by the 46 articles of the *UCP*, subdivided as before into five parts. The headings of Part A and B were slightly altered to "Form and Notification of Credits" and "Liabilities and Responsibilities" respectively. Part C was still headed "Documents" whilst the previous Part D ("Interpretation of Terms") fell away and was replaced by "Miscellaneous Provisions". As before Part E was headed "Transfer".

Generally speaking most of the substantive changes fell into one of two categories. In the first place the British influence was clearly visible. Certain changes simply reflected the adoption of the British practice.[122] The English text furthermore replaced the French as the official version.[123] This was, of course, also beneficial to the developing nations of the Commonwealth "whose native language is not English but for whom English is an essential commercial

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120 See in general International Chamber of Commerce *Uniform Customs and Practice for Documentary Credits* (1962) ICC Publication 222 ICC Publishing Paris.

121 The definition contained in s (b) read as follows: "[T]he expressions 'documentary credit(s)' and 'credit(s)' ... mean any arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and in accordance with the instructions of a customer (the applicant for the credit), is to make payment to or to the order of a third party (the beneficiary) or is to pay, accept or negotiate bills of exchange (drafts) drawn by the beneficiary, or authorises such payments to be made or such drafts to be paid, accepted or negotiated by another bank, against stipulated terms and conditions." For critical analyses of this definition see Schinnerer (*op cit* n 117) 248-249, as well as, by the same author, "Zur Neufassung der Einheitlichen Richtlinien und Gebräuche für das Dokumentenakkreditiv" (1963) 4 *Zeitschrift für Rechtsvergleichung* 207 215. For the definition in the current (1993) revision of the *UCP*, which does not differ materially from that quoted above, see a 2.

122 Schinnerer (*op cit* n 117) 251; Bachmayer O "Einheitliche Richtlinien und Gebräuche für Dokumentenakkreditive, Revision 1962" (1963) 11 *Oesterreichisches Bank-Archiv* 278 279-282; Megrah (*op cit* n 104) 473.

123 De Rooy (*op cit* n 5) 11; Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/12; Bachmayer (*op cit* n 122) 278; Schinnerer (*op cit* n 121) 212. See also Megrah (*op cit* n 104) 473 who laments that "the effort to produce a *vade mecum* for the less discerning and less experienced ... was marred here and there by English that is less than impeccable".

language".[124] The most important changes falling into this category related to bills of lading and insurance documents. In terms of the new revision bills of lading, unless otherwise specified in the credit, had to "show that the goods are loaded on board".[125] "Shipped" bills of lading were thus required and "received for shipment" bills of lading were no longer sufficient.[126] This was an adoption of the British practice.[127] Likewise the insistence that insurance documents were to be "as specifically described in the credit" and that "[c]over notes issued by brokers will not be acceptable unless specifically authorised in the credit",[128] broke with the previous practice[129] and reflected the British practice.[130]

Secondly, certain changes reflect a different point of departure. Whereas the position of the bank was central in the previous revisions, the role of the applicant was stressed to a greater degree in the 1962 *UCP*. Wheble states in this regard:

> "The subject matter of the code was reviewed in the light of the fact that the credit and the rights and responsibilities arising from it stem from the mandate given by the applicant for the credit. It stressed the applicant's responsibility for giving clear and precise instructions and placed severe restrictions on the right of the banker to act on an 'intelligent guess' as to what was really intended."[131]

The logical consequence of this point of departure was that the discretion of the banks in dealing with documentary credits, especially in the context of

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124 Megrah (*op cit* n 104) 471.

125 A 18.

126 In terms of a 19 of the 1951 revision of the *UCP*, "received for shipment" bills of lading were acceptable.

127 Ellinger (*op cit* n 6) 313-314. See also Regling (*op cit* n 104) 145; Bachmayer (*op cit* n 122) 281.

128 A 24.

129 In terms of a 28 of the 1951 revision of the *UCP*, a cover note issued by a broker was acceptable.

130 Ellinger (*op cit* n 6) 324-325. See also Megrah (*op cit* n 104) 473; Bachmayer (*op cit* n 122) 282; Schinnerer (*op cit* n 117) 251.

131 Wheble B S "Uniform Customs and Practice for Documentary Credits 1971 Revision" (1971) 4 *Cornell International Law Journal* 97 98. See also De Rooy (*op cit* n 5) 11; Schinnerer (*op cit* n 117) 246.

accepting or rejecting certain documents, had to be curtailed. This was insisted upon by the English banks.[132] Not all options[133] were, however, removed at this stage. Seven remained,[134] thereby necessitating a reconsideration of this matter in future revisions of the *UCP*.[135]

3 6 5 Related Developments

As mentioned above[136] the ICC in 1951 adopted the *Standard Forms for Issuing Documentary Credits*. Although most banks adhering to the *UCP* had also signified adherence to the *Standard Forms*, in many instances the adherence was by no means meticulous. Different forms were often encountered.[137] This, as well as the fact that the development of the *UCP* necessitated adaptations of the *Standard Forms*, prompted the ICC Commission on Banking Technique and Practice to appoint a working group in June 1964 to create new *Standard Forms*.[138]

The working group's suggestions were accepted by the commission in February 1967. Due, however, to reservations subsequently raised by banks in the Commonwealth,[139] the commission, in October 1967, decided once again to

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132 Liesecke R "Neuere Theorie und Praxis des Dokumentenakkreditivs" 1976 *Wertpapier Mitteilungen* 258 259 states as follows: "Bereits vor der Revision 1962 der ER war es der Wunsch englischer Bankkreise ... an die Stelle der 'options' der Bank klare Regelungen für die Behandlung der Dokumente zu setzen ('will' statt 'may reject'). Erst nachdem diesem Wunsch 1962 zum Teil Rechnung getragen war, traten England und die Länder des Commonwealth den ER bei." See also in the same vein Regling (*op cit* n 104) 143.

133 The word option as used here has the meaning of a discretionary power.

134 See aa 15(3), 21, 25, 29, 30, 31, and 41 of the 1962 *UCP*.

135 See par 3 7 3 below.

136 See par 3 5.

137 See Anonymous "Anwendung der Standardformeln für die Eröffnung von Dokumenten-Akkreditiven" (1962) 2 *Bank-Betrieb* 64 where this fact is lamented as causing "Schwierigkeiten und vor allem vermeidbare Mehrarbeit".

138 The working group was led by M Legrève, the general manager of the Banque de Bruxelles. See in general Schütz E "Bald neue Standardformulare für die Eröffnung dokumentärer Akkreditive" (1967) 7 *Bank-Betrieb* 222.

139 This occurred in spite of a sensitivity as to the importance of the English practice. With reference to the working group's approach Schütz (*op cit* n 138) 222 states as follows: "Die Arbeidsgruppe hat sich bei ihrer Tätigkeit davon leiten lassen, Formulare zu entwerfen, die für die weitaus größte Anzahl der Akkreditiv-Geschäfte Anwendung finden können. Sie hat sich nicht darauf beschränkt, ein Formular für das übliche

review the *Standard Forms*.[140] The ICC eventually accepted the new *Standard Forms* in December 1970 recommending adherence as soon as possible.[141] The result has been described as follows:

> "Die bisherigen zahlreichen verschiedenen Arten von Formularen wurden hierbei auf ein Mindestmaß beschränkt. Sie enthalten versciedene Rubriken die es ermöglichen sollen, klare, vollständige und genaue Weisungen zu erteilen. Dadurch werden Schwierigkeiten vermieden, die in der Praxis auftreten, wenn die verwendeten Begriffe ungenau oder irreführend sind."[142]

3 7 The Revision of 1974

3 7 1 Introduction

Practical problems, which were either not dealt with in the 1962 *UCP* or the result of different interpretations of certain articles, soon arose. At first the ICC dealt with these problems on an *ad hoc* basis by publishing suggested solutions which were followed to a greater or lesser degree.[143] Working groups were also established to deal with specific questions.[144] These problems, however, coupled with significant developments in international trade, especially in transport, eventually necessitated a further revision of the *UCP*.[145]

Dokumentenakkreditiv auszuarbeiten, sondern hat im Hinblich darauf, daß die Formulare auch im angelsächsischen Raum ... Verwendung finden sollen".

140 Schütz E "Nochmalige Erörterung der Standardformulare für die Eröffnung dokumentärer Akkreditive" (1967) 7 *Bank-Betrieb* 362.

141 See Anonymous "Neue Standardformulare für die Eröffnung von Dokumenten-Akkreditiven" (1972) 12 *Bank-Betrieb* 125-126; Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/21. The new *Standard Forms* were published as ICC Brochure 268, and an improved version as ICC Brochure 323.

142 Anonymous (*op cit* n 141) 125-126.

143 Slongo U *Die Zahlung unter Vorbehalt im Akkreditiv-Geschäft* Dissertation (1979) Universität Bern 65.

144 Slongo (*op cit* n 143) 65 in this respect refers to a working group formed in 1965 to investigate the problems related to reserved payment.

145 De Rooy (*op cit* n 5) 11-12; Müller F "Die neue Revision der 'Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive" (1975) 15 *Bank-Betrieb* 307; Horn N "Internationale Zahlungen und Akkreditiv" in Horn N, Von Bieberstein W F M, Rosenberg L & Pavicevic B *Dokumentenakkreditive und Bankgarantien im internationalen Zahlungsverkehr* (1977) Alfred Metzner Verlag Frankfurt am Main 11.

3 7 2 Preparatory Work

In March 1971 the ICC formed a working group to prepare the next revision.[146] This work had a truly international character. In the special *Comité de liaison avec les pays socialistes* the viewpoint of the then socialist countries was represented for the first time.[147] The United Nations Commission on International Trade Law (UNCITRAL) was also involved for the first time.[148] Thus viewpoints from countries not represented in the ICC could also be canvassed. The text was eventually settled by the Commission on Banking Technique and Practice in October 1974 and approved by the Executive Committee of the ICC on 3 December 1974 to be brought into operation on 1 October 1975.[149] Adherence from this date was also recommended by the United Nations.[150]

3 7 3 Material Changes

Introduction

Apart from having one article more (47 in total) the basic layout of the *UCP* was not changed. The English text remained the official version, and the sub-divisions were identical.[151]

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146 De Rooy (*op cit* n 5) 12. The working group was led by the British banker Bernard Wheble who had played such a decisive role in the preparation of the 1962 revision. See Müller (*op cit* n 145) 307.

147 Slongo (*op cit* n 143) 66; Horn (*op cit* n 145) 11.

148 Liesecke (*op cit* n 132) 259; Ellinger (*op cit* n 12) 580; Slongo (*op cit* n 143) 66. The involvement of UNCITRAL followed the presentation of a study by the ICC to the United Nations in 1969 on the economic and legal impact of documentary credits on international trade, with the request that it would advise member states to adhere to the *UCP*. See Anonymous "Internationale Handelskammer: Dokumenten-Akkreditive - Studie für die Vereinten Nationen" (1969) 9 *Bank-Betrieb* 184.

149 Slongo (*op cit* n 143) 65; De Rooy (*op cit* n 5) 12.

150 Horn (*op cit* n 145) 11.

151 See in general International Chamber of Commerce *Uniform Customs and Practice for Documentary Credits* (1974) ICC Publication 290 ICC Publishing Paris. See also Liesecke (*op cit* n 132) 259.

The most important changes fell mainly into one of three categories.[152] First, certain changes continued the trend, embarked upon in the 1962 revision, of limiting the bank's discretion or options in dealing with documentary credits. Secondly, other changes related to the needs experienced in practice to clarify certain areas by new definitions or provisions. Finally, developments in the field of transport, especially the emergence and expansion of container transport, necessitated certain changes.

Changes Limiting the Bank's Options

As mentioned above, one of the hallmarks of the 1962 *UCP*, due to pressure from the British banks, was the curtailment of the discretion of the banks to accept or reject certain documents.[153] However, in seven instances this discretion still remained.[154] The decision of the bank in this regard was moreover binding on all further parties,[155] which led to problems in practice due to the incompetence or lack of experience of many banks.[156]

Of the seven options retained in the 1962 revision, only one, the article 32(b) option to "refuse commercial invoices issued for amounts in excess of the amount permitted by the credit", survived.[157] This further curtailment of options was widely welcomed.[158] The purpose of the curtailment is described as by Slongo as follows:

> "Ziel dieser Massnahme ist es, die Akkreditivbedingungen möglichst durch den Akkreditiv-Auftraggeber, subsidiär durch die RGDA [Einheitliche Richtlinien und Gebräuche für Dokumentenakkreditive] und möglichst wenig durch die Bank

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152 On what follows see especially Eisemann (*op cit* n 119) 9-25. See further Horn (*op cit* n 145) 11-12; Slongo (*op cit* n 143) 68-69; Liesecke (*op cit* n 132) 259; Müller (*op cit* n 145) 307; De Rooy (*op cit* n 5) 11-12.

153 See par 3 6 4.

154 See aa 15(3), 21, 25, 29, 30, 31, and 41 of the 1962 *UCP*. For a discussion of these articles in this context see Eisemann (*op cit* n 119) 15-16.

155 See general provision (e) of the 1962 *UCP* which read as follows: "When a bank entitled to avail itself of an option it enjoys under the following articles does so, its decision shall be binding upon all the parties concerned."

156 Slongo (*op cit* n 143) 69-70; De Rooy (*op cit* n 5) 14-15.

157 See general provision (e) of the 1974 *UCP*.

158 See Eisemann (*op cit* n 119) 16-17 who, however, laments the retention of the a 32 (b) option. See further Slongo (*op cit* n 143) 70; De Rooy (*op cit* n 5) 14.

> bestimmen zu lassen. Dadurch sollen im Dokumenten-Akkreditiv-Geschäft unerfahrene Banken vor materiellen Entscheidungen unerfahrener Banken verschont bleiben"[159]

Changes to Clear up Misunderstandings

Most of the changes fell into this category. Only the most important, those to articles 2, 3, 7 and 8, as well as the new article 47 need to be considered here.[160]

A misunderstanding of the legal nature of revocable credits had arisen due to the wording of article 2 of the 1962 revision which read as follows:

> "*A revocable credit does not constitute a legally binding undertaking* between the bank or banks concerned and the beneficiary because such a credit may be modified or cancelled at any moment without notice to the beneficiary.[161]

The introductory statement italicised above is simply wrong.[162] The peculiarity of the revocable credit is that it can be amended or cancelled without prior notice to the beneficiary.[163] The possibility of amendment or cancellation does not, however, influence the legal nature of the credit. Until revoked the revocable credit constitutes a binding obligation. Thus, in the 1974 revision, the confusing introductory statement was omitted.[164]

In article 3, dealing with irrevocable credits, the responsibilities of the issuing and confirming banks were set out in considerably more detail.[165] In the process

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159 (*Op cit* n 143) 70.

160 A brief summary of other less important changes is given by Müller (*op cit* n 145) 308-310.

161 My italics.

162 Eisemann (*op cit* n 119) 11.

163 Eberth R "Documentary Credits in Germany and England" 1977 *Journal of Business Law* 29 35.

164 See Liesecke (*op cit* n 132) 260 who with reference to this statement explains as follows: "Mit ihm war nicht gemeint, daß beim widerruflichen Akkreditiv überhaupt eine Verpflichtung fehlt. Sie besteht unter der Auflösenden Bedingung des Widerrufs und ist Rechtsgrund der Zahlung, wenn kein Widerruf erklärt wird." See further Eberth (*op cit* n 163) 35; Müller (*op cit* n 145) 307; De Rooy (*op cit* n 5) 15.

165 De Rooy (*op cit* n 5) 15-16 ("duidelijker omschrijving"); Müller (*op cit* n 145) 307 ("in sehr detaillierter Weise"); Slongo (*op cit* n 143) 70-71 ("minuziös und detailliert").

an important misunderstanding was cleared up. The article stated clearly for the first time that in the event of a bank having undertaken in terms of the credit to accept a bill drawn on it, the bank was liable in terms of the credit, not only to accept the bill (as was sometimes contended), but also to pay it when due.[166]

Changes to article 7 and 8, the articles embodying the principle of strict compliance, were especially important. Article 7 dealt with the responsibility of the bank to examine the documents to ascertain whether they were in accordance with the terms and conditions of the credit. For the first time it specifically provided that in the event of the documents being mutually inconsistent (as opposed to being inconsistent with the terms of the credit itself), they were also to be considered as not being in accordance with the terms and conditions of the credit. This provision cleared up a misunderstanding and strengthened a fundamental principle of documentary-credit practice.[167]

Article 8 in which specific applications of the principle of strict compliance were dealt with,[168] also contained new provisions to reflect the then current practice. The central provision of article 8, virtually identical in the revisions of 1962 and 1974, was the following:

> "Payment, acceptance or negotiation against documents which appear on their face to be in accordance with the terms and conditions of a credit by a bank authorized to do so, binds the party giving the authorization to take up the documents and reimburse the bank which has effected the payment, acceptance or negotiation."[169]

Both revisions provided further[170] that on receipt of the documents a bank had to determine whether the honouring of the credit was in accordance with its

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166 Eisemann (*op cit* n 119) 11; De Rooy (*op cit* n 5) 15-16; Müller (*op cit* n 145) 307.

167 Eisemann (*op cit* n 119) 11-12; Müller (*op cit* n 145) 308; Slongo (*op cit* n 143) 71. This principle has been retained in the later revisions of the *UCP*. See a 13(a) of the 1993 *UCP* in this regard.

168 This article has been termed the key article of the *UCP*. See Slongo (*op cit* n 143) 71. See also Eisemann (*op cit* n 119) 12 ("Herzstück").

169 A 8(b) of the 1974 revision. The provision is still materially the same. See a 14(a) of the 1993 revision in this regard.

170 For what follows see generally the entire a 8 of the 1962 revision and a 8(c) & (e) of the 1974 revision.

terms and conditions. Should the bank wish to claim that the honouring of the credit was not in accordance with its terms and conditions, notice to this effect had to be given to the bank from which the documents were received. The notice also had to state that the documents were being held at the disposal of such bank, or were being returned to it. This was all established practice.

In this context, however, the 1974 revision contained the following new provision:

> "If the issuing bank fails to hold the documents at the disposal of the remitting bank or fails to return the documents to such bank, the issuing bank shall be precluded from claiming that the relevant payment, acceptance or negotiation was not effected in accordance with the terms and conditions of the credit."[171]

The viewpoint of the Swiss Federal Court in a 1964 decision[172] to the effect that the bank could no longer rely on defective documents once it had retained these in order to deal with the goods in some way,[173] hereby found express approval in the *UCP*.[174]

Another important innovation was article 8(g) which for the first time gave recognition to the often encountered practice of banks honouring credits against non-conforming documents, but doing so "under reserve".[175] Typically the beneficiary of the credit tendered documents, which were defective but not seriously defective. The bank remitting the documents (for example the

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171 A 8(f) of the 1974 revision. For the similar current provision see a 14(e) of the 1993 *UCP*.

172 BGE 90 II 302.

173 This posed a problem where the goods were perishable and the bank wished to retain the documents in order to arrange for storage or emergency sale. See Gutteridge & Megrah (*op cit* n 28) 192-193; Liesecke (*op cit* n 132) 263.

174 Müller (*op cit* n 145) 308; Slongo (*op cit* n 143) 72; De Rooy (*op cit* n 5) 15.

175 On payment under reserve in general see Eberth R "Rechtsfragen der Zahlung unter Vorbehalt im Akkreditiv-Geschäft" 1983 *Wertpapier Mitteilungen* 1302; Slongo (*op cit* n 143) *passim*. This practice was well known by 1974. See Eisemann (*op cit* n 119) 13 who bluntly states as follows: "Der letzte Paragraph in Art. 8 ... bestätigt einfach eine eingefleischte Regel, die keine erfahrene Bank je mißachten konnte. Wenn die Reform gleichwohl diese Regel ausdrücklich aufgenommen hat, so dient dies vor allem der Klarstellung und der Veränderung möglicher Diskussionen mit akkreditiveröffnenden Banken, die - um es einmal so zu formulieren - weniger Erfahrung in diesem Bereich haben."

confirming bank) strongly suspected that the purchaser (applicant for the credit) would accept the documents in spite of the defects. Instead of rejecting the documents, the remitting bank therefore paid the beneficiary "under reserve" or against a guarantee in respect of the irregularities.[176] This meant that the beneficiary was bound to repay the money on demand if the issuing bank rejected the documents, whether on its own initiative or on the buyer's instructions.[177] Against this background article 8(g) stressed that such guarantee or reserve "concerns only the relations between the remitting bank and the beneficiary".

Finally the new article 47 cleared up the uncertainty[178] as to whether the beneficiary of a non-transferable credit could assign the proceeds of the credit. The article provided:

> "The fact that a credit is not stated to be transferable[179] shall not affect the beneficiary's rights to assign the proceeds of such credit in accordance with the provisions of the applicable law."[180]

Changes Relating to Developments in Transport

A feature of the decade preceding the 1974 revision was a surge in the use of container transport, also in the context of combined transport operations (that is transport in which at least two different modes of transport are used). As one of the main advantages of containers is their ability to be transferred easily from rail or road to ship and *vice versa*, the development of containerisation has increased significantly the importance of combined transport operations.[181] The *UCP* was not initially designed for this type of transport and consequently needed to be adapted. The provisions relating to transport documents were especially affected. As stated by Todd:

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176 See Gutteridge & Megrah (*op cit* n 28) 196; Todd P *Bills of Lading and Bankers' Documentary Credits* (1990) Lloyd's of London Press Ltd London 151; Zahn, Eberding & Ehrlich (*op cit* n 23) par 2/321.

177 *Banque de L'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd* [1982] 2 Lloyd's Rep 476 (QB).

178 See Müller (*op cit* n 145) 310.

179 Which implied that it was non-transferable (see a 46(d)).

180 For the current provision which is substantially the same, see a 49 of the 1993 *UCP*.

181 Todd (*op cit* n 176) 73-74.

> "The traditional bill of lading assumes carriage from port to port, and is not well suited to combined transport operations, where the shipment is part of a larger transaction (e. g., container transport from an inland terminal in one country to an inland terminal in another). There will usually be at least three different carriers involved in the total operation, which will involve at least one sea and two land legs, but there is no reason why one document (combined or multimodal transport document) should not cover all three legs."[182]

It was in this direction that the 1974 revision of the *UCP* headed. Certain changes simply adjusted the *UCP* to containerisation as such, whilst others related to combined transport. Article 19, in dealing with bills of lading, for instance, stated specifically that bills of lading "covering unitised cargoes, such as those on pallets or in Containers"[183] would be accepted, thereby ending a controversy[184] as to their acceptability. Article 17 moreover provided that shipping documents which contained a clause such as "shipper's[185] load and count" or "said by shipper to contain", would be accepted unless the credit provided otherwise. This article resulted from the fact that the carrier of a container could not count the goods in the container and had to rely on the information supplied by the shipper.[186] As modern container ships are constructed so as to carry many containers on deck, bills of lading with the provision that "goods may be carried on deck" would also be accepted in terms of article 22(b).

The essence of combined transport operations is that one carrier, who has come to be known as the combined transport operator, makes himself responsible for the entire transport. There is only one contract of carriage entered into between the shipper and the combined transport operator.[187] Article 23(a) contained the following provision regarding combined transport:

> "If a credit calls for a combined transport document, i. e. one which provides for a combined transport by at least two different

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182 (*Op cit* n 176) 73.

183 A 19(b)(iii).

184 De Rooy (*op cit* n 5) 12.

185 Ivamy E R H *Mozley and Whiteley's Law Dictionary* (1988) Butterworths London 439 defines "shipper" as a "consignor of goods to be sent by sea".

186 De Rooy (*op cit* n 5) 12; Müller (*op cit* n 145) 308.

187 Todd (*op cit* n 176) 96.

> 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 document required and/or the issuer of such document, banks will accept such documents as tendered."[188]

In terms of this article a bank, in combined transport operations, had to accept transport documents issued by the combined transport operator. The importance of this provision was that it broke with the tradition regarding marine bills of lading which, to be acceptable, had to be issued by the shipping company itself or its agent.[189] The combined transport operator who contracts with the shipper as a principal and not as the agent of any shipping company[190] clearly does not fall into either category and, in the absence of article 23, documents issued by him would have been rejected.[191]

3 7 4 Related Developments

In conclusion it may be noted that in 1973 the ICC first published its *Uniform Rules for a Combined Transport Document*.[192] An improved version, the current one, was published in 1975.[193] The *Rules* are however not binding on any one; they are for guidance only.[194]

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188 For an in depth analysis of combined transport and a 23 of the *UCP* in historical perspective, as well as the problems surrounding a 23, see Gleisberg G *Die Prüfung von Dokumenten des kombinierten Transports beim Dokumenten-Akkreditiv* (1980) Institut für Bankwissenschaft und Bankrecht Universität Köln 3-16.

189 See a 19 of the *UCP* (1974 revision).

190 Todd (*op cit* n 176) 96.

191 See a 19(a)(i). See also De Rooy (*op cit* n 5) 14; Müller (*op cit* n 145) 309.

192 ICC Publication 273 ICC Publishing Paris. See in general on the background to this document Gleisberg (*op cit* n 188) 3-8.

193 ICC Publication 298 ICC Publishing Paris.

194 Gutteridge & Megrah (*op cit* n 28) 281.

3 8 The Revision of 1983

3 8 1 Introduction

The 1974 revision of the *UCP* came into operation on 1 October 1975. In spite of its popularity and success[195] it was replaced exactly nine years later by a further revision.[196] This revision[197] was prompted mainly by the need to adapt documentary credit practice to further technological developments, especially in transport, communication and data transmission. Another compelling reason for a new revision was, however, the emergence or increasing use of new types of credits not dealt with in the *UCP*, particularly standby credits and deferred payment credits. Furthermore, recommendations of the ICC Commission on Banking Technique and Practice, which since 1975 had taken a stance on questions of interpretation of the *UCP* submitted to them,[198] soon revealed difficulties in the interpretation of several provisions, which could best be addressed in a fresh revision.

Thus, in 1979, the commission appointed a working group, in which the interests of banking, trade, industry, transport and insurance were

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195 Eberth R "Die Revision von 1983 der Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive" Sonderbeilage 4 1984 *Wertpapier Mitteilungen* (7. Juli 1984) 3 terms it "einer der erfolgreichsten Regelungen des internationalen Handelsrechts".

196 *Uniform Customs and Practice for Documentary Credits* (1983) ICC Publication 400 ICC Publishing Paris.

197 For what follows see especially Wheble's foreword to the 1983 *UCP* 6, as well as, by the same author, *UCP 1974/1983 Revisions Compared and Explained* (1984) ICC Publication 411 ICC Publishing Paris 5, and "UCP 1983 - Major Changes in Documentation" *ICC/Lloyd's of London Press Ltd Seminar on Documentary Credits* (11 June 1984) 1. See also Eberth (*op cit* n 195) 3; Nielsen J *Aktuelle Rechtsfragen zum Dokumenten-Akkreditiv* (1984) Kommunikationsforum Recht Wirtschaft Steuern Tagungs- und Verlagsgeselschaft Köln 5-7; Ulrich C M *Rechtsprobleme des Dokumentenakkreditivs* (1989) Schweizer Schriften zum Handels- und Wirtschaftsrecht Band 126 Schulthess Polygraphischer Verlag Zürich 6-7; Rowe M "New Rules for Old; The 1983 Revision of the Uniform Customs and Practice for Documentary Credits" *International Bar Association Seminar on Problems of Letters of Credit and Bankers' Guarantees* (8-9 May 1984) Amsterdam 214-223; Freebury C "Letters of Credit - How to Stay in Control" *ICC/Lloyd's Seminar* (11 June 1984); Schmitthoff C M "The New Uniform Customs for Letters of Credit" 1983 *Journal of Business Law* 193-199; Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/13; Eisemann & Schütze (*op cit* n 23) 50-51.

198 These have been published as *Decisions (1975-1979) of the ICC Banking Commission* (ICC Publication 371) and *Opinions (1980-1981) of the ICC Banking Commission* (ICC Publication 399). The latter name better reflects the true legal nature of the publications. See Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/20.

represented,[199] to make recommendations for a new revision. Banks represented in the East-West Liaison Committee of the ICC once again participated,[200] as did many other countries not represented in the ICC, through the involvement of UNCITRAL.[201] The council of the ICC eventually approved the new revision on 21 June 1983 to come into operation on 1 October 1984.[202]

3 8 2 Material Changes

Introduction

Leaving aside minor changes,[203] there were broadly speaking five areas of change. These were adjustments to the outward form of the *UCP*, refinements concerning the the liability of the advising bank, the introduction of new forms of credits into the *UCP*, a comprehensive revision of the provisions of the *UCP* relating to transport documents and, finally, adaptations relating to developments in the field of communication and data transmission.

Outward Form

The basic structure of the *UCP* remained very much the same. One interesting structural change was that the introductory "General Provisions and Definitions" of the 1974 revision were brought into the main body of the 1983 *UCP* to form the first six articles. According to Wheble[204] this was done to stress the "equal importance" of these provisions and the rest of the *UCP*. In other respects, except for minor changes, the layout was the same. The English text remained the official version.[205]

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199 Eberth (*op cit* n 195) 3.

200 Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/13.

201 Zahn, Eberding & Ehrlich (*op cit* n 23) par 1/13; Eberth (*op cit* n 195) 3.

202 Eberth (*op cit* n 195) 3-4.

203 See Nielsen (*op cit* n 197) 7 who distinguishes between "[u]nwesentliche" and "[w]esentlich Neuregelungen". For a discussion of the less important changes see Wheble (*op cit* n 197 *UCP 1974/1983 Revisions Compared and Explained*) and Eberth (*op cit* n 195).

204 (*Op cit* n 197 *1974/1983 Revisions Compared and Explained*) 6.

205 Title page of the 1983 *UCP*.

Liability of the Advising Bank

The advising bank, as noted above, simply advises the beneficiary that a credit has been opened in his favour by the issuing bank without obligating itself as against the beneficiary. In contrast to its predecessors the 1983 revision did not free the advising bank from all possible liability. Article 8 provided as follows:

> "A credit may be advised to a beneficiary through another bank (the advising bank) without engagement on the part of the advising bank, but *that bank shall take reasonable care to check the apparent authenticity of the credit* which it advises."[206]

This article clearly imposed a duty of care on an advising bank to satisfy itself as to the genuineness of the messages it had received.[207] A failure to do so could render it liable to the beneficiary if the credit was a fake.[208]

New Forms of Documentary Credits

In terms of the 1983 revision of the *UCP* its articles were applicable to "all documentary credits, including, to the extent to which they may be applicable, standby letters of credit".[209] The standby letter of credit, as discussed above,[210] is essentially a document in the form of a documentary credit but with the function of a first demand bank guarantee.

The desirability of some form of uniform custom for standby letters of credit arose from the fact that standby letters of credit had spread from the American domestic arena to the international arena and by 1983 were being encountered in several countries including England, Australia, Canada, India, Iran, Japan, Korea, the Philippines and France.[211] Reservations had, however, been expressed as to whether the extension of the *UCP* was the most suitable manner

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206 My italics. For the current provision which is materially the same see a 7 of the 1993 *UCP*.

207 See Ellinger (*op cit* n 12) 587 who also notes that this provision gives effect to a published opinion of the Banking Commission of the ICC.

208 On the basis of this liability see par 1 5 6 above.

209 A 1.

210 See par 1 6 5.

211 Eberth (*op cit* n 195) 5; Getz H A "Enjoining the International Standby Letter of Credit: The Iranian Letter of Credit Cases" (1980) 21 *Harvard International Law Journal* 192 193. Barlow L (Untitled Address) *ICC/Lloyd's of London Seminar on Documentary Credits* (11 June 1984) 4.

in which to provide such a uniform custom. Schmitthoff adopted the following position:

> "In my view, standby letters of credit are such a different institution from ordinary documentary credits that I consider it unwise and potentially leading to confusion that the new U.C.P. should extend to this type of financial facility."[212]

Barlow explained the contrary view of the ICC as follows:

> "To avoid any confusion, it was essential in the light of their increasing volume, to have mentioned them either by inclusion or exclusion. If the latter had been chosen, there would have been the problem of defining a standby credit, as well as the difficulty of deciding when a document was, or was not a document[213]."[214]

This extension of the *UCP* did not revolutionise the practice regarding standby letters of credit. Most standby letters of credit prior to the 1983 revision were issued subject to the *UCP* in any event,[215] a practice made possible by the wide and general terms in which the concept "documentary credit" was defined in the 1974 revision.[216] This practice was strengthened in 1977 when the Banking Commission of the ICC expressed the opinion that standby letters of credit did fall within the definition of "documentary credit" in the 1974 revision of the *UCP*.[217] Therefore the express incorporation of standby letters of credit into the 1983 revision of the *UCP* to a large degree merely reflected the standard practice.[218]

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212 (*Op cit* n 197) 195.

213 Due to the fact that standby credits would then have had to be differentiated from the traditional commercial documentary credits by the type of document required to be presented for a credit to qualify as a commercial, as opposed to a standby, documentary credit.

214 (*Op cit* n 211) 4. UNCITRAL was instrumental in the inclusion of standby letters of credit. See par 3 10 3 below.

215 Getz (*op cit* n 211) 201.

216 See General Provision (b).

217 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 10. Wheble rejects the view that the opinion of the Banking Commission would suffice as these opinions were by no means as widely circulated as the *UCP* itself.

218 Eberth (*op cit* n 195) 5.

Finally, it must be borne in mind that the articles of the *UCP* applied to standby letters of credit only "to the extent to which they may be applicable".[219] The relevance of each article had to be determined with reference to the meaning and purpose of the specific article.[220] Many articles, for instance those dealing with transport and insurance documentation and shipment of goods, clearly had no relevance to standby letters of credit. The key principle of independence of the bank's obligation as well as the doctrine of strict compliance were, however, equally applicable to standby letters of credit.[221]

Another form of documentary credit which had increased dramatically in popularity was the deferred payment credit. This type of documentary credit, as discussed above,[222] is a credit in terms of which the documents are surrendered to the purchaser on an earlier date than that agreed on for payment by the purchaser. Payment is thus "deferred" to a later date. By making use of a deferred payment credit as opposed to a usuance credit, the parties could avoid the stamp duty levied on bills of exchange.[223]

Due to the fact that the documents were surrendered prior to payment, the risk arose that the purchaser could, in the event of the documents being in order but the goods defective, in some way attempt to prevent payment to the beneficiary.[224] In this respect Barlow mentions an Italian decision to the effect that a deferred payment credit affords the purchaser the opportunity of examining the goods prior to payment.[225] Such an interpretation violates the

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219 A 1 of the 1983 *UCP*. The position is the same under a 1 of the current 1993 revision of the *UCP*.

220 See Eberth (*op cit* n 195) 5: "[Es bedarf] einer Untersuchung von Sinn und Zweck der einzelnen Bestimmungen, um zu ermitteln, ob sie auf die hier zur Rede stehende neue Spielart des Dokumenten-Akkreditivs als Sicherungsinstrument außerhalb des Warenverkehrs passen."

221 Eberth (*op cit* n 195) 5; Rowe (*op cit* n 197) 216.

222 See par 1 6 4.

223 Barlow (*op cit* n 211) 4; Rowe (*op cit* n 197) 220.

224 Eberth (*op cit* n 195) 7.

225 Barlow (*op cit* n 211) 4. (Neither the name nor reference of the decision is given.) Similar sentiments which had arisen in Switzerland were rejected by the Swiss Federal Tribunal. See in this regard Meier-Boeschenstein O C "Current Developments: Switzerland" *International Bar Association Seminar on Problems of Letters of Credit and Bankers' Guarantees* (8-9 May 1984) Amsterdam 360 388.

central principles of independence of the obligations of the different parties and that they "deal in documents and not in goods".[226] The 1983 revision of the *UCP*, in dealing expressly with deferred payment credits for the first time, made it quite clear that these central principles were equally applicable to this type of credit.[227]

Changes due to Developments in Transport

The adaptation of the *UCP* to developments in the field of transport was the main purpose of the 1983 revision.[228] Containerisation and combined transport had increased substantially in the years preceding the new revision, both in over-all volume and geographical extent.[229] Although the 1974 revision, as discussed above, did address these developments to some extent, many problems continued to arise in practice.[230] The main problem was that the 1974 revision was to a large degree still based on traditional transport documents which were not well-suited to developments in the field of transport itself.[231] Problems were also experienced in the demarcation of the different articles dealing with transport documentation, as well as with the broad wording of article 23(a), in terms of which the bank, in the case of combined transport documents, had to "accept such documents as tendered" unless the documents were specified in the credit.[232]

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226 A 4 of the 1983 *UCP*.

227 See a 10 which provided as follows: "An irrevocable credit constitutes a definite undertaking of the issuing bank, provided that the stipulated documents are presented and that the terms and conditions of the credit are complied with: ... (ii) if the credit provides for deferred payment - to pay ... on the date(s) determinable in accordance with the stipulations of the credit." See also a 16 which provided as follows: "If a bank so authorized ... incurs a deferred payment undertaking ... against documents which appear on their face to be in accordance with the terms and conditions of a credit, the party giving such authority shall be bound to reimburse the bank... ."

228 Wheble (*op cit* n 197 "UCP 1983 - Major Changes in Documentation") 2-3; Eberth (*op cit* n 195) 17. In Nielsen's classification ((*op cit* n 197) 7) this is the only "[w]esentliche Neuregelung".

229 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 46; Eberth (*op cit* n 195) 17.

230 For what follows see Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 46; Eberth (*op cit* n 195) 17.

231 Rowe (*op cit* n 197) 216-217, as well as by the same author "Letters of Credit: the ICC Revises the Rules" January 1983 *Financial Law Review* 17.

232 Eberth (*op cit* n 195) 17. See par 3 7 3 above.

In introducing and explaining the approach of the 1983 revision to transport documentation, Wheble commented as follows:

> "It was ... considered essential to make a *completely new approach* to the whole question of transport documentation on a functional basis, 'legislating' for what the transport community was, is and seems likely to be producing in the way of documentation."[233]

This "facts of life approach"[234] required that allowance be made for developments such as: (i) the increasing volume and geographical spread of container transport; (ii) the increase in combined transport (multi-modal and inter-modal) where transshipment had become the norm rather than the exception; and (iii) the trend away from the traditional "on board" or "shipped" transport document to the "taken in charge" transport document which is more suitable for purposes of combined transport.[235]

The 1983 revision thus attempted to establish the broad characteristics of an acceptable transport document.[236] Three different situations were distinguished: where the credit calls for (i) marine bills of lading (article 26), (ii) postal receipts and certificates of posting (article 30), and (iii) other transport documents (article 25). The "key provision"[237] was article 25 which set out clearly certain mandatory general requirements which the document in question had to meet in order to be acceptable under the credit,[238] as well as additional elements the document could contain which would not affect its acceptability,[239]

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233 (*Op cit* n 197 *1974/1983 Revisions Compared and Explained*) 46 (my italics). Eberth (*op cit* n 195) 17 likewise speaks of "eine völlige strukturelle Umgestaltung".

234 Wheble (*op cit* n 197 "UCP 1983 - Major Changes in Documentation") 4.

235 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 46 and Wheble (*op cit* n 197 "UCP 1983 - Major Changes in Documentation") 4.

236 This approach was not, however, to endure. The 1993 revision of the *UCP* opted to deal with each specific type of transport document separately. See par 3 9 4 below.

237 Schmitthoff (*op cit* n 197) 194 who goes on to describe the article as "remarkable" and "very forward looking".

238 A 25(a).

239 A 25(b).

and finally elements which would make rejection of the document mandatory.[240] Article 26 was similarly constructed.

Important innovations were moreover contained in articles 27(a) and 29. In terms of article 27(a) "on board" or "shipped" transport documents were no longer the norm as was the case under the 1974 revision.[241] Transport documents indicating that the goods had been "taken in charge" or "received for shipment" were now acceptable unless the credit specifically called for an "on board" transport document, when article 26 applied, or when it would be inconsistent with other stipulations in the credit if the document was not an "on board" transport document.[242]

Article 29 dealt with transshipment. The concept was defined in article 29(a) so as to encompass "transshipment" within one mode of transport as well as between different modes of transport.[243] Since the advent of container transport, transshipment had become the norm rather than the exception. This trend had already been recognised in the 1974 revision in terms of which bills of lading indicating that the goods would be transshipped were acceptable unless transshipment was prohibited in the credit.[244] A big problem was, however, the "thoughtless inertia of tradition"[245] and the use of antiquated application forms which led to the inappropriate use of the "transshipment prohibited" clause in letters of credit. It was, for example, a contradiction in terms for a credit to allow combined transport but to prohibit the transshipment inherent in it. Thus article 29(c) set out circumstances in which documents indicating that transshipment would take place could be accepted despite the prohibition of

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240 A 25(c).

241 See a 20(a) of the 1974 *UCP*.

242 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 46, 51 and (*op cit* n 197 "UCP 1983 - Major Changes in Documentation") 7; Eberth (*op cit* n 195) 19.

243 The concept was not defined in the 1974 revision, but was generally understood to relate only to carriage by sea. See Eberth (*op cit* n 195) 19; Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 54 and (*op cit* n 197 "UCP 1983 - Major Changes in Documentation") 8. In the current 1993 revision transshipment is defined separately in relation to each specific type of transport document. See a 23(b), 24(b), 27(b) and 28(c).

244 See a 21 of the 1974 *UCP*.

245 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 54.

transshipment in the credit,[246] thereby "reconci[ling] the commercial facts of life with the wording of certain credits".[247]

Changes due to Developments in the Fields of Communication and Data Transmission

An important feature of the years preceding the 1983 revision was the advances made in the field of communication, the tendency being towards paperless electronic data transmission.[248] In international banking this had led to the formation of the Society for Worldwide Interbank Financial Telecommunications (SWIFT)[249] by which it was possible *inter alia* for a bank to communicate the opening of a documentary credit to another bank. In recognition of this "rapid development and increasing use of automated communication systems in the international banking community"[250] the 1983 revision provided for the communication of the opening of a documentary credit by "any teletransmission"[251] instead of, as in the 1974 revision, by "cable, telegram or telex".[252]

Article 22(c) of the new revision was also important in this context. In terms of this provision, unless otherwise stipulated in the credit, a bank had to accept as original documents those produced or appearing to be produced by "reprographic systems" or by "automated or computerized systems", provided the documents were marked as originals and if necessary appeared to have been

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246 Eberth (*op cit* n 195) 20; Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 54 and (*op cit* n 197 "UCP 1983 - Major Changes in Documentation") 8.

247 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 54.

248 Rowe M "Automating International Trade Payments - Legal and Regulatory Issues" 1987 *Journal of International Banking Law* 234-240. See also Todd (*op cit* n 176) 118; Schmitthoff & Adams (*op cit* n 100) 78; Eberth (*op cit* n 195) 11.

249 Only banks can be members of SWIFT. Its headquarters are in Brussels and it has regional offices in the United States, the Netherlands and Belgium. On SWIFT in general see Schmitthoff & Adams (*op cit* n 100) 78; Todd (*op cit* n 176) 118. On SWIFT in the specific context of letters of credit see especially Rowe (*op cit* n 248) 234-235. See also Anonymous "S.W.I.F.T. Report: Organizational Details Begin Informative Series" June 1990 *Letter of Credit Update* 20; and "S.W.I.F.T. Report: Changes in Types of Messages Highlighted" December 1990 *Letter of Credit Update* 17.

250 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 26; Rowe (*op cit* n 197) 220-221.

251 A 12(a).

252 A 4.

authenticated. It would accordingly appear that a facsimile as well as an "electronic document" could qualify as original documents.[253] Wheble comments generally on these developments in the following terms:

> "Trade facilitation techniques, sponsored by governments and by the United Nations, have resulted in the alignment of many trade documents, establishing a new method of producing documents which, although produced by reprographic systems, are originals. Similarly, and as an extension of trade facilitation measures, original documents are being produced by automated or computerized systems. These changes in the methods of data transmission as the result of the 'communications revolution' have to be accepted as a fact of life, and it has been necessary to recognize this in UCP... ."[254]

3 9 The Revision of 1993[255]

3 9 1 Introduction

A new revision of the *UCP*, which is also the current revision, came into operation on 1 January 1994.[256] The work on this revision was embarked upon by the ICC Commission on Banking Technique and Practice in 1989, completed in March 1993 and accepted by the ICC in May 1993.[257] Initially it was thought that this revision would be exceptionally innovative in that it would for the first time provide rules for an electronic data interchange (EDI) credit.[258] This idea,

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253 Ellinger (*op cit* n 12) 596.

254 (*Op cit* n 197 *1974/1983 Revisions Compared and Explained*) 41. See also Eberth (*op cit* n 195) 14; Rowe (*op cit* n 197) 221.

255 See also Hugo C "The 1993 Revision of the Uniform Customs and Practice for Documentary Credits" to be published in the course of 1996 in the *South African Mercantile Law Journal*.

256 Del Busto C (ed) *Documentary Credits - UCP 500 and 400 Compared* (1993) ICC Publication 511 ICC Publishing Paris III (Preface); Petkovic D "UCP 500: Evolution not Revolution" (1994) 2 *Journal of International Banking Law* 39.

257 Del Busto (*op cit* n 256) III; Dolan J F & Van Huizen P "International Rules for Letters of Credit - The UCP: A Final Report" (1993-1994) 9 *Banking & Finance Law Review* 173 174; Petkovic (*op cit* n 256) 39; Nielsen J "Die Revision der Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive (ERA 500) zum 1. Januar 1994" Sonderbeilage 2 (19. März 1994) *Wertpapier Mitteilungen* 3. Prior to its acceptance the Commission circulated proposals for comment. The published comments received include: Murphy D F "Unsolved Mysteries - U.C.P. 500" December 1992 *Letter of Credit Update* 16; Wheble B "UCP 500 At Last: But What Next?" October 1992 *Letter of Credit Update* 29.

258 At the 12th ICC Banking Conference held in Paris on 25-26 October 1989, "the predominant view of a panel of experts was that it is time for a new revision, taking into account the need to establish rules for an 'EDI credit'". See Katz R "ICC in Action: More

however, was abandoned early in the revision process.[259] As a consequence, although the 1993 revision contains some important changes, it does not differ radically from its predecessor.[260]

The preliminary work was done by two sub-groups of the working group. The first investigated the articles of the *UCP* relating to the transport of goods, whilst the other articles were left to the second group. The representations of the sub-groups were then submitted to the various national committees of the ICC for comment. A consolidated working group then finalised the revision.[261]

Del Busto, the chairman of both the Commission of Banking Technique and Practice and the consolidated working group, interpreted the mandate of the working group as follows:

> "(1) simplification of the rules; (2) an articulation of the banking practices as well as an effort to facilitate the development of those practices; (3) an improvement of the Articles to define the integrity of the Documentary Credit by clarifying the primary responsibilities of the Issuing Bank and the Confirming Bank; (4) a need to address non-documentary conditions; and (5) a need to list the elements of acceptability for each type of transport document presented under a Documentary Credit."[262]

Points 1, 2 and 3 were basically addressed by reformulating existing rules and incorporating many opinions of the Commission of Banking Technique and

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on Incoterms 1990: Major EDI, Guarantee Discussions" December 1989 *Letter of Credit Update* 7 8.

259 Independent rules for EDI credits were ruled out as premature at the ICC Banking Commission's meeting on 24 October 1990. Instead it was decided to investigate whether the *UCP* could not be adapted to both paper and EDI as a first step. With this in mind a special EDI working party was set up. See in this regard Katz R "ICC in Action: Progress on UCP Revision, Guarantee Rules, New Incoterms Guide" December 1990 *Letter of Credit Update* 9 10. However, it was soon decided that there would be no reference to EDI in the *UCP*. See Katz R "ICC in Action: UCP Revision; Guarantee Rules; EDI Details; Credit Case Study Excerpts" September 1991 *Letter of Credit Update* 11.

260 Ellinger E P "The Uniform Customs and Practice for Documentary Credits - the 1993 Revision" 1994 *Lloyd's Maritime and Commercial Law Quarterly* 377 382; Davenport B & Smith M "Documentary Credits: Reform of the Uniform Customs and Practice" 1993 *Butterworths Journal of International Banking and Financial Law* 419. See also Petkovic (*op cit* n 256) 39 for the view that "its drafters have had to confront fewer pioneering issues than did the drafters of its predecessor".

261 Del Busto C "The Principles of the Revision Process for UCP 500" September 1991 *Letter of Credit Update* 9-10.

262 (*Op cit* n 256) III. See also Nielsen (*op cit* n 257) 3 ("Zielsetzung").

Practice on the interpretation of the 1983 revision.[263] The most important of these reformulations are reviewed below.[264] Thereafter points 4 and 5, that is non-documentary conditions and transport documents, are discussed under their own specific headings.

3 9 2 Clarification of Existing Rules and the Incorporation of Banking Practice

Examination of Documents

One of the cornerstones of the law relating to letters of credit is the so-called doctrine of strict compliance.[265] The underlying principle is that the bank must refuse payment if the documents tendered do not comply strictly with the requirements stipulated in the credit. However, courts in different jurisdictions have held divergent views as to what amounts to "strict compliance". The classic *dictum* of Lord Sumner in *Equitable Trust Co of New York v Dawson Partners Ltd* that "[t]here is no room for documents which are almost the same or which will do just as well"[266] has not been uniformly followed. Courts in the United States especially have favoured a less strict standard.[267]

The 1983 revision of the *UCP* required banks to "examine all documents with reasonable care to ascertain that they appear on their face to be *in accordance* with the terms and conditions of the credit".[268] Article 13(a) of the 1993 revision is substantially the same except that the term "in accordance" is replaced by "in compliance". Important, however, is that the article attempts to give some content to the term "compliance":

> "Compliance of the stipulated documents on their face with the terms and conditions of the Credit, *shall be determined by*

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263 These opinions are published on a continuing basis by the ICC. See for instance Dekker J C *Case Studies on Documentary Credits* ICC Publication 459 (1989) ICC Publishing S A Paris. Other publications in this regard referred to by Nielsen (*op cit* n 257) 3 n 3 (but unavailable to me) include: *Opinions of the ICC Banking Commission 1984-1986* ICC Publication 434; *Opinions of the ICC Banking Commission 1987-1988* ICC Publication 469; *More Case Studies on Documentary Credits* ICC Publication 489.

264 See par 3 9 2.

265 For a discussion of the doctrine see par 6 2 3 and 6 3 5 below.

266 [1927] 27 Lloyd's Rep 49 (HL).

267 See par 6 3 5 below.

268 A 15 (my italics).

> *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."[269]

As Petkovic points out this change attempts to create a more uniform standard in regard to what constitutes documentary compliance.[270] It is clear that the ICC Commission on Banking Technique and Practice does not favour either of the extreme views in this regard. Del Busto comments as follows:

> "[A] word-by-word, letter-by-letter correspondence between the documents and the Credit terms is a practical impossibility. Thus courts wedded to a 'mirror image' version of strict compliance and reasonable care have failed to provide a functional standard of document verification. Conversely, courts that interpret strict compliance as allowing deviations that do not cause ostensible harm to the Applicant, or that do not violate the court's own version of 'reasonableness', 'equity', 'good faith', or 'boni mores' have equally failed to provide a functional standard."[271]

He further points out that the absence of this functional standard of verification has resulted in a proliferation of costly litigation and uncertainty. Therefore, the guiding rule adopted in the 1993 revision is that of "international standard banking custom and practice", some but not all of which is to be found in the *UCP* itself.[272] A good example is article 37(c) which provides as follows:

> "The description of the goods in the commercial invoice must correspond with the description in the Credit. In all other documents, the goods may be described in general terms not inconsistent with the description of the goods in the Credit."

This is a clear departure from the strict standard. The standing of "international standard banking custom and practice" not reflected in the *UCP* is less certain.

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269 My italics.

270 (*Op cit* n 256) 42. See also Davenport & Smith (*op cit* n 260) 419.

271 Del Busto (*op cit* n 256) 39. See also Ellinger (*op cit* n 260) 391: "The new provision 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 discrepancy. It is to be hoped that the new provision will encourage the courts to follow this lead."

272 Del Busto (*op cit* n 256) 39-40. Del Busto's comments are susceptible to the interpretation that banking practice not reflected in the *UCP* may also be referred to for guidance. In this respect it must, however, be stressed that a 13(a) specifically provides that compliance "shall be determined by international standard banking practice *as reflected in these articles*" (my italics).

Whilst Byrne regards the introduction of this concept as the single most important statement in the 1993 revision,[273] Nielsen doubts whether it can provide a functional standard due to the absence of objective criteria upon which such practice can be determined. However, as he acknowledges, the provision at least precludes the determination of documentary compliance with reference to a mere local custom or practice.[274] It is submitted, however,[275] that this wording may well provide the ICC Commission on Banking Technique and Practice with the opportunity of continually fashioning international standard banking practice by their publications.[276]

A further change relating to the examination of documents is that whereas under the 1983 revision banks were required to examine all documents they received,[277] article 13(a) of the 1993 revision provides that only documents stipulated in the credit must be examined. If unstipulated documents are received the banks "shall return them to the presenter or pass them on without responsibility". Nielsen suggests that the better option is to return them to the presenter as this would preclude even the possibility of the point being taken that the unstipulated documents are inconsistent on their face with the stipulated documents.[278]

A further important change relating to the examination of documents has to do with the time within which the banks must complete such examination. Whilst the 1983 revision simply stated that the "issuing bank shall have a reasonable

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273 Byrne J E "UCP 500 Explored: The Standard of Care in Documentary Examination - Standard Banking Practice" October 1991 *Letter of Credit Update* 6.

274 (*Op cit* n 257) 11.

275 This is the view taken by Dolan and Van Huizen (*op cit* n 257) 182-183. The authors also mention that American bankers have interpreted these words as allowing themselves so to fashion standard banking practice. However, a 13(a) of the *UCP* requires the standard banking practice to be international. A mere American practice would accordingly not suffice.

276 Such as, for example that by Del Busto (*op cit* n 256). In the past the ICC has published several collections of opinions on the interpretation of previous revisions of the *UCP*. See for instance Dekker (*op cit* n 263) and the other publications referred to in n 263 above.

277 A 15.

278 (*Op cit* n 257) 11. On my reading of a 13(a), however, were the point to be taken it is in any event doomed to fail. In other words, what Nielsen is saying is simply that by returning the documents to the presenter one removes the temptation from the issuing bank or applicant to raise a futile defence. See also Ellinger (*op cit* n 260) 390-391.

time in which to examine the documents",[279] article 13(b) of the 1993 revision now provides as follows:

> "The Issuing Bank, the Confirming Bank, if any, or a Nominated Bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly."

The seven-day period stipulated is the maximum time allowed (the "long stop"[280]) and does not affect the obligation of the bank to complete the examination within a shorter period if such shorter period would be reasonable.[281] The seven-day limit was a compromise between the proposals from different national committees ranging from a five to a ten-day period.[282]

The seven-day period does not only apply as against the beneficiary but also in the relationships between the different banks involved. Thus, the nominated bank has seven days to examine the documents as against the beneficiary, as does the confirming bank as against the nominated bank, and the issuing bank as against the confirming bank.[283] The seven-day period may, however, be considered "flexible upon 'force majeure' conditions".[284]

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279 A 16(c).

280 Petkovic (*op cit* n 256) 41. See also Nielsen (*op cit* n 257) 11 ("[e]s handelt sich um eine Maximalfrist, dessen Ausnutzung in der Praxis die Ausnahme sein sollte"), and Davenport & Smith (*op cit* n 260) 420 ("by London practice, it should be considerably shorter").

281 For a historical analysis of the concept "reasonable time" in documentary credit practice see Chatterjee S K "Persisting Controversy as to 'Reasonable Time' under the Documentary Credit Mechanism: An Overview of the 1993 UCP for Documentary Credits" (1994) 6 *Journal of International Banking Law* 235. It is submitted though that Chatterjee's interpretation of the 1993 revision as equating "reasonable time" with "seven banking days" (on 237) is clearly incorrect. Ellinger (*op cit* n 260) 391 leaves the question open: "It remains to be seen whether the banks will treat the 'seven banking days' as a norm or regard them as applicable only in the case of complex and bulky sets of documents."

282 Del Busto (*op cit* n 256) 40. See also Murphy (*op cit* n 257) 18.

283 Del Busto (*op cit* n 256) 41; Nielsen (*op cit* n 257) 11-12.

284 Del Busto (*op cit* n 256) 41. See in this regard a 17 of the *UCP*: "Banks assume no liability or responsibility for the consequences arising out of the interruption of their business by Acts of God, riots, civil commotions, insurrections, wars or any other causes beyond their control, or by any strikes or lockouts." See further Chatterjee (*op cit* n 281) 240.

Finally, it is noteworthy that article 14(c) specifically authorises the London practice[285] of banks, having determined that there are discrepancies, approaching the applicant for a waiver of these discrepancies.[286] However, the article further provides that such an approach "does not ... extend the period mentioned in sub-Article 13(b)" within which to determine the acceptability of the documents. This cross-reference is problematical. It is unclear whether the period referred to is "seven banking days" or "a reasonable time, not to exceed seven banking days".[287]

Article 13(b) has not been received favourably by all commentators. In the first place, as pointed out by Petkovic,[288] the *UCP* does not define what is meant by a "banking day". Especially problematic in this regard is whether it includes a Saturday in financial centres such as Hong Kong, Singapore (and South Africa) where banks are open for business for half-days. He accordingly suggests that it would be prudent for banks to define the term in their credits.

The article is furthermore regarded as "an unsatisfactory compromise" by Murphy. He argues as follows:

> "[I]f we bankers have to continue justifying 'reasonable time' in the courts in any event, the I.C.C. might as well have left the 7 banking days time limit out for all the good that it does."[289]

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285 Davenport & Smith (*op cit* n 260) 420. See also Del Busto (*op cit* n 256) 46 who terms it a "universal banking practice".

286 The approach should only be made once the bank has determined that there are discrepancies. In other words, as stated by Petkovic (*op cit* n 256) 42, "[t]he issuing bank may not ... consult with the applicant on the question of compliance - only on the question of waiver".

287 Oelofse A N "Developments in the Law of Documentary Letters of Credit" 1995 *Annual Banking Law Update* Rand Afrikaans University Research Unit for Banking Law 4 refers to the decision of the English Court of Appeal in *Bankers Trust Co v State Bank of India* [1991] 2 Lloyd's Rep 443 that such consultations could be taken into account for the purpose of deciding whether the bank had determined whether the documents were acceptable within a "reasonable time" as required in article 16(c) of the 1983 revision. He regards article 14(c) as confirming this decision with the proviso that the seven-day period may not be exceeded. This, too, is the interpretation of Nielsen (*op cit* n 257) 12. But see also Avidon M E "Letters of Credit - New UCP 500 to Take Effect January 1, 1994" 1994 *Banking Law Journal* 83 84-85; Davenport & Smith (*op cit* n 260) 420.

288 (*Op cit* n 256) 41.

289 (*Op cit* n 257) 18.

Murphy is also of the opinion that banks may find it difficult to meet the seven-day deadline in the case of "excessively detailed credits".[290]

Presumption of Irrevocability

As before the 1993 revision provides that documentary credits may be either revocable or irrevocable. However, in contradistinction to the previous revisions Article 6(c) of the 1993 revision now provides that in the absence of a clear indication whether it is revocable or irrevocable, "the credit shall be deemed to be irrevocable". Del Busto comments as follows:

> "The replacement of the word 'revocable' by 'irrevocable' signalled the reversal of the long standing, although unpopular, presumption of revocability in Credit operations... UCP 400's presumption of revocability impaired the reliability of the Credit and forced courts attempting to protect third party reliance to search for irrevocability in remote places or in [the] language in the Credit."[291]

Irrevocable credits being the rule rather than the exception, this change simply brings the provisions of the *UCP* in line with documentary-credit practice[292] and with what appears to be the position under the UCC.[293]

Amendments

The 1983 revision provided that irrevocable credits could not be amended "without the agreement of the issuing bank, the confirming bank (if any), and

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290 In this regard Murphy (*op cit* n 257) 17 argues that instead of simply discouraging excessive detail (see a 5(a)(i)), such detail should have been "explicitly forbidden" or "treated as 'surplusage', as such details (sic) goes beyond the purposes of a documentary credit, in an endeavor by the applicant to make the banks 'police' the underlying contract". If this had been done, so argues Murphy, the seven days would have sufficed for any credit.

291 (*Op cit* n 256) 14.

292 Hence Ellinger's reference to this provision as "[o]ne of the most sensible changes", the previous revision being "out of touch with reality" ((*op cit* n 260) 384). See further Nielsen (*op cit* n 257) 5; Del Busto (*op cit* n 256) 15; Davenport & Smith (*op cit* n 260) 419.

293 This is stated as a fact by Murphy (*op cit* n 257) 17 without reference to authority. There is no specific provision in this regard in article 5 of the UCC, the matter having been "intentionally left to the courts" (See American Law Institute & National Conference of Commissioners on Uniform State Laws *Uniform Commercial Code* 12 ed Official Text - 1990 - With Comments 604 (Official Comment to article 5-103)).

the beneficiary".[294] This provision is retained in the 1993 revision.[295] However, the 1993 revision also addresses "a widespread practice of amending the credit without the express consent of the beneficiary".[296] This practice evolved on the assumption that the beneficiary's silence amounts to assent, an assumption which in many jurisdictions would not correctly reflect the law. This problem is addressed in article 9(d)(iii) which provides as follows:

> "The terms of the original Credit ... will remain in force for the Beneficiary until the Beneficiary communicates his acceptance of the amendment to the bank that advised such amendment."

To this general rule the article admits one exception:

> "[T]he tender of documents to the Nominated Bank or Issuing Bank, that conform to the Credit and to not yet accepted amendment(s), will be deemed to be notification of acceptance by the Beneficiary of such amendment(s) and as of that moment the Credit will be amended."

Whilst the beneficiary is only bound by the amendment from the moment of "notification of acceptance", the issuing bank is bound by an amendment "from the time of the issuance of such amendment" and the confirming bank is bound "as of the time of its advice of the amendment".[297] The precise meaning of the terms "notification", "issuance" and "advice" is by no means clear and will have to be interpreted by the courts. This matter is, however, considered in more detail below.[298]

Negotiation Credits

The obligation of the issuing bank need not necessarily be expressed as an undertaking towards the beneficiary only, but may be towards any person (or a designated person) who negotiates the seller's draft. Such credits are termed negotiation credits.[299] However, a practice has developed of dispensing with

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294 A 10(d).

295 A 9(d)(i).

296 Davenport & Smith (*op cit* n 260) 420.

297 A 9(d)(ii).

298 See par 5 2 3.

299 See par 1 6 6 above.

bills of exchange in this situation by simply undertaking a deferred payment obligation as against any bank (or a designated bank) which pays the beneficiary against delivery to it of the documents.[300] In recognition of this practice the 1993 revision now defines negotiation as "the giving of value[301] for Draft(s) and/or document(s) by the bank authorised to negotiate".[302] It is accordingly clear that the term "negotiation" as employed in the context of documentary credits has an entirely different meaning to the negotiation of a bill of exchange.[303]

Branches

There has been some uncertainty as to whether branches of a bank in different countries should, for the purposes of the *UCP*, be considered separate legal entities.[304] The 1993 revision now specifically provides that "[f]or the purposes of these Articles, branches of a bank in different countries are considered another bank".[305] Different branches of a bank in the same country must presumably be regarded as the same bank.[306]

The term "another bank", when used in the *UCP*, may accordingly be a separate legal entity or part of the same legal entity provided the two branches

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300 Petkovic (*op cit* n 256) 40.

301 The nature of the "value" required is not stated, a fact lamented by Ellinger (*op cit* n 260) 389, 402. The question raised by this omission is whether the negotiating bank which promises to pay "when we have received the funds" or pays "under reserve" has given value. This is not quite clear. See in this regard Ellinger *supra* 389 and Dolan & Van Huizen (*op cit* n 257) 181.

302 A 10(b)(ii). On this definition see especially Nielsen (*op cit* n 257) 7, 10 who explains this *erweiterter Negoziierungsbegriff* as follows: "[U]nter den Tatbestand der Negoziierung [fällt] nicht nur der traditionelle Ankauf von Tratten in Verbindung mit ordnungsgemäßen Akkreditivdokumenten, sondern auch die Variante des alleinigen Dokumentenankaufs." See also Petkovic (*op cit* n 256) 40.

303 Del Busto (*op cit* n 256) 28-29. For this reason it was decided not to address the consequences of negotiation "with" and "without recourse" in the *UCP*. As Del Busto explains: "[T]his issue pertains to the draft or the bill of exchange law relationship between the endorser and endorsee ... [which falls] within the province of national negotiable instrument law and beyond the jurisdiction of the UCP." See also Petkovic (*op cit* n 256) 40-41.

304 Petkovic (*op cit* n 256) 39. In law different branches of a bank are not different juristic persons. See Oelofse (*op cit* n 287) 1.

305 A 2.

306 Avidon (*op cit* n 287) 87.

involved are in different countries. Therefore, a foreign branch of the issuing bank may for instance confirm or negotiate the documentary credit.[307] An important implication of this provision is moreover that documents cannot be presented (for example in order to be in time) to a foreign branch of the bank nominated to receive the documents.[308]

Signature

A final noteworthy clarification relates to the meaning of "signature". Especially problematical were the questions whether a facsimile document bearing a signature could be regarded as signed, and whether the "chop mark" used extensively in parts of Asia constituted a signature.[309] The 1993 revision now 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".[310] It must be borne in mind, however, that mandatory provisions of a national legal system as to, for example, the signing of bills of exchange, cheques or contracts of suretyship, will prevail over the *UCP*. Therefore, Wheble's warning with reference to the 1983 revision that banks will often "have to rely on their own knowledge of legal requirements or commercial customs relating to 'signature'"[311] is equally applicable to the 1993 revision.

3 9 3 Non-Documentary Conditions

A non-documentary condition is a condition which does not specify any documents to be presented in compliance with it. Despite an assumption in the 1983 revision of the *UCP* (evident in several articles)[312] that *documentary* conditions are inherent in documentary-credit practice, *non-documentary*

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307 Ellinger (*op cit* n 260) 383.

308 Nielsen (*op cit* n 257) 4.

309 Davenport & Smith (*op cit* n 260) 419; Petkovic (*op cit* n 256) 42.

310 A 20(b).

311 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 42.

312 See aa 1, 4, 15, 16, 17, and especially 22(a) which provided as follows: "All instructions for the issuance of credits and the credits themselves and, where applicable, all instructions for the amendments thereto and the amendments themselves, must state precisely *the document(s) against which payment, acceptance or negotiation is to be made.*" (My italics.)

conditions have remained common in letters of credit. Much attention has been devoted in recent years to the question of how these conditions should be dealt with.[313] Typical examples cited by Nielsen are the following: "Shipment on a seaworthy vessel not more than 15 years old", and "Copies of documents to be sent by beneficiary immediately after shipment to the applicant".[314]

The problem with conditions of this nature is that they may draw the bank into the underlying contract between the applicant for the credit and the beneficiary. This would violate the independence principle as well as the fundamental principle acknowledged in the *UCP* that in the documentary-credit context "all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate".[315] As stated by Byrne:

> "A nondocumentary condition, taken at face value, necessarily erodes the intermediated character of the undertaking, entangling the bank and the court in sorting out and deciding the sordid details of the dispute(s) between the underlying parties. Once this process occurs, it is very difficult to say how the credit is different from the underlying transaction and the fundamental character of the instrument - that it is intermediate and intermediated - is gone."[316]

Whilst most commentators agree that non-documentary conditions should be avoided in documentary credits,[317] they are divided as to what should be done where they do appear. This is a problem which has also surfaced in the revision process of article 5 of the UCC. The task force working on article 5 has identified four possible options: (i) in the presence of non-documentary

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313 Byrne J E "Nondocumentary Conditions in LC's & Bank Guarantees: They just Don't Belong" April 1991 *Letter of Credit Update* 9; Anonymous "Nondocumentary Conditions are Spotlighted in Sample L/C Backing Bond Issue" August 1990 *Letter of Credit Update* 14; Rabinowitz G L "London Lawyer Compares ABA Unit's UCC Art. 5 Proposals, English Law" December 1989 *Letter of Credit Update* 23 24-26.

314 (*Op cit* n 257) 12.

315 A 4 (1993 revision).

316 (*Op cit* n 313) 9.

317 Byrne (*op cit* n 313) 9; Anonymous (*op cit* n 313) 14; Petkovic (*op cit* n 256) 41; Dolan & Van Huizen (*op cit* n 257) 184-185. See also *Banque de L'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd* [1983] 1 All ER 1137 (CA) in which a condition requiring "shipment to be effected on vessel belonging to Shipping Company that is a member of an International Shipping Conference" was regarded as unfortunate due to the fact that it conflicted with the fundamental principle that the bank deals in documents and not in goods.

conditions, the undertaking may be treated as something other than a documentary credit (for instance a guarantee); (ii) the non-documentary condition may be regarded as being satisfied by any document stating performance of the condition; (iii) the undertaking could be enforced as a documentary credit binding the issuer to all conditions including the non-documentary ones; and (iv) the non-documentary conditions may simply be ignored. The task force itself regarded the fourth option as the most attractive.[318]

One of the main aims of the 1993 revision of the *UCP* was to address the problem of non-documentary conditions.[319] Del Busto[320] reports that in doing so two possible solutions were considered, namely: (i) that a discretion be granted to the banks "to accept any document they deemed sufficient in purported compliance with a non-documentary condition"; and (ii) that the non-documentary condition should simply be disregarded. The second was the unanimous choice "because of its conceptual simplicity and operational ease". Hence article 13(c) provides as follows:

> "If a Credit contains conditions without stating the document(s) to be presented in compliance therewith, banks will deem such conditions as not stated and will disregard them."

There is little doubt that this provision will be widely welcomed by bankers.[321]

3 9 4 Transport Articles

There is a broad consensus that the review of the transport articles was the most important facet of the 1993 revision.[322] That this was the view of the ICC

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318 Rabinowitz (*op cit* n 313) 24.

319 Del Busto (*op cit* n 256) III (Preface); Petkovic (*op cit* n 256) 41 who refers to this as "one of the major goals".

320 (*Op cit* n 256) 43.

321 But see Dolan & Van Huizen (*op cit* n 257) 184-185 who regard it as "less desirable ... than current practice". The current practice according to the authors is that "well-managed banks" refuse to issue, confirm or advise documentary credits containing non-documentary conditions, and "well-advised courts" refuse to apply documentary-credit law to such instruments if the condition is central to the engagement.

322 Nielsen (*op cit* n 257) 3 "Das Schwergewicht der Reform"; Ellinger (*op cit* n 260) 381 "one of the major incentives for the promulgation of the 1993 Revision"; Dolan & Van Huizen (*op cit* n 257) 186 "fundamentally revised".

Commission of Banking Technique and Practice is borne out by the fact that in the preliminary stages of the revision process a sub-working group was appointed to investigate specifically the transport articles. This group was led by the highly regarded[323] former chairman of the Commission, Bernard Wheble.[324]

As noted above,[325] the 1983 revision adopted a general approach to the matter of transport documentation. This is evident from the fact that, barring the less important postage of goods,[326] the entire field of transport documentation was dealt with in two articles. Article 26 regulated the situation where the credit called for a marine bill of lading. All other forms of transport documentation were dealt with under article 25 which attempted to establish the broad characteristics of an acceptable transport document.

To the consternation of some commentators,[327] there was a radical departure from the approach to transport documentation "on a functional basis"[328] in the 1993 revision. Seven different types of transport documents are dealt with separately. They are: (i) marine or ocean bills of lading,[329] (ii) non-negotiable sea waybills,[330] (iii) charter party bills of lading,[331] (iv) multimodal transport

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323 See par 3 6 3 n 119 above. See further Del Busto (*op cit* n 261) 9 who regards him as "an acknowledged authority in the field of documentary credit practice and well versed in the issues of transport documentation".

324 The personal views of the current chairman of the Commission of Banking Technique and Practice were also published early in the revision process. See Del Busto C "Moving toward UCP 500: 15 Transport Issues that must be Addressed" December 1990 *Letter of Credit Update* 7.

325 See par 3 8 2.

326 Nielsen (*op cit* n 257) 15 who refers to its "keine nennenswerte Rolle".

327 Nielsen (*op cit* n 257) 15 regards it as "völlig überraschend". See also Ellinger (*op cit* n 260) 402 who says that "it is to be doubted if a separate provision was required for each of the separate transport documents governed by the code".

328 Wheble (*op cit* n 197 *1974/1983 Revisions Compared and Explained*) 46.

329 A 23.

330 A 24.

331 A 25.

documents,[332] (v) air transport documents,[333] (vi) road, rail or inland waterway transport documents,[334] and (vii) courier and post receipts.[335]

A detailed consideration of each of these types of transport documents falls outside the scope of this discussion.[336] In essence as a point of departure article 23 stipulates the requirements for a marine bill of lading, which do not differ substantially from those set out in the 1983 revision.[337] These are then applied *mutatis mutandis* to other types of transport documents. Finally the provisions relating to postage of goods were extended to apply also to courier services. It would appear that the decision to detail the requirements for each type of transport document separately was based on the assumption that it would simplify the examination of the documents.[338]

It is submitted that the most significant aspect of the revision of the provisions relating to transport documentation is the extension of the provisions dealing with marine bills of lading to non-negotiable sea waybills. Although, according to Nielsen, these documents are still scarce in documentary-credit practice,[339] Del Busto explains that article 24 was prompted by "an increasing commercial trend towards the use of the non-negotiable sea waybill in European, Scandinavian, North American and certain Far Eastern trade areas".[340]

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332 A 26.

333 A 27.

334 A 28.

335 A 29.

336 For comprehensive discussions see Nielsen (*op cit* n 257) 14-19; Ellinger (*op cit* n 260) 395-398; Dolan & Van Huizen (*op cit* n 257) 186-195.

337 Ellinger (*op cit* n 260) 395.

338 Nielsen (*op cit* n 257) 15: "Der Revision 1993 liegt offenbar die Vorstellung zugrunde, daß es für den Sachbearbeiter im Dokumentengeschäft leichter ist, ein bestimmtes Transportdokument aufgrund eines Anforderungskateloges zu prüfen, der speziell für dieses Dokument zugeschnitten ist."

339 (*Op cit* n 257) 16 "Sie kommen im Akkreditivgeschäft nur selten vor". They appear to be more prevalent in the United States. See Kozolchyk B "Evolution and Present State of the Ocean Bill of Lading from a Banking Law Perspective" (1992) 23 *Journal of Maritime Law and Commerce* 161 162.

340 (*Op cit* n 256) 72. See also Kozolchyk (*op cit* n 339) 220; Petkovic (*op cit* n 256) 42-43.

The use of non-negotiable sea waybills in documentary-credit practice has one far-reaching implication for the banks involved. Whereas the traditional marine bill of lading constitutes (i) a receipt of the goods by the carrier, (ii) a contract of carriage, and (iii) a document of title,[341] the sea waybill acts only as a receipt and contract of carriage.[342] It is not a document of title. Therefore the security function of the marine bill of lading from the bank's point of view (namely that once in possession of the bill of lading it effectively controls the goods) is absent in the case of the non-negotiable sea waybill.[343] This has led to some vehement criticism. Murphy states as follows:

> "The I.C.C. appear to have forgotten the role of banks ... of still being merchant venturers, in that some banks are prepared to risk their capital on the strength of some of their clients' balance sheets. However, as those companies' main bankers have already appropriated whatever tangible securities they may have owned, the financing bank has to look to the underlying goods as their ultimate security. Historically, the legally recognized negotiable bill of lading ... exemplified security.... Now it would appear that the I.C.C., in detailing the standards of acceptability of transport documents, are leaning over backwards to allow practically any piece of paper (and, in the future, no piece of paper) to be presented by practically anybody!"[344]

Although it is undoubtedly true that the bank's security is diminished in the case of the waybill, it would appear that this document is a necessary addition to transport documents utilised in international trade. Its value is that, unlike the marine bill of lading, it need not be presented by the consignee in order to obtain delivery of the goods. The carrier simply delivers to the consignee named in the bill. The waybill can accordingly be carried on the vessel itself. The waybill concept has long been in use in rail and air transport. Its application to sea carriage, in Jack's view, was partly "to overcome the problem that, while goods now arrive more rapidly, the postal services relied on to convey bills of lading have deteriorated".[345] Another reason is pressure

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341 Jack R *Documentary Credits* 2 ed (1993) Butterworths London 173-174; Todd (*op cit* n 176) 6-8, 97-98.

342 Jack (*op cit* n 341) 180-181; Todd (*op cit* n 176) 97-98.

343 Todd (*op cit* n 176) 97-98.

344 (*Op cit* n 257) 19. See also Todd (*op cit* n 176) 98: "In short, in a commercial credit the waybill is simply not a substitute for the traditional bill of lading. A bank should only accept a waybill if reimbursement is unlikely to be a problem."

345 (*Op cit* n 341) 180.

from carriers who prefer these documents due to the fact that their potential liability to consignees is considerably less than under marine bills of lading.[346] One final, and it is submitted very important, consideration is touched upon by Eiselen:

> "There have been several attempts to create an electronic bill of lading, but these documents are no more than carrier issued certificates because they lack the essential characteristics of negotiability and documents of title. Consequently in an effort to promote EDI it has been recommended that trading parties refrain from requiring bills of lading in their transactions and rather to use non-negotiable waybills which need not be paper based."[347]

The "most sophisticated attempt"[348] to facilitate the use of electronic bills of lading was that of the Comité International Maritime (CMI) in 1990.[349] The product of their endeavours (the "CMI Rules") is regarded by Dolan and Van Huizen as "tantamount to an electronic document comparable with a sea waybill".[350] That these developments have impacted severely on the role of the traditional marine bill of lading, and will continue to do so, can hardly be denied. To borrow a phrase from Kozolchyk, this may well be the beginning of the era of the marine bill of lading's "demise or transition".[351]

3 9 5 Conclusion

On the whole the 1993 revision has been well received. Ellinger regards it as "a much improved and better drafted codification of the banking practice related to documentary credits than any earlier version of the U.C.P."[352] These words

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346 Todd (*op cit* n 176) 97. See also Murphy (*op cit* n 257) 19: "transporters wish the business to be made as easy as possible to them".

347 Eiselen S "EDI and Banking Law" 1995 *Annual Banking Law Update* Rand Afrikaans University Research Unit for Banking Law 17. See also Jack (*op cit* n 341) 181.

348 Kozolchyk (*op cit* n 339) 229.

349 Dolan & Van Huizen (*op cit* n 257) 193-195. For a full discussion of the CMI Rules and the "Private key" electronic bill of lading see Kozolchyk (*op cit* n 339) 229-240. This was not the first attempt of facilitating electronic bills of lading. On the failed Seadocs experiment devised for the North Sea crude oil cargoes in 1986 see Kozolchyk *supra* 227-228.

350 (*Op cit* n 257) 194.

351 (*Op cit* n 339) 240. See also 163 where he refers to their "demise or metamorphosis".

352 (*Op cit* n 260) 402.

may be a bit premature in the sense that there has been too little time to gauge the extent to which its application may give rise to practical problems.[353] Nevertheless, whatever time may reveal in this regard, it cannot be doubted that the continued development of the *UCP* during the past six decades has been an immense achievement. Not only has it succeeded in drawing in for all practical purposes the entire community of trading nations in the world, and keeping them in the fold, but it has also managed to adapt to the unparalleled developments in transport and communication technology during this time. Furthermore, despite the large number of credits issued yearly and the enormous amount of money represented thereby, the *UCP* has given rise to surprisingly few disputes. Davenport and Smith's rendition of the secret of its success provides an apt conclusion:

> "Sensible and practical technical experts are continuously at work on a sensible and practical code for use by other sensible and practical people. There is no need to wait for governments to ratify or adopt political postures, as in the case of too many multilateral treaties... . It is a demonstration that many matters of international agreement are better prepared by sensible and practical people who know what they are talking about than by the civil servants and academics who prepare and draft the many treaties which now so much affect international trade."[354]

3 10 Legislation

3 10 1 Introduction

The *UCP* is without doubt the most important source to be consulted in documentary-credit practice. The precise legal nature of the *UCP* is considered below.[355] It must be noted at this stage, however, that the *UCP* is not legislation in the true sense of the word. In fact, it can safely be said that legislation in the true sense of the word has not been an important source of documentary-credit law in most countries. The one important exception is the United States of America where the law of documentary credits is regulated in Article 5 of the Uniform Commercial Code (UCC). No other country has attempted a comprehensive legislative treatment of these instruments.[356]

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353 See Nielsen (*op cit* n 257) 21.

354 (*Op cit* n 260) 421.

355 See Chapter 4.

356 Kozolchyk (*op cit* n 9) par 17 refers to limited legislative provisions in Greece, Mexico, El Salvador, Colombia, Guatamala, Honduras, Lebanon, Syria and Czechoslovakia.

Furthermore, Article 5 of the UCC was not universally accepted in the United States. The State of New York, *inter alia*, for all practical purposes rejected it. Due to the fact that New York is by far the most important centre of international trade in the United States, the rejection of Article 5 by this state necessarily diminished its relevance internationally. The article has nevertheless been of considerable importance in trade within the United States as well as in international trade by-passing New York. However, the revision process of Article 5 was completed during the course of 1995, and the probabilities are that New York's attitude towards this revision will be more positive. If this proves to be the case the new Article 5 could make a greater impact on international trade than its predecessor.

In the broad context of legislation another instrument which merits attention on an international level is the *United Nations Convention on Independent Guarantees and Standby Letters of Credit*. The Draft Convention was accepted at the 1995 Session of the United Nations Commission on International Trade Law (UNCITRAL) and finally approved in December 1995 by the General Assembly.[357] However, the Convention has not yet been ratified by any state and is accordingly not yet in force. Although the name gives the impression that the Convention is limited to standby letters of credit, it has the potential of wider application and may be applied contractually also to commercial documentary credits.

3 10 2 Article 5 of the UCC

The idea of a Uniform Commercial Code incorporating an article on documentary credits was first propagated in 1940 by William Schnader, a former president of the National Conference of Commissioners on Uniform State Laws (National Conference).[358] The idea gathered considerable momentum in 1944 when it gained the support of the American Law Institute.[359] Professor Karl Llewellyn was appointed as Chief Reporter.[360]

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357 See the General Assembly Resolution A/50/48 dated 11 December 1995.

358 Raith R T *Das Recht des Dokumentenakkreditivs in den USA und in Deutschland* (1985) Stollfuß Verlag Bonn 27.

359 Harfield (*op cit* n 8) 227-228; Raith (*op cit* n 358) 27; Anonymous "Letters of Credit under the Proposed Uniform Commercial Code: An Opportunity Missed" (1953) 62 *Yale Law Journal* 227 n3.

360 Raith (*op cit* n 358) 27. See also Corbin A L "The Uniform Commercial Code - Sales; Should it be Enacted?" (1950) 59 *Yale Law Journal* 821 who remarks as follows: "Without

Several drafts were presented to joint meetings of the National Conference and the American Law Institute between 1946 and 1951. What was intended to be the final edition of the Code was approved by the National Conference and the American Law Institute in 1951. The official draft containing the text of the Code, with explanatory comments, was subsequently published in 1952.[361]

The State of New York, however, instead of adopting the Code as was generally expected, referred the text to its Law Revision Commission, which in 1956 eventually advised against the adoption of the Code. This led to a revision of the UCC, the official text of which was published in 1958.[362] The UCC, as far as it pertains to documentary credits, was subsequently adopted by all the American states,[363] although not in identical form.[364] New York adopted the code in 1962 but, with Alabama and Missouri following in its wake, modified it by including the following provision:

> "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 in part to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Thirteenth or by any subsequent Congress of the International Chamber of Commerce."[365]

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question, the leading spirit in the whole undertaking was the reporter, K. N. Llewellyn; but every other member took an active and critical part in discussion and construction of all provisions."

361 Anonymous (*op cit* n 359) 227 n3.

362 Harfield H "Code Treatment of Letters of Credit" (1962) 41 *Cornell Law Quarterly* 92 94-96; Raith (*op cit* n 358) 27-28.

363 Although the State of Louisiana has not adopted the remainder of the UCC (see *American Jurisprudence 2d Desk Book Cumulative Supplement* (April 1991) Lawyers Cooperative Publishing New York Item 124), the provisions relating to documentary credits were adopted. See Hillman W C "Letters of Credit: Injunctions against Honor" in *International Bar Association Seminar on Problems of Letters of Credit and Bankers' Guarantees* (8-9 May 1984) Amsterdam 66 74; Raith (*op cit* n 358) 28.

364 The UCC is not federal law, but becomes state law insofar as it is adopted in each state. The most important departure from the official text, ie that of New York and the states following it, receives attention below. On other variations which may cause problems in the field of conflict of laws, see Hillman (*op cit* n 363) 73-6. See also Raith (*op cit* n 358) 28.

365 New York UCC § 5-102(4). See White J J & Summers R S *Handbook of the Law under the Uniform Commercial Code* (1980) West Publishing Co St Paul Minnesota 718-20.

This sub-section incorporated into the section of the Code dealing with the scope of Article 5, has been described as "the most extraordinary statutory statement ever made".[366] Harfield explains as follows:

> "Its effect is to subordinate the entire article to another set of rules. The subordination is not to another statute, but to another set of rules which are not enacted by any public body but by an industry. The subordination is not merely to another set of rules established by an industry, but to whatever rules that industry may choose to adopt from time to time in the future."[367]

The message from New York was very clear: Article 5 was not wanted. The compromise arrived at was the culmination of a sometimes heated debate on the advisability of the adoption of Article 5.[368] The New York view, as summarised in the final paragraph of the New York Law Revision Commission's rejection of the article, was as follows:

> "The Commission ... doubts whether any codification of the law of letters of credit is needed ... Most letter of credit transactions, moreover, take place in international trade. The desirable objective of uniformity, both nationally and internationally, is now obtained to a high degree by decisional law and commercial usage. Legislation in such a field ... should not be adopted unilaterally by American jurisdictions unless the need for it in the enacting jurisdiction is so great as to override considerations of flexibility of present and future international uniformity. As the present New York law on the subject is on the whole satisfactory the Commission does not believe that such need has been shown."[369]

In reaction to this view Mentschikoff, the Associate Chief Reporter of the UCC, argued that the New York stance was based on a number of "myths"

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366 Harfield (*op cit* n 362) 95.

367 (*Op cit* n 362) 95.

368 See Harfield (*op cit* n 362) 94-6; Mentschikoff S "Letters of Credit: The Need for Uniform Legislation" (1956) 23 *University of Chicago Law Review* 571; Wiele G *Das Dokumenten-Akkreditiv und der anglo-amerikanische Documentary Letter of Credit* (1955) Schiffahrts Verlag Hamburg 78-80; Raith (*op cit* n 358) 28-30. The debate was furthermore not limited to Article 5. The UCC as a whole was widely criticised. See especially the conflicting viewpoints of Beutel F K "The Proposed Uniform [?] Commercial Code Should not be Adopted" (1952) 61 *Yale Law Journal* 334 and Gilmore G (a member of the drafting staff of the UCC from 1948 - 1951) "The Uniform Commercial Code: A Reply to Professor Beutel" (1952) 61 *Yale Law Journal* 364. See also Corbin (*op cit* n 360) 821.

369 As quoted by Raith (*op cit* n 358) 30 from "Report of the Law Revision Commission 1956 Report Relating to the Uniform Commercial Code at 36-37".

which due to constant repetition by a "small but vocal group" had obtained much credence. These "myths" include (i) that there was a large degree of uniformity in international documentary-credit practice, and (ii) that the law of documentary credits was clear, well known and uniform.[370]

Mentschikoff's dismissal of the antagonists of Article 5 as a "small but vocal group" is unsound. Relatively small it may well have been in the context of America as a whole, but it was a very powerful and significant group. Most noteworthy was the opposition of the New York Clearing House, whose members were responsible for issuing the overwhelming majority of documentary letters of credit in American international trade.[371] Significant opposition also emanated from the ICC. Wiele remarks in this regard:

> "Insbesonders auf die Kommissionen, die das revidierte Regulativ von 1951 ausgearbeitet haben, hat die Regelung des l/c im UCC einen nachhaltigen Eindruck hinterlassen. Man geht nicht fehl, wenn man diesen Eindruck überwiegend als ausgesprochen negativ bezeichnet. Diese Reaktion beruht nicht etwa auf dem materiellen Gehalt der Bestimmungen, sondern allein auf der Tatsache, daß plötzlich eine innerstaatliche Regelung eines hauptsächlich für den Welthandel bestimmten Instruments geschaffen werden soll, das mit den bestehenden internationalen Regelungen nicht in Einklang steht."[372]

In his quest to disperse the "myth" of uniformity of documentary-credit practice Mentschikoff, with reference to the American trade figures for 1954, showed that the majority of American trade (export as well as import) was with countries not adhering to the *UCP*.[373] Having made this point he discusses case law reflecting a distinct lack of uniformity in different American states, as well as internationally.[374] Ironically, with the adherence of the Commonwealth to the 1962 Revision of the *UCP*,[375] the impact of these findings was greatly reduced. The majority of American trade could no longer be said to be with countries not

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370 (*Op cit* n 368) 571.

371 Harfield (*op cit* n 362) 96. As to the individuals opposing the article Harfield (at 95) remarks that they included "skilled and intelligent as well as merely respectable persons".

372 Wiele (*op cit* n 368) 78-79.

373 (*Op cit* n 368) 572-574.

374 (*Op cit* n 368) 581-615. See also Anonymous (*op cit* n 359) 235 n 39.

375 See par 3 6 2 above.

adhering to the *UCP*. This had a ripple effect on the uniformity of documentary-credit law, as much of the non-uniformity could basically be ascribed to differences in American and British practice.[376] Thus, with the benefit of hindsight, the strongest argument in favour of the existence of Article 5 was probably the absence of a comprehensive body of case law in any American state except New York,[377] coupled with the fact that domestic use of documentary credits was by no means insignificant.[378] Statutory regulation could consequently have lightened the burden of those American merchants, bankers and lawyers who were less accustomed to dealing with documentary credits than their New York compatriots.[379] This consideration also appears to underlie the following remarks in the Official Comment to § 5-101 of the Code:

> "Letters of credit have been known and used for many years, in both international and domestic transactions, and in many forms; but except for a few provisions, ... they have not been the subject of statutory enactment, and the law concerning them has been developed in the cases. ... This Article is intended within its limited scope ... to set an independent theoretical frame for the further development of letters of credit."[380]

More than four decades have passed since the drafting of the original article 5. During this period five revisions of the *UCP* have been undertaken and international trade and banking have adapted to major technological advances especially in the fields of transport and communications. A new revision of article 5 was inevitable.

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376 See for example Mentschikoff's remarks relating to assignability and documentary compliance (*op cit* n 368) 602 and 609-15.

377 Harfield (*op cit* n 362) 94; White & Summers (*op cit* n 365) 718.

378 Mentschikoff (*op cit* n 368) 615-619.

379 Raith (*op cit* n 358) 29 perceives this as the main argument of those favouring the Code: "Das Hauptargument derjenigen, die das Akkreditiv regeln wollten, bestand darin, daß durch die Zusammenfassung der grundlegenden Rechtsregeln zum Akkreditiv in einem Artikel des UCC die Arbeit mit dieser komplexen Zahlungsalternative sowohl für die Geschäftswelt als auch für Anwälte und Richter erheblich erleichtert würde."

380 American Law Institute & National Conference of Commissioners on Uniform State Laws *Uniform Commercial Code Official Text - 1990* (1992) Philadelphia & Chicago 601.

The revision process began in 1990.[381] The first step was that the UCC Committee of the American Bar Association appointed a task force composed of "knowledgeable practitioners and academics" who made recommendations for revisions to article 5. A Drafting Committee was subsequently appointed. The goals of the drafting effort were formulated as follows:

> "-conforming the Article 5 rules to current customs and practices;
> -accommodating new forms of Letters of Credit, changes in customs and practices, and evolving technology, particularly the use of electronic media;
> -maintaining Letters of Credit as an inexpensive and efficient instrument facilitating trade; and
> -resolving conflicts among reported decisions."[382]

The drafting process was characterised by wide participation.[383] The nine Drafting-Committee meetings were open and all attendants were entitled to participate freely in the debates. The draft was debated twice by the National Conference, and once by the American Law Institute, and was regularly reviewed and discussed *inter alia* in *Letter of Credit Update*.[384] A Proposed

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381 The process is discussed in detail in American Law Institute *Uniform Commercial Code Revised Article 5 - Letters of Credit - Proposed Final Draft* (April 6, 1995) Prefatory Note xv-xxvi. The full text of the prefatory note, draft and official commentary is published in April 1995 *Letter of Credit Update* 27-63.

382 American Law Institute (*op cit* n 381) xvii.

383 American Law Institute (*op cit* n 381) xvii-xviii: "Twenty Advisors were appointed, representing a cross-section of interested parties. In addition 20 Observers regularly attended drafting meetings and over 100 were on the mailing list to receive all drafts of the revision." The advisers and observers represented all interests: users (applicants and beneficiaries) (10), governmental agencies (5), US Council on International Banking (5), major banks (7), regional banks (8), and law professors (7).

384 Much has been written on the revision of Article 5. See, for example: Rabinowitz (*op cit* n 313) 23, continued in January 1990 *Letter of Credit Update* 10; Harfield H "Additional Comments on UCC Article 5 Revision" January 1991 *Letter of Credit Update* 10; Dolan J F "American Bar Association Unit Alerted on Art 5 Revision" February 1991 *Letter of Credit Update* 7; Byrne J E "Point by Point Commentary, UCC Art. 5 Revision Draft" May 1991 *Letter of Credit Update* 13, and by the same author "Point-by-Point Commentary, UCC Article 5 Revision Draft" May 1992 *Letter of Credit Update* 14, June 1992 *Letter of Credit Update* 16; Del Busto C "Reflections on U.C.C. Article 5 Revision (January 20, 1992 Draft)" September 1992 *Letter of Credit Update* 29; White J J "Memorandum for Article 5 Revision" December 1993 *Letter of Credit Update* 22; Avidon M "Notes on the March 11-13, 1994 Meeting of the UCC Article 5 Drafting Committee in New York City" August 1994 *Letter of Credit Update* 11; Ring C C Jr "Revised UCC Article 5 - Letters of Credit" January 1995 *Letter of Credit Update* 21; and, finally, the contributions of the United States Council on International Banking "USCIB Study of Fundamental Problems with the Seventh Draft (March 31, 1993) Revision of UCC Article 5" July 1993 *Letter of Credit Update* 15, "USCIB Positions on 15 December 1993 Draft of Revised UCC Article 5" January 1994 *Letter of Credit Update*

Final Draft was accepted in April 1995 and submitted to the National Conference and American Law Institute, both of which accepted the draft.

Apart from addressing the goals quoted above, the revision introduces important changes likely to affect the scope of application of the statute. For example, § 5-116(c) provides:

> "Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject."

The sub-section continues by stipulating that in the event of a conflict between Article 5 and the provisions of the *UCP*, the *UCP* shall "govern except to the extent of any conflict with the nonvariable provisions specified in Section 5-103(c)". Three situations can be distinguished:[385] (i) where a provision of Article 5 and the *UCP* do not conflict, both apply; (ii) where a non-variable provision of Article 5 conflicts with the *UCP*, the relevant provision of Article 5 will apply; and (iii) where any other provision of Article 5 conflicts with the *UCP*, the *UCP* will apply.

The effect of § 5-116(c) is, on the one hand, that the New York position of subordinating article 5 to the *UCP* has to a large degree been adopted. On the other hand, however, the New York option has also been limited in the sense that article 5 can no longer be totally excluded. The so-called "nonvariable provisions" apply irrespective of what the *UCP* may provide. The revised Article 5 is therefore likely to have a greater impact internationally on the law and practice of documentary credits. The revised Article 5 conforms to a large extent with the principles of the *UCP*.[386] American credits will therefore typically be governed by both the *UCP* and the UCC.

Having been passed by the American Law Institute and the National Conference, the revised Article 5 can now be ratified by the different states. This may yet take some time. Furthermore, once ratified by a particular state,

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Special Supplement s1, and "USCIB Positions on 2/19/94 Draft of Revised UCC Article 5" March 1994 *Letter of Credit Update* 20.

385 American Law Institute (*op cit* n 381) Official Comment to § 5-116(c) par 3.

386 *Ibid.* The commentators point out that although this is true of the revised article 5 and the 1993 revision of the *UCP*, future revisions of the *UCP* may differ.

the new revision will only govern credits "issued on or after the effective date" determined in the ratification.[387] Thus, the previous revision is likely to remain relevant for some time yet.

3 10 3 The United Nations Convention on Independent Guarantees and Standby Letters of Credit

The United Nations Commission on International Trade Law (UNCITRAL) from its inception in 1966 has taken an active interest in the work of the ICC relating to documentary credits.[388] In the development of the *UCP* it played an important role in two respects. In the first place UNCITRAL served "as a channel through which States and interested banking and trade institutions not represented [in the ICC] could express their views".[389] Secondly, it was at the suggestion of UNCITRAL that the 1983 revision of the *UCP* was expressly extended to standby letters of credit.[390]

The specific interest of UNCITRAL in standby letters of credit (and independent guarantees)[391] once again came to the fore during the twenty-first Session (1988) when a report on the functions, characteristics, legal framework within which they operated, and practical problems relating to the use of these instruments was considered. Considerable disparity and uncertainty were revealed. The Commission accordingly decided to undertake work aimed at achieving greater certainty and uniformity across the world.[392] This finally culminated in the adoption of the "Draft United Nations Convention on

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387 See American Law Institute (*op cit* n 381) Transition Provisions 51.

388 UNCITRAL Secretariat *The United Nations Commission on International Trade Law* 2 ed (1991) Vienna par 100. See also par 3 7 2 above.

389 UNCITRAL Secretariat (*op cit* n 388) par 102. See also par 3 7 2 above.

390 UNCITRAL Secretariat (*op cit* n 388) par 101. See also par 3 8 2 above.

391 Although these instruments differ somewhat in form, functionally they are very much alike. See par 1 6 5 above.

392 UNCITRAL Secretariat (*op cit* n 388) par 104-105. The work was carried out at two levels: (i) contractual rules; and (ii) statutory law. At the first level UNCITRAL actively supported and participated in the ICC's work on uniform rules for guarantees. At the second level the work was directed at establishing a convention.

Independent Guarantees and Standby Letters of Credit" at the twenty-eighth Session in 1995.[393]

A noteworthy provision of the Convention is article 1(2) which provides as follows:

> "This Convention applies also to an international letter of credit not falling within article 2 [in which the standby letter of credit and independent guarantee are defined] if it expressly states that it is subject to this Convention."

This article, an opt-in provision, makes it possible by contractual incorporation to subject a commercial (as opposed to a standby) documentary credit to the provisions of the Convention. The potential scope of application is therefore wider than merely standby letters of credit and independent guarantees.

The precise date upon which the Convention will enter into force is not yet known. In terms of article 28 it will enter into force "on the first day of the month following the expiration of one year from the date of the deposit of the fifth instrument of ratification, acceptance, approval or accession." States ratifying the Convention after "the deposit of the fifth instrument of ratification" are likewise bound by it from "the first day of the month following the expiration of one year after the date of the deposit of the appropriate instrument on behalf of that State". Furthermore, the Convention applies only to undertakings issued after the date upon which the Convention becomes operative in the state concerned. It is accordingly clear that it may be some time yet before the Convention enters into force; it is even possible that it may never enter into force.[394]

There is little doubt, however, that the Convention successfully addresses certain problematic areas in the law of documentary credits and is a valuable instrument for the purposes of comparative research. Certain of its provisions are referred to in context below.[395]

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393 See August 1995 *Letter of Credit Update* 39 where the full text of the Convention is also reproduced.

394 The United Nations Convention on the Carriage of Goods by Sea (the so-called "Hamburg Rules"), for example, although adopted by the General Assembly in 1978, only entered into force in 1991. The United Nations Convention on International Bills of Exchange and International Promissory Notes which was adopted by the General Assembly in 1988, has not yet entered into force.

395 See especially par 5 5 and 6 4.

Chapter Four

The Legal Nature of the UCP[1]

4 1 Introduction

Despite the world-wide acceptance of the *UCP*, and the time elapsed since it was first adopted, the legal nature of this document remains a much debated topic.[2] This is also one of the very few topics relating to letters of credit that has received serious consideration in South African legal literature.[3] The matter has nevertheless not yet been settled.[4]

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1 For an earlier version of this chapter see Hugo C F "The Legal Nature of the Uniform Customs and Practice for Documentary Credits: Lex Mercatoria, Custom, or Contracts?" (1994) 6 *South African Mercantile Law Journal* 143-168.

2 For an Anglo-American perspective, see Ellinger E P "The Uniform Customs - their Nature and the 1983 Revision" 1984 *Lloyd's Maritime and Commercial Law Quarterly* 578 583-6; Gutteridge H C & Megrah M *The Law of Bankers' Commercial Credits* 7 ed (1984) Europa Publications London 6; Sarna L *Letters of Credit* 3 ed (1989) (loose-leaf edition) Carswell Toronto par 2(13); Todd P *Bills of Lading and Bankers' Documentary Credits* (1990) Lloyd's of London Press London 18-19; Schmitthoff C M & Adams J *Schmitthoff's Export Trade* 9 ed (1990) Stevens & Sons London 401-403. For a European perspective, see Schönle H "Die Rechtsnatur der Einheitlichen Richtlinien und Gebräuche für Dokumentenakkreditive" (1968) 16 *Neue Juristische Wochenschrift* 726; Eberth R "Zur Rechtsnatur der Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive" in Barfuß W (ed) *Festschrift für Neumayer* (1985) Nomos Baden-Baden 199; Von Westphalen F Graf *Rechtsprobleme der Exportfinanzierung* 3 ed (1987) Verlag Recht und Wirtschaft Heidelberg 227-231, as well as "Die Einheitlichen Richtlinien und Gebräuche für Dokumenten-Akkreditive (1974) und die Einheitlichen Richtlinien für Inkassi im Licht des AGB-Gesetzes" 1980 *Wertpapier Mitteilungen* 178; Zahn J C D, Eberding E & Ehrlich D *Zahlung und Zahlungssicherung im Außenhandel* 6 ed (1986) Walter de Gruyter Berlin par 1/15-19; Eisemann F & Schütze R A *Das Dokumentenakkreditiv im Internationalen Handelsverkehr* 3 ed (1989) Verlag Recht und Wirtschaft Heidelberg 51-58; Canaris C-W *HGB Staub Großkommentar - Bankvertragsrecht* Vol I 4 ed (1988) Walter de Gruyter Berlin 639-641 (par 925-927); De Rooy F P *Documentair Kredieten* 2 ed (1980) Kluwer Deventer 16-18; Ulrich C M *Rechtsprobleme des Dokumentenakkreditivs* (1989) Schulthess Zürich 35-44.

3 Stassen J C "The Legal Nature of the Uniform Customs and Practice for Documentary Credits (UCP)" 1982 *Moderne Besigheidsreg* 125.

4 Von Westphalen (*op cit* n 2 *Rechtsprobleme der Exportfinanzierung*) 227 ("nicht abgeschlossen"); Zahn, Eberding & Ehrlich (*op cit* n 2) par 1/15 ("Anlaß zu Zweifeln"); Eisemann & Schütze (*op cit* n 2) 51 ("heftig diskutiert"); Lücke G *Das Dokumenten-Akkreditiv in Deutschland, Frankreich und in der Schweiz - Eine rechtsvergleichende Darstellung* (1976) Christian Albrechts Universität Kiel 15 ("umstritten"); Stassen (*op cit* n 3) 125 ("some extreme claims").

In this context the main question of interest is whether the *UCP* incorporates rules which have legal effect in their own right, or whether in order to have legal effect the provisions of the *UCP* need to be incorporated into the different contracts between the parties.[5] Due to the fact that banks normally insist on express adoption of the *UCP*, thereby incorporating the provisions of the *UCP* into the contracts, this question does not often arise in practice.[6] It is nevertheless a question which has fascinated theoreticians especially in continental Europe. From a South African perspective the matter was expressly left open by Goldstone J in *Phillips v Standard Bank of SA Ltd*.[7] Before considering the proper approach from a South African point of view, theories advanced elsewhere will accordingly be considered.

It is functional, in this regard, to distinguish broadly between theories emanating from the civil-law countries on the European continent and those advanced from the common-law perspective by English and American jurists. First of all, however, it is necessary to deal with the contention that the *UCP* forms part of a new supranational *lex mercatoria*, as this contention has led certain jurists to argue that the nature of the *UCP* need not or should not be determined from the perspective of any particular legal system: it qualifies as law on an international level totally independent of the provisions of national law.

4 2 The UCP: Part of a Supranational New Lex Mercatoria?

4 2 1 The Theory of the New *Lex Mercatoria*

Three distinct periods can be identified in the history of the law of international trade.[8] The first is the emergence of the European *lex mercatoria* during the

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5 Eberth (*op cit* n 2) 200; Ellinger (*op cit* n 2) 583.

6 Eberth R "Documentary Credits in Germany and England" 1977 *Journal of Business Law* 29 30; Ellinger (*op cit* n 2) 583-584. The final clause of the Standard Bank's *Irrevocable Documentary Credit Application*, for example, reads: "I/We agree that this credit shall be subject to Uniform Customs and Practice for Documentary Credits published (and amended from time to time) by the International Chamber of Commerce."

7 1985 3 SA 301 (W) 304.

8 On the history of international trade law see Schmitthoff C M "Das Neue Recht des Welthandels" (1964) 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 47; Von Caemmerer E "The Influence of the Law of International Trade on the Development and Character of the Commercial Law in the Civil Law Countries" in Schmitthoff C M (ed) *The Sources of the Law of International Trade* (1964) Stevens & Sons London 88-100 (also in Leser H G (ed) *Ernst von Caemmerer gesammelte Schriften* Vol I (1968) J C B Mohr Tübingen 11); Honnold J "The Influence of the Law of

middle ages. The *lex mercatoria* of this period was custom of a universal nature applied by the special mercantile courts throughout Europe to a special social class - the merchants. In this sense it can be described as law which operated on a supranational level.[9] The second period, during the eighteenth and nineteenth centuries, saw the adoption of the principles of the *lex mercatoria* by the different national states into their own national legal systems. This "nationalisation" of the *lex mercatoria*, however, led to stagnation[10] and diversification of the law of international trade. As stated by Stassen:

> "The change from a universal *lex mercatoria* to separate systems of national commercial law ... created serious problems for the smooth functioning of international trade. Notwithstanding the general similarity between different national systems on the level of principle, the development of diverse national systems of commercial law ... led to differences on the level of particular rules which complicate international trade."[11]

It is consequently not surprising that the pendulum did not stop there. During the twentieth century, and especially after World War II, various initiatives designed to achieve international uniformity brought about a "tremendous revival".[12] The *UCP* has been one of the most successful of these initiatives. This third period in the history of the law of international trade is the context in which the much debated theory of a modern, or new, *lex mercatoria* has

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International Trade on the Development and Character of English and American Commercial Law" in Schmitthoff C M (ed) *The Sources of the Law of International Trade* (1964) Stevens & Sons London 70-87; Berman H J & Kaufman C "The Law of International Commercial Transactions (*Lex Mercatoria*)" (1978) 19 *Harvard International Law Journal* 221-229; De Ly F *De Lex Mercatoria - Inleiding op de Studie van het Transnationaal Handelsrecht* (1989) Maklu Antwerpen 105-119; Stassen (*op cit* n 3) 125-127.

9 See par 2 4 1 above.

10 Medwig M T "The New Law Merchant: Legal Rhetoric and Commercial Reality" (1993) 24 *Law and Policy in International Business* 589 594.

11 (*Op cit* n 3) 126. See also Goldstajn A "International Conventions and Standard Contracts as Means of Escaping from the Application of Municipal Law" in Schmitthoff C M (ed) *The Sources of the Law of International Trade* (1964) Stevens & Sons London 103 106 where he summarises the development of "international business law" thus: "integration (within the framework of the then existing markets), disintegration (by incorporation into the various municipal laws), and re-emergence of the need of universal integration."

12 Medwig (*op cit* n 10) 595.

arisen.[13] The pioneering work in this regard is generally ascribed to Schmitthoff who first expressed himself on this theme in 1957:

> "We are beginning to rediscover the international character of commercial law and the cycle now completes itself: The general trend of commercial law everywhere is to move away from the restriction of national law to universal [sic], international conception of the law of international trade."[14]

An early major contribution to this debate was the publication in 1964 of *The Sources of the Law of International Trade*, edited by Schmitthoff and to which several prominent international trade lawyers contributed.[15] "The aim of this book", explains Schmitthoff in the introduction, "is to explore the sources from which the law of international trade is derived. Are we witnessing the rise of a new *lex mercatoria* and what will be its form and shape?"[16]

Schmitthoff's thesis proceeds from his perception of an existing uniformity in the law of international trade throughout the world.[17] This leads him to speak of a new *lex mercatoria*, which he stresses, is new and not simply a rebirth of the old. There is a fundamental difference between the medieval *lex mercatoria* and its modern counterpart. Whilst the medieval *lex mercatoria* was true international customary law (*wahres internationales Gewohnheitsrecht*) based on the universally acknowledged customs of the merchant class, the new *lex mercatoria* accepts as its premiss the existence of sovereign national states so

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13 For good and recent expositions of the respective viewpoints, see Medwig (*op cit* n 10) 589; Wilkinson V L D "The New *Lex Mercatoria* - Reality or Academic Fantasy?" (1995) 12(2) *Journal of International Arbitration* 103. Wilkinson's article contains a comprehensive bibliography at 116-117.

14 As quoted by Bärmann J "Ist internationales Recht Kodifizierbar?" in Flume W (Herausgeber) *Internationales Recht und Wirtschaftsordnung, Festschrift für F A Mann* (1977) C H Beck München 547 566, who also casts some doubt on whether Schmitthoff can indeed be regarded as the father of this theory. This theory also forms the basis of Schmitthoff's articles "The Law of International Trade, its Growth, Formulation and Operation" in Schmitthoff C M (ed) *The Sources of the Law of International Trade* (1964) Stevens & Sons London 3, and "Das Neue Recht des Welthandels" (*op cit* n 8).

15 Schmitthoff C M (ed) *The Sources of the Law of International Trade* (1964) Stevens & Sons London. Amongst the contributors were John Honnold (Pennsylvania), Ernst von Caemmerer (Freiburg), Alexandar Goldstajn (Zagreb) and Clive Schmitthoff himself (London).

16 Schmitthoff (*op cit* n 15) ix.

17 Schmitthoff C M (*op cit* n 14 "The Law of International Trade, its Growth, Formulation and Operation") 3.

that it exists only as a direct or indirect creation (*Rechtsschöpfung*) of all states.[18] The law of international trade is therefore applied in every municipal jurisdiction by authority of the sovereign of the territory in question and not *proprio vigore*, as part of a *jus gentium* or international law.[19]

Schmitthoff[20] identifies two sources of the law of international trade. The first he terms "international legislation". The term is misleading due to the absence of a body with international legislative powers. This is acknowledged by Schmitthoff who regards the term as "a convenient expression to indicate deliberate normative regulations devised internationally and then introduced into the municipal law by municipal legislation." This can be done by the ratification of a multilateral convention or the unilateral adoption of a uniform model law.[21]

The second source of international trade law identified by Schmitthoff is "international commercial custom", a term which he uses solely to denote "custom *formulated* by international agencies". Custom not so formulated he terms "commercial usage or practice" which may be "commercial custom *in statu nascendi*". The essential difference is that usage lacks the certainty already inherent in custom.[22] The certainty of custom in this instance is a result of its specific formulation by the international agency.

Whilst "international legislation", after its adoption into the national law, applies *ipso iure*, "international commercial custom" does not. Therefore, parties wishing their relations to be governed by such custom, need to subject themselves to it contractually. The custom then applies not as "custom" but as

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18 Schmitthoff C M (*op cit* n 8 "Das Neue Recht des Welthandels") 61.

19 Schmitthoff (*op cit* n 14 "The Law of International Trade, its Growth, Formulation and Operation") 4; Goldstajn (*op cit* n 11) 106; Stassen (*op cit* n 3) 126.

20 Schmitthoff (*op cit* n 14 "The Law of International Trade, its Growth, Formulation and Operation") 16. See also Goldstajn (*op cit* n 11) 113-115.

21 Schmitthoff's classification is by no means the only one. For a different approach see Wilkinson (*op cit* n 13) 107-112 who differentiates between general principles of law, uniform laws of international trade, customs and usages, and arbitral awards.

22 Schmitthoff (*op cit* n 14 "The Law of International Trade, its Growth, Formulation and Operation") 15-16. See also Kozolchyk B *Letters of Credit* in Ziegel J S (ed) *International Encyclopedia of Comparative Law* IX (1979) J C B Mohr Tübingen par 20-21 who distinguishes between "formal customs" and "informal customs".

contract term.[23] This also has implications for the supranationality of "international commercial custom": it can only be supranational - in the sense of ousting national law - if the parties work out their contract in such detail that it becomes unnecessary to resort to national law to determine the legal position of the parties (a *vollständige Regelung der Rechtsbeziehungen*). In this situation the contract may be regarded as supranational in the sense that there is simply no room for applying national law. The contract is "self-regulatory".[24] It is in this regard that the "model contracts" sponsored by the United Nations Economic Commission for Europe,[25] as well as the "standard conditions" issued by trade associations,[26] are important developments.

The application of the *lex mercatoria* in international commercial arbitrations has a further dimension to it. Whilst national courts must adjudicate on the basis of their own substantive law and conflict principles, arbitrators are not similarly bound. In fact, in arbitration proceedings a dispute need not be adjudicated on the basis of any particular national law.[27] The UNCITRAL Model Law on International Commercial Arbitration (the adoption of which is currently being

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23 Schmitthoff (*op cit* n 8 "Das Neue Recht des Welthandels") 63-64.

24 Schmitthoff (*op cit* n 8 "Das Neue Recht des Welthandels") 69: "[Der Begriff der Parteiautonomie muß auch zulassen] daß die Parteien versuchen, ihre Vertragsbestimmungen in sich selbst so volständig zu gestalten, daß für die Anwendung nationalen Rechtes überhaubt kein Raum mehr ist. Denn schlieslich erhebt sich die Frage des anwendbaren Rechtes nur, wenn der Vertrag Lücken enthält. Wenn der Vertrag aber eine vollständige Regelung der Rechtsbeziehungen zwischen den Parteien enthält, dann löst sich das auf ihn anwendbare Recht von den nationalen Rechten los, der Vertrag wird 'überstaatlich' in dem Sinne, daß er nicht länger national gebunden ist: er ist 'self-regulatory'."

25 These include standard contracts for the supply of plant and machinery for export, the supply and erection of plant and machinery for import and export, the export of durable consumer goods and engineering articles, the sale of cereals, citrus fruit, sawn softwood, solid fuels, potatoes and steel products. See Schmitthoff & Adams (*op cit* n 2) 73-74.

26 Schmitthoff & Adams (*op cit* n 2) 73 refer *inter alia* to the following associations who have established such standard conditions: the British Wool Confederation, the Federation of Oil, Seeds and Fats Associations, the Grain and Feed Trade Association, the International Wool Textile Organisation, the London Metal Exchange, the London Rubber Trade Association, the Refined Sugar Association and the Timber Trade Federation of the United Kingdom.

27 This was remarked on early in the *lex mercatoria* debate by Goldstajn (*op cit* n 11) 112: "the parties not infrequently omit to specify in their contract which law shall govern their relations, as they expect that the arbitration shall settle their differences in the spirit of general principles and generally recognized and accepted practice." See also Spickhoff A "Internationales Handelsrecht vor Schiedsgerichten und staatlichen Gerichten" 56 (1992) *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 116.

considered in South Africa[28]), for example, provides that the arbitration tribunal "shall decide the dispute in accordance with *such rules of law as are chosen by the parties* as applicable to the substance of the dispute".[29] It is clear from the legislative history of the provision that the term "rules of law" as utilised here is not limited to a national legal system but enables a party to choose, *inter alia*, "rules embodied in a convention or similar legal text elaborated on the international level, even if not yet in force".[30] The Model Law further provides that the tribunal "shall decide *ex aequo et bono* or as *amiable compositeur*" if the parties have expressly authorised it to do so,[31] and, in all cases, "shall take into account the usages of trade applicable to the transaction".[32]

There appears to be a growing practice amongst international commercial arbitrators to resort to the internationally accepted principles of international trade, or the new *lex mercatoria*, when authorised to do so.[33] National courts have also been willing to enforce arbitral awards based on the *lex mercatoria*.[34] The case *Deutsche Schachtbau- und Tiefbohrgesellschaft mbH v R'As al*

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28 Butler D "The Recovery of Interest in Arbitration Proceedings: An Agenda for Law-makers" (1995) 6 *Stellenbosch Law Review* 291 321.

29 A 28(1) (my italics). For a discussion of a 28 see Holtzmann H M & Neuhaus J E *A Guide to the UNCITRAL Model Law on International Commercial Arbitration - Legislative History and Commentary* (1994) Kluwer Deventer 764-807.

30 Holtzmann & Neuhaus (*op cit* n 29) 805.

31 A 28(3).

32 A 28(4). This sub-article was modelled on a 33(3) of the UNCITRAL Arbitration Rules. See Holtzmann & Neuhaus (*op cit* n 29) 807.

33 Rivkin D W "Enforceability of Arbitral Awards Based on *Lex Mercatoria*" (1993) 9 *Arbitration International* 67 states: "The controversy surrounding the existence, the credibility, even the validity of Lex Mercatoria has not dampened its increasing appeal as a choice of governing substantive law to an arbitration." See also Schmitthoff & Adams (*op cit* n 2) 655 n 45. However, the specific term *lex mercatoria* is seldom used. Rivkin (*supra* 68-69) quotes the following examples: (i) the arbitrator's award is to be "consistent with the legal principles familiar to civilized nations"; (ii) the relationship is based "on the principles of goodwill and good faith"; the agreement is based on "goodwill and sincerity of belief and on the interpretation of this agreement in a fashion consistent with reason"; and (iv) "[t]he Law governing the substantive issues between the parties shall be determined by the Tribunal, having regard to the quality of the Parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world". See also the discussion of the *Rakoil* case below.

34 See Medwig (*op cit* n 10) 603-610. See also in general Rivkin (*op cit* n 33) 67.

Khaimah National Oil Co and Shell International Petroleum Co Ltd[35] provides an excellent example. The parties had given no indication in the contract of the law to be applied to the substance of the dispute by the arbitration tribunal. In terms of the applicable ICC Rules of Arbitration, the arbitrators were to apply the law they deemed appropriate. The tribunal decided that it would be inappropriate to apply a national system of law and that the substantive law governing the obligations of the parties was the "internationally accepted principles of law governing contractual relations". Rakoil's contention that the award was against public policy because it was rendered "not on the basis of any particular national law, but upon some unspecified and possibly ill-defined, internationally accepted principles of law" was rejected by the Court of Appeal.[36]

This, however, is not a true exception to Schmitthoff's principle that "international commercial custom" can only apply in the case of contractual subjugation. Although the contractual link with a specific custom may be tenuous, the very application of the *lex mercatoria* remains inextricably linked to the contracting will of the parties.

4 2 2 The *UCP*

Where does the *UCP* stand against the background of the debate on the new *lex mercatoria*? The *UCP* itself cannot, of course, determine its own status. The different revisions do, however, contain interesting provisions reflecting the ICC's views in this regard. General provision (a) to the 1974 revision, for example, reads as follows:

> "These provisions and definitions apply to all documentary credits and are binding upon all parties thereto unless otherwise expressly agreed."

This provision, which is materially the same in all the previous revisions of the *UCP*, creates the impression that its drafters regarded the *UCP* as a universal

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35 [1987] 2 Lloyd's Rep 246 (CA). For discussions of the case see Rivkin (*op cit* n 33) 75-76; Medwig (*op cit* n 10) 609-610.

36 251-253.

supranational set of rules which is automatically applicable unless expressly excluded by the parties.[37]

However, in order to fit into the scheme of the new *lex mercatoria*, the *UCP* must either qualify as "international legislation" or "international commercial custom". To meet the test of objective statutory law or "international legislation", the *UCP* would have to be either a multilateral convention or a model statute. Since it was formulated, not by official representatives of governments, but by a private non-governmental organisation, the ICC, it cannot be regarded as a multi-lateral convention.[38] The question whether the *UCP* can be regarded as a model statute is slightly more problematical. It is clear from the historical development of the *UCP* that the ICC had as its main objective the widest possible adherence to the principles contained in the *UCP*.[39] One of the possible manners of adoption of the *UCP* is for the legislature of a particular country to direct its application as a primary or subsidiary source of law. However, this has occurred only in isolated instances.[40] The *UCP* itself certainly contains no indication of an intention to create a model statute. In the overwhelming majority of countries adherence has simply been by the banks themselves, collectively or individually.

Schmitthoff regards the *UCP* as one of the best examples of "international commercial custom".[41] Thus, according to his analysis of the new *lex mercatoria*, it has no force *proprio vigore*, but must be incorporated into the contract between the parties. Accordingly, the basis of its applicability is the autonomy of the parties to make their own contract. There is support for this viewpoint in the revisions of the *UCP* subsequent to that of 1974. The 1983 revision, for instance, provided:

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37 Schönle (*op cit* n 2) 726; Slongo U *Die Zahlung unter Vorbehalt im Akkreditiv-Geschäft* (1979) Huber Dübendorf 48-49; Stassen (*op cit* n 3) 125.

38 Canaris (*op cit* n 2) 639 (par 925); Stassen (*op cit* n 3) 126.

39 See Wheble B *UCP 1974/1983 Revisions Compared and Explained* ICC Publication 411 (1984) ICC Publishing Paris 10-11.

40 In Mexico, the former Czechoslovakia (I am unaware of the present situation) and Honduras. See Kozolchyk (*op cit* n 22) par 22; Ulrich (*op cit* n 2) 35.

41 Schmitthoff (*op cit* n 8 "Das Neue Recht des Welthandels") 64-65 and (*op cit* n 14 "The Law of International Trade, its Growth, Formulation and Operation") 18. See also, for support of this view Goldstajn (*op cit* n 11) 115-116; Von Caemerrer (*op cit* n 8) 97-99.

> "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 issued subject to Uniform Customs and Practice for Documentary Credits, 1983 revision, ICC Publication no 400.*"[42]

The current 1993 revision is even clearer. It specifically provides that its provisions "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.*"[43] It would accordingly appear that the drafters of the *UCP* treat its application as being based primarily on express contractual incorporation.[44]

In the context of arbitration proceedings, however, the *UCP* may well be applied in a documentary-credit dispute despite the absence of express incorporation. Article 33(3) of the UNCITRAL Rules, for example, provides:

> "In all cases, the arbitral tribunal shall decide in accordance with the contract and *shall take into account the usages of the trade applicable to the transaction.*"[45]

It can hardly be doubted that the *UCP* constitutes "usages of the trade applicable to the transaction". Hence, this provision authorises - or even requires - the arbitrator to take cognisance of the provisions of the *UCP* in a documentary-credit dispute. However, the contractual link, although it may be tenuous, is still present. As Holtzmann and Neuhaus report:

> "The provision [article 33(3) of the Rules and 28(4) of the Model Law] was said to ensure that the parties' expectations were fulfilled, on the ground that parties choose arbitration in part because they expect that arbitrators 'will above all base their

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42 A 1 (my italics).

43 A 1 (my italics).

44 See Dolan J F & Van Huizen P "International Rules for Letters of Credit - The UCP: A Final Report" (1993-1994) 9 *Banking and Finance Law Review* 173 175; Ellinger E P "The Uniform Customs and Practice for Documentary Credits - the 1993 Revision" 1994 *Lloyd's Maritime and Commercial Law Quarterly* 377 382. It must, however, be pointed out that the wording of the 1983 and 1993 revisions does not exclude an interpretation that the *UCP* may apply in a specific legal system even in the absence of express incorporation. See in this regard par 4 3 1, 4 3 2 and 4 4 2 below.

45 My italics. See also the identically worded a 28(4) of the UNCITRAL Model Law. See further the discussion in Holtzmann & Neuhaus (*op cit* n 29) 772, 807.

> decisions on the wording and history of the contract and the usages of trade'".[46]

Finally, in the absence of wording expressly subjecting the contract to the *UCP*, the question may still arise whether the provisions, or some of them, may not have been incorporated *ex lege* or tacitly by the parties themselves.[47] The degree to which the *UCP* can be said to be customary may well be decisive in answering this question. However, whether such incorporation can occur, or the extent to which it can occur, or the conditions to be met for it to occur, are questions which are properly answered from the perspective of a particular national legal system.

From the above it is clear that the new *lex mercatoria*, and the *UCP* insofar as it may be part of it, is dependent upon being legitimated in some way on a national level. It is supranational only in the sense that the law is the same in many different countries. This is a point addressed forcefully by Canaris. Dealing with attempts to define the nature of the *UCP* without reference to a national legal system,[48] he argues as follows:

> "Derartige Bemühungen sind jedoch aus rechtsquellentheoretischen Gründen von vornherein aussichtlos, da die Internationale Handelskammer unzweifelhaft keine Rechtssetzungshoheit besitzt. Die ERG sind daher *keine internationale rechtsordnung 'sui generis'* und auch *kein 'normatives Regelwerk'*; wenn in diesem Zusammenhang von der 'Notwendigkeit' die Rede ist, den ERG 'als Ausdruck des faktisch (!) Üblichen unabhängig von der Parteivereinbarung rechtsgestaltende (!) Wirkung zuzusprechen', oder von 'einer internationalen Ordnung sui generis, deren wirklicher (!) Geltungsgrund angesichts der universellen Verbreitung und fast lückenlosen Befolgung dieser Ordnung nicht in dem subjektiven Willen der Parteien, sondern in der tatsächlichen (!) Anerkennung durch die beteiligten Wirtschaftskreise (!) zu finden ist', so tritt darin die unzulässige Vermengung von Faktizität und Normativität unverhüllt zu Tage. Ebenso verfehlt ist es, die Geltung der ERG auf einen *'weltweiten einheitlichen Handelsbrauch' ohne Anknüpfung an den jeweiligen Einzelvertrag* zurückzuführen; demgegenüber ist es eine rechtsquellentheoretische Selbstverständlichkeit, daß

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46 (*Op cit* n 29) 772.

47 See Ellinger (*op cit* n 44) 382-383; Dolan & Van Huizen (*op cit* n 44) 175.

48 See in this regard Eberth (*op cit* n 2) 214-216; Eisemann F & Eberth R *Das Dokumentenakkreditiv im Internationalen Handelsverkehr* 2 ed (1979) Verlag Recht und Wirtschaft Heidelberg 48; Eisemann & Schütze (*op cit* n 2) 57-58.

> Handelsbräuche nur nach Maßgabe des einschlägigen nationalen Rechts Relevanz erlangen... ."[49]

4 3 The Nature of the UCP from a Civil-Law Perspective

4 3 1 Germany

German theoreticians have attempted to define the nature of the *UCP* with reference to customary law (*Gewohnheitsrecht*), trade usage (*Handelsbrauch*) and standard conditions of contract (*Algemeine Geschäftsbedingungen*).

The requirements to be met for the *UCP* to qualify as *Gewohnheitsrecht* have been stated as follows by Eberth:

> "In dieser Eigenschaft müßten die Richtlinien dann durch eine länger andauernde, im ganzen gleichformige Übung und durch den Rechtsgeltungswillen der beteiligten Kreise, die opinio necessitatis, charakterisiert sein."[50]

The essential characteristics are accordingly: in the first place a continual uniform practice and, secondly, the *opinio necessitatis*, that is the opinion of those affected that the practice is indeed law.[51] A broad consensus has developed that the *UCP*, in any event in its entirety, cannot qualify as *Gewohnheitsrecht*. In the first place it has been argued that the many revisions of the *UCP* are not compatible with the requirement of a continual practice.[52] Secondly, the *UCP* is not a simple declaration of generally practised principles, but, to a large extent, an independent regulation aimed also at the future, in which considerations of efficacy, practicability and fairness have played important parts.[53] Thirdly, it has also been argued that the German title

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49 Canaris (*op cit* n 2) 639-640 (par 925). See also Slongo (*op cit* n 37) 49-50.

50 (*Op cit* n 2) 203. See also Eisemann & Schütze (*op cit* n 2) 53-54.

51 Schärrer H *Die Rechtstellung des Begünstigten im Dokumenten-Akkreditiv* (1980) Stämpfli Bern 32 states with reference to the similar position in Switzerland: "Voraussetzung, dass überhaupt Gewohnheitsrecht vorliegen kann, ist das Vorliegen einer ständigen Übung und die innere Rechtsüberzeugung der Beteiligten, dass die Übung einem Rechtsatz entspreche (opinio necessitatis)."

52 Canaris (*op cit* n 2) 640-641 (par 926); Eberth (*op cit* n 2) 203; Raith R T *Das Recht des Dokumentenakkreditivs in den USA und in Deutschland* (1985) Stollfuß Bonn 41; Slongo (*op cit* n 37) 50-51.

53 Slongo (*op cit* n 37) 50-51; Canaris (*op cit* n 2) 640 (par 926).

"Einheitliche Richtlinien und Gebräuche" does not support this view.[54] Fourthly, it has been pointed out that practice has not always been, and in the future will not necessarily be, uniform.[55] Finally, the required *opinio necessitatis* is also absent as the *UCP* is not generally regarded as binding law.[56] It accordingly appears that at best certain central concepts of the *UCP*, such as the abstract nature of the obligations,[57] or the doctrine of strict compliance,[58] may qualify as *Gewohnheitsrecht* in German law.[59]

The view that the *UCP* may qualify as *Handelsbrauch* has found more support.[60] The concept of this type of trade usage, which is specifically provided for in paragraph 346 of the German *Handelsgesetzbuch* (*HGB*),[61] is described by Eberth as follows:

> "Handelsbräuche stellen nach deutscher Rechtsauffassung tatsächliche, gleichmäßige Übungen dar, die auf einer einheitlichen Auffassung der beteiligten kaufmännischen Verkehrskreise basieren und nach einem gewissen Zeitablauf zur Entstehung gelangen, ohne daß ein Rechtsgeltungswille der Gemeinschaft zur Bildung des Handelsbrauchs erforderlich ist."[62]

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54 Schönle (*op cit* n 2) 727.

55 Schönle (*op cit* n 2) 727.

56 Canaris (*op cit* n 2) 640 (par 926); Eberth (*op cit* n 2) 203.

57 See Wessely W *Die Unabhängigkeit der Akkreditivverpflichtung von Deckungsbeziehung und Kaufvertrag* (1975) C H Beck München 56.

58 See Eisemann & Schütze (*op cit* n 2) 53 n 58.

59 Canaris (*op cit* n 2) 640-641 (par 926); Raith (*op cit* n 52) 41.

60 See Zahn, Eberding & Ehrlich (*op cit* n 2) par 1/18; Horn N "Internationale Zahlungen und Akkreditiv" from Horn N, Von Bieberstein W F M, Rosenberg L & Pavicevic B *Dokumentenakkreditive und Bankgarantien im internationalen Zahlungsverkehr* (1977) Metzner Frankfurt am Main 9 13; Lücke (*op cit* n 4) 16-17.

61 "Par 346 [Handelsbräuche]: Unter Kaufleuten ist in Ansehung der Bedeutung und Wirkung von Handlungen und Unterlassungen auf die im Handelsverkehre geltenden Gewohnheiten und Gebräuche Rücksicht zu nehmen" (quoted from Glanegger P, Niedner H J, Renkl G & Ruß W *HGB Handelsrecht, Bilanzrecht, Steuerrecht - Kommentar zum Handelsgesetzbuch* 2 ed (1990) Müller Heidelberg 1113).

62 (*Op cit* n 2) 203-204.

A major difference between *Gewohnheitsrecht* and *Handelsbrauch* is the absence of the *opinio necessitatis* requirement.[63] The most important practical consequence of recognising the *UCP* as *Handelsbrauch* is that it would apply irrespective of the knowledge or will of the parties.[64] The proponents of the view that the *UCP* may qualify as *Handelsbrauch*[65] are supported by an isolated decision of the *Bundesgerichtshof*.[66] The balance of opinion does not, however, support this view.[67] Most of the objections to regarding the *UCP* as *Gewohnheitsrecht* are equally applicable to *Handelsbrauch*:[68]

> "Abweichende Übungen in der Vergangenheit, die Möglichkeit divergierender Usancen in der Zukunft, Unterschiede in der Interpretation und Anwendung in den verschiedenen Ländern sowie Unbilligkeit einzelner Regeln verhindern nicht nur die Fortbildung der Einheitlichen Richtlinien und Gebräuche zu Gewohnheitsrechtsnormen. Sie erlauben auch nicht die Richtlinien in ihrer Gesamtheit als Handelsbräuche zu bezeichnen."[69]

As in the case of *Gewohnheitsrecht* the possibility exists, however, that certain specific provisions may well meet the test. In each instance the specific provision in question must therefore be examined to determine whether it meets the requirements of a generally observed, actual and consistent practice observed in the relevant segment of the mercantile community.[70] This possibility must, however, not be overemphasized. The existence of a

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63 Canaris (*op cit* n 2) 640-641 (par 926).

64 Zahn, Eberding & Ehrlich (*op cit* n 2) par 1/19; Raith (*op cit* n 52) 41-42; Angersbach U *Beiträge zum Institut des Dokumenten-Akkreditivs* (1965) Julius-Maximilians-Universität Würzburg 14; Lücke (*op cit* n 4) 16.

65 See n 60 above.

66 See BGH 14. Feb 1958 (1958 *Wertpapier Mitteilungen* 456 459). But see also BGH 4. Okt 1984 (1984 *Wertpapier Mitteilungen* 1443), in which the court, having referred to this decision, expressly left the question open.

67 See Canaris (*op cit* n 2) 640-641 (par 926); Schönle (*op cit* n 2) 728; Eisemann & Schütze (*op cit* n 2) 54-55; Eberth (*op cit* n 2) 203-205.

68 As stated above, an important exception is that the *opinio juris* (*opinio necessitatis*) required for classification as *Gewohnheitsrecht*, is not required for classification as *Handelsbrauch*. See in this regard Canaris (*op cit* n 2) 640-641 (par 926).

69 Schönle (*op cit* n 2) 728.

70 Schönle (*op cit* n 2) 728; Canaris (*op cit* n 2) 641 (par 926); Eberth (*op cit* n 2) 205.

Handelsbrauch remains a question of fact, the proof of which remains a difficult task.[71]

Finally, several commentators regard the *UCP* as *Algemeine Geschäftsbedingungen*.[72] The *Gesetz zur Regelung des Rechts der Algemeinen Geschäftsbedingungen (AGBG)*[73] defines the concept as follows:

> "Algemeine Geschäftsbedingungen sind alle für eine Vielzahl von Verträgen vorformulierten Vertragsbedingungen, die eine Vertragspartei (Verwender) der anderen Vertragspartei bei Abschluß eines Vertrages stellt. Gleichgültig ist, ob die Bestimmungen einen äußerlich gesonderten Bestandteil des Vertages bilden oder in die Vertragsurkunde selbst aufgenommen werden... ."[74]

Algemeine Geschäftsbedingungen are in the first place "vorformulierte Geschäftsbedingungen". The standard conditions must therefore be drawn up prior to incorporation into the contract.[75] This preformulation need not be by one of the parties to the contract: it can be done by a third party, such as the ICC.[76] The second requirement is that they must be preformulated for a "Vielzahl von Verträgen". This has been interpreted as at least three to five applications.[77] The *UCP* clearly satisfies these requirements.[78] The measure of doubt as to whether the *UCP* can be regarded as *Algemeine*

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71 Canaris (*op cit* n 2) 641 (par 926).

72 Although they themselves do not support this view, Eisemann & Schütze (*op cit* n 2) 56 nevertheless refer to it as the "herrschende Meinung". See further Von Westphalen (*op cit* n 2 *Rechtsprobleme der Exportfinanzierung*) 228-231 (according to Eisemann & Schütze "der führende Verfechter der Einordnung der ERA als AGB"); Canaris (*op cit* n 2) 641 (par 927); Liesecke R "Die neuere Rechtsprechung, insbesondere des Bundesgerichtshofes, zum Dokumentenakkreditiv" 1966 *Wertpapier Mitteilungen* 458; Raith (*op cit* n 52) 43; Horn (*op cit* n 60) 13.

73 Vom 9. Dezember 1976 (Bundesgesetzblatt Teil I 3317).

74 Par 1 (quoted from Hefermehl H in Westermann H P (Herausgeber) *Handkommentar zum Bürgerlichen Gesetzbuch* Vol 1 7 ed (1981) Aschendorff Münster 2419).

75 Hefermehl (*op cit* n 74) 2421-2422.

76 Hefermehl (*op cit* n 74) 2422: "Nur eine Vertragspartei kann Geschäftsbedingungen stellen. Von wem die formulierten Vertragsbedingungen entworfen sind, ist grundsätzlich gleichgültig." See also Canaris (*op cit* n 2) 641 (par 927).

77 Hefermehl (*op cit* n 74) 2422.

78 Canaris (*op cit* n 2) 641 (par 927); Eisemann & Schütze (*op cit* n 2) 56.

Geschäftsbedingungen relates to the third requirement, namely that the conditions must be put by the contracting party imposing them (the "Verwender") to the other. In this respect Eisemann and Schütze argue:

> "Zweifelhaft ist jedoch, ob die Einheitlichen Richtlinien von einer Vertragspartei der anderen Partei bei Vertragsabschluß 'gestellt werden', die Akkreditivbank also der 'Verwender' ist. Bei den ERA wird man davon ausgehen können, daß die Einbeziehung auf dem Willen beider Vertragsparteien beruht, daß es also keiner 'Verwender' im Sinne von § 1 AGBG gibt."[79]

This line of reasoning does not seem to have found favour elsewhere. By arguing that there is no "Verwender" due to the fact that the application of the *UCP* typically arises from the will of both parties, Eisemann and Schütze in effect postulate that the one party's status as "Verwender" is dependent upon the will of the other party. Why this should be the case is unclear.

Unlike *Handelsbrauch*, *Algemeine Geschäftsbedingungen* are not incorporated by operation of law. Should the "herrschende Meinung" therefore be accepted, the most important consequence is that the *UCP* can have legal effect only insofar as it has been incorporated in their contract by the parties.[80] In this regard paragraph 2 of the *AGBG* provides:

> "Algemeine Geschäftsbedingungen werden nur dann Bestandteil eines Vertrages, wenn der Verwender bei Vertragsabschluß die andere Vertragspartei ausdrücklich oder ... durch deutlich sichtbare Aushang am Ort des Vertragsabschlusses auf sie hinweist und der anderen Vertragspartei die Möglichkeit verschafft, in zumutbarer Weise von ihrem Inhalt Kenntnis zu nehmen, und wenn die andere Vertragspartei mit ihrer Geltung einverstanden ist."[81]

The leading German theory is therefore that the *UCP* in its entirety qualifies as *Algemeine Geschäftsbedingungen*. This, in turn, implies that the legal effect of the *UCP* is linked to the will of the parties. It must, however, be borne in mind that classification as *Algemeine Geschäftsbedingungen* does not preclude

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79 (*Op cit* n 2) 56-57. See also Eberth (*op cit* n 2) 206. It must be borne in mind, however, that Eberth was Eisemann's co-author in the previous editions of Eisemann & Schütze (*op cit* n 2).

80 Von Westphalen (*op cit* n 2 *Rechtsprobleme der Exportfinanzierung*) 228-229; Canaris (*op cit* n 2) 641-642 (par 928); Horn (*op cit* n 60) 13.

81 Quotation taken from Hefermehl (*op cit* n 74) 2425.

specific articles of the *UCP* from qualifying as *Handelsbrauch*. The incorporation by operation of law of any such article into the contract remains possible.

4 3 2 Other Civil-Law Countries

Views originating from other civil-law countries contribute little new to the debate in Germany. The views of Dutch, Swiss, French and Spanish commentators range from regarding the application of the *UCP* as dependent upon contractual incorporation to its application as trade usage or customary law independent of the will of the parties.

From a Dutch perspective, Van Delden, having analysed several decisions of the *Hoge Raad* concludes that "de UCP naar Nederlands recht ... niet gewoonterecht zijn, omdat zij (nog) niet krachtens bestendig gebruikelijk beding of krachtens gebruik van toepassing worden geacht".[82] De Rooy, on the other hand, takes a slightly different view:

> "Ik ben derhalve van mening dat de Uniforme Regelen *in hun totaliteit* slechts krachtens uitdrukkelijke of stilzwijgende instemming van partijen de rechtsverhoudingen tussen de bij het documentair krediet betrokken partijen kunnen beheersen, doch dat de *meer algemene regels* en bepalingen van de UR ook zonder uitdrukkelijke of stilswijgende instemming van partijen de rechtsverhouding tussen de bij het documentair krediet betrokken partijen beheersen, aangezien deze regels en bepalingen gezien kunnen worden als een codificatie van internationaal geldende gewoonte... ."[83]

De Rooy's distinction between the *UCP* "in hun totaliteit" which must be contractually incorporated by the parties, and certain "meer algemene regels" which as "internationaal geldende gewoonte" have effect irrespective of the will of the parties, is in line with the German view of the *UCP* being in principle *Algemeine Geschäftsbedingungen*, which does not exclude the possibility of certain provisions qualifying as *Handelsbrauch*. De Rooy distinguishes, albeit somewhat tentatively,[84] between general terms ("algemene bepalingen")[85] and

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82 Van Delden R *Betalingsverkeer (documentair krediet/documenten)* (1990) Kluwer Deventer 88-90.

83 (*Op cit* n 2) 17-18 (my italics).

84 (*Op cit* n 2) 17: "waarbij ik toegeef dat dit onderscheid niet altijd even duidelijk is".

articles of a more technical nature ("artikelen met een meer technisch karakter").[86] Only the first mentioned category is likely to meet the test of "internationaal geldende gewoonte". De Rooy's argument is supported by the fact that the more technical articles tend to change more radically from revision to revision.[87]

From a Swiss viewpoint Ulrich's conclusion seems very much like a reiteration of the German "herrschende Meinung":

> "Aus den obenstehenden Ausführungen geht hervor, dass die ERA in ihrer Gesamtheit als Allgemeine Geschäftsbedingungen ... zu qualifizieren sind, wobei einzelne ihrer Bestimmungen Handelsbräuche wiedergeben."[88]

There is, however, one important difference: the Swiss have a different understanding of *Handelsbrauch*. Unlike in Germany, *Handelsbräuche* are only binding insofar as the parties to the contract have so agreed, expressly or tacitly. Due to the absence of the *opinio necessitatis* the *UCP* can also not be applied as *Gewohnheitsrecht*.[89] Therefore, in Switzerland, the application of the *UCP* is always linked to the will of the parties.[90]

According to Eberth[91] the debate in France centres on whether the *UCP* should be regarded simply as standard conditions of contract (*contrat-type*), or whether

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85 These include a 3(a) dealing with the obligations of the issuing bank, a 3(c) which provides that the credit may not be revoked or altered without the consent of all the parties involved, and a 8(a) stipulating that the parties deal in documents and not goods. (These references are to the 1974 Revision of the *UCP*. The corresponding references to the 1993 revision are aa 9(a), 9(d) and 4 respectively.)

86 He cites the following examples from the 1974 revision: a 20(a) requiring an "on board" bill of lading, a 22(a) which provides for the rejection of a bill of lading showing that the goods are loaded on deck, and a 28(a) requiring the insurance documents to be expressed in the same currency as the credit. The corresponding articles in the 1993 revision are aa 23(a), 31 and 34(f) respectively.

87 *Cf* eg a 20(a) (1974 revision) and a 27(a) (1983 revision): a complete about turn was made from disallowing a "taken in charge" bill of lading in the absence of an express stipulation for an "on board" bill of lading to allowing it.

88 (*Op cit* n 2) 43.

89 See par 4 3 1.

90 Schärrer (*op cit* n 51) 66-67 (also n 67); Ulrich (*op cit* n 2) 39-40; Slongo (*op cit* n 37) 52.

91 (*Op cit* n 2) 208-209.

it has the quality of usage in the form of *usages conventionnels* which, in terms of article 1160[92] of the *Code Civil* must be taken into account in the interpretation of a contract, or, whether as *usages de droit* or *règles coutumières*, it may even have the status of customary law. Most commentators favour the view that the *UCP* is *contrat-type* and must therefore be incorporated contractually.[93]

In Spain, on the other hand, there appears to be substantial support amongst commentators for the view that the *UCP* qualifies as *usos normativos* or *normas consuetudinarias*. This view is, however, not shared by the *Tribunal Supremo* which regards the *UCP* as general conditions of contract.[94]

4 4 The Nature of the UCP from a Common-Law Perspective

4 4 1 Introduction

The legal nature of the *UCP* has not been debated as vigorously in the common-law jurisdictions as on the European continent.[95] This is not due to an absence of theoretical possibilities. In general terms English and American law admit the same possibilities encountered in continental law, that is custom, trade usage or contract terms. The reason must rather be sought in the more casuistic nature of the common law.[96] Alternatively, it may even simply be ascribed to the fact that the greater degree of consensus amongst the commentators has never elevated the nature of the *UCP* to an "issue". The question they choose to address is simply whether the *UCP* constitutes an "independent source of law"

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92 "The clauses which are customary in a contract shall be supplemented, although they have not been inserted." (Translation taken from Cachard H *The French Civil Code* (1930) Lecram Paris 325.)

93 Lücke (*op cit* n 4) 18 who refers to Stoufflet, Nasser, Hamel-Lagarde-Jauffret and Epschtein. It is clear from Eberth (*op cit* n 2) 208-210 that there is no complete consensus.

94 Eberth (*op cit* n 2) 211.

95 Eberth (*op cit* n 2) 212: "Im englischen und amerikanischen Recht sind - strukturbedingt - weniger intensive Bemühungen um eine zutreffende begriffliche Qualifizierung und funktionsgerechte systematische Einordnung der Richtlinien unternommen worden".

96 See for instance Ellinger (*op cit* n 2) 583: "It may be argued that the question is theoretical."

or "a set of standard terms and conditions which apply subject to the agreement of the parties".[97]

4 4 2 English Law

In order to constitute an independent source of law in England, the *UCP* must qualify as either custom or usage. Custom is defined as follows in *Halsbury's Laws of England*:

> "A custom is a particular rule which has existed either actually or presumptively from time immemorial and obtained the force of law in a particular locality although contrary to, or not consistent with, the general common law of the realm."[98]

The essential attributes of custom are that (i) it must be immemorial, (ii) reasonable, (iii) certain (as regards its nature as well as the locality), and (iv) it must have continued without interruption since its immemorial origin.[99]

English commentators have consistently rejected the notion that the *UCP* may qualify as custom. Although the term "custom" is used in certain instances to designate the *UCP*, it is always clear from the context that the term is then not employed in the technical sense described above.[100] The matter is regarded as trite; there does not appear to be any in-depth analysis of the question in English case law[101] or legal theory. This is understandable. It is clear that

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97 Ellinger (*op cit* n 2) 583. Schmitthoff C M "International and Procedural Aspects of Letters of Credit" in Horn N *The Law of International Trade Finance* (Studies in Transnational Economic Law - Vol 6) (1989) Kluwer Deventer 227 228-229 prefers the terminology "normative" as against "contractual".

98 Lord Hailsham of St Marylebone (ed) *Halsbury's Laws of England* Vol 12 4 ed (1975) Butterworths London 2. See also *Lockwood v Wood* (1844) 6 QB 50 64 (115 ER 19 24-25): "A custom which has existed from time immemorial without interruption within a certain place, and which is certain and reasonable in itself, obtains the force of a law, and is, in effect, the common law within that place to which it extends, though contrary to the general law of the realm."

99 Halsbury (*op cit* n 98) 5. For a detailed jurisprudential discussion of custom see Allen Sir Carleton K *Law in the Making* 6 ed (1958) Clarendon Press Oxford 64-156.

100 Schmitthoff, for instance, has described the *UCP* as "international commercial custom" (see par 4 2 2). From the context, however, it is clear that he does not regard it as a source of law independent of the contract between the parties.

101 In *Golodetz & Co Inc v Czarnikow-Rionda Co Inc* [1979] 2 Lloyd's Rep 450 (QB) 455 Donaldson J remarked without any discussion that the *UCP* rules "do not have the force of law". See also Schmitthoff (*op cit* n 97) 229-230 who argues that *Banque de l'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd* [1983] 1 Lloyd's Rep 228 (CA) provides

neither the *UCP* in its entirety, nor any single provision of it, can meet the requirements set by English law for custom. Numerous arguments can be raised in this regard. The fact of the many revisions of the *UCP* is at odds with the requirement that a custom must have continued without interruption since its immemorial origin. Thus, only those principles that have remained unaffected through the different revisions could possibly meet this requirement. For a custom, furthermore, to be regarded as immemorial, it must be shown to have originated prior to 1189.[102] Although this principle is softened by a presumption that the custom is immemorial if the origin is unknown to living testimony,[103] it remains highly doubtful that any principle formulated in the *UCP* could qualify as immemorial. Finally, the English concept of custom is that it is restricted to a particular locality; custom is local custom.[104] This is clearly incompatible with the universal application of the *UCP*.

Usage, on the other hand, is defined in *Halsbury's Laws of England* as follows:

> "[A] rule of conduct amounts to a usage if so generally known in the particular department of business life in which the case occurs that, unless expressly or impliedly excluded, it must be considered as forming part of the contract."[105]

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authority for the view that the *UCP* does not qualify as custom or usage. In that case Donaldson MR, having referred to an argument founded on the common law, stated that he would have accepted the argument in a case where the *UCP* did not apply (232). This distinction, so argues Schmitthoff, would have been unnecessary had the *UCP* qualified as custom or trade usage. This argument seems somewhat forced.

102 The classic formulation is that of Blackstone Sir William *Commentaries on the Laws of England* Vol 1 12 ed (1793) Strahan & Woodfall London 76 n 10: "If any one can shew the beginning of it within legal memory, that is within any time since the first year of reign of Richard the first, it is no good custom." See also Halsbury (*op cit* n 98) 5.

103 Halsbury (*op cit* n 98) 5.

104 Blackstone (*op cit* n 102) 74 refers to customs as affecting "only the inhabitants of particular districts". They stem from a practice, which "for reasons that have been now long forgotten, [that] particular counties, cities, towns, manors and lordships, were very early indulged with the privilege of abiding by their own customs, in contradistinction to the rest of the nation at large". See also Allen (*op cit* n 99) 127-7: "A custom applying to all the Queen's subjects is not truly a custom at all in the legal sense, for, as Coke says, 'that is the common law'. Customs, then, are *local variations* of the general law." See further Halsbury (*op cit* n 98) 10.

105 (*Op cit* n 98) 28. See also *Moult v Halliday* [1898] 1 QB 125 129 in which trade usage, although incorrectly termed "custom", was defined as follows: "A custom is what is so well known and understood that in transacting business it is unnecessary to mention it, because it is so well known that it must be taken to be incorporated in every contract, unless something to the contrary is said."

The essential attributes of usage are that it must be (i) notorious, (ii) certain, (iii) reasonable and (iv) it must not offend against the intention of any legislative enactment.[106]

None of the objections mentioned above to treating the *UCP* as custom apply to usage. The notion that the *UCP* may qualify as usage has nevertheless found little favour in England.[107] The possibility is, however, not rejected completely in *Benjamin's Sale of Goods*. Dealing with the question whether the UCP may apply in the absence of contractual incorporation, the authors conclude as follows:

> "Whilst the Code has been widely used in the United Kingdom since 1962, it *may* not have gained the notoriety required for the establishment of a trade usage."[108]

A further matter to be noted is that the English commentators, when dealing with the nature of the *UCP*, tend to regard it in its entirety.[109] Unlike their continental counterparts they are not alive to the possibility of certain provisions of the *UCP* meeting the requirements of trade usage. This is true even of Schmitthoff and Ellinger who do refer to German and French legal literature in this regard.[110]

It is submitted that it is conceivable that certain provisions of the *UCP* may well pass the test for trade usage. Although required to be long established, a usage need not be immemorial. The crucial question is the notoriety it has

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106 Halsbury (*op cit* n 98) 32.

107 As in the case of custom, the term is encountered in certain instances but then invariably used in a different sense. See, for example, Schmitthoff (*op cit* n 97) 229, who having designated the *UCP* as "international commercial custom" in an earlier publication (see n 100 above), uses the term "transnational trade usage of contractual nature". Once again, however, from the context it is clear that he does not regard it as a source of law independent of the contract between the parties.

108 Ellinger E P "Documentary Credits and Finance by Mercantile Houses" in Guest A G (editor) *Benjamin's Sale of Goods* 3 ed (1987) Sweet & Maxwell London 1378 (par 2163). (My italics.)

109 Gutteridge & Megrah (*op cit* n 2) 6; Todd (*op cit* n 2) 18; Schmitthoff & Adams (*op cit* n 2) 402.

110 See Schmitthoff (*op cit* n 97) 228-229; Ellinger (*op cit* n 2) 584.

achieved.[111] In the case of a usage forming part of the *lex mercatoria*, the notoriety must be cosmopolitan.[112] The test has been formulated as follows:

> "[The] usage must have acquired such notoriety in the ... particular branch of trade that any person in that branch who enters into a contract of a nature affected by the usage must be taken to have done so with the intention that the usage should form part of the contract."[113]

Central concepts such as the independence of the issuing bank's obligation to honour the credit and the doctrine of strict compliance may well meet this test.

By rejecting custom and trade usage as possible bases for regarding the *UCP* as an independent source of law, English commentators have clearly taken the view that the *UCP*, to be applicable, must be incorporated into the contract between the parties. Thus it is regarded as "a set of standard terms and definitions which apply subject to the agreement between the parties",[114] or "a body of rules binding on those ... who have adopted them",[115] or as provisions that "apply only if the parties have incorporated them into their contract".[116] Due to the ready availability of the *UCP* it is accepted that the incorporation can be by reference only.[117]

One final question needs to be addressed: does this mean that incorporation of the *UCP* must necessarily be express, or is tacit (consensual) incorporation possible? Some light is cast on this question by the case *Harlow and Jones Ltd v American Express Bank Ltd*. The decision was concerned not with the status of the *UCP* but with that of the ICC's *Uniform Rules for Collection*.[118] The point

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111 Allen (*op cit* n 99) 132: "the rule of immemorial antiquity does not apply to [trade usages]; any long established user, supported by notoriety, is sufficient."

112 On the close relationship between usage and the *lex mercatoria* in general, see Halsbury (*op cit* n 98) 37-38.

113 Halsbury (*op cit* n 98) 32.

114 Ellinger (*op cit* n 2) 583.

115 Gutteridge & Megrah (*op cit* n 2) 6.

116 Schmitthoff & Adams (*op cit* n 2) 402. See also Todd (*op cit* n 2) 18.

117 Ellinger (*op cit* n 2) 586.

118 ICC Publication 322 (1979) ICC Publishing Paris.

was taken by the defendant that these rules did not apply as they had not been expressly incorporated. This contention was rejected by Gatehouse J in the following terms:

> "The answer is that they did not need to be. The expert witnesses from both plaintiffs and defendants were agreed that all banks operating in England subscribe to the Uniform Rules. It is clear beyond argument that defendants do so."[119]

Referring to this case, Ellinger points out that due to the fact that the *UCP* has attained a considerably greater degree of acceptance in international banking than the *Uniform Rules for Collection*, "the ruling ought to apply even more decisively to this Code".[120] There is much to be said for this reasoning. But what was the basis of the court's willingness to apply the *Uniform Rules*? This was not spelt out. It is suggested, however, that the *Harlow* case does not provide authority for the view that the *UCP*, in the absence of express incorporation, will apply as a custom or trade usage. The better interpretation is that in the absence of express incorporation, tacit (consensual) incorporation will, especially as against a bank, be the norm rather than the exception.[121] This reasoning does not, however, apply to the same degree to standby letters of credit where the *UCP* is often not incorporated.[122]

4 4 3 American Law

The position in the United States is less certain. This is mainly due to the fact that the concepts of custom and usage are less clearly defined than in England. A statement like that of McGivern that the *UCP* is "a fairly comprehensive record of custom and usage",[123] must accordingly be treated with caution.[124] As another commentator points out:

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119 [1990] 2 Lloyd's Rep 343 (QB) 349.

120 Ellinger (*op cit* n 44) 382-383.

121 This is borne out by the fact that the defendant's own operations manual as well as its standard form collection document referred to the *Uniform Rules*. See 349 of the report.

122 Ellinger (*op cit* n 44) 383.

123 "International Letters of Credit and their Use in Agricultural Export Situations" (1983) 37 *Arkansas Law Review* 217 228.

124 McGivern's statement, in conjunction with similar sentiments expressed elsewhere, has led Eberth (*op cit* n 2) 213 to conclude that the *UCP* is generally regarded as trade usage in America. Due to the uncertainty of the meaning of "trade usage" this conclusion does not contribute much to a better understanding of the nature of the *UCP*.

> "American courts, apparently unconcerned with the complexities of custom or trade usage, fail to distinguish among several different types of situations that arise, preferring for the most part to label and treat each alike."[125]

In a quest to stem this terminological confusion American commentators have tried, on the whole, to distinguish custom and usage on the basis that custom is an independent source of law whilst usage depends upon contract.[126]

Custom, in this sense, is acknowledged by the American courts. It is, however, a less familiar concept than in England.[127] This is ascribed to, *inter alia*, the lack of a tradition similar to that found in England where the whole common-law system was to a large degree derived from custom.[128] The English tests for custom are rarely applied. Basically the American courts set two requirements: (i) there must be some societal value that will be served directly by enforcing the custom; and (ii) the practice must have been in use for a considerable length of time.[129] These requirements are not as prohibitive to regarding a particular provision of the *UCP* as custom, as those set in English law.[130]

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125 Anonymous "Custom and Trade Usage: Its Application to Commercial Dealings and the Common Law" (1955) 55 *Columbia Law Review* 1192. See also Raith (*op cit* n 52) 31: "diese beiden Erscheinungen [werden] häufig durcheinandergebracht". A good example, specifically in the field of letters of credit, is provided by the controversial case *Dixon, Irmaos & Cia Ltda v Chase Nat Bank of the City of New York* (1944) 144 F 2d 759 (Circuit Court of Appeals 2d Circuit). The credit *in casu* called for a "full set" of bills of lading. This term was interpreted by the court with reference to a New York practice in terms of which the guarantee of a prime bank was regarded as a sufficient substitute for a missing document. The court found that this practice, which it described synonymously as a trade usage and a custom, justified a departure from the rule of strict compliance. The case sparked of a debate. See Backus D C & Harfield H "Custom and Letters of Credit: The Dixon, Irmaos Case" (1952) 52 *Columbia Law Review* 589; Honnold J "Letters of Credit, Custom, Missing Documents and the *Dixon* Case: a Reply to Backus and Harfield" (1953) 53 *Columbia Law Review* 504.

126 Anonymous (*op cit* n 125) 1193 n 2.

127 Llewellyn K N "The Normative, the Legal and the Law-Jobs: The Problem of Juristic Method" (1939-1940) 49 *Yale Law Journal* 1355 1359 regards the term as "too blunt and confused to serve in careful analysis".

128 Anonymous (*op cit* n 125) 1203.

129 Anonymous (*op cit* n 125) 1204.

130 Especially significant is the absence of the requirement of immemorial origin. See Anonymous (*op cit* n 125) 1205.

Usage on the other hand has generally been regarded as dependent upon the contract.[131] This concept of "consensual"[132] trade usage is not very helpful. It simply assists in answering the question whether a certain practice may have been incorporated tacitly into the contract. It differs, therefore, from usage in English law which is clearly concerned with the question whether a certain practice may be incorporated into the contract by operation of law. It would appear, in any event, that the term "consensual" in this regard is not really appropriate. As a general rule, if reliance is placed on a trade usage, the parties are required to have had knowledge of the practice. However, it is accepted that "even in the absence of proof of B's actual knowledge A may still take advantage of the usage if the court decides that B should have known or a reasonable man would have known of the usage."[133] This objective element of trade usage has been incorporated into the UCC's definition of the concept. The current wording reads:

> "A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question."[134]

This notion of trade usage is clearly not limited to consensual trade usage. It is not necessary for both parties consciously to be aware of the trade usage. All that is required is such regularity so as to "justify an expectation of its observance".[135] Trade usage, so defined, can accordingly be regarded as a possible source of law independent of the will of the parties.

It is submitted that it is theoretically conceivable that certain provisions of the *UCP* could fall within the ambit of the American conception of trade usage, or possibly even custom. Practically speaking, however, because America has opted for legislation dealing with letters of credit in the form of article 5 of the

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131 See n 126 above.

132 The adjective is taken from Anonymous (*op cit* n 125) 1193.

133 Anonymous (*op cit* n 125) 1199-1200.

134 § 1-205(2).

135 White J J & Summers R S *Handbook of the Law under the Uniform Commercial Code* 2 ed (1980) West Publishing St Paul Minnesota 98.

UCC,[136] the question is not likely to arise often. It is trite that neither trade usage nor custom can prevail over a conflicting statutory provision. The question is accordingly only likely to arise against the background of a *lacuna* in the statute.[137] Article 5 of the UCC specifically provides for this possibility:

> "This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this Article." [138]

One situation in which the question may arise, is where one has to determine the revocability of a credit which is not expressly designated as revocable or irrevocable. The UCC is silent on this point. It is dealt with in the *UCP*, the 1993 revision of which deems a credit irrevocable unless it is specifically designated to be revocable.[139] It is suggested that in the United States the incorporation of this provision by operation of law may well be possible.

4 5 Conclusions from the Comparative Survey

In dealing with the nature of the *UCP*, most of the legal systems surveyed admit three theoretical possibilities, which, for the sake of convenience, can be termed (i) custom, (ii) trade usage, and (iii) contract terms. The terms "custom" and "trade usage" may, however, be misleading in that they do not always have the same meaning in the different jurisdictions. In practical terms the important question regarding the nature of the *UCP* is whether it applies only by contractual incorporation, or whether it may apply independently of the will of the parties. To avoid the risk of terminological confusion it is thus safer, when comparing the approach of different jurisdictions, to focus on this practical question.

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136 See par 3 10 2 above.

137 In states such as New York that have adapted the current a 5 of the UCC so as to render the whole a 5 inoperative where the parties have indicated that the credit is subject to the *UCP*, the question will also seldom arise, for, either the *UCP* is incorporated expressly (in which case the question of incorporation by operation of law will not arise), or a 5 applies. However, the position is likely to be different under the revised a 5. The expectations are that similar adaptations will not be made. See par 3 10 2 above.

138 § 5-102(3) of the current UCC. See also the comparable § 5 103(b) of the revised a 5.

139 A 6. See also the discussion of this development in par 3 9 2 above.

The majority of commentators favour the view that the *UCP*, to be applicable, must be incorporated by the parties into their contract. There is very little support in both the civil-law and common-law countries for the notion that the *UCP* may apply in its entirety independently of the will of the parties. However, certain commentators from the European continent have argued that certain provisions of the *UCP* may well apply independently of the will of the parties. Such provisions are then regarded as having been incorporated into the contracts by operation of law. This argument has not been considered in England or the United States. The English and American conceptions of trade usage do not, however, exclude such a possibility.

It is submitted that this is not a particularly useful line of reasoning. To isolate certain provisions of the *UCP* and argue that they should be incorporated into the contract by operation of law as some form of trade usage or custom, does not, on close analysis, address the question of the nature of the *UCP*. Although a strong case can be made out that certain provisions of the *UCP* should so be incorporated, the relevant provision is then clearly not incorporated as a provision of the *UCP*, but as a trade usage or custom. In other words these provisions are simply existing trade usages or customs that have been codified in the *UCP*.

4 6 The Nature of the UCP from a South African Perspective

4 6 1 Introduction

In South Africa the *UCP* is normally incorporated expressly into the contract between the parties. It is trite that the South African law of contract also admits the possibility of tacit incorporation, that is incorporation on the basis of the unexpressed consensus of the parties. In both instances the incorporation is then linked to the will of the parties.

The question as to whether the *UCP* in its entirety, or certain provisions of it, may form part of the contract independently of the will of the parties is closely related to the concept "implied term". In *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* Corbett AJA, in a judgment that has been termed "the *locus classicus* on the implication of terms",[140] defined this concept as follows:

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140 Vorster J P "The Influence of English Law on the Implication of Terms in the South African Law of Contract" (1987) 104 *South African Law Journal* 588 594.

> "[I]t is used to describe an unexpressed provision of the contract which the law imports therein, generally as a matter of course, without reference to the actual intention of the parties. ... [I]t does not originate in the contractual *consensus*: it is imposed by the law from without. ... Such implied terms may derive from the common law, *trade usage or custom*, or from statute. ... The implied term ... is essentially a standardised one, amounting to a rule of law which the Court will apply unless validly excluded by the contract itself. While it may have originated partly in the contractual intention, often other factors, such as *legal policy*, will have contributed to its creation."[141]

In the context of the nature of the *UCP* this *dictum* raises two questions. First, it poses the question whether the *UCP* may qualify as "trade usage or custom", and as such be incorporated by operation of law into the contract. Secondly, it raises the possibility that the *UCP* may be incorporated by operation of law simply by virtue of the dictates of "legal policy".

4 6 2 Incorporation of Trade Custom by Operation of Law

The *locus classicus* dealing with custom in South African law, is the decision of the Appellate Division in *Van Breda v Jacobs*.[142] The case concerned a local custom amongst Cape fishermen. Referring to Voet[143] and Halsbury,[144] Solomon JA found that with reference to the requirements for a valid custom, there is "a marked agreement between the Roman-Dutch and the English law",[145] the only material difference being that whilst the English law requires an immemorial origin, Roman-Dutch law is satisfied if the custom is simply old.

According to the *Van Breda* case, the requirements for custom in South African law are that it must be (i) long established, (ii) reasonable, (iii) uniformly observed, and (iv) certain.[146] These requirements are taken from Voet, the Roman-Dutch authority who deals most extensively with the topic. They are,

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141 1974 3 SA 506 (A) 531E-532H.

142 1921 AD 330.

143 1 3 27-35.

144 Vol 10 par 423-424 of the edition then in use. See n 98 above for the reference to the current edition.

145 333-334.

146 334.

however, postulated by several other old authorities. The best brief rendition is probably that of Schorer commenting on Grotius:

> "In order that a custom may have the force of law, frequency of acts and length of time are required. ... [N]othing is laid down anywhere as to the number of acts or of years, that question is properly left to the discretion of the judge. ... For the rest, justice is an essential... . It is further essential that the acts be uniform... ."[147]

Solomon JA's *dictum* linking the South African and English law on the requirements for custom, was taken further in *Coutts v Jacobs*.[148] Van der Riet J found that the *Van Breda* case was not "sufficient authority for holding that our law recognizes customs only and differs from English law in regard to customs of trade or trade usages",[149] and applied the English law by requiring that a trade usage be "notorious, certain, and reasonable and not contrary to positive law".[150]

The *Coutts* case leaves one with the impression that South African law distinguishes between custom and trade usage in the same manner as English law. This was, however, rejected by Erasmus J in *Catering Equipment Centre v Friesland Hotel*, who found that there is no Roman-Dutch authority supporting such a distinction.[151] This does not mean, however, that a practice which may pass as trade usage in England cannot form part of our law. The court stresses from the outset the one major difference between the English and South African requirements for custom:

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147 De Groot H *The Introduction to Dutch Jurisprudence of Hugo Grotius with an Appendix Containing Selections from the Notes of William Schorer* (translation by Maasdorp A F S) 3 ed (1903) Juta Cape Town 359 (Schorer Note 6 *ad Gr* 1 2 21). See also Van der Linden 1 1 7; Van Leeuwen 1 3 10-11. That the position was similar in Friesland appears from Huber 1 2 48-55: "Unwritten law is the same as custom, which gradually obtained binding force through popular usage. ... [C]ustoms have the same force as laws, provided that they be righteous, general and certain. Righteous, that is to say, not clashing with virtue, sound reason or the common law of nations. General, that is to say, adopted by the whole people, or by the greater part of it. Certain, that is to say, of such long and frequent usage, that there can be no doubt of them." (Huber U *The Jurisprudence of my Time (Hedendaegse Rechtsgeleertheyt) by Ulric Huber* (translated by Gane Sir Percival) Vol 1 (1939) Butterworths Durban 9.)

148 1927 EDL 120.

149 130.

150 132.

151 1967 4 SA 336 (O) 339A-340E.

> "It is quite clear from the authorities that a custom in order to be valid in Roman-Dutch Law should not necessarily, actually or presumptively, date from time immemorial. From a historical point of view it is of the greatest significance that time immemorial has nowhere been emphasized as an essential to the validity of a custom in Roman-Dutch Law."[152]

This fundamental difference implies that many practices that would be regarded as trade usages according to English law, may meet the test for custom in Roman-Dutch law.[153] The court finally concluded that "the old Roman-Dutch Law was concerned with customs only and they included trade customs".[154] Our positive law has since proceeded mainly on the basis that South African law does not distinguish between custom and trade usage.[155] In the context of South African law the term "trade custom" therefore better reflects the true nature of those trade practices that may be incorporated into a contract *by operation of law*.

However, a practice may be incorporated not only by operation of law, but also by virtue of the unexpressed consensus of the parties - that is as a *tacit term* of the contract. Practices of this nature are sometimes referred to as "trade usages".[156] Recently, in the case *Absa Bank Ltd v Blumberg and Wilkinson* Cameron J stated the requirements for the incorporation trade usage in this sense thus:

> "[I]t must be universally and uniformly observed within the trade concerned; established; well known; reasonable; certain; and not

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152 338C-D.

153 338H.

154 339H.

155 See *Tropic Plastic and Packaging Industry v Standard Bank of SA Ltd* 1969 4 SA 108 (D) 119H. This is true in spite of a *dictum* by Stratford JA in *Barnabas Plein & Co v Sol Jacobson & Son* (1928 AD 25 30-31) to the effect that it is doubtful whether a plaintiff must prove a trade usage to the same degree as that required for a custom. But see also *Golden Cape Fruits (Pty) Ltd v Fotoplate (Pty) Ltd* 1973 2 SA 642 (C) 645G-646H in which a slightly more cautious approach is taken. See also Hosten W J (revised by Schoeman E) "Custom and Usage" in Joubert W A (founding editor) & Rabie P J (ed) *The Law of South Africa* Vol 5 Part 2 First Reissue (1994) Butterworths Durban par 378. See further Christie R H *The Law of Contract in South Africa* 2 ed (1991) Butterworths Durban 188-189 who argues for the retention of the distinction.

156 See Hosten (*op cit* n 155) par 379.

> in conflict with the law or with the clear provisions of the contract".[157]

It is accordingly clear that there is a solid foundation in South African law for the incorporation of trade customs by operation of law. Although there is no South African case in which a documentary credit has been interpreted with reference to a custom, it is noteworthy that there are cases in which bills of exchange have been interpreted in this manner. In *Tropic Plastic and Packaging Industry v Standard Bank of SA Ltd*[158] the court had to decide a dispute on the rate of exchange payable on a foreign bill. The bill of exchange, drawn in England, contained the words "exchange as per endorsement" and the rate of exchange on the date the bill was drawn with the corresponding amount in South African currency above the sterling amount for which the bill was drawn. The respondent argued, on the basis of trade custom, that the exchange rate so indorsed bound the acceptor in spite of the provision in the Bills of Exchange Act that the rate of exchange is that existing "at the place of payment on the day the bill is payable".[159] The court found no fault with this line of reasoning but rejected the defence on the basis that the "custom relied on is anything but certain" and that the evidence did not show it to be "so universal and notorious that [the applicants] must be presumed to have had knowledge of it and to have included it in the contract."[160]

The decision of the Appellate Division in *Standard Bank of South Africa Ltd v Sham Magazine Centre*[161] is also relevant in this context. Dealing with the meaning of the words "account payee only" on a crossed cheque, Holmes JA declined to give effect to the "ordinary grammatical meaning" (that is that the words prohibit the transfer of the cheque). He pointed out that the words had "[o]ver very many years ... acquired a significance and meaning understood in

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157 1995 4 SA 403 (W) 409I. See also Christie (*op cit* n 155) 190-192; Lubbe G F & Murray C M *Farlam and Hathaway - Contract - Cases, Materials and Commentary* 3 ed (1988) Juta Cape Town 423; Kerr A J *The Principles of the Law of Contract* 4 ed (1989) Butterworths Durban 292-295. The essential difference between trade usage in this sense and trade custom as described above is that a person cannot be bound by a trade usage of which he has no knowledge, but can be bound by a trade custom of which he is unaware. See Hosten (*op cit* n 155) par 379.

158 1969 4 SA 108 (D).

159 Bills of Exchange Act 34 of 1964 s 70(d).

160 120C-D.

161 1977 1 SA 484 (A) 501H-502B.

banking practice" and interpreted the words in accordance with this practice. Holmes JA's decision is also in accordance with *Wides v Davidson*[162] in which the following *dictum* from a nineteenth-century English decision was quoted with approval:

> "Mercantile contracts are very commonly framed in a language peculiar to merchants; the intention of the parties ... would often be defeated, if this language were strictly construed according to its ordinary import in the world at large; evidence, therefore, of mercantile custom and usage is admitted in order to expound it, and arrive at its true meaning. Again, in all contracts as to the subject-matter of which a known usage prevails, parties are found to proceed with the tacit assumption of these usages... ."[163]

It is submitted that, should the opportunity arise, South African courts should be equally willing to incorporate terms into documentary credits by operation of law, or similarly to ascribe a meaning to words used in a documentary credit which departs from the ordinary grammatical meaning. Due to the many definitions of words and terms found in the *UCP*, it may be especially valuable in the interpretation of technical language.[164] Certainly, the South African law is flexible enough to support this conclusion.

4 6 3 Incorporation on the Basis of Legal Policy

An approach to the interpretation of contracts suggested by Lubbe and Murray is to regard it as "an objective, normative process, directed towards establishing the legal consequences of a transaction with reference not merely to the intention of the parties, *but also in view of relevant considerations of legal policy*".[165] It is this very perception that underlies Corbett AJA's recognition in the *Alfred McAlpine* case,[166] that a term may be incorporated into a contract by operation of law simply on considerations of legal policy.

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162 1959 4 SA 678 (W).

163 681E.

164 Several articles of the *UCP* ascribe specific meanings to specific words or phrases. See for instance a 23(b) ("transhipment (sic)"), a 33(c) ("freight prepayable"), a 32(a) ("clean transport document"), a 36 ("insurance against all risks"), a 39(a) ("about" or "circa"). a 42(c) ("for one month"), a 46 ("shipment", "on or about"), a 47 ("to", "until", "from", "after", "first half of a month", "second half of a month", "beginning of a month", "middle of a month", "end of a month").

165 Lubbe & Murray (*op cit* n 157) 463 (my italics).

166 See par 4 6 1 above.

The case of *Falch v Wessels*[167] contains an interesting example of incorporation by operation of law on the basis of considerations of legal policy. The question the court had to decide was whether, in the sale of a house, the electric stove formed part of the *res vendita*. In his judgment Ackermann J rejected the argument that the stove was part of the immovable property by virtue of *accessio*,[168] but nevertheless finds that it did form part of the *res vendita*. He argued:

> "*In die lig van heersende verkeersopvattings*... meen ek dat 'n stoof bestem is om 'n woonhuis (of woonstel) van permanente diens te wees... . Gevolglik is ek van mening dat die Defy stoof beskou moet word as ingesluit by die onroerende eiendom wat die onderwerp van die koopkontrak gevorm het".[169]

Although the judgment was primarily based on an interpretation of our common law (from which, according to the *Alfred McAlpine* case, a term may also be incorporated by operation of law)[170] the italicised portion of this *dictum* shows that policy considerations also played an important role. The question may accordingly be posed whether the incorporation of the whole or portions of the *UCP* by operation of law on considerations of legal policy is not also competent.

4 6 4 Conclusions

Normally the *UCP* is contractually incorporated. In the absence of express or tacit contractual incorporation it is submitted that South African law may well admit some form of incorporation by operation of law. In this respect the following theoretical possibilities must be considered:

(i) One may argue that certain specific articles of the *UCP* may meet the test of trade custom and, as such, be incorporated by operation of law. This argument,

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167 1983 4 SA 172 (T). See also *Senekal v Roodt* 1983 2 SA 602 (T).

168 180-181. Ackermann J refers to his own judgment on the same question in *Senekal v Roodt* 1983 2 SA 602 (T) 609B in which he said: "Dit wil my voorkom dat waar daar deur ons skrywers en in ons uitsprakereg verwys word na roerende hulpsake wat vir doeleindes van 'n koopkontrak deel vorm van die onroerende *res vendita*, of by die *res vendita* ingesluit word, mens eintlik te doen het met 'n ... beding wat *ex lege* ... ingevoeg word, en nie met 'n situasie waar die hulpsaak in werklike saakregtelike sin onroerend geword het nie."

169 182B-D (my italics).

170 1974 3 SA 506 (A) 531G.

for which some support exists in the civil-law countries,[171] is not without merit. It could especially be of value in the context of interpreting terms encountered in a letter of credit. Our courts have interpreted technical language on bills of exchange in the light of banking practice or custom; they should not hesitate to do the same with letters of credit. In this context the *UCP* is likely to be a most authoritative source of banking practice or custom. However, as pointed out earlier,[172] this approach does not shed much light on the nature of the *UCP* itself; the specific article of the *UCP* is then relied upon as a banking practice or custom, and not as a provision of the *UCP*.

(ii) One may also argue that the incorporation by operation of law of a specific article should take place simply on policy considerations. In this case the incorporation would not be dependent upon the specific term qualifying as trade custom. The question would simply be whether considerations of legal policy justify incorporation by operation of law. An important policy consideration to be taken into account is the international aspect of the letter of credit; the South African interpretation of this instrument should not differ substantially from that followed elsewhere.

(iii) Whilst the aforegoing arguments deal with the incorporation by operation of law of a specific article, one may also argue that the *UCP* in its entirety, or all its provisions, may qualify as trade custom and be incorporated as such by operation of law. This contention must be rejected in South Africa, as it has consistently been rejected elsewhere. The strongest arguments against it are, in the first place, the many different revisions of the *UCP* (a fact at odds with the requirement that a custom should be long established), and, secondly, that many of the articles of the *UCP* are of a very technical non-customary nature.

(iv) One may argue that the *UCP* in its entirety, or all its provisions, should be incorporated into the contract by operation of law on the basis of policy considerations. The objections raised above to the incorporation of the entire *UCP* as trade custom are not applicable if the incorporation is simply on considerations of policy. The case for such incorporation is therefore much stronger. However, it is questionable whether there are good policy considerations for the incorporation of each individual provision of the *UCP*.

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171 See par 4 3 1 and 4 3 2 above.

172 See par 4 5 above.

(v) A final possibility is to argue that there is a trade custom in South Africa, and policy considerations in support of the custom, that a term be included in letters of credit subjecting the letter of credit to the *UCP*. In terms of this approach it is unnecessary for each provision to qualify as trade custom, or to find policy considerations favouring the incorporation of each individual provision of the *UCP*. The question is simply whether it is customary to incorporate a term subjecting the letter of credit to the *UCP*, or whether there are good policy considerations favouring the incorporation of such a term by operation of law. This approach avoids the necessity of attempting to distinguish between those provisions of the *UCP* that should and those that should not be incorporated, a rather forced distinction.[173] Furthermore, due to the fact that the term incorporated according to this approach, is that the letter of credit is subject to the current revision of the *UCP*, it disposes of the difficulty of dealing with the effect of a new revision on incorporation by operation of law, especially where the basis of incorporation is trade custom.

In the final analysis, however, it must be emphasised that incorporation by operation of law is only likely to arise in exceptional circumstances. As has been noted, the norm is express contractual incorporation. It is furthermore suggested that in the absence of express incorporation, the argument for tacit (consensual) incorporation will generally be very strong. In this respect I would regard the English *Harlow* case[174] as good law in South Africa.

Finally, it must be noted, that the views expressed here relate to the application of the *UCP* to commercial documentary credits. The *UCP* is incorporated only in approximately half of the standby letters of credit issued.[175] Against this background the case for the incorporation of the *UCP* by operation of law in standby letters of credit is significantly weaker.

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173 See n 84 above.

174 See the discussion at n 118 above.

175 Lipton J "Uniform Regulation of Standby Letters of Credit and Other First Demand Security Instruments in International Transactions" (1993) 8 *Journal of International Banking Law* 402 403.

Chapter Five

The Legal Nature of the Relationship between the Bank Issuing or Confirming a Documentary Credit and the Beneficiary

5 1 Introduction

To merchants and bankers, so it would appear, the relationship between the bank issuing or confirming a documentary credit and the beneficiary thereof, is a simple matter. Even before the advent of the *UCP*, Mead expressed it thus:

> "The seller of the goods believes that, if he has such an instrument, he has the direct obligation of the issuing bank, running in his favor, enforcible by him against that bank... ."[1]

Lawyers, however, have found it considerably more difficult to establish in their respective legal systems a theoretical foundation for this relationship which manages to satisfy the expectations of the parties involved. A large number of divergent theories have been suggested from the different jurisdictions. In the quest for finding the best solution for South African law, much can be learnt from these different theories. In this chapter the theories emanating from the common-law and civil-law jurisdictions are accordingly considered after which possible South African approaches are suggested.

First, however, one important point must be stressed. History has proved time and again that the law must, as Holdsworth expressed it, "in the long run accommodate [itself] to business needs".[2] The commercial expectations of the parties must be met. The *UCP* is an important reflection of these expectations. Therefore, in order to evaluate properly the many theories found in the different jurisdictions, it is essential to take due cognisance of the relevant provisions of the *UCP*.

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1 Mead C A "Documentary Letters of Credit" 22 (1922) *Columbia Law Review* 297 300-301. See also Ellinger E P *Documentary Letters of Credit* (1970) University of Singapore Press Singapore 39.

2 Holdsworth Sir W *A History of English Law* Vol VIII (1966) Methuen London 119.

5 2 Perspectives from the UCP

5 2 1 Introduction

The *UCP* does not attempt to define precisely the legal nature of the relationship between the bank issuing or confirming a documentary credit and the beneficiary thereof. The liability of both the confirming and the issuing bank is simply described as "a definite undertaking" to comply with its obligations under the documentary credit.[3] The *UCP*, however, is not concerned with the nature of or the manner in which this "definite undertaking" comes into being. This matter is clearly left to lawyers to work out.

In the quest to find a proper theoretical foundation in law for the bank-beneficiary relationship, it is of fundamental importance that lawyers heed the provisions of the *UCP* in two specific areas. The first relates to the independence principle, and the second to the moment from which the parties are bound in terms of the credit.

5 2 2 The Principle of Independence

The independence principle is expressed as follows in article 3 of the *UCP*:

> "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 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."[4]

This is a very strong rendition of the independence principle. Not only is it expressly regarded as part of the very "nature" of the documentary credit, but it is also stated in absolute terms, that is without any reference whatsoever to a possible exception. It may, however, be stated as a general rule that the law does not favour such an absolute independence; in other words there are

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3 I e to pay, to accept and pay a bill drawn in terms of the credit, or to negotiate a bill drawn in terms of the credit. See in this respect a 9(a) and (b) of the *UCP*.

4 My italics. See also article 4: "In Credit operations all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate."

situations in which the principle is disregarded. This matter is dealt with below.[5]

5 2 3 The Moment from which the Parties are Bound

As already noted, the *UCP* terms the liability of both the issuing and confirming bank a "definite undertaking". But from which moment is such a bank bound? The *UCP* is strangely silent on this point. However, the provisions dealing with the amendment of documentary credits may provide some guidance as, in this regard, there can be no distinction between the initial issue of a credit and the issue of an amendment.[6] The relevant provision is article 9(d)(ii) which reads:

> "The Issuing Bank shall be irrevocably bound by an amendment(s) issued by it *from the time of the issuance of such amendment(s)*. A Confirming Bank may extend its confirmation to an amendment and shall be irrevocably bound *as of the time of its advice of the amendment*."[7]

Thus, the issuing bank is bound from the time of "issuance" and the confirming bank from the time of "advice" of an amendment. But what is the time of "issuance" or "advice"? Do these terms refer to the moment of dispatch or the moment of receipt of the amendment (and if so by whom?), or even to the moment at which the amendment comes to the knowledge of the beneficiary? This is by no means clear. The Oxford Dictionary defines "issuance" as "[t]he action of issuing, putting forth, or giving out",[8] while "advice" is "[i]nformation given, notice; intelligence, news; ... Formal or official notice from a party concerned".[9]

If one were to adopt a dictionary approach in interpreting these terms it would appear that the amendment must be regarded as issued at the moment when it is

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5 See chapter 6 below.

6 Jack R *Documentary Credits* 2 ed (1993) Butterworths London 23.

7 My italics.

8 *The Oxford English Dictionary* 2 ed (1989) Vol VIII Prepared by Simpson J A & Weiner E S C Clarendon Press Oxford 134. The word "issuance" is an Americanism. The English equivalent "issue" is, however, similarly defined as "[t]he action of giving or sending out" (136).

9 *The Oxford English Dictionary* 2 ed (1989) Vol I Prepared by Simpson J A & Weiner E S C Clarendon Press Oxford 191.

dispatched.[10] The dictionary meaning of "advice" is less conclusive. It is suggested, however, that the thrust of the definition appears to require knowledge on the part of the beneficiary.

It is, however, unlikely that courts, in interpreting the *UCP*, will pay much attention to dictionary definitions. The terms are likely to be interpreted with reference to the credit as a whole as well as banking practice.[11] In this respect the following comments of Del Busto, Chairman of the ICC Commission on Banking Technique and Practice, with reference to article 9(d)(ii) are of considerable significance:

> "For the Issuing and Confirming Bank, if any, the time of effectiveness of the amendment is the issuance or advice and communication of the amendment. *Such a time is consistent with the banking practice that deems an issuer liable from the time of his release of the communication of liability and not upon delivery or receipt of the amendment advice by the Beneficiary.* This practice simplifies reliance by the Beneficiary who would otherwise risk cancellation of the communicated amendment though issued but advice of it not received by him."[12]

In accordance with this view the bank issuing an amendment is bound to it from the moment of releasing it, that is before it has come into the possession or knowledge of the beneficiary. Likewise the bank confirming the amendment is bound thereby from the moment it releases its advice of the confirmation.

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10 See, however, *Bailey v South African Liberal Life Insurance Co* 1928 CPD 463 467 in which the "issuance" of an insurance policy was judicially interpreted as taking place upon delivery of the policy.

11 See, for instance, Anonymous "Judicial Interpretation of the UCP" April 1995 *Letter of Credit Update* 64-75 in which the intervention of the United States Council on International Banking (USCIB) as *amicus curiae* in a specific case (*Banca del Sempione v Suriel Finance NV and Provident Bank of Maryland* (1994) 852 F Supp 417 (US District Court D Maryland)) is reported upon. The intervention flowed from what the USCIB termed "a serious misinterpretation of how to apply the UCP". The view put forward by the USCIB is that courts should not be free to interpret the *UCP* "outside the context of standard international banking practice" as was done by the trial court in the *Banca del Sempione* case. A useful South African analogy in the field of cheques is the interpretation of the words "account payee only" on a crossed cheque in *Standard Bank of SA Ltd v Sham Magazine Centre* 1977 1 SA 484 (A) 501H-503H Holmes JA specifically rejected the ordinary grammatical meaning approach followed in the earlier decision *Dungarvin Trust (Pty) Ltd v Import Refrigeration Co (Pty) Ltd* 1971 4 SA 300 (W) 306F-H (read with 305C and 302G).

12 Del Busto C (ed) *Documentary Credits - UCP 500 & 400 Compared* (1983) ICC Publication 511 ICC Publishing Paris 25 (my italics).

However, Del Busto gives no authority for the statement, nor is it elaborated upon. This interpretation is simply stated to be "banking practice".

It is submitted that the matter is less clear-cut than Del Busto's interpretation seems to suggest. Certainly, the overwhelming majority of English commentators do not agree.[13] His view also conflicts with the dominant theory in Germany.[14] It is accordingly suggested that Del Busto's interpretation, which may well be coloured by American practice under the UCC,[15] cannot truly be said to reflect international practice in this respect. It must further be borne in mind that his comments do not have any legal status as such. What the courts must interpret in the final instance, admittedly with reference to banking practice, is the text of the contractually incorporated *UCP* itself. The interpretation offered by Del Busto is but an opinion. In this respect it is noteworthy that the practice of the ICC Commission of Banking Technique and Practice to comment on and interpret the provisions of the *UCP*, which has recently been highlighted by the issue of certain "Position Papers", has been attacked vehemently in the following terms by the editors of *Letter of Credit Update*:

> "With these 'Position Papers', the Banking Commission has taken a radically different turn. (Under the leadership of its very active chairman, aggressive 'interpretations' of UCP language are being put forth by a kind of 'super court of the last resort'.) These interpretations are not written in the formulary style of the UCP but as a commentary or judicial opinion might be written. And they are not the product of the Banking Commission in any direct

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13 In fact, as far as I could ascertain, no English commentator supports this view. See concerning the common-law jurisdictions Jack (*op cit* n 6) 78-79 who favours the interpretation that the bank is bound "from the moment of receipt of advice of [the credit] by the beneficiary". The same view is held by Schmitthoff C M & Adams J *Schmitthoff's Export Trade - The Law and Practice of International Trade* 9 ed (1990) 423-424 ("when the beneficiary receives the communication and accepts it"); Clarke M "Bankers' Commercial Credits among the High Trees" (1974) 33 *Cambridge Law Journal* 260 262; Ellinger (*op cit* n 1) 90-91; Gutteridge H C & Megrah M *The Law of Banker's Commercial Credits* 7 ed (1984) Europa Publications London 34; Treitel G H *The Law of Contract* 8 ed (1991) Sweet & Maxwell London 139.

14 See par 5 4 4 below. For other civilian countries see Van Delden R *Betalingsverkeer (Documentair Krediet/Documenten)* (1990) Kluwer Deventer 94 who, although personally propogating a theory which holds the bank bound from the moment of dispatch (see 5 4 3 below), acknowledges "[m]eestal wordt ... anders geleer".

15 Where due to statutory regulation different considerations apply. See in this respect par 3 10 2 above and 5 3 4 below.

> way but, at best, of a group of experts and, at worst, of del Busto and those whom he chose to consult."[16]

These comments are, of course, specifically directed at the "Position Papers". Nevertheless it is suggested that they are equally applicable to the comments of Del Busto in the publication quoted above. It would be dangerous to award these comments too high a status. This fact is appreciated by Del Busto himself as is apparent from the preface of the relevant work where he states as follows:

> "[I]t must be acknowledged that not all of the commentaries reported herein may be necessarily subscribed to by certain members of the Working Group, or their associations. The commentaries made by me in a personal capacity, as reporter and editor, do not necessarily reflect the collective opinions of the members of the Working Group, the members of the ICC Commission of Banking Technique and Practice or the International Chamber of Commerce."[17]

One final point must be made: although, as argued above, the provisions of article 9(d)(ii) can properly be applied also to the initial issue of a documentary credit, not all provisions dealing with amendment of credits can similarly be projected to their issue. In this regard I refer specifically to article 9(d)(iii) which provides as follows:

> "The terms of the original Credit ... will remain in force for the Beneficiary until the Beneficiary *communicates his acceptance of the amendment to the bank that advised such amendment*."[18]

It would be wrong, on the strength of this provision, to argue that a beneficiary acquires his rights under the original issue of a credit only on communication of his acceptance of it. In fact, in the case of an original issue, such communication is very rare. It is, however, necessary in the case of an amendment as the banks need to know whether they are bound in terms of the original or amended credit; hence the requirement that acceptance must be "communicated".[19] The term "communication" is left undefined and will

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16 Anonymous (editorial comment) "Amending the UCP" November 1994 *Letter of Credit Update* 8-9. See also in general on the position papers Taylor D "UCP Position Papers - A Look at the Process" February 1995 *Letter of Credit Update* 24.

17 Del Busto (*op cit* n 12) V.

18 My italics.

19 Hertl H "Automatic Acceptance of Amendments" December 1994 *Letter of Credit Update* 23.

require judicial interpretation. As is the case with "issuance" and "advice" the term could possibly refer to the dispatch or receipt of the acceptance, or could require that the bank must have knowledge of the acceptance.

5 2 4 Conclusion

One may conclude from the above that any legal theory attempting to explain the bank-beneficiary relationship under a documentary credit must, in order to be in harmony with the *UCP*, comply with the following principles: (i) The liability of both the issuing and confirming bank must be independent of the relationships between the issuing bank and its client (the buyer), the issuing bank and the confirming bank, as well as that between the buyer and seller. (ii) A bank is bound by a documentary credit issued by it from the moment of "issuance". The precise meaning of this term, however, is not clear and will accordingly have to be interpreted by the courts. (iii) A bank confirming a credit is bound in terms of its confirmation from the moment "advice" of the confirmation has been given. Again, however, the precise meaning of "advice" is a matter of interpretation. (iv) The issuing and confirming banks are similarly bound by an amendment from the moment of "issuance" and "advice" respectively. (v) The beneficiary is bound to the terms of an amendment (as opposed to the terms of the original credit) from the moment the acceptance has been communicated to the bank advising the amendment. Again, the term "communicate" requires judicial interpretation.

It would accordingly appear that the *UCP* does not provide clear guidance as to the precise moment from which the parties are bound. This question will be determined by the way in which the different national courts interpret some rather unclear terminology. There is no doubt that international banking practice will be an important consideration in this regard. However, legal theory cannot simply be disregarded. Courts are likely to favour an interpretation of the *UCP* that properly fits into the legal framework of the specific country involved. This has proved to be exceptionally difficult in both the common-law and civil-law jurisdictions.

5 3 The Legal Nature of the Bank-Beneficiary Relationship from a Common-Law Perspective

5 3 1 Introduction

The legal nature of the relationship between the bank issuing the documentary credit and the beneficiary of it has never been addressed thoroughly in English case law, and in this sense must still be regarded as "unresolved".[20] It appears that the relationship is simply assumed to be contractual. In the important case *United City Merchants (Investments) Ltd v Royal Bank of Canada*, which was pursued all the way to the House of Lords, Lord Diplock went so far as to accept the contractual nature of the relationship between the bank and beneficiary as "trite law".[21]

The "triteness" of this law, however, is not at all apparent from the impressive body of academic writing that has arisen on the topic.[22] A large number of theories have been advanced which attempt to define the relationship between the banker and beneficiary within the parameters of the law of contract. There is, however, also a school of thought which rejects the contractual basis of the relationship altogether, and simply proceeds on the basis of mercantile usage. Finally, certain American credits are regulated by article 5 of the Uniform Commercial Code (UCC) and need to be considered separately.

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20 Gutteridge & Megrah (*op cit* n 13) 26.

21 [1983] 1 AC 168 (HL) 182H-183D. The case is discussed in par 6 3 2 and 6 3 4 below. Support for this view is also to be found in the much earlier case *Donald H Scott & Co Ltd v Barclays Bank Ltd* [1923] 2 KB 1 (CA) 14. See further Jack (*op cit* n 6) 78.

22 This is one of the most published topics in the field of documentary credits. For the most comprehensive analysis see Ellinger (*op cit* n 1) 39-125. The most recent exposition is that of Jack (*op cit* n 6) 23-24, 78-79. See further Gutteridge & Megrah (*op cit* n 13) 24-34; Todd P N "Sellers and Documentary Credits" 1983 *Journal of Business Law* 468-481; Penn G A, Shea A M & Arora A *The Law and Practice of International Banking - Banking Law Volume II* (1987) Sweet & Maxwell London 294-303; Sarna L *Letters of Credit* 3 ed (1989) (loose-leaf edition) Carswell Toronto par 2(1)-(2); Kozolchyk B *Letters of Credit* in Ziegel J S (ed) *International Encyclopedia of Comparative Law* Vol IX (1979) J C B Mohr Tübingen par 234-248, and "The Legal Nature of the Irrevocable Commercial Letter of Credit" (1965-6) 14 *American Journal of Comparative Law* 395 400-421; Hershey O F "Letters of Credit" (1918) 32 *Harvard Law Review* 1-20; Mead (*op cit* n 1) 300-305; McCurdy W E "Commercial Letters of Credit" (1921-2) 35 *Harvard Law Review* 539 563-566, and "The Right of the Beneficiary under a Commercial Letter of Credit" (1923-1924) 37 *Harvard Law Review* 323-337; Thayer P W "Irrevocable Credits in International Commerce: Their Legal Nature" (1936) 36 *Columbia Law Review* 1031 1038-1043; Davis A G "The Relationship between Banker and Seller under a Confirmed Credit" (1936) 52 *Law Quarterly Review* 225-240, and *The Law Relating to Commercial Letters of Credit* 3 ed (1963) Pitman London 65-77.

5 3 2 Contractual Theories

Offer and Acceptance

The basis of this theory is that the issue of a documentary credit by the bank to the beneficiary constitutes an offer which may be accepted by the beneficiary. In the context of this theory, basically three questions are addressed: (i) whether the offer of the bank is an offer for a unilateral or bilateral contract; (ii) the manner and time of acceptance; and (iii) whether the requirement of valuable consideration is satisfied.

Is the documentary credit an offer for a unilateral contract? The English understanding of the concept "unilateral contract" is described as follows by Treitel:

> "A unilateral contract may arise when one party promises to pay the other a sum of money if the other will do ... something without making any promise to that effect: for example, when one person promises to pay another £100 if he will walk from London to York... . ... [T]he contract is described as unilateral as the promisee has clearly made no counter-promise to perform the required act...; it is contrasted with a bilateral contract, in which each party undertakes an obligation and in which acceptance, as a general rule, takes place on communication by the offeree of his counter-promise."[23]

The beneficiary of a documentary credit does not normally make any undertaking towards the bank.[24] Thus, if the credit is to be viewed as an offer by the bank to the seller-beneficiary, English law generally regards it as an offer for a unilateral contract. This view is supported by most commentators.[25]

The second problem with which the offer and acceptance theory is confronted is to determine the manner and moment of acceptance. This is a problem with important ramifications as was first noted by McCurdy, one of the earliest commentators:

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23 Treitel (*op cit* n 13) 36.

24 Although it is exceptional, a seller may in certain circumstances undertake to perform. See Todd (*op cit* n 22) 475 who cites *British Imex Industries Ltd v Midland Bank Ltd* [1958] 1 QB 542 (QB) in which the seller undertook to pay a confirming commission.

25 Schmitthoff & Adams (*op cit* n 13) 423 n 19; Todd (*op cit* n 22) 475; Penn, Shea & Arora (*op cit* n 22) 296; McCurdy (*op cit* n 22 "Commercial Letters of Credit") 571.

> "If the letter of credit is an offer it is an offer to accept a draft with specified shipping documents attached. Hence there is an interval between the issue of the letter of credit and the presentation of the drafts during which the bank could revoke its offer. If the buyer were discovered to have been fraudulent, or if he became insolvent, the issuing bank could at once revoke the unaccepted offer. But the very purpose of the letter of credit is to guard against such possibilities."[26]

The valid point made here is that if the documentary credit is to be regarded as an offer, it can be revoked prior to acceptance irrespective of the fact that it is termed "irrevocable".[27] Support for the offer and acceptance theory is nevertheless to be found in English and American case law. In *Urquhart Lindsay & Co Ltd v Eastern Bank Ltd* Rowlatt J stated:

> "There can be no doubt that, on the plaintiffs acting on the undertaking contained in this letter of credit, consideration moved from the plaintiffs, which bound the defendants to the irrevocable character of the arrangement between the defendants and the plaintiffs... ."[28]

Shortly thereafter, in the American case *Moss v Old Colony Trust Co*, Rugg CJ argued in similar vein:

> "[A] letter of credit is an offer by a bank ... to be bound to the person to whom it is directed, when accepted and acted upon by the latter according to its stipulations. ... The letter of credit, when so accepted and acted upon ... becomes a contract... ."[29]

In answer to McCurdy's criticism Davis, one of the main proponents of the offer and acceptance theory, takes a different view on the moment of acceptance. Referring to the *Urquhart* and *Moss* cases he argues that the beneficiary accepts the offer by "acting on the undertaking". This, according to Davis, is not the moment of presentation of the documents (as suggested by

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26 McCurdy (*op cit* n 22 "Commercial Letters of Credit") 569. See also Jack (*op cit* n 6) 80.

27 In the case of revocable documentary credits this difficulty does not arise as "the banker is not bound unless and until he is willing to be bound, the intimation of such willingness taking the form of an acceptance of the documents when tendered to him". See Gutteridge & Megrah (*op cit* n 13) 31.

28 [1921] All ER 340 (KB) 342. These remarks, however, were *obiter*. See Ellinger (*op cit* n 1) 83. See also *Elder Dempster Lines Ltd v Ionic Shipping Agency Inc* [1968] 1 Lloyd's Rep 529 (QB) 535: "The best explanation of the legal phenomenon constituted by a banker's letter of credit is that it is an offer which is accepted by being drawn upon."

29 (1923) 140 NE 803 (Supreme Judicial Court of Massachusetts) 808.

McCurdy), but "some time anterior to the tender of the documents - at the latest when the goods are shipped".[30] The commencement of the manufacture or shipment of the goods by the beneficiary would, for instance, qualify as acceptance.

It is suggested that Davis's construction is correct. It accords with the principle of English law that an offer for a unilateral contract can no longer be revoked once acceptance of the offer can be inferred by part-performance. If, to return to Treitel's example of the walk from London to York,[31] the offeree sets off on his walk, the offer can no longer be withdrawn simply because he has not completed the walk.[32]

Although Davis's argument goes some way towards addressing McCurdy's criticism, it is still unsatisfactory. The bank is thereby precluded from revoking the credit once the beneficiary has commenced procuring, manufacturing or shipping the goods, but nothing prevents the bank from revoking the credit at any stage prior to these actions. This does not conform with the provisions of the *UCP* in terms of which the bank is irrevocably bound from the moment of "issuance".[33] Davis's counterargument that this places the moment of irrevocability too early due to the fact that the need for protection does not really arise until the beneficiary has actually acted,[34] is fallacious. As Ellinger says:

> "If the banker is justified in cancelling the irrevocable credit before the 'acting' of the seller, the latter may well suffer serious financial loss. For example, if the buyer fails before the seller commences performance and the bank revokes the credit, the seller may have to dispose of the goods at a loss. Similarly, in

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30 (*Op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 73.

31 See the text at n 23 above.

32 Treitel (*op cit* n 13) 37-38.

33 See par 5 2 3 above and the authorities cited in n 13 below. See also *Hamzeh Malas & Sons v British Imex Industries Ltd* [1958] 2 WLR 100 (CA) 102 where Jenkins LJ is reported as follows: "[I]t seems to be plain enough that *the opening of a confirmed letter of credit constitutes a bargain* between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay" (my italics).

34 Davis (*op cit* n 22 "The Relationship between Banker and Seller under a Confirmed Credit") 233.

such a case if the seller is a manufacturer he might not be able to obtain new orders. The loss, here, would be very real indeed."[35]

An interesting possible solution to the revocation of the irrevocable credit is suggested by Todd.[36] He argues that revocation by the bank may put the buyer in breach of contract with the seller. Apart from an action against the buyer, it is possible that the seller may have an action in tort against the bank, for inducing breach, or for interference with the contract. Such an action would cover revocation of the credit from its receipt by the seller. Todd acknowledges, however, that this construction is also not entirely satisfactory. In the first place the measure of damages may well differ in contract and tort, and, secondly, the liability of the banker may depend on the precise terms of the contract of sale, which does not accord with the principle of the independence of the credit.[37]

It would accordingly appear that a wholly satisfactory solution to the acceptance problem which would give legal effect to the expectations of the parties has as yet not been forthcoming in English legal theory.

In any event, the third and final problem mentioned above, that of consideration, still remains. In terms of this peculiarity of the common law a party can only be held liable to a contract not under seal, if he has received valuable consideration, that is a *quid pro quo*, for his undertaking.[38] Furthermore, it has been firmly established in English law[39] that although consideration need not move to the promisor, it must move from the promisee and not from a stranger to the contract.[40] Applied to the relationship between

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35 90-91.

36 (*Op cit* n 22) 480-481.

37 See aa 3 and 4 of the *UCP* and in general the discussion in par 5 2 2 above.

38 For a detailed analysis of the requirement of valuable consideration in the English law of contract, see Treitel (*op cit* n 13) 63-148. For a recent concise and thoroughly documented exposition of the development of the doctrine and its role in contemporary law, see Zimmermann R *The Law of Obligations - Roman Foundations of the Civilian Tradition* (1990) Juta & Co Cape Town 504-7. See also Zwalve W J "'Consideration' en Reeds Bestaande Verplichtingen uit Overeenkomst in het Moderne Engelse Recht" (1991) 10 *Rechtsmagazijn Themis* 476.

39 American law differs in this respect. See n 55 below.

40 *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] AC 847 (HL) 853: "if a person with whom a contract not under seal has been made is to be able to enforce it

the bank issuing or confirming a documentary credit and the beneficiary of it, the doctrine requires the bank or a third party to receive consideration, specifically from the beneficiary, for the bank's undertaking. Finally, consideration may not be past consideration, that is may not be some or other previous performance.[41]

Commentators favouring the offer and acceptance theory have found it difficult to deal with this requirement. Nor is the English case law of much help. The defence of no consideration has never been pressed.[42] The existence of valid consideration is simply assumed.[43] In dealing with this stance of the English courts, Davis concludes:

> "It has been impliedly accepted that consideration does move from the promisee, the seller, and the validity of an irrevocable letter of credit has not been made a matter of doubt by a discussion of the niceties of one of the most troublesome problems of English law."[44]

The applicability of the consideration doctrine to the documentary credit has nevertheless troubled several commentators. McCurdy points out that the beneficiary's procurement, shipment or manufacture of the goods cannot qualify as consideration for the bank's undertaking, due to the fact that this is not what the bank bargains for, and performance by the beneficiary (seller) of an act he is bound to perform under an already existing contract of sale with the purchaser, being past consideration, cannot be consideration for the bank's undertaking.[45] Ellinger rejects this view. He argues that the seller's obligation to commence performing under the contract of sale should not be viewed as preceding the opening of the credit, that is as past consideration, due to the fact that the contract of sale imposes an obligation on the purchaser to procure the

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consideration must have been given by him to the promisor or to some other person at the promisor's request." See further Treitel (*op cit* n 13) 77-79.

41 Treitel (*op cit* n 13) 73-77.

42 The defence was raised but abandoned in *Dexters, Ltd v Schenker & Co* (1923) 14 Ll L Rep 586. See further Gutteridge & Megrah (*op cit* n 13) 27; Jack (*op cit* n 6) 81; Goode R M *Payment Obligations in Commercial and Financial Transactions* (1983) Sweet & Maxwell London 31.

43 See the *obiter dictum* of Rowlatt J in the *Urquhart Lindsay* case quoted at n 28 above. See also *Dexters Ltd v Schenker & Co* (1923) 14 Ll L Rep 586.

44 (*Op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 76.

45 (*Op cit* n 22 "Commercial Letters of Credit") 571.

documentary credit and this obligation is a condition precedent to the seller's duty to perform his bargain.[46] Nevertheless McCurdy's view that the consideration requirement is an insurmountable obstacle[47] to the offer and acceptance theory, is also supported by several contemporary commentators.[48]

The view that the seller's performance of the contract of sale cannot constitute consideration for the bank's promise deserves, however, to be re-evaluated due to comparatively recent developments in the English law of contract. In *New Zealand Shipping Co Ltd v A M Satterthwaite & Co Ltd*[49] Lord Wilberforce, who spoke for the majority, said:

> "An agreement to do an act which the promisor is under an existing obligation to a third party to do, may quite well amount to valid consideration and does so in the present case... ."[50]

In this case A, a firm of stevedores, was bound by a contract with B to unload certain goods. C had promised A not to sue the firm for damaging the goods. The court found that performance of the duty to unload the goods constituted good consideration for C's promise.[51] This decision prompted Todd, in a recent article, to state categorically that performance by the seller of the contract of sale "can no doubt constitute consideration for a new contract between the seller and the bank".[52] The consideration could lie in any step taken by the beneficiary-seller towards performing the contract of sale, for example to commence manufacturing the goods. If the seller already has the goods when

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46 Ellinger (*op cit* n 1) 88-89.

47 For a discussion of certain other attempts to construe consideration in this context, none of which have attracted significant support in the English positive law, see Clarke (*op cit* n 13) 262-264.

48 See also Sarna (*op cit* n 22) 2-2 - 2-3; Gutteridge & Megrah (*op cit* n 13) 28.

49 [1975] AC 154 (PC).

50 168E.

51 167-168.

52 (*Op cit* n 22) 475. See also Clarke (*op cit* n 13) 262. There is also limited support for this view in Treitel (*op cit* n 13) 139 where he regards it as a "possible solution" although not that favoured by him.

the credit is notified to him, consideration could lie in his refraining to make other attempts to dispose of them.[53]

The problem, however, remains that for the bank to be liable under this view of consideration, it is necessary for the seller-beneficiary to act in some way, which is not in accordance with the expectations of the parties as evidenced in the *UCP*. This leads Treitel to the following conclusion:

> "The widely held commercial view is that the bank is bound as soon as the seller is notified of the credit. If (as seems probable) this view also represents the law, it is best regarded as [an] exception to the doctrine of consideration."[54]

An analysis of the abovementioned sources, it is submitted, leads one to the tentative conclusion that in English law the offer and acceptance theory has considerable difficulty in dealing satisfactorily with the consideration requirement. Against this background, however, it is of interest to note that in the United States the law relating to consideration differs somewhat from that in England. Especially significant in the context of documentary credits is the fact that the common-law concept of consideration has been extended to include detriment to someone other than the promisee, that is consideration need not necessarily move from the promisee.[55] Thus, the consideration for the bank's undertaking towards the seller may theoretically be the promise by the purchaser to reimburse the bank. Although this construction has found significant support,[56] it is also not fully satisfactory. Thayer's criticism is sound:

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53 Treitel (*op cit* n 13) 139.

54 (*Op cit* n 13) 139. This is also the view favoured by Jack (*op cit* n 6) 80 who is, however, not overly concerned about this problem. He states at 79-80: "As it is plainly established in English law that the opening of an irrevocable credit establishes a contract between the bank and the beneficiary, it is not important in practice whether there is consideration to be found for the bank's promise or whether the contract is an exception to the general rule as to consideration." See also Goode (*op cit* n 42) 30-31.

55 This is well established in American law. See McCurdy (*op cit* n 22 "Commercial Letters of Credit") 575-579 and (*op cit* n 22 "The Right of the Beneficiary under a Commercial Letter of Credit") 332; Gutteridge & Megrah (*op cit* n 13) 27 n 17.

56 For the views of commentators supporting this theory see McCurdy (*op cit* n 22 "Commercial Letters of Credit") 574-582; Mead (*op cit* n 1) 302-5; and Davis (*op cit* n 22 "The Relationship between Banker and Seller under a Confirmed Credit") 229-240. The Canadian case *Sovereign Bank of Canada v Bellhouse, Dillon & Co*, (1913) 23 QR (KB) 413, is directly in point. The purchaser, having procured an irrevocable letter of credit in favour of the seller, instructed the bank to cancel it. In an action between the seller and the

> "It manifestly is the intention of the parties that the buyer should not be projected into the subsequent relations between the bank and the seller; is it not probable however that the buyer who furnishes consideration would continue to cast more than a shadow on the screen? Suppose for example that there is failure of consideration, supervening insolvency, or fraud on the part of the buyer in procuring the credit. These are precisely the type of risks that the seller expects to avoid. If consideration is to be taken as moving from the buyer, it nevertheless would seem that such circumstances might be used as defences by the bank in actions by the seller."[57]

Guarantee

The guarantee theory is discussed by most commentators, but supported by none. According to this theory the documentary credit amounts to a guarantee by the bank to the seller-beneficiary, that the buyer will perform his obligations under the contract of sale. The theory can be traced back to several old American cases.[58] The guarantee theory probably arose due to confusion between the important security function[59] of the documentary credit on the one hand, and its legal nature on the other.

The theory has been rejected for several good reasons. In the first place, if a documentary credit was a guarantee, the bank would no longer be obliged to pay if the buyer was no longer obliged to pay. Thus, if the sale was void, had been altered, or the buyer was discharged from his contractual obligations, the bank would no longer be liable. This, however, would violate the independence

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bank the court found that the letter could not be revoked as the contract was not between the bank and purchaser but between the bank and seller. The judgment is summarized as follows in the headnote: "No rule of law prevents a person, furnishing consideration in favor of another person, from binding the latter with a third." See also *American Steel Co v Irving Nat Bank* (1920) 266 Fed 41 (Circuit Court of Appeals 2nd Circuit) 44.

57 Thayer (*op cit* n 22) 1040. See also Kozolchyk (*op cit* n 22 "The Legal Nature of the Irrevocable Documentary Letter of Credit") 406; (*op cit* n 22 *Letters of Credit*) par 237.

58 Amongst the *dicta* cited by Hershey (*op cit* n 22) 14 are the following: *Lawrason v Mason* (1806) 3 Cranch (US) 492 ("We will become your security for 130 barrels of corn payable in 12 months"); *McLaren v Watson* (1841) 26 Wend (NY) 425 ("I hereby guarantee payment"); *Boyd v Snyder* (1878) 49 Md 342 ("This contract of guarantee ... analogous to a general letter of credit"); *Lafargue v Harrison* (1885) 9 Pac 259, (1886) 11 Pac 632 ("a guarantee by them of the credit to Mel and Sons during the time and for the amount specified"). See also Thayer (*op cit* n 22) 1038 n 33.

59 See par 1 4 above.

principle.[60] The second objection, which in a sense flows from the first, is that whilst a guarantor assumes a secondary liability, the liability of the bank under a documentary credit is primary. The bank does not guarantee the debt of another, but undertakes an independent, primary obligation to pay money or honour a draft.[61] Thirdly, the documentary credit would in any event not comply with statutory requirements for guarantees under English law.[62] In the fourth place, if the documentary credit was a guarantee, it would have to be accepted by the beneficiary. Thus, the acceptance problem discussed under the offer and acceptance theory, would be equally applicable here.[63] A final objection is that the guarantee theory encounters the same problems as the offer and acceptance theory in dealing with the consideration requirement.[64]

Contract for the Benefit of a Third Party

This theory accepts the absence of a direct contract between the banker and the seller-beneficiary. The contract is regarded as entered into between the banker and the buyer for the benefit of the seller. Such a construction violates the English doctrine of privity, whereby "a contract cannot, as a general rule, confer rights or impose obligations on any person except the parties to it".[65]

The theory was nevertheless supported by Denning LJ in *Smith and Snipes Hall Farm Ld v River Douglas Catchment Board*:

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60 Gutteridge & Megrah (*op cit* n 13) 31; Ellinger (*op cit* n 1) 47-48; Penn, Shea & Arora (*op cit* n 22) 299-301; Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 68. On the independence principle in general see aa 3 and 4 of the *UCP* and the discussion in par 5 2 2 above and 5 6 2 below.

61 Gutteridge & Megrah (*op cit* n 13) 31; Mead (*op cit* n 1) 301; Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 68; Ellinger (*op cit* n 1) 48; Penn, Shea & Arora (*op cit* n 22) 299; Kozolchyk (*op cit* n 22 *Letters of Credit*) par 239; Thayer (*op cit* n 22) 1038 n 33.

62 S 4 of the Statute of Frauds requires a guarantee to be evidenced by a note or memorandum identifying the principal debtor and the debt he owes. See Penn, Shea & Arora (*op cit* n 22) 299; Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 68; Gutteridge & Megrah (*op cit* n 13) 31.

63 Ellinger (*op cit* n 1) 48-49; Hershey (*op cit* n 22) 14; Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 68.

64 Ellinger (*op cit* n 1) 49.

65 Treitel (*op cit* n 13) 523. See further *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] AC 847 (HL) 853: "[I]n the law of England certain principles are fundamental. One is that only a person who is party to a contract can sue on it. Our law knows nothing of a ius quaesitum tertio arising by way of contract."

> "[A] man who makes a deliberate promise which is intended to be binding, that is to say, under seal or for good consideration, must keep his promise; and the court will hold him to it, not only at the suit of the party who gave the consideration, but also at the suit of one who was not a party to the contract, provided that it was made for his benefit and that he has a *sufficient interest* to entitle him to enforce it... ."[66]

As an example of "sufficient interest", Denning LJ thereupon, in an *obiter dictum*, mentions "the right of a seller to enforce a commercial credit issued in his favour by a bank, under contract with the buyer".[67]

Although Denning LJ's view initially enjoyed the support of Gutteridge and Megrah,[68] it was subsequently rejected, and the existence of the doctrine of privity reaffirmed by the House of Lords (with Lord Denning himself dissenting) in *Scruttons Ltd v Midland Silicones Ltd.*[69]

After the entrenchment of the doctrine of privity in the *Scrutton* case, supporters of the theory attempted to bring documentary credits within one of the exceptions to the privity rule. Two arguments have been raised. First, it has been argued that mercantile usage may justify a departure from the privity rule.[70] It is, however, questionable whether such an exception does in fact exist.[71] Secondly, it has been argued that the seller may rely on a statutory

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66 [1949] 2 KB 500 (CA) 514 (my italics). See also Denning LJ's judgment in *Drive Yourself Hire Co (London) Ld v Strutt* [1954] 1 QB 250 (CA) 275.

67 515.

68 See Ellinger (*op cit* n 1) 50 who refers to the 2 ed (1955) at 25-26.

69 [1962] AC 446 (HL). See further Treitel (*op cit* n 13) 529 who cites subsequent cases following this decision.

70 See, for the most recent support for this approach, Todd (*op cit* n 22) 479-480. See further Cheshire G C & Fifoot C H S *The Law of Contract* 5 ed (1964) Butterworth London 369-371. Ellinger (*op cit* n 1) 51 n 35 refers also to Bartholomew G W "Banker and Seller under Irrevocable Letters of Credit" (1959) 5 *McGill Law Journal* 95-100 as a supporter of this theory.

71 See for example Furmston M P *Cheshire, Fifoot and Furmston's Law of Contract* 11 ed (1986) Butterworths London 441 in which the exception dealt with and its possible application to documentary credits has, in comparison to the 5 ed (see n 70 above), been watered down considerably. This exception, furthermore, is not mentioned at all by Treitel (*op cit* n 13). Ellinger (*op cit* n 1) 51 also notes that although referred to in the 21 ed of Anson W R *Principles of the English Law of Contract*, the view was abandoned in the next edition. This may be ascribed to the fact that the main authority relied on by Cheshire &

exception to the privity rule. Section 56 of the Law of Property Act provides as follows:

> "A person may take an immediate or other interest in land *or other property*, or the benefit of any condition, right of entry, covenant or agreement over or respecting land or other property, although he may not be named as a party to the conveyance or other instrument... ."[72]

"Property" is defined as "any thing in action" subject to the context otherwise requiring.[73] In *Beswick v Beswick*[74] Lord Denning MR and Danckwerts LJ interpreted the section as a clear provision which does away with the doctrine of privity in the case of written contracts. The House of Lords, however, rejected this contention on the basis that the context, in this instance, did require a more restricted interpretation of "property".[75] Although the precise interpretation of section 56 remains problematical, it is accepted today that the provision does not apply to a bare promise in writing by A to B to pay a sum of money to C.[76]

Finally, even if the wider interpretation of section 56 were to be adopted, the contract for the benefit of a third party theory would nevertheless be unsuitable. Any theory constituting the seller a privy to the contract between the banker and buyer violates the principle of independence of the banker's obligation; the banker's obligation towards the seller would depend on the contract between the banker and the buyer.[77]

Fifoot in propogating their initial view, *Pyrene Co Ltd v Scindia Navigation Co Ltd* [1954] 2 QB 402, cannot be regarded as authority for their conclusion. The decision was partly based on Denning LJ's view (discussed above) and on another exception to the rule, namely agency. See Ellinger (*op cit* n 1) 51; Treitel (*op cit* n 13) 558.

72 S 56(1) Law of Property Act 1925 (my italics).

73 S 205(1).

74 [1966] Ch 538 (CA) 556F-557C. See also *Drive Yourself Hire Co (London) Ld v Strutt* [1954] 1 QB 250 (CA) 274-275.

75 *Beswick v Beswick* [1968] AC 58 (HL) 77B-E, 81C, 87C-F.

76 Treitel (*op cit* n 13) 573. See also Ellinger (*op cit* n 1) 52.

77 Ellinger (*op cit* n 1) 52; Sarna (*op cit* n 22) par 2(3).

The position in America differs somewhat from that in England in that most states, since the decision of *Lawrence v Fox*,[78] do allow actions on contracts by third party beneficiaries.[79] The first documentary credit case in support of this theory was *Carnegie v Morrison*.[80] In this case a banker had sent to his client (the buyer) a letter of credit containing a promise to meet the drafts of the seller. The buyer sent the letter to the seller. The bank later wrote to the seller informing him that the credit could not be granted. The seller nevertheless presented drafts which were dishonoured, and was successful in the subsequent action against the bank. Although it is not quite clear on what ground the court based its decision, the commentators agree that "the general tenor of the opinion seems to be that the seller was the beneficiary of a contract between the drawee bank and the buyer".[81] There is very little support for this theory in American case law.[82] Commentators have likewise consistently rejected it on the basis that it violates the independence principle. As McCurdy explains:

> "[I]n jurisdictions where [the seller] can maintain an action at law in his own name his rights are derivative, and consequently he would take the benefits of the contract subject to all defenses which the issuing and drawee banks had against the buyer. Thus fraud in the inception, supervening fraud, failure in consideration, insolvency of the buyer, would all be defenses available to the banks. Both from the seller's and from the buyer's point of view this result would destroy the value and usefulness of the irrevocable letter of credit."[83]

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78 (1859) 20 NY 268 (as cited and interpreted by Mead (*op cit* n 1) 302 and Ellinger (*op cit* n 1) 53).

79 Hershey (*op cit* n 22) 16; McCurdy (*op cit* n 22 "Commercial Letters of Credit") 573; Ellinger (*op cit* n 1) 53.

80 (1841) 2 Metc (43 Mass) 381 (as cited and interpreted by Ellinger (*op cit* n 1) 52-3 and Thayer (*op cit* n 22) 1038).

81 McCurdy (*op cit* n 22 "Commercial Letters of Credit") 573. See also Hershey (*op cit* n 22) 15; Thayer (*op cit* n 22) 1038 n 33..

82 Although the *Carnegie* case was applied specifically to an irrevocable letter of credit in *First Wisconsin Nat Bank of Milwaukee v Forsyth Leather Co* (1926) 206 NW 843 (Supreme Court of Wisconsin) the theory received no further support and was rejected in several cases. See *Lamborn v National Park Bank of New York* (1925) 148 NE 664 (Court of Appeals of New York); *Banco Nacional De Credito Ejidal SA v Bank of America* (1954) 118 F Supp 308 (US District Court ND California). See further Ellinger (*op cit* n 1) 52-53.

83 (*Op cit* n 22 "Commercial Letters of Credit") 573. See also Thayer (*op cit* n 22) 1038; Hershey (*op cit* n 22) 16; Mead (*op cit* n 1) 302.

Assignment (and Novation)

According to the assignment theory the moment the contract between the buyer and issuing bank is entered into, it is simultaneously assigned by the buyer to the seller.[84] The theory was first advanced by McCurdy who, although regarding it as "not wholly satisfactory" expresses the opinion that there is support for the theory in case law.[85]

The main case relied on by McCurdy is *In re the Agra and Masterman's Bank (Limited), Ex parte the Asiatic Banking Corporation (Limited).*[86] The Agra Bank had issued an open letter of credit[87] to its client, Dickson, Tatham & Co, in the following terms: "You are hereby authorised to draw upon this bank, at six months' sight, to the extent of 15,000l., and such drafts I undertake duly to honour on presentation. This credit will remain in force for twelve months from this date, and parties negotiating bills under it are requested to indorse particulars on the back hereof." Dickson, Tatham & Co subsequently drew bills under the credit and discounted them to the Asiatic Banking Corporation. The Agra Bank, when payment was demanded by the Asiatic Banking Corporation, set up a cross-claim against Dickson, Tatham & Co. The court held the bank liable on the basis that once the Asiatic Banking Corporation had accepted and acted upon the offer contained in the letter of credit, a valid contract was constituted (free from any cross-claims). In the course of the judgment Cairns LJ suggested an alternative line of argument based on assignment:

> "But assuming the contract to have been at law a contract with Dickson, Tatham & Co., and with no other, it is clear that the contract was in equity assignable, and that Dickson, Tatham & Co. must be taken to have assigned (if assignment were needed) to the Asiatic Banking Corporation, and to have been by the writers of the letter intended to assign to them the engagement in the letter providing for the acceptance of the bills."[88]

This *dictum* forms the basis for McCurdy's assignment theory. However, the applicability of the *Agra* case to the modern irrevocable documentary credit

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84 Gutteridge & Megrah (*op cit* n 13) 32; Ellinger (*op cit* n 1) 56; McCurdy (*op cit* n 22 "Commercial Letters of Credit") 583.

85 (*Op cit* n 22 "Commercial Letters of Credit") 583, 591.

86 [1867] 36 LJNS 222 (Ch).

87 As to what constitutes an open letter of credit see par 2 4 3 above.

88 226. There is no support for this line of reasoning in the judgment of Turner LJ.

which is issued directly to the seller, is highly questionable. It is rejected entirely by other commentators. Even McCurdy, who first proposed the theory, recognises that it "strains the facts somewhat to follow this construction when the letter is addressed to the seller and sent directly to him by the bank".[89]

A further problem of the assignment theory is that an assignment takes place subject to equities, that is the debtor can raise any defence which was available against the assignor, against the assignee. The assignment theory accordingly does not do justice to the principle of independence of the bank's obligation under the letter of credit.[90] Cairns LJ deals with this problem as follows:

> "Generally speaking a chose of action assignable only in equity must be assigned subject to the equities existing between the original parties to the contract. But this is a rule that must yield when it appears from the nature or terms of the contract that it must have been intended to be assignable free and unaffected by such equities."[91]

However, it is questionable whether such an exception does in fact exist. Contemporary text books make no mention of it.[92] It would accordingly appear that this is a valid objection to the assignment theory. This is accepted by McCurdy who regards the fact that assignment is subject to equities as the main problem with the theory. As a possible solution he suggests that the assignment theory needs to be supplemented by a novation:

> "In order to preclude the setting up of these defenses it would be necessary to go a step further and find a novation assented to in advance by the seller. Thus, where the sales contract provides that the buyer shall procure an irrevocable letter of credit, this amounts to an assent in advance by the seller to release the buyer from obligations of payment in return for the procurement of the letter of credit."[93]

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89 (*Op cit* n 22 "Commercial Letters of Credit") 583. See further Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 71; Ellinger (*op cit* n 1) 57-58; Penn, Shea & Arora (*op cit* n 22) 301-302; Gutteridge & Megrah (*op cit* n 13) 33.

90 Ellinger (*op cit* n 1) 58-59; Gutteridge & Megrah (*op cit* n 13) 33; McCurdy (*op cit* n 22 "Commercial Letters of Credit") 583.

91 226.

92 See Treitel (*op cit* n 13) 592-595 and Furmston (*op cit* n 71) 503-504, both of which deal with the rule that an assignee takes subject to equities in absolute terms.

93 (*Op cit* n 22 "Commercial Letters of Credit") 584.

By virtue of a novation, the bank is accordingly substituted for the buyer as the other party to the contract. This would dispose of the problem of assignment being subject to equities as, in the case of novation, "the original debt is not, strictly, transferred" but "[t]he third party's right against the debtor is based on the new contract between him and the debtor".[94]

It appears, therefore, that the *novation theory* can account for the independence of the documentary credit. It has nevertheless found no further support. The main problem is that in terms of this theory, the buyer would be released from his obligation as against the seller once he has procured the documentary credit. In the event of the bank not honouring the credit, the seller would accordingly have no recourse against the buyer. This, however, is clearly in conflict with well-established case law. In *E D & F Man Ltd v Nigerian Sweets and Confectionery Co Ltd* Ackner J described the buyers' position as follows:

> "The respondents' [buyers'] liability to the sellers was a primary liability. This liability was suspended during the period available to the issuing bank to honour the drafts and was activated when the issuing bank failed."[95]

Were the bank for whatever reason to dishonour the credit, the seller can accordingly look to the buyer for payment.[96]

A further problem noted by Ellinger,[97] is that a novation becomes effective when the "assignee" notifies his acceptance to the debtor. No such notice is given by the seller-beneficiary to the bank in the case of an irrevocable documentary credit. This difficulty cannot be solved by regarding the contract of sale as an anticipatory acceptance of the novation, for it is a contract between the buyer and seller and is not normally shown to the banker.

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94 Treitel (*op cit* n 13) 577.

95 [1977] 2 Lloyd's Rep 50 (QB) 56. See also *W J Alan & Co Ltd v El Nasr Export & Import Co* [1972] 2 All ER 127 (CA); *Maran Road Saw Mill v Austin Taylor & Co Ltd* [1975] 1 Lloyd's Rep 156 (QB). See further Clarke (*op cit* n 13) 269-276 and Van Houten S H "Letters of Credit and Fraud: A Revisionist View" (1978) 62 *Canadian Bar Review* 371 374.

96 Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 71; Ellinger (*op cit* n 1) 63; Penn, Shea & Arora (*op cit* n 22) 303; Gutteridge & Megrah (*op cit* n 13) 33.

97 (*Op cit* n 1) 63.

Agency

This theory is propagated by Gutteridge and Megrah. They argue as follows:

> "The parties contemplate that the seller is not content to rely on the buyer's ability or readiness to pay the price, but insists on payment being made in such form as will obviate the possibility of the buyer's failing to pay... . The seller, therefore requires the buyer to procure an independent promise of payment made by a bank... . If a contract of sale is entered into in these circumstances there does not seem to be any reason why it should not be held that the buyer has the implied authority of the seller to arrange for payment of the price to be made in the manner stipulated for."[98]

There are several problems with this theory. Jack dismisses it as simply not conforming with the intention of the parties.[99] Certain other specific problems have also been identified. In the first place, as pointed out by Ellinger, if the buyer is to be regarded as the seller's agent rather than a principal, the contract for the opening of the credit would be one between the banker and the seller. As such, nothing would prevent the banker and seller from amending the terms of the credit. This is clearly not in accordance with the intention of the parties.[100] Furthermore, from the seller's point of view this theory would have a most unsatisfactory consequence: if the buyer is the seller's agent for procuring the credit, and the buyer-agent were to induce the banker fraudulently to open the credit, the seller would be liable for the misrepresentation of his agent. Therefore, in the event of the seller in these circumstances enforcing the credit against the bank, the bank would have an equal claim for damages against the seller. This, also, would be in complete conflict with the intention of the parties.[101]

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98 (*Op cit* n 13) 33.

99 (*Op cit* n 6) 81-82.

100 Ellinger (*op cit* n 1) 64-65. See also a 9(d)(i)-(iii) of the *UCP*.

101 Ellinger (*op cit* n 1) 65-66: "[T]he irrevocable credit would become a broken reed. It would no longer give the seller the security for which he bargains, i.e. an assurance of a banker that, upon compliance with the terms of the credit and irrespective of almost any previous or subsequent events, the sum of the credit will be paid." See also Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 72; Sarna (*op cit* n 22) par 2(7); Kozolchyk (*op cit* n 22 "The Legal Nature of the Irrevocable Documentary Letter of Credit") 409.

Seller's Offer

Thayer, in the quest to surmount the consideration problem, suggested the following solution which was later termed "the seller's offer theory"[102]:

> "The undertaking of the bank to honour drafts is made in consideration of a prior undertaking by the seller to surrender documents to the bank instead of to the buyer. This undertaking is not express, but is necessarily to be implied from the stipulation by the seller in the contract of sale for an irrevocable credit."[103]

Thus the seller, in the contract of sale, offers to surrender the documents to the bank instead of to the buyer, and the bank accepts this offer by issuing the credit.

It is suggested that this theory strains the facts somewhat. It simply does not reflect the true situation between the parties. It is doubtful whether a true offer can possibly be construed on the part of the seller. English law requires that an offer "must consist of a definite promise to be bound provided certain specified terms are accepted".[104] The seller does not, however, give any such promise to the banker. Should the seller for instance deliver the documents directly to the buyer instead of to the bank, the bank would not be able to prevent him from doing so. The only consequence of the seller's action would be that he would not be able to avail himself of the credit.[105]

However, even if one were to accept that it is an offer, it is clear that there are no direct dealings between the seller and the bank. The seller's offer would therefore have to be communicated to the bank by the buyer. But in what capacity does the buyer communicate the offer to the bank? If he does so as the seller's agent,[106] the objections to the agency theory are applicable.[107]

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102 Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 72; Ellinger (*op cit* n 1) 77; Penn, Shea & Arora (*op cit* n 22) 303.

103 Thayer (*op cit* n 22) 1056.

104 Furmston (*op cit* n 71) 29. See also Ellinger (*op cit* n 1) 78.

105 Ellinger (*op cit* n 1) 78. See also Penn, Shea & Arora (*op cit* n 22) 303 who regard this as the main defect of the theory.

106 Gutteridge & Megrah (*op cit* n 13) 33 n 42 regard Thayer's theory as "not dissimilar" to their own agency theory whereby the buyer is the seller's agent.

107 Ellinger (*op cit* n 1) 77 n 10.

5 3 3 Non-Contractual Theories

Estoppel (and Trust)

The estoppel theory attempts to circumvent some of the problems encountered by the contractual theories. According to this theory the issue of a documentary credit amounts to a representation by the issuing banker that he has received the price and is holding it for the use of the seller. The banker is accordingly estopped from denying that he holds this money as against the seller who has acted in reliance on the representation. The theory which has very little support,[108] can be traced back to the American case of *Johannessen v Munroe*.[109]

In this case a merchant procured a open letter of credit[110] from the defendants. Before accepting the letter of credit from the merchant in partial settlement of a debt, the plaintiff enquired from the defendants whether the credit was valid and would be honoured. The answer of the defendants was in the affirmative. They nevertheless subsequently purported to cancel it. The court found that all the elements of estoppel were present and that the defendants were precluded from relying on the invalidity of the credit.

Although the decision may be correct, it is inapplicable to the modern irrevocable documentary credit in which the seller-beneficiary does not normally direct any enquiry to the banker. A representation such as that in the *Johannessen* case is accordingly absent.[111]

There are several reasons for rejecting the estoppel theory. First, it is questionable whether the bank makes any representation whatsoever. As Thayer states:

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108 Although most commentators refer to the theory, it is, as far as I could ascertain, supported only by Hershey (*op cit* n 22) 16-18.

109 (1899) 53 NE 535 (Court of Appeals of New York). Ellinger (*op.cit* n 1) 67-68 refers to earlier English cases which may be interpreted as relying on estoppel. The basis of these decisions is, however, not clear. Ellinger himself favours the interpretation that they do not rely on estoppel.

110 On this earlier form of letter of credit see par 2 4 3 above.

111 Ellinger (*op cit* n 1) 69.

> "[I]n order to raise an estoppel there must be a misrepresentation as to some state of facts already in existence. The undertaking given by the bank to the seller, on the contrary, is not representative but essentially promissory in its nature, and is so understood by all the parties concerned. It is a declaration of intention rather than a state of mind."[112]

Secondly, assuming that there is a representation, the seller would only be able to raise estoppel if he had acted to his detriment on the faith of the representation. The estoppel theory is accordingly, like the offer and acceptance theory, unable to explain the irrevocability of the credit, in accordance with the *UCP*, from the moment it has been issued.[113]

Finally, estoppel is a defence, not a cause of action.[114] In order to supply a cause of action in support of the estoppel, Hershey, with reference to the *Johannessen* case, regards the "representation" of the bank as having received funds for meeting the credit - that is, that the bank was holding the amount in trust for the seller.[115] However, in an earlier decision, *Morgan v Larivière*, the House of Lords rejected the theory that the bank qualified as a trustee in these circumstances.[116] Due to the fact that, in the case of the modern documentary credit, the banker seldom receives the amount of the credit in advance from the buyer, the point rejected in the *Morgan* case is even less likely to succeed today.[117]

Mercantile Usage

The theory that the relationships created by a documentary credit should be explained simply on the basis of mercantile usage, was first expressed by

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112 (*Op cit* n 22) 1042. See also McCurdy (*op cit* n 22 "Commercial Letters of Credit") 586; Ellinger (*op cit* n 1) 69; Mead (*op cit* n 1) 302.

113 Thayer (*op cit* n 22) 1043; Ellinger (*op cit* n 1) 69; Sarna (*op cit* n 22) par 2(9).

114 Ellinger (*op cit* n 1) 70; Sarna (*op cit* n 22) par 2(9).

115 (*Op cit* n 22) 18.

116 [1875] LJNS 44 457 (Ch) 464: "Nor, in my opinion, can the letter of the appellants, informing the respondents that the credit had been opened (no sum being set apart or appropriated as a specific sum to be drawn upon), constitute them trustees for the amount for which the respondent is to be at liberty to draw."

117 Ellinger (*op cit* n 1) 71; Mead (*op cit* n 1) 302; McCurdy (*op cit* n 22 "Commercial Letters of Credit") 585; Sarna (*op cit* n 22) par 2(9).

Finkelstein in 1930. Commenting on decisions of the time he came to the following conclusion:

> "The courts have adjudicated the rights of the various parties to these instruments with surprisingly few differences of opinion. The approach in all types of problems has been that of the law merchant ... The theory that the irrevocable letter of credit is a mercantile specialty has now for some time been acted upon and has been functionally adopted ... [I]ts formal recognition as a mercantile specialty cannot long be delayed."[118]

Such "formal recognition" has, however, not been forthcoming. In fact, as noted above, the House of Lords in the *United City Merchants* case,[119] appears to have opted for a contractual model. Nevertheless, both Trimble and Ellinger have subsequently developed their respective theories from the basis of mercantile usage.

Trimble, in an article tracing the historical development of letters of credit from medieval times, makes the point that the contractual theories have difficulty dealing with irrevocability and consideration. He then concludes:

> "[A] letter of credit is a 'mercantile specialty'... because it is governed, and throughout its history has always been governed, by the law merchant and has always been enforced by the common law courts in accordance with the basic principles of the law merchant. Hence, the problems of consideration and of irrevocability that still bother our text writers and some of our courts would seem to be, in reality, nonexistent in the law."[120]

Trimble accordingly regards the documentary credit as part of the old law merchant, and as such, part of the law of the land. Ellinger, on the other hand, rejects this view. He points out that the letter of credit known to the old law merchant differed in important respects from the modern irrevocable credit.[121] Ellinger accordingly prefers not to rely on the old law merchant but rather on

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118 The original source (Finkelstein H N *Legal Aspects of Commercial Letters of Credit* (1930) New York 294-295) was unavailable to me. I rely here on Trimble R J "The Law Merchant and the Letter of Credit" (1947-1948) 61 *Harvard Law Review* 981 1001. See also Ellinger (*op cit* n 1) 105.

119 [1983] 1 AC 168 (HL) 182H-183D. See the text at n 21 above.

120 (*Op cit* n 118) 1002.

121 (*Op cit* n 1) 106-108. See the discussion in par 2 4 3 above.

modern mercantile usage.[122] He argues that the validity of the irrevocable documentary credit is based on "a usage which treats irrevocable credits as binding from the date at which they reach the hands of the seller".[123] This usage he regards as most clearly defined in the *UCP*.[124]

Ellinger acknowledges the fact that there is very little support in case law for the mercantile usage theory.[125] He develops his thesis negatively by attacking the main objection to the theory. This is that mercantile usage, however extensive, cannot prevail if contrary to the positive law, and English positive law requires consideration moving from the promisee.

Addressing this problem, Ellinger points out that the phrase "contrary to positive law" in this context should be liberally interpreted so as to mean no more than that "a usage may not be recognised if it contradicts a decision on a specific point or a specific application of a common law principle".[126] Thus, a usage constituting an exception to a common-law principle may be acceptable, or, expressed differently, whilst a usage requiring a previous decision to be overruled is unacceptable, a usage requiring that a previous decision be distinguished is possible. The recognition of new negotiable instruments by virtue of mercantile usage provides a good example.[127] This reasoning, so Ellinger concludes, is equally applicable to documentary credits:

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122 On the concept "usage" in English law, see par 4 4 2 above.

123 (*Op cit* n 1) 108.

124 (*Op cit* n 1) 108 n 16. The current revision of the *UCP* is, however, not completely clear on the moment of irrevocability. See par 5 2 3 above.

125 Ellinger (*op cit* n 1) 120. He does, however, find limited support for the mercantile usage theory in *International Banking Corporation v Barclays Bank Ltd* (1925) 5 *Legal Decisions Affecting Bankers* 1 (CA) 4 in which Atkin LJ had the following to say in regard to negotiation credits: "[T]he law relating to such transactions is not at the present moment so crystallized that it is not dependable upon proof of custom. In any case it is plain that it is emphatically the kind of transaction where commercial usage when proved will eventually determine the legal rights between the parties". It would appear from this *dictum* that Atkin LJ did not see any legal obstacle to recognizing usage as a source of validity of documentary credits.

126 (*Op cit* n 1) 109. For case law in support of this liberal interpretation see n 127 below.

127 Ellinger (*op cit* n 1) 114-120 discusses several cases dealing with the establishment of new negotiable instruments by usage. Of special importance are *Gorgier v Mieville* (1824) 3 B&C 45 (107 ER 651) in which it was held that bearer bonds issued by the Prussian government were by mercantile usage negotiable instruments; and *Goodwin v Robarts* (1875) LR 10 Ex 337 in which the argument that only instruments known to the ancient

> "The usage enunciating the validity of irrevocable credits ... conflicts with principle in the same way as usages establishing the negotiability of negotiable instruments. ... The usage relating to documentary credits only necessitates the establishment of an exception in the same way as the usages enforcing negotiable instruments. If the liberal interpretation of the maxim 'contrary to positive law' is accepted then there seems to be nothing repugnant in the usage concerning irrevocable credits."[128]

In support of Ellinger's theory Goode puts forward the view that all the other theories "fall to the ground because, in an endeavour to produce an acceptable theoretical solution, they distort the character of the transaction and predicate facts and intentions at variance with what is in practice done and intended by the parties".[129] Further support for the theory that the documentary-credit undertaking is "a unique commercial specialty rooted in neither the common law nor the civil law but in the *lex mercatoria*"[130] has recently arisen in Canada. Dolan comes to this conclusion on the basis of the important decision of the Canadian Supreme Court in *Bank of Nova Scotia v Angelica Whitewear Ltd.*[131] In this case the court, having found that the applicable law was the civil law of Quebec, nevertheless reviewed extensively the English, American and Canadian common-law authorities. This, states Dolan, was not "simply an exercise in scholarship", but "an implicit acknowledgement that the law of credits must reflect uniformity on fundamental issues", and thus "the Court is saying that the *lex mercatoria*, not local law, must determine these letter of credit rules".

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law merchant could achieve negotiability by usage, was rejected by Cockburn CJ. Cockburn CJ's decision was subsequently upheld by the House of Lords ((1876) 1 App Cas 476) after which the principle that new usages may give rise to new negotiable instruments could be considered to be firmly entrenched.

128 (*Op cit* n 1) 120.

129 Goode R *Commercial Law* 2 ed (1995) Penguin Harmondsworth 987.

130 Dolan J F "Documentary Credit Fundamentals: Comparative Aspects" (1989) 3 *Banking & Finance Law Review* 121 122.

131 (1987) 36 DLR (4th) 161 (SCC). For a discussion of the case see Lalonde L "Documentary Letters of Credit: *B.N.S. v. Angelica-Whitewear*" (1988) 2 *Banking & Finance Law Review* 377.

5 3 4 Provisions of the UCC

Introduction

The above survey of the common-law jurisprudence on the legal nature of the relationship between the bank issuing or confirming a documentary credit and the beneficiary thereof reveals, to generalise somewhat, the following main problems: the first is simply the question whether the theoretical basis of this relationship ought properly to be sought in the law of contract? If this question is answered in the affirmative, two further problems predominate: (i) the problem of determining the moment of irrevocability, and (ii) the problem of satisfying the consideration doctrine.

Article 5 of the current UCC contains several provisions material to these questions. The revision process of this article is, however, nearing completion. A "Proposed Final Draft" was recently published.[132] The proposed revision differs in many respects from the current statute. Several of its provisions need to be considered in the context of the questions posed above.

It must be borne in mind, however, that the UCC is state law, and must accordingly, once passed by both the American Law Institute and the National Conference of Commissioners on Uniform State Laws, be adopted by the individual American states before it actually becomes law.[133] This is bound to take some time. Furthermore, it does not have retrospective effect; thus, credits issued under the current UCC will remain unaffected by the revision.[134] The current UCC is therefore likely to govern many credits for some time yet.

Current Provisions

Regarding the question whether the relationship is contractual, the provisions of the UCC are inconclusive. § 5-103(1)(a) terms a letter of credit an "engagement by a bank". But what is an "engagement"? Commentators are not in agreement.

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132 American Law Institute *Uniform Commercial Code Revised Article 5 - Letters of Credit - Proposed Final Draft* (April 6, 1995). The full text and official commentary were published in April 1995 *Letter of Credit Update* 27-63. On this revision in general see par 3 10 2 above.

133 See the editorial comments "UCC Article 5 Moves towards Completion" and "Next Steps" April 1995 *Letter of Credit Update* 3-4.

134 In terms of the "Transition Provisions" of the proposed revision it shall apply only to credits "issued on or after the effective date of this [Act]".

Van Houten, for instance, regards the term as "deliberately vague" so as not to determine finally whether the relationship is contractual.[135] Dolan regards the word as "significant" and "clearly part of a design to loosen the letter of credit from the tether of common law theory" thereby opening the way for its recognition as a "creature of the law merchant".[136] On the other hand, the official comment to § 5-114 of the UCC, terms the letter of credit "essentially a contract between the issuer and the beneficiary".[137] This comment, however, is regarded as unfortunate by White and Summers:

> "The obligations, particularly those of an issuer to a beneficiary, that arise under a letter of credit are not exclusively contractual in nature, and it is unfortunate that some of the Code comments suggest as much. ... [T]he ... letter of credit is not itself a contract, and the issuer's obligation to honor drafts is not, strictly speaking, a contractual one to the beneficiary. The beneficiary does not enter into any agreement with the issuer. Indeed, prior to issuance of the letter of credit, issuer and beneficiary may be wholly unknown to each other. Yet once the letter of credit is established, the issuer becomes *statutorily* obligated to honor drafts drawn by the beneficiary that comply with the terms of the credit."[138]

The authors also stress that one of the prime purposes of the drafters of article 5 was to "set an independent theoretical framework" for letters of credit, that is a framework independent of the law of contract, guarantee, third party beneficiaries, assignment and negotiable instruments.[139]

Despite the uncertainty regarding the contractual status of the bank-beneficiary relationship, the UCC does address in clear terms the problems of consideration and the moment of irrevocability. As regards consideration, § 5-105 simply

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135 Van Houten (*op cit* n 95) 375.

136 Dolan (*op cit* n 130) 125-126.

137 American Law Institute & National Conference of Commissioners on Uniform State Laws *Uniform Commercial Code Official Text - 1990 With Comments* 12 ed West Publishing 617. See also Harfield H *Bank Credits and Acceptances* 5 ed (1974) Ronald Press Co New York 55.

138 White J J & Summers R S *Handbook of the Law under the Uniform Commercial Code* 2 ed (1980) West Publishing Co St Paul Minnesota 711. One may add that there is an aura of inadvertence surrounding this part of the official comment as it is not reproduced in the comments to § 5-103 in which the phrase "engagement of a bank" is scrutinised. See *Uniform Commercial Code Official Text* (*op cit* n 137) 604.

139 (*Op cit* n 138) 711.

provides that "[n]o consideration is necessary to establish a credit or to enlarge or otherwise modify its terms."

The complicated problem of determining the moment of irrevocability is dealt with as follows in § 5-106(1):

> "Unless otherwise agreed a credit is established
> (a) as regards the customer as soon as a letter of credit is sent to him or an authorized written advice of its issuance is sent to the beneficiary; and
> (b) as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance."

Although with reference to the relationship between the bank and its client the credit is regarded as established from the moment the bank has "sent"[140] either the credit to its client or the advice of the issue thereof to the beneficiary,[141] the bank *vis a vis* the beneficiary is only bound (and the credit regarded as established) from the moment the beneficiary receives the credit or advice of its issue. As regards the beneficiary the consequence of the credit having been "established" is that it "can be modified or revoked only with his consent".[142] Thus, in terms of the UCC, a letter of credit becomes irrevocable once the beneficiary has received it.[143]

The effect of these provisions of the UCC is clearly to remove any doubt as to the validity of the letter of credit.[144] Whether the letter of credit under the UCC is regarded as "essentially a contract", a statutory instrument, or simply as a creature of the law merchant, its validity under the UCC is beyond question.

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140 The word "send" is defined in § 1-201 of the UCC as follows: "'Send' in connection with any writing or notice means to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed".

141 § 5-106(1)(a).

142 § 5-106(2).

143 See the official comment to § 5-106 of the UCC (*op cit* n 137): "The primary purpose of determining the time of establishment of an irrevocable credit is to determine the point at which the issuer is no longer free to take unilateral action with respect to the cancellation of the credit or modification of its terms. ... The beneficiary ... cannot rely upon the credit until and unless he receives it."

144 Sarna (*op cit* n 22) par 2(14).

However, as noted above, the UCC does not apply to all letters of credit.[145] In situations where it does not apply, for instance to the vast number of credits issued subject to the *UCP* in the State of New York, the problem of finding a suitable theoretical basis for the relationship between the banker and beneficiary remains.

New Revision

The question whether the relationship between the bank and beneficiary is contractual is not dealt with specifically in either the text or the official commentary to the proposed revision. There are, however, two provisions which, on analysis, cast some light on the nature of this relationship.

In the first place § 5-102(10) defines a letter of credit as "a *definite undertaking* ... by an issuer to a beneficiary at the request or for the account of an applicant ... to honor a documentary presentation by payment".[146] By terming the credit a "definite undertaking" the revision has adopted the wording of the *UCP*.[147] But what is an "undertaking"? The term is left undefined and is not even commented upon in the official commentary. Van Houten's charge of "deliberate vagueness"[148] seems equally applicable here. The question, in any event, is academic in relation to credits governed by article 5 as the bank in this instance is clearly bound by operation of law.

The second noteworthy provision in this context is concerned with the moment from which the bank is bound. § 5-106(a) reads as follows:

> "A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer *sends or otherwise transmits* it to the person requested to advise or to the beneficiary."[149]

Whereas the current UCC holds the bank liable to the beneficiary from the moment the beneficiary has received the credit, the revision opts for the

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145 See par 3 10 2 above.

146 My italics.

147 This is specifically acknowledged in par 6 of the commentary to § 5-102(10) (*op cit* n 137).

148 See n 135 above.

149 My italics. For the definition of "send" see n 140 above.

moment of dispatch. It is suggested that this provision is incompatible with a contractual approach. The liability of the bank, and its inability *vis a vis* the beneficiary to withdraw or revoke the credit, from any moment earlier than its receipt by the beneficiary cannot be founded on contract. These consequences simply arise by operation of law.

On this interpretation consideration should not pose a problem. Nevertheless, in the wake of its predecessor, the revision provides that "[c]onsideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation".[150]

One final point must be made: although the current article 5 has not been a major role player in documentary-credit practice on a global level it is suggested that the revised version is likely to be considerably more influential. The reason is that unlike its predecessor which for all practical purposes did not apply in New York (the most important American international trade centre), it would appear that the new revision is likely to apply to all American credits.[151] It is further clear that the revised article 5 must necessarily weaken the case of those favouring a contractual model for the bank-beneficiary relationship.

5 3 5 Conclusion

From the above one may conclude that, apart from credits governed by the UCC, common-law theory has great difficulty in dealing with the relationship between the banker and seller-beneficiary. In England the courts seem to have opted for a contractual approach despite its inherent difficulties.[152] In this respect it must be noted that the difficulties are clearly limited to legal theory - they do not extend to legal practice. This, in my opinion, can be ascribed mainly to two factors. First, there are overwhelming policy considerations favouring the validity of documentary credits. As noted by Jenkins LJ in *Hamzeh Malass & Sons v British Imex Industries Ltd*:

> "[T]he opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay... . *An elaborate*

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150 § 5-105.

151 See par 3 10 2 above.

152 *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168 (HL) 182-183.

> *commercial system has been built up on the footing that bankers' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with that established practice.*"[153]

Secondly, there are equally compelling commercial reasons for banks not to take the point that the theoretical basis of their liability under documentary credits is, to say the least, suspect. The very livelihood of banks is, after all, dependent upon them being perceived as willing to meet their obligations.

As a consequence, despite the fact that documentary credits have not been satisfactorily accounted for in legal theory, there is little doubt that the courts will enforce them. Harfield's somewhat exasperated conclusion seems apposite:

> "To conclude, then, the banker's letter of credit is a legally enforceable instrument ... . There is neither need nor utility to employ Procrustean techniques to establish its validity."[154]

5 4 The Legal Nature of the Bank-Beneficiary Relationship from a Civil-Law Perspective

5 4 1 Introduction

In the Continental legal literature it is possible to discern two different approaches to the question as to the nature of the obligation of the issuing and confirming bank under a documentary credit. The first, as evidenced predominantly in the earlier theories, attempts to bring the documentary credit in its entirety (that is both the buyer-bank and bank-beneficiary relationships) within the confines of a single existing statutory institution.[155] This led to what Wiele terms "Konstruktionsspielereien": He continues:

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153 [1958] 2 QB 127 (CA) 129 (my italics).

154 (*Op cit* n 137) 55. See also Davis (*op cit* n 22 *The Law Relating to Commercial Letters of Credit*) 77: "[I]t is thought that any argument submitted to an English Court that there was no legal obligation between the banker and the seller would receive little sympathy." See further Jack (*op cit* n 6) 79-80.

155 Lücke G *Das Dokumenten-Akkreditiv in Deutchland, Frankreich und der Schweiz - Eine rechtsvergleichende Darstellung* (1976) Christian Albrechts Universität Kiel 23: "[Immer wurde] wieder versucht, daß DA in seiner Gesamtheit unter ein gesetzlich geregeltes Vertragsverhältnis zu subsumieren." See also Wiele G *Das Dokumenten-Akkreditiv und der anglo-amerikanische Documentary Letter of Credit* (1955) Schiffahrts Verlag Hamburg 33; Angersbach U *Beiträge zum Institut des Dokumenten-Akkreditivs* (1965) Julius-Maximilians-Universität Würzburg 51.

> "Man hat [versucht] ... das DA in eines der vorhandenen Institute unserer Rechtsordnung zu zwängen, das für sich allein dem dreiseitigen Rechtsverhältnis gerecht wird."[156]

The second approach, more evident in the later theories, scrutinizes the relationship between the bank and the beneficiary without reference to that between the bank and its client.[157] The different theories emanating from both these approaches are considered below. In this respect I have concentrated on German and Dutch theories with only brief references to the Swiss, Austrian and French literature and civil codes. I deal first of all with the earlier theories which are very similar in the different jurisdictions. This allows a combined approach - that is the different jurisdictions can be considered together.[158] The more contemporary theories are then discussed. Here, however, it is functional to distinguish between the Dutch and German theories.

5 4 2 The Early Theories

Suretyship (Borgtocht/Bürgschaft) and Aval

Dumon-Tak, an early Dutch commentator, took the view that the bank could be regarded as the surety of the buyer,[159] an approach which also found support in a decision of the French *Cour de Cassation* in 1926.[160] The most thorough exposition of this theory is to be found in the work of the Dutch

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156 Wiele (*op cit* n 155) 33.

157 Angersbach (*op cit* n 155) 51; Wiele (*op cit* n 155) 34.

158 This approach is favoured also by Lücke (*op cit* n 155) 23 who with reference to the early theories advanced in Germany, France and Switzerland remarks that the "anzutreffende Ähnlichkeit der Gedankengänge läßt eine gemeinschaftliche Darstellung der früheren Einordnungsversuche angebracht erscheinen".

159 Dumon-Tak J A *Rembourscredieten* (1923) A Vilders Leiden 65. See also Cahn E M *Het Accreditief* (1935) HJ Paris Amsterdam 49.

160 See Cahn (*op cit* n 159) 49-51 who quotes substantial portions of the judgment. See also De Rooy F P *Documentair Kredieten* 2ed (1980) Kluwer Deventer 87. The decision was not favourably received in France and and has received no support since. See Van Delden (*op cit* n 14) 81 ("eenduidend verworpen").

commentators.[161] Suretyship (*borgtocht*) was defined as follows in article 1857 of the *Burgerlijk Wetboek* (*BW*):[162]

> "Borgtocht is eene overeenkomst, waarbij een derde zich, ten behoeve van den schuldeischer, verbindt om aan de verbindtenis van den schuldenaar te voldoen, indien deze niet zelf daaraan voldoet."[163]

Applied to the documentary credit this theory entails that by issuing a documentary credit the bank binds itself to honour the obligation of the buyer to the seller in the event of the buyer himself failing to perform. The theory has since been rejected,[164] mainly on account of the fact that the subsidiary nature of *borgtocht* (and the concomitant availability of the *beneficium excussionis* to the surety)[165] was regarded as incompatible with the primary nature of the issuing bank's liability under a documentary credit.[166] The early commentators were well aware of this fact. What they had in mind though was a special type of surety, the so called *zelfschuldige borg*,[167] that is a surety who has waived the *beneficium excussionis*.[168] In practice the *zelfschuldige borg* is actually much

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161 See especially De Rooy (*op cit* n 160) 87-89. The best exposition in the German literature is that of Angersbach (*op cit* n 155) 56-57, but see also Lücke (*op cit* n 155) 24.

162 The reference is to the old *BW*. Boek 7 Titel 14 of the *Nieu Burgerlijk Wetboek* (*NBW*) which governs *borgtocht* today, came into operation on 1 January 1992. See Wessels B & Bertrams R I V F *Bijzondere Contracten XV Borgtocht* (1990) (loose-leaf edition) Kluwer Deventer XV-1.

163 For the position in Germany see the similar definition in par 765 of the *Burgerliches Gesetzbuch* (*BGB*): "Durch den Bürgschaftsvertrag verpflichtet sich der Bürge gegenüber dem Gläubiger eines Dritten, für die Erfüllung der Verbindlichkeit des Dritten einzustehen."

164 Cahn (*op cit* n 159) 51-53; De Rooy (*op cit* n 160) 87-88; Van Delden (*op cit* n 14) 81; Angersbach (*op cit* n 155) 56-57.

165 De Rooy (*op cit* n 160) 87-88; Kamphuisen P W *Mr C Asser's Handleiding tot de Beoefening van het Nederlands Burgerlijk Recht - Bijzondere Overeenkomsten Deel II* 4 ed (1976) Tjeenk Willink Zwolle 316-317; Wessels & Bertrams (*op cit* n 162) XV-1857-2; Angersbach (*op cit* n 155) 56-57.

166 See a 9(a) of the *UCP*. According to Del Busto (*op cit* n 12) 22-23 one of the objects of redrafting this provision in the *UCP 500* was to emphasize better the primary nature of the bank's liability.

167 Dumon-Tak (*op cit* n 159) 65 n2; Cahn (*op cit* n 159) 51-52. The concept (*selbstschuldnerische Bürgschaft*) is also known in German law. See Angersbach (*op cit* n 155) 57.

168 Wolffensperger G J & Frenkel B S *Pitlo Het Nederlands Burgerlijk Wetboek Deel 3A De Benoemde Overeenkomsten* 8 ed (1979) Gouda Quint B V Arnhem 377-378.

more the rule than the exception as creditors have long been loath to accept a suretyship entailing this benefit.[169] In the Netherlands the *NBW*[170] has brought theory in line with practice by doing away with the *beneficium excussionis*.[171] The phrase "indien deze niet zelf daaraan voldoet" was accordingly struck from the definition quoted above.[172] An equivalent defence, the *Einrede der Vorausklage*, however, remains part of German law.[173]

Although the *zelfschuldige borg* and the surety under the *NBW* address some of the problems of this theory, the accessory nature of suretyship[174] is also a major obstacle. The surety binds himself to perform the obligation of another, the main debtor. Therefore, applied to the documentary credit, the theory would entail that if the seller were to be unable to enforce payment against the buyer because of a defect in the primary obligation, the bank would also not be liable. This would clearly violate the principle of independence of the bank's obligation under a documentary credit.[175]

In an attempt to circumvent the accessory nature of suretyship it has been argued that the bank may be regarded as (akin to) an aval rather than a surety.[176] By virtue of the provisions of the *Wetboek van Koophandel* (*WVK*), the obligation of the aval "is geldig, zelfs indien wegens een andere oorzaak dan een vormgebrek, de door hem gewaarborgde verbintenis nietig is".[177] The accessory nature of suretyship is accordingly absent in the case of aval. There

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169 Wolffensperger & Frenkel (*op cit* n 168) 378; Wessels & Bertrams (*op cit* n 162) XV-1857-2.

170 A 7 14. The provision came into effect on 1 January 1992. See n 162 above.

171 Wessels & Bertrams (*op cit* n 162) XV-Inl-17; Kamphuisen (*op cit* n 165) 317; Wolffensperger & Frenkel (*op cit* n 168) 395.

172 See a 7 14 1 1 *NBW*.

173 See par 771 of the *BGB*.

174 De Rooy (*op cit* n 160) 87-88; Kamphuisen (*op cit* n 165) 317-321; Wessels & Bertrams (*op cit* n 162) XV 1859-1; Angersbach (*op cit* n 155) 57; Wessely W *Die Unabhängigkeit der Akkreditivverpflichtung von Deckungsbeziehung und Kaufvertrag* (1975) C H Beck München 23.

175 See a 3 of the *UCP*.

176 De Rooy (*op cit* n 160) 88-89; Cahn (*op cit* n 159) 53-54.

177 A 131.

are, however, several reasons why this theory must be rejected. First, aval is an institution peculiar to the law of bills of exchange.[178] Secondly, the aval is liable in the same way as the debtor for whom he signs the instrument; if it is for the acceptor, the aval is liable as acceptor; if it is for the drawer or indorser he is liable as drawer or indorser. In contrast, the bank issuing a documentary credit is liable in terms of the documentary credit and not the contract of sale.[179]

In conclusion it must furthermore be noted that suretyship and aval proceed from a point of departure completely different to that of the commercial, as opposed to the standby, documentary credit.[180] As De Rooy states:

> "[M]en stelt zich borg of aval met de bedoeling om niet aangesproken te worden; de bank opent haar documentaire krediet met de bedoeling wel aangesproken te worden."[181]

Contract for the Benefit of a Third Party (Derdenbeding/Vertrag zugunsten Dritter)

The doctrinal problems experienced in the common-law jurisdictions with the concept of a contract for the benefit of a third party[182] do not arise in the legal systems based on the civil law. The contract for the benefit of a third party is expressly recognized in the civil codes of both Germany and the Netherlands as an exception to the general rule that a contract does not create rights or obligations for third parties.

The theory that the documentary credit may amount to a contract for the benefit of a third party was one of the more prominent early theories.[183] It was subsequently rejected by most commentators but still retains a measure of

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178 De Rooy (*op cit* n 160) 89.

179 Cahn (*op cit* n 159) 54; De Rooy (*op cit* n 160) 89.

180 See par 1 6 5 above.

181 (*Op cit* n 160) 89.

182 See par 5 3 2 above.

183 Angersbach (*op cit* n 155) 57 ("Häufig ... als Vertrag zugunster Dritter angesehen"); Wiele (*op cit* n 155) 33 ("häufiger"). Dumon-Tak (*op cit* n 159) 65 was, as far as I could ascertain, the first Dutch jurist supporting the theory. He regarded it as appropriate "in sommige gevalle".

support in the Netherlands. This can partly be ascribed to differences in the respective codes.

The *BGB* provides the following basis for the *Vertrag zugunsten Dritter*:

> "Durch Vertrag kann eine Leistung an einen Dritten mit der Wirkung bedungen werden, daß der Dritte unmittelbar das Recht erwirbt, die Leistung zu fordern."[184]

The *derdenbeding*, on the other hand, is defined as follows in the *NBW*:

> "Een overeenkomst schept voor een derde het recht een prestatie van een der partijen te vorderen of op andere wijze jegens een van hen een beroep op de overeenkomst te doen, indien de overeenkomst een beding van die strekking inhoudt en de derde dit beding aanvaardt."[185]

The main difference between the respective provisions is that whilst Dutch law requires acceptance of the *derdenbeding* by the beneficiary, German law does not. Applied to the documentary credit, therefore, according to German law the bank would become bound as against the beneficiary the moment the bank agrees as against its client to open a documentary credit. According to Dutch law, on the other hand, the bank would only become bound once the beneficiary has accepted the documentary credit. Neither construction is in accordance with the commercial expectations of the parties[186] or with the provisions of the *UCP*.[187] As a consequence there has been a widespread rejection of this theory both in Germany[188] and the Netherlands.[189]

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184 Par 328 *BGB*.

185 A 6 5 3 2 of the *NBW*. See also a 1353 of the *BW*.

186 See for the German perspective Angersbach (*op cit* n 155) 57-59; Lücke (*op cit* n 155) 27. For the Dutch point of view see Cahn (*op cit* n 159) 47; De Rooy (*op cit* n 160) 91.

187 See a 9 of the *UCP* and the discussion in par 5 2 3 above.

188 Angersbach (*op cit* n 155) 60; Wiele (*op cit* n 155) 33; Lücke (*op cit* n 155) 27; Nielsen J *Aktuelle Rechtsfragen zum Dokumenten-Akkreditiv* (1984) Kommunikationsforum Recht Wirtschaft Steuern Tagungs- und Verlagsgeselschaft Köln 23.

189 Van Delden (*op cit* n 14) 71, 73, 75; De Rooy (*op cit* n 160) 90-92; Mertens R F H "De Rechtsverhoudingen tussen Partijen bij het Documentair Krediet (Accreditief)" in Bossers G F M, Ringeling A R O & Tratnik M (eds) *Cinco Ana Na Caminda - Opstellen Aangeboden ter Gelegenheid van het Eerste Lustrum van de (Faculteit der Rechtsgeleerdheid van de) Universiteit van Aruba* (1993) Aruba 55 66; Boon M N *Het Documentair Accreditief - De Rechtspositie van de Opdrachtgever ingevolge de UCP*

The Dutch commentator Dorhout-Mees, however, still favours the *derdenbeding* as the proper theoretical framework for the documentary credit. He argues as follows:

> "Het wil mij voorkomen dat deze constructie de juiste is. De werkelijke gang van zaken is immers deze, dat de koper zich verplicht heeft, te zorgen dat de bank het krediet stelt, en dat hij dientengevolge van de bank bedingt dat deze het krediet inderdaad ten behoewe van de verkoper opent, gelijk art. 1353 B.W. toestaat."[190]

Dorhout-Mees counters the acceptance problem by arguing that there is a tacit acceptance in anticipation by the beneficiary in the contract of sale. This explanation is dismissed by De Rooy as being forced and, in any event, not in accordance with practice:

> "Wanneer koper en verkoper in hun koopcontract bepalen dat een documentair krediet geopend zal worden impliceert dit nog niet dat de verkoper ook inderdaad van dit krediet gebruik zal maken. Het is zeer wel mogelijk dat ... de transactie doch buite het krediet om afgewikkeld wordt."[191]

Another fundamental problem with the *derdenbeding* or *Vertrag zugunsten Dritter* theory is that it also violates the independence principle. In the case of the *derdenbeding* or *Vertrag zugunsten Dritter* the right of the third party is dependent upon the contract between the *stipulator* and *promisor*. Applied to the documentary credit this would lead to the unacceptable conclusion that the bank's obligation under the documentary credit is dependent upon the contract between the bank and the buyer,[192] a result in conflict with the *UCP*.[193] Dorhout-Mees addresses this problem as follows:

(1988) Nederlands Instituut voor het Bank- en Effectenbedrijf Publikatiereeks 66 42; Pabbruwe H J "De Overeenkomst Bank - Begunstigde bij het Onherroepelijk Documentair Crediet" 4960 (2 september 1967) *Weekblad voor Privaatrecht, Notaris-ambt en Registratie* 337 339. The theory was also rejected by certain early commentators. See Van Nierop H A "Documentaire Credieten" (1934) 3355 *Weekblad voor Privaatrecht, Notaris-ambt en Registratie* 155 157; Cahn (*op cit* n 159) 45-48.

190 Dorhout Mees T J *Nederlands Handels- en Failissementsrecht III Waardepapieren en Geldverkeer; Handelskoop; Verzekering* 7 ed (1980) Gouda Quint B V Arnhem 97. (The a 1353 referred to is the article replaced by the a 6 5 3 2 quoted above.)

191 De Rooy (*op cit* n 160) 91.

192 See for instance par 334 *BGB*. See further Cahn (*op cit* n 159) 47; Pabbruwe (*op cit* n 189) 339; De Rooy (*op cit* n 160) 91-92; Angersbach (*op cit* n 155) 58; Lücke (*op cit* n 155)

> "Men zal ... moeten aannnemen dat uit de mededeling van de bank aan de verkoper in verband met de hele transactie volgt, dat de bank tegenover de verkoper afstand doet van alle weren, aan haar verhouding tot de koper ontleend."[194]

It is suggested, however, that this construction is somewhat forced.

A final criticism raised by Van Delden[195] is that the beneficiary acquires rights and obligations, and that the contract therefore cannot truly be regarded as for the *benefit* of the third party. The obligation he identifies is to present documents. It is suggested that this criticism is unsound. The beneficiary does not acquire an obligation to present documents; his right to payment is merely conditional upon his presenting the documents.

Payment

The payment theory is ascribed to the Dutch commentator Zeylemaker[196] who formulated it as follows:

> "De koper vervult zijn betalingsplicht eerst door de accreditiefstelling en heeft daarmede aan zijn verplichtingen voldaan voor het geval binnen de tijd, dat de accreditiefstelling duurt, door den verkoper wordt gepresteerd."[197]

This formulation, however, does not appear to me to deal with the relationship between the bank and the beneficiary at all, but deals rather with the relationship between the buyer and the seller-beneficiary.[198] Even if one were to accept that the issue of the documentary credit does amount to payment by the

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27; Raith R *Das Recht des Dokumenten-Akkreditivs in den USA und in Deutschland* (1985) Stolfuß Verlag Bonn 118; Wessely (*op cit* n 174) 23.

193 A 3(b) provides as follows: "A Beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the Applicant and the Issuing Bank." See also par 5 2 2 above.

194 Dorhout-Mees (*op cit* n 190) 97.

195 (*Op cit* n 14) 74-75.

196 See Pabbruwe (*op cit* n 189) 339; De Rooy (*op cit* n 160) 89-90.

197 As quoted by De Rooy (*op cit* n 160) 90. Zeylemaker's work itself was not available to me.

198 Although De Rooy (*op cit* n 160) 89-90 deals with this theory in the chapter on the relationship between the bank and the beneficiary, he does not scrutinize this relationship in the context of this theory at all.

buyer, this has no bearing on the relationship between the issuing bank and the seller-beneficiary. So viewed, the theory is of no assistance in defining the relationship between the bank and beneficiary.

In his interpretation of the payment theory Pabbruwe, however, does shed some light on the relationship between the bank and the seller-beneficiary. He regards the bank as having taken over the debt of the buyer, that is *schuldoverneming* occurs.[199] *Schuldoverneming* is defined as follows in the *NBW*:

> "Een schuld gaat van de schuldenaar over op een derde, indien deze haar van de schuldenaar overneemt. De schuldoverneming heeft pas werking jegens de schuldeiser, indien deze zijn toestemming geeft nadat partijen hem van de overneming kennis hebben gegeven."[200]

The possibility that the documentary credit may amount to a *Schuldübernahme*[201] in German law is also raised by German commentators.[202] Applied to the documentary credit *schuldoverneming* or *Schuldübernahme* implies that the bank takes over the buyer's payment obligation under the contract of sale. A fundamental problem with this theory is, however, that in the case of *schuldoverneming* or *Schuldübernahme* the original debtor is discharged.[203] Thus, applied to the documentary credit, the seller would not be

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199 Pabbruwe (*op cit* n 189) 339.

200 A 6 2 3 10. The predecessor in the *BW* was a 1453 dealing with *delegatie*. The difference between *delegatie (passiewe novatie)* and *schuldovername* is described thus in Bolweg M F H J *Pitlo Het Nederlands Burgerlijk Wetboek Deel 3 Algemeen Deel van het Verbintenisrecht* 8 ed (1979) Gouda Quint B V Arnhem 399-400: "De passiewe novatie is ... een drie-partijencontract. Schuldoverneming daarentegen is een twee-partijencontract. Dit verschil is echter minder belangrijk dan het schijnt. Want ook de voorstander van de schuldoverneming kan niet aan de debiteur de bevoegdheid toekennen om zonder goedvinden van de crediteur de schuld over te dragen... . Het verschil zit dus slechts hierin dat delegatie tot stand komt door samenwerking van crediteur, oude en nieuwe debiteur, terwijl de schuldoverneming tot stand komt door overeenstemming tussen oude en nieuwe debiteur plus de goedkeuring van de crediteur, hetzij op het moment zelf, hetzij tevoren, hetzij achteraf."

201 A 414 of the *BGB*: "Eine Schuld kann von einem Dritten durch Vertrag mit dem Gläubiger in der Weise übernommen werden, daß der Dritte an die Stelle des bisherigen Schuldners tritt."

202 Angersbach (*op cit* n 155) 61; Lücke (*op cit* n 155) 25.

203 Brunner C J H & Hondius E H *Verbintenissenrecht* Vol I (1990) (loose-leaf edition) Kluwer Art 155 (6 2 3 10) aant 3; Bolweg (*op cit* n 200) 400; Jauernig O (herausgegeben von) *Burgerliches Gesetzbuch* 4. Auflage (1987) C H Beck München 414.

able to revert to the buyer in the event of the bank failing to perform. This is in conflict with the general mercantile understanding of documentary credits.

Dutch law, however, also recognizes the institution *versterkende schuldoverneming* or *schuldtoetreding*:

> "Is er van deze rechtsfiguur sprake, dan vindt geen overgang van de schuld plaats, maar komt er voor dezelfde schuld naast de oorspronkelijke schuldenaar een nieuwe schuldenaar bij; beiden zijn jegens de schuldeiser hoofdelijk aansprakelijk."[204]

The same concept (*Schuldbeitritt*) is also known in German law.[205] This construction, by retaining the obligation of the buyer, is better suited to the documentary credit. As such it has received the support of several commentators.[206] The theory must nevertheless be rejected for violating the independence principle. The bank issuing a documentary credit does not take up "dezelfde schuld" as would be the case under this theory, but its own, separate and independent obligation.[207]

Finally, it may be noted that the related *Erfüllungsübernahme* theory propagated by the early German commentator Ritter,[208] is even less tenable. The difference between *Erfüllungsübernahme* and *Schuldübernahme* is explained as follows by Westermann:

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204 Brunner & Hondius (*op cit* n 203) a 155 (6 2 3 10) aant 3. The authors also use the terms *cumulatieve schuldoverneming* and *onvoltooide schuldoverneming*. See also Cahn (*op cit* n 159) 58 who with reference to a 1453 of the *BW* commented as follows: "In de Nederlandsche literatuur word delegatie vaak slechts behandeld als een vorm van schuldvernieuwing. Haar betekenis is echter uitgebreider. Men kan onderscheiden de délégation parfaite, waarbij de oorspronkelijke schuldenaar wordt ontslagen en welke dus schuldvernieuwing medebrengt, en de délégation imparfaite, waarbij de schuldeischer zich zijn rechten tegen den ouden debiteur voorbehoudt en er dus slechts een nieuwen schuldenaar bij krijgt. See also De Rooy (*op cit* n 160) 92-93 who distinguishes between *volkomen delegatie* and *onvolkomen delegatie*.

205 Jauernig (*op cit* n 203) 414; Westermann H P (herausgegeben von) *Handkommentar zum Bürgerlichen Gesetzbuch* 1. Band 7. Auflage (1981) Aschendorffse Verlagsbuchhandlung Münster 914 who also uses the term "kumulative Schuldübernahme".

206 This is the view favoured by Cahn (*op cit* n 159) 59. According to De Rooy (*op cit* n 160) 93 n 23 the theory has also found the support of Wolfsbergen, Hamel, Marais and Nasser.

207 Angersbach (*op cit* n 155) 61; Lücke (*op cit* n 155) 25.

208 Ritter C "Vom Akkreditiv" (1921) 4 *Hanseatische Rechts-Zeitschrift* 609 616. Raith (*op cit* n 192) 117 and Lücke (*op cit* n 155) 25 ascribe the theory to Jacoby.

> "Erfüllungsübernahme bedeutet eine nur dem Schuldner gegenüber begründete Pflicht, ihn von seiner Schuld zu befreien oder doch dafür zu sorgen, daß er vom Gläubiger nicht in Anspruch genommen wird... Im Gegensatz zur Schuldübernahme und zum Schuldbeitritt ... erhält der Gläubiger keine Rechte aus der Erfüllungsübernahme."[209]

In addition to the considerations for rejecting the *Schuldübernahme* theory which are equally applicable here, the bank in terms of the *Erfüllungsübernahme* would only be bound to perform *vis a vis* its client; the beneficiary-seller would acquire no right against the bank. This is clearly not in accordance with the intentions of the parties to a documentary credit.[210]

Acceptance in Advance

Another theory advanced in the Continental literature is that the documentary credit is to be regarded as an acceptance in advance by the issuing bank of a bill of exchange to be drawn on it by the beneficiary.[211] This theory is related to the doctrine of virtual acceptance as encountered in Anglo-American law.[212]

There are several compelling reasons why this theory should be rejected.[213] In the first place an acceptance is required by statute to be written on the bill itself[214] and to be unconditional.[215] The theory furthermore only covers acceptance credits and cannot account for payment credits.[216] Finally, the

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209 (*Op cit* n 205) 816. The concept is created in par 329 of the *BGB*: "Verpflichtet sich in eine Vertrage der eine Teil zur Befriedigung eines Gläubigers des anderen Teiles, ohne die Schuld zu übernehmen, so ist im Zweifel nicht anzunehmen, daß der Gläubiger unmittelbar das Recht erwerben soll, die Befriedigung von ihm zu fordern."

210 Angersbach (*op cit* n 155) 60; Raith (*op cit* n 192) 117.

211 Lücke (*op cit* n 155) 28 who ascribes the *Vorwegerteiltes Wechselakzept*-theory to the French commentator Rousseau and early decisions of the Cour de Paris (1922-1927). See also De Rooy (*op cit* n 160) 94.

212 See on this doctrine par 2 4 3 above.

213 See in this regard De Rooy (*op cit* n 160) 94-95.

214 See a 25 of the *Geneva Uniform Law on Bills of Exchange and Promissory Notes* (*GULB*). In the Netherlands a 124 of the *Wetboek van Koophandel* (*WVK*) furthermore lays down a specific form for an acceptance not met in a documentary credit.

215 A 26 of the *GULB*.

216 Lücke (*op cit* n 155) 29. This reason for rejecting the acceptance in advance theory is all the more compelling in continental Europe where acceptance credits are less popular than in the common-law jurisdictions.

concept of an acceptance of a bill still to be drawn is rather forced. The documentary credit may of course be an undertaking or a promise by the issuing bank to accept such bill, but a promise or undertaking to accept cannot be equated to acceptance itself.[217]

Treuhandvertrag

According to this theory, which is ascribed to the early German commentator Jacobsohn,[218] the bank plays the role of a mediator (*Schiedsrichter*) between the buyer and seller. Angersbach explains as follows:

> "Hierbei handele es sich nicht um ein fiduziarisches Rechtsverhältnis, sondern die Akkreditivbank sollte eine Art Schiedsrichterstellung zwischen Käufer und Verkäufer einnehmen. Der Vertrag werde von der Bank einerseits und vom Käufer und Verkäufer andererseits geschlossen, wobei es Zufall sei, daß nur der Käufer mit der Bank in Verbindung trete."[219]

The theory must be rejected for not being in accordance with the expectations of the parties. The seller is not interested in becoming involved in the opening of the credit. This is an obligation of the buyer to the seller in terms of the contract of sale. The bank therefore does not play any mediatory role; to the contrary it serves solely the interests of its client, the buyer. From the point of view of the seller the bank simply assists its client to comply with its obligations under the contract of sale; the bank is the *Erfüllungsgehilfin des Käufers*.[220]

The theory must in any event also be rejected for being in conflict with the principle that the bank's obligation is independent from the sale underlying the documentary credit.[221]

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217 See also par 2 4 3 above.

218 Angersbach (*op cit* n 155) 54; Lücke (*op cit* n 155) 24; Wiele (*op cit* n 155) 33; Raith (*op cit* n 192) 117.

219 Angersbach (*op cit* n 155) 54-55.

220 Angersbach (*op cit* n 155) 55.

221 Lücke (*op cit* n 155) 24.

Kreditauftrag

The theory that the documentary credit may amount to a *Kreditauftrag* as envisaged in paragraph 778 of the *BGB* can be traced back to a decision of the Reichsgericht.[222] Paragraph 778 provides as follows:

> "Wer einen anderen beauftragt, im eigenen Namen und auf eigene Rechnung einem Dritten Kredit zu geben, haftet dem Beauftragten für die aus der Kreditgewährung entstehende Verbindlichkeit des Drittens als Bürge."

Applied to the documentary credit this theory entails that the buyer requests the bank to extend credit to the seller and binds himself as surety for the repayment thereof. The theory has been generally rejected.[223] The bank does not grant the seller, whom it very often does not even know, any credit. According to this theory the bank would be the creditor of the seller. This would violate the whole object of the documentary credit which is that the seller should have a right against the bank, that is that the seller should be the bank's creditor and not the bank's debtor.

5 4 3 Contemporary Dutch Theories

Introduction

As evident from the above discussion Dutch commentators have struggled to find in their law a theoretical framework capable of explaining the nature of the bank's obligation under a documentary credit satisfactorily. In 1967 Pabbruwe commented as follows:

> "[S]inds het ontstaan van het accreditief zijn vele pogingen ondernomen om de rechtsgeldigheid van de overeenkomst te verklaren, sonder dat deze pogingen echter ooit tot een opinio communis hebben geleid."[224]

It is clear from the work of more recent commentators that this is still very much the case today.[225] Contemporary commentators on the whole support one

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222 Raith (*op cit* n 192) 117; RGZ 102 155 158.

223 See Wolff "Das Akkkreditiv" (1922) 51 *Juristische Wochenschrift* 770; Angersbach (*op cit* n 155) 56; Lücke (*op cit* n 155) 23; Raith (*op cit* n 192) 117; Wessely (*op cit* n 174) 22.

224 Pabbruwe (*op cit* n 189) 339.

225 See for instance Van Delden (*op cit* n 14) 67-77; Boon (*op cit* n 189) 41; Mertens (*op cit* n 189) 66.

of two theories: (i) the documentary credit is a *sui generis* contract, or (ii) the documentary credit is a unilateral juristic act. Neither, however, is fully satisfactory.

Agreement Sui Generis

The theory that the documentary credit amounts to an agreement *sui generis* has recently been termed "[m]omenteel ... de algemene opvatting".[226] Whether this is indeed the case can be questioned. In any event it is clear that those supporting a *sui generis* contract theory, in some instances have completely different constructions in mind. De Rooy, for example, argues as follows:

> "De rechten en verplichtingen van de ... partijen 'dienen niet langs constructieven weg gevonden te worden maar eenvoudig door na te gaan uit welke behoefte de rechtsfiguur is ontstaan', dus door na te gaan welke eisen de praktijk aan deze figuur stelt."[227]

He then points out that the moment of conclusion of this *sui generis* contract is the moment the documentary credit is dispatched; from this moment the bank can no longer decide not to open the credit or change the conditions under which it is issued.[228] De Rooy accordingly sets the moment of irrevocability earlier than most commentators[229] who regard the receipt rather than the dispatch of the credit as the operative moment. However, as Mertens[230] points out, this aspect of De Rooy's theory is not suggestive of a contract, whether *sui generis* or not, as an acceptance by the beneficiary cannot be construed at this stage. This criticism is sound. De Rooy's theory amounts to recognition of the fact that the bank's liability does not arise from consensus but by operation of law.

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226 Mertens (*op cit* n 189) 66. See too De Rooy (*op cit* n 160) 105. The theory is also supported by Pabbruwe (*op cit* n 189) 339; Bannier F A W, Boll J M, Mijnssen F H J, Rank W A K & De Rooy R E *Betalingsverkeer* (1987) Tjeenk Willink Zwolle 68-69.

227 De Rooy (*op cit* n 160) 98 with reference to "E.M. Meyers in zijn noot bij HR 19 april 1929, NJ 1929, p. 1722."

228 See Mertens (*op cit* n 189) 66 who refers to De Rooy F P *Documentary Credits* (1984) Deventer 82.

229 In this he enjoys the significant support of Del Busto. See n 12 above.

230 (*Op cit* n 189) 67.

Although Mertens agrees in principle that the bank-beneficiary relationship under a documentary credit is to be regarded as a contract *sui generis*, he favours a different construction of this contract to that of De Rooy:

> "Het is echter zeer wel mogelijk ... om het aanbod om een documentair krediet relatie aan te gaan te laten uitgaan van de begunstigde/verkoper. Deze spreekt immers met de koper/opdrachtgever af, dat betaling zal plaatsvinden door middel van een documentair krediet dat moet worden geopend door de koper. Het is zeer wel mogelijk om in die afspraak een aanbod van de begunstigde aan de ... bank(en) te zien, dat door de koper/opdrachtgever als vertegenwoordiger van de begunstigde aan de bank wordt overgebracht."[231]

The buyer, by procuring the issue of the documentary credit to the beneficiary, therefore acts as the agent of the seller-beneficiary. The contract comes into being the moment the bank advises the buyer (seller-beneficiary's agent) that it agrees to open the credit, that is even before the notification of the credit has been dispatched to the beneficiary.

This amounts to the same theory advocated in England by Gutteridge and Megrah.[232] The reasons suggested there for its rejection are equally applicable here.

Unilateral Juristic Act (Supplemented by Agreement)

Boon and Wery both argue that the bank is obligated as a consequence of a unilateral juristic act (*eenzijdige rechtshandeling*).[233] The dogmatic problem encountered in this instance is that article 6 1 1 1 of the NBW provides that

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231 *Ibid.*

232 See n 98 above.

233 Boon (*op cit* n 189) 42; Wery P L "Mr R van Delden, Overzicht van de Handelskoop" 1985 *Rechtsmagazijn Themis* 587-593. There appears to be considerable support for this theory. Mertens (*op cit* n 189) 66 n 36 mentions that apart from Boon and Wery the theory is also supported by Van Delden, Van Empel and Van Huizen. There is also support for this view in Austrian and Swiss legal literature. In this respect Boon cites the Austrian commentator Schönle H "Rechtsprobleme des Dokumentenakkreditivs mit hinausgeschobener Zahlung" 36 (1988) *Oesterreichisches Bank-Archiv* 311-312. See also Ulrich C M *Rechtsprobleme des Dokumentenakkreditivs* Schweizer Schriften zum Handels- und Wirtschaftsrecht Band 126 (1989) Schulthess Polygraphischer Verlag Zürich 150 who regards the opening of the credit as an "einseitige empfangsbedürftige Verpflichtungserklärung". It would appear, however, that the majority view in Switzerland favours the *Anweisung*-theory. See n 269 below.

"[V]erbintenissen kunnen slechts ontstaan, indien dit uit de wet voortvloeit".[234] Commentators are not in agreement as to the precise effect of this provision on the theory under consideration. Boon argues as follows:

> "[A]rt. 6.1.1.1. Nieuw B.W., dat even als art. 1269 B.W. een - gematigd - gesloten stelsel ten aanzien van de bronnen van verbintenissen beoogt te scheppen, heeft tot gevolg, dat de bank *binnen het systeem van het (Nieuw) B.W.* niet aan haar belofte is gehouden."[235]

Boon does not, however, regard this as an insurmountable problem. She argues that it is not necessary to work within the confines of the Code. She regards the bank's obligation as being derived from a rule of the *lex mercatoria*, which applies notwithstanding the provisions of the Code:

> "[D]e onderhavige verbintenis berust op een regel van lex mercatoria en zo'n regel geldt hiertelande ook wanneer hij *niet* in ons interne systeem past."[236]

This viewpoint accordingly accepts the existence of a modern contemporary *lex mercatoria*. Whether such a *lex mercatoria* does in fact exist is, however, by no means established.[237] However, even if its existence is accepted at least one commentator has expressed serious doubt as to whether it could have the effect of nullifying the provisions of the Dutch Code.[238]

Van Delden,[239] on the other hand, takes the view that this construction can be accommodated under the NBW. He refers to article 3 2 2 of the NBW in which some light is cast on the term *rechtshandeling*:

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234 This provision succeeds a 1269 of the BW which provided: "Alle verbintenissen ontstaan of uit overeenkomst of uit de wet."

235 Boon (*op cit* n 189) 42. See also Mertens (*op cit* n 189) 66.

236 Boon (*op cit* n 189) 42. This theory is strongly reminiscent of that advocated by Dolan. See n 130 above.

237 The question whether a modern *lex mercatoria* distinct from national law does in fact exist, has been the centre of a debate for the last 40 years. See par 4 2 1 above. For a Dutch perspective see Van Delden (*op cit* n 14) 69-70, 84.

238 See Van Delden (*op cit* n 14) 70.

239 (*Op cit* n 14) 83.

> "Een rechtshandeling vereist een op een rechtsgevolg gerichte wil die zich door een verklaring heeft geopenbaard."

The term "rechtshandeling" in article 3 2 2 according to Van Delden embraces also the *eenzijdige rechtshandeling*.[240] He then argues as follows:

> "Het in art. 3.2.2. NBW genoemde rechtsgevolg is in dit geval de verbintenis van de bank. Weliswaar is wel gesteld, dat dit in strijd zou zijn met de bedoeling van de NBW-wetgewer, een geslote systeem van verbintenissen te vestigen, en dat daarin niet zouden zijn begrepen verbintenissen, voortvloeiende uit eenzijdige rechtshandelingen, doch zulks blijkt uit art. 6.1.1.1 NBW niet. Dat artikel zegt, dat verbintenissen slechts kunnen ontstaan, indien dit uit de *wet voortvloeit*. Welnu art. 3.2.2 omvat mede eenzijdige rechtshandelingen. Daarin is een verbintenis niet als een der beoogde rechtsgevolgen uitgesloten. Uit de wet (art. 3.2.2) vloeit dus voort, dat verbintenissen ook kunnen ontstaan uit eenzijdige rechtshandelingen."[241]

Van Delden does not, however, view the documentary credit as a simple unilateral juristic act binding the bank. The innovative theory suggested by him is considerably more elaborate.[242] He argues that the relationship between the bank and beneficiary develops in two phases. The first phase, that of the "accreditief-bevestiging, de accreditief-brief (letter of credit), accreditief-mededeling, of het accreditief-advies",[243] contains three elements.

First, the documentary credit amounts to an express unilateral juristic act by the bank directed towards the beneficiary in terms of which the bank is obligated as against the beneficiary to perform in terms of the credit. The bank's obligation arises from the moment of dispatch (*verzending*) of the documentary credit but is subject to the condition that the beneficiary in turn takes up certain obligations.

Secondly, the documentary credit implicitly (*impliciet*) contains an irrevocable offer by the bank to conclude a contract the content of which is contained in the

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240 He refers also to a 3 2 1 (3) in which there is specific reference to an "eenzijdige rechtshandeling".

241 83.

242 For what follows see Van Delden (*op cit* n 14) 67-69.

243 67.

documentary credit. The non-acceptance of this offer is a resolutive condition for the bank's liability from its unilateral act.

In the third place, the documentary credit also contains an irrevocable offer (normally implicitly), that the above contract be governed by the principles of the *UCP*. The non-acceptance of this offer is once again a resolutive condition for the bank's liability from its unilateral act.

The second phase of this relationship is the beneficiary's acceptance of the documentary credit. The acceptance may be constituted in different manners but Van Delden regards the "verrichten van de prestaties door de begunstigde" as the typical one.[244] A contract between the bank and beneficiary comes into existence at this stage. By virtue of this contract the beneficiary becomes obligated to perform (by presenting the necessary documents) and becomes bound by the provisions of the *UCP*.

There is considerable merit in Van Delden's theory in terms of which the bank's unilateral juristic act is later supplemented by an agreement. Especially important is the recognition of the fact that although one may argue that the beneficiary could acquire rights from the unilateral juristic act of the bank, it is inconceivable that the beneficiary may in the same way acquire obligations.[245] In this respect Van Delden recognises two obligations: (i) the beneficiary's obligation to deliver the documents; and (ii) the beneficiary's obligation to accept the provisions of the *UCP* as those governing the credit. It is suggested that Van Delden is wrong in regarding the delivery of the documents as an obligation of the beneficiary.[246] This is not an obligation; it is a condition to be met before the bank is entitled, *vis a vis* its client, and obliged, *vis a vis* the beneficiary, to perform in terms of the credit. However, Van Delden is clearly correct in his argument that the beneficiary can only be bound to the *UCP* by consent.[247] To hold otherwise would imply that the *UCP* applies by operation of law, a proposition which has been rightly and uniformly rejected.[248]

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244 68.

245 91.

246 For an example of an obligation that can be taken up by the beneficiary see n 24 above.

247 See his detailed discussion of this matter at 86-92.

248 See in general the discussion of the legal nature of the *UCP* in chapter 4 above.

5 4 4 Contemporary German Theories

Introduction

The nature of the issuing bank's obligation under a documentary credit has proved to be less controversial in Germany than in the Netherlands. This can be ascribed to the fact that in Germany, despite the period of initial uncertainty evident in the discussion of the early theories, a clear *hersschende Meinung* did in fact emerge in the courts[249] as well as amongst the commentators,[250] to the effect that the documentary credit amounts to an *abstraktes Schuldversprechen*. There is, however, some contemporary support for the theory that the documentary credit amounts to an *Anweisung*. Although the unilateral juristic act (*einseitiges Rechtsgeschäft*) theory discussed above has also been raised in Germany,[251] it has not gained any prominence[252] and is regarded as being precluded by the provisions of the *BGB*.[253] The same holds true for the theory that the documentary credit is a *Rechtsinstitut sui generis*[254] derived from the *lex mercatoria*.[255]

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249 BGH (23. März 1955) 1955 *Wertpapier Mitteilungen* 765 767; BGH (18. September 1958) 1959 *Wertpapier Mitteilungen* 25; BGH (21. März 1973) 1973 *Wertpapier Mitteilungen* 483 484. See also Liesecke R "Das Dokumentenakkreditiv in der neueren Rechtsprechung des Bundesgerichtshofs" 1960 *Wertpapier Mitteilungen* 210 211, as well as "Die neuere Rechtsprechung, insbesondere des Bundesgerichtshofes, zum Dokumentenakkreditiv" 1966 *Wertpapier Mitteilungen* 458 459.

250 Canaris C-W *HGB Staub Großkommentar - Bankvertragsrecht* Vol I 4 ed (1988) Walter de Gruyter Berlin 681 (par 984); Zahn J C D, Eberding E & Ehrlich D *Zahlung und Zahlungssicherung im Außenhandel* 6 Auflage (1986) Walter de Gruyter Berlin par 2/132; Eisemann F & Schütze R A *Das Dokumentenakkreditiv im Internationalen Handelsverkehr* 3. Auflage (1989) Verlag Recht und Wirtschaft Heidelberg 144-145; Lücke (*op cit* n 155) 36-38; Wiele (*op cit* n 155) 52-57; Von Westphalen F Graf *Rechtsprobleme der Exportfinanzierung* 3. Auflage (1987) Verlag Recht und Wirtschaft Heidelberg 256-257; Nielsen (*op cit* n 188) 26; Angersbach (*op cit* n 155) 69-70.

251 See Canaris (*op cit* n 250) 680 (par 982).

252 Canaris (*op cit* n 250) 680 (par 982): "[V]ereinzelt [wird] der Versuch gemacht, die Verpflichtung der Bank aus einem einseitigen Rechtsgeschäft zu erklären."

253 Par 305 *BGB* provides as follows: "Zur Begründung eines Schuldverhältnisses durch Rechtsgeschäft ... ist ein Vertrag zwischen den Beteiligten erforderlich, soweit nicht das Gesetz ein anderes vorschreibt." There is no relevant statutory exception. See Canaris (*op cit* n 250) 680 (par 982).

254 See Boon's theory at n 236 above.

255 Raith (*op cit* n 192) 120.

Abstraktes Schuldversprechen

The *abstrakte Schuldversprechen* is rooted in paragraph 780 of the *BGB* which provides as follows:

> "Zur Gültigkeit eines Vertrags, durch den eine Leistung in der Weise versprochen wird, daß das Versprechen die Verpflichtung selbständig begründen soll (Schuldversprechen), ist, soweit nicht eine andere Form vorgeschrieben ist, schriftliche Erteilung des Versprechens erforderlich."

The *abstrakte Schuldversprechen* is a unilateral obligatory contract (*einseitig verpflichtender Vertrag*)[256] with the special characteristic that the debtor's obligation is divorced from any underlying or causal relationship between the parties. As Westermann explains:

> "Die Besonderheit liegt darin, daß die Leistungspflicht des Schuldners von dem eigentlichen Grund- oder Kausalverhältnis und damit von den sonstigen wirtschaftlichen Beziehungen zwischen den Beteiligten losgelöst (abstrahiert) und selbständig versprochen und anerkannt wird, dh als neue Verpflichtung verselbständigt wird..."[257]

The debtor is obligated by the promise alone. Applied to the documentary credit this construction accordingly allows the bank's obligation towards the beneficiary-seller to be regarded as totally independent of the relationship between the buyer and the seller, as well as of that between the buyer and the issuing bank. The commercial expectation of the independence of the documentary credit is accordingly met by this construction.

The *abstrakte Schuldversprechen* is a contract. It comes into being by an offer followed by an acceptance. The bank's notification to the beneficiary of the documentary credit is regarded as the offer. An express acceptance of this offer by the beneficiary is not required by virtue of the provisions of paragraph 151 of the *BGB*:[258]

> "Der Vertrag kommt durch die Annahme des Antrags zustande, ohne daß die Annahme dem Antragenden gegenüber erklärt zu werden braucht, wenn eine solche Erklärung nach der

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256 Jauernig (*op cit* n 203) 851.

257 Westermann (*op cit* n 205) 1968.

258 Angersbach (*op cit* n 155) 70; Zahn, Eberding & Ehrlich (*op cit* n 250) par 2/133; Canaris (*op cit* n 250) 680 (par 983).

> Verkehrsitte nicht zu erwarten ist oder der Antragende auf sie verzichtet hat. Der Zeitpunkt, in welchem der Antrag erlischt, bestimmt sich nach dem Antrag oder den Umständen zu entnehmenden Willen des Antragenden."

An express acceptance is not neccessary as it is not customary (*nicht Verkehrsüblich*).[259] The acceptance is tacit; the contract becomes operative once the beneficiary has acquired knowledge thereof.[260] Prior to this moment, that is during the period between dispatch and receipt of the documentary credit, the bank may unilaterally revoke the credit as no contract has as yet come into existence.[261] It is accordingly clear that this theory does not allow the credit to be regarded as binding from the moment it is dispatched: receipt is required.

Paragraph 780 further requires a *Schuldversprechen* to be in writing. However, by virtue of the provisions of paragraph 350 of the *HGB*,[262] the bank as *Vollkaufmann* involved in a *Handelsgeschäft* is not bound by this formality.[263] Were it not for this provision the opening of a documentary credit by telex or telegram (a common practice) would not have been able to qualify as an *abstraktes Schuldversprechen*.[264]

Anweisung (Payment Order)

The *Anweisung* is defined as follows in paragraph 783 of the *BGB*:

> "Händigt jemand eine Urkunde, in der er einen anderen anweist, Geld, Wertpapiere oder andere vertretbare Sachen an einem Dritten zu leisten, dem Dritten aus, so ist dieser ermächtigt, die Leistung bei dem Angewiesenen im eigenen Namen zu erheben;

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259 Zahn, Eberding & Ehrlich (*op cit* n 250) par 2/133.

260 Angersbach (*op cit* n 155) 70: "[D]as Schuldversprechen der Bank [wird] durch Schweigen des Begünstigten wirksam".

261 Par 130 *BGB*. See also Zahn, Eberding & Ehrlich (*op cit* n 250) par 2/133; Canaris (*op cit* n 250) par 680-681 (par 983).

262 "Auf eine Bürgschaft, *ein Schuldversprechen* oder ein Schuldanerkenntnis finden, sofern die Bürgschaft auf der Seite des Bürgen, das Versprechen oder das Anerkenntnis auf der Seite des Schuldners ein Handelsgeschäft ist, die Formvorschriften des § 766 Satz 1, des § 780 und des § 781 Satz 1 des Bürgerlichen Gesetzbuch keine Anwendung." (My italics.) See generally on par 350 Glanegger P, Niedner H J, Renkl, G & Ruß W *HGB Handelsrecht Bilanzrecht Steuerrecht* 2 ed (1990) Müller Heidelberg 1125-1126.

263 Canaris (*op cit* n 250) 681 (par 985); Angersbach (*op cit* n 155) 70; Liesecke (*op cit* n 249 "Das Dokumentenakkreditiv in der neueren Rechtsprechung des Bundesgerichtshofs") 211.

264 Canaris (*op cit* n 250) 681 n 106 (par 985).

der Angewiesene ist ermächtigt, für Rechnung des Anweisenden an den Anweisungsempfänger zu leisten."

The foundation for the *Anweisung* is completed in the very next paragraph which provides: "Nimmt der Angewiesene die Anweisung an, so ist er dem Anweisungsempfänger gegenüber verpflichtet."[265] As to the relationships between the parties two stages can accordingly be identified. Prior to acceptance of the *Anweisung* by the *Angewiesene*, the *Anweisung* is simply a double authorisation (*Doppelermächtigung*). The *Anweisungsempfänger* is thereby authorised to obtain performance from the *Angewiesene* in his own name, and the *Angewiesene* is authorised to perform for the account of the *Anweisende*. After acceptance of the *Anweisung* by the *Angewiesene*, the *Angewiesene* becomes obligated as against the *Anweisungsempfänger* to perform.[266] Two relationships underlie this obligation of the *Angewiesene*: that between the *Anweisende* and the *Anweisungsempfänger* (the *Valutaverhältnis*), and that between the *Anweisende* and *Angewiesene* (the *Deckungsverhältnis*).

Apart from the formal written *Anweisung* under paragraph 783 German law also recognises the *formlose Anweisung*, that is an *Anweisung* not complying with the formalities laid down in paragraph 783.[267] It is in this *formlose Anweisung*,

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265 Par 784 BGB.

266 An unaccepted bill of exchange is a good example of an *Anweisung* in the first stage, while an accepted bill of exchange constitutes an Anweisung in the second stage. However, bills of exchange are regulated in Germany by a separate statute and the provisions of the BGB apply only insofar as they are not in conflict with the *Wechselgesetz*. See Westermann (*op cit* n 205) 1978.

267 Wiele (*op cit* n 155) 33-34 differentiates between the "schriftliche, ausdrücklich in den dispositiven Vorschriften §§ 783 ff. BGB geregelte" and the "von der Rechtswissenschaft entwickelte Anweisung im weiteren Sinne". The concept of a *formlose Anweisung* or an *Anweisung im weiteren Sinne* was recognised by the BGH "unter dem Gesichtspunkt der Vertragsfreiheit". See Angersbach (*op cit* n 155) 63.

rather than its statutory counterpart,[268] that certain commentators seek the theoretical foundation for the documentary credit.[269]

In terms of this theory (i) the seller-beneficiary (*Anweisungsempfänger*) by virtue of the *Anweisung* is entitled to obtain payment in his own name from the bank (*Angewiesene*), and can enforce the claim for payment against the bank if the bank has accepted the *Anweisung*; and (ii) the bank may debit the payment against the account of its client, the buyer (*Anweisende*).

The main attraction of this theory is the well-established abstract nature of the *Anweisung*.[270] The obligation of the *Angewiesene* (bank) towards the *Anweisungsempfänger* (seller-beneficiary) is in principle independent of both the *Deckungsverhältnis* (ie the relationship between the buyer and the bank) and the *Valutaverhältnis* (ie the relationship between the buyer and the seller-beneficiary).[271] However, several commentators argue that the abstract nature

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268 The par 783 *Anweisung*, by requiring an *Anweisungsurkunde* to be delivered by the *Anweisende* to the *Anweisungsempfänger*, cannot accommodate the documentary credit. See Wessely (*op cit* n 174) 24. Angersbach (*op cit* n 155) 63 explains as follows: "Die Anweisung erfordert einen formalen Vertrag zwischen Anweisenden und Anweisungsempfänger. Beim DA [Dokumenten-Akkreditiv] besteht ein solcher überhaupt nicht, denn der Akkreditivsteller wendet sich direkt an die Akkreditivbank und die Zahlungsanweisung gelangt nicht über den Begünstigten an die Bank." The *formlose* or *erweiterte Anweisung* on the other hand does not require an *Anweisungsurkunde* and includes an *Anweisung* "vom Anweisenden unmittelbar an den Angewiesenen gerichtet". See Wessely (*op cit* n 174) 25; Angersbach (*op cit* n 155) 64.

269 In Switzerland the *Anweisungs*-theory is the dominant. See Lücke (*op cit* n 155) 30; Schärrer H *Die Rechtstellung des Begünstigten im Dokumenten-Akkreditiv* (1980) Stämpfli Bern 49-53; Slongo U *Die Zahlung unter Vorbehalt im Akkreditiv-Geschäft* (1979) Theodor Huber Dübendorf 30-32. However, a 466 of the Swiss code defines the *Anweisung* in the following terms (which approximate the German *formlose Anweisung* rather than the provisions of par 783 *BGB*): "Durch die Anweisung wird der Angewiesene ermächtigt, Geld, Wertpapiere oder andere vertretbare Sachen auf Rechnung des Anweisenden an den Anweisungsempfänger zu leisten, und dieser die Leistung von jenem in eigenem Namen zu erheben."

270 Raith (*op cit* n 192) 118: "Was den Einwendungsausschluß betrifft, so ist dieser Vorsschlag durchaus hilfreich." See also Lücke (*op cit* n 155) 30.

271 Par 784 allows "Einwendungen ... welche die Gültigkeit der Ahnnahme betreffen oder sich aus dem Inhalte der Anweisung oder dem Inhalte der Ahnnahme ergeben oder dem Angewiesenen unmittelbar gegen den Anweisungsempfänger zustehen". These would include defences such as the contractual incapacity of the *Angewiesene*, the absence of contractual consensus, set-off and *Rechtsmißbrauch*. See Westermann (*op cit* n 205) 1981. These defences do not affect the independence principle. The view that the phrase "Einwendungen aus dem Inhalte der Anweisung" refers to any defences arising from the relationship between the *Anweisende* and the *Angewiesene* (see Angersbach (*op cit* n 155) 65) must be rejected. The defences allowed under this phrase are only defences "die aus

of the *Anweisung* still does not go far enough,[272] the problem being that the *Angewiesene* is released from the obligation to pay if both the *Deckungs-* and *Valutaverhältnis* are void.[273] Applied to the documentary credit this would have the unacceptable consequence that if both the sale and the contract between the buyer and the issuing bank were void, the issuing bank would not be obliged to perform under the documentary credit.

A further less fundamental objection to this theory concerns the incompatibility of the *Anweisungsrecht* and the provisions of the *UCP* relating to the transfer of the credit.[274] Wiele also raises the objection that the *Anweisung*, by virtue of the provisions of article 790 of the *BGB*, is in principle revocable and therefore not suited to the irrevocable documentary credit.[275] However, as pointed out by Angersbach, this does not pose much of a problem as the article in question would not override an express provision to the contrary in the documentary credit.[276]

5 4 5 Conclusion

As is the case with the common law, the civilian systems have experienced much difficulty in finding a satisfactory theoretical foundation for explaining the relationship of the bank issuing or confirming a documentary credit and the beneficiary thereof. The abstract nature of the relationship, the difficulty to construe a contractual relationship between the parties and the concept of irrevocability are the main problems. The theory that best satisfies the expectations of the business community is the *abstrakte Schuldversprechen* peculiar to German law. The inability of the other systems to explain this relationship satisfactorily has, however, been of very little concern in practice.

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der Urkunde selbst hervorgehen". See Lücke (*op cit* n 155) 32 and Westermann *supra* 1981.

272 Wessely (*op cit* n 174) 25 speaks of the "ungenügende Abstraktheit der Anweisung". See also Angersbach (*op cit* n 155) 65; Lücke (*op cit* n 155) 30-31.

273 Westermann (*op cit* n 205) 1982; Lücke (*op cit* n 155) 31; Wessely (*op cit* n 174) 27. German law takes the view that if both *Deckungs-* and *Valutaverhältnis* are void, the *Anweisungsempfänger* does not have an interest more worthy of protection than the interest of the *Angewiesene* (with no legal right of recovery against the *Anweisende*) not to pay. See in this regard Wessely *supra* 28.

274 Lücke (*op cit* n 155) 31. See in this regard a 48 of the *UCP* and par 792 *BGB*.

275 34.

276 62.

In a passage reminiscent of Harfield's dismissal of the same problem in the common-law jurisdictions,[277] Schärrer concludes as follows:

> "Abschliessend ist aber doch noch einmal auf die recht grosse Unbekummertheit, mit welcher die Praxis derartigen juristischen Einordnungsversuchen gegenübersteht, hinzuweizen. Die Tatsache, dass täglich eine unbekannt grosse Zahl von Dokumenten-Akkreditiven erfolgreich abgewickelt wird, ohne dass je die Frage nach deren Rechtsnatur auftaucht, lässt zwei Schlüsse zu: erstens hat wohl die geltende Regelung in den ERGDA [*UCP*] und in der Praxis tatsächlich einen hohen Grad an Autonomie erreicht, und zweitens hat eine Abklärung der Rechtsnatur des Dokumenten-Akkreditivs, wie sie auch ausfalle, ohne Zweifel nur einen sehr kleinen Erkenntniswert."[278]

The fact remains that the law must eventually adapt itself to commerce: after all "commercial law" as stressed by Holdsworth, "exists primarily to settle mercantile disputes, and not to dictate to the merchants the modes in which they shall carry on their business".[279]

5 5 The UNCITRAL Convention[280]

Although the full name of the Convention (the United Nations Convention on Independent Guarantees and Standby Letters of Credit) suggests that it deals only with standby letters of credit and independent guarantees, it must be borne in mind that the potential scope of applicability is larger due to an "opt-in provision".[281] To be more specific, it is possible also to subject a commercial documentary credit to the provisions of the Convention by an express provision to that effect.

The Convention contains a number of provisions relevant to the relationship between the bank and beneficiary. Article 1(1) provides as follows:

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277 See n 154 above.

278 (*Op cit* n 269) 54. See also Slongo (*op cit* n 269) 25 "[e]s fällt auf, wie wenig sich die Praxis um die rechtlichen Qualifikation der im Dokumenten-Akkreditiv bestehenden Rechtsverhältnisse kümmert"; Van Delden (*op cit* n 14) 83 ("er zal geen rechter te vinden zijn, die een onherroepelijk accreditief ... als niet bestaand of nietig zou verklaren").

279 Holdsworth (*op cit* n 2) 119. See also in general Chorley R S T "The Conflict of Law and Commerce" (1932) 48 *Law Quarterly Review* 51-72.

280 See in general on this instrument par 3 10 3 above.

281 A 1(2). See the discussion in par 3 10 3 above.

> "This Convention applies to an international undertaking referred to in article 2:
> (a) If the place of business of the guarantor/issuer at which the undertaking is issued is in a Contracting State, or
> (b) If the rules of private international law lead to the application of the law of a Contracting State,
> unless the undertaking excludes the application of the Convention."

As is the case under both the current revision of the *UCP*[282] and the revised Article 5 of the UCC,[283] the bank's obligation is expressed as arising from an "undertaking". The undertaking, in turn, is defined as "*an independent commitment*, ..., given by a bank ... to pay to the beneficiary a certain or determinable amount..."[284] It is submitted that the term "independent commitment" is not conclusive in determining whether or not the bank's obligation is contractual. In relation to this question, however, the provisions of article 7 are most instructive:

> "(1) Issuance of an undertaking occurs when and where the undertaking leaves the sphere of control of the guarantor/issuer concerned.
> ...
> (4) An undertaking is irrevocable upon issuance, unless it stipulates otherwise."

In terms of article 7 the bank is accordingly bound in terms of its undertaking from the moment the undertaking leaves its "sphere of control". Although determining this precise moment may hold problems of its own,[285] it is, I submit, clear that article 7 effectively prevents an interpretation that the undertaking is contractual. The fact that the bank is bound from a moment earlier than that upon which the beneficiary learns of the undertaking is clearly in conflict with any consensual model.[286]

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282 Article 9(a). See the discussion in par 5 2 3 above.

283 § 5-102(10). See the discussion in par 5 3 4 above.

284 A 2 (my italics).

285 The interesting question in this regard is whether the undertaking is still within the issuer's "sphere of control" when it has reached the bank designated to advise the beneficiary of the undertaking, but before the advising bank has done so. The answer to this question will depend upon the precise legal relationship between the issuing and advising banks.

286 See Kozolchyk B "The Impact of the UNCITRAL Bank Guarantee, Standby Letter of Credit Convention upon International Commerce and Financial Markets" July 1994 *Letter of Credit Update* 26 27: "The above described features place the Convention's undertaking in a highly select group of independent or 'abstract' promises. Strictly speaking, *these are*

The provisions of the Convention relating to amendments are also of considerable interest in this context. Article 8(2) and (3) provide as follows:

> "(2) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, an undertaking is amended upon issuance of the amendment if the amendment has previously been authorized by the beneficiary.
> (3) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, where any amendment has not previously been authorized by the beneficiary, the undertaking is amended only when the guarantor/issuer receives a notice of acceptance of the amendment by the beneficiary... ."

Unlike the *UCP*[287] and in conformity with the revised UCC[288] the Convention does not differentiate between the moment the bank is bound by an amendment and the moment the beneficiary is bound by it. If the beneficiary has authorised an amendment, the amendment is effective from the moment of its "issuance". In the absence of such authorisation, the amendment is effective from the moment the bank receives a "notice of acceptance" from the beneficiary. However, the bank is able to vary this position, not only by agreement with the beneficiary, but also by unilaterally stipulating otherwise in the initial documentary credit.[289] For instance, in terms of article 8(3), a bank could stipulate unilaterally in a documentary credit that any amendment of it would be effective from the moment it is issued. This, it is suggested, is a somewhat startling possibility. Such a provision would effectively make nonsense of the concept of an *irrevocable* documentary credit. The provisions of the *UCP* in terms of which *a beneficiary*[290] can only be held to the terms of an amended credit as opposed to the original credit if he has consented to the amendment are preferable. Moreover, in the event of both the *UCP* and the Convention applying to a credit, the provisions of the *UCP* are likely to prevail.[291]

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promissory and not contractual undertakings because they bind the promisor regardless of consent or acceptance by the promisee-beneficiary." (My italics.)

287 See par 5 2 3 above.

288 § 5-106(b).

289 See the proviso by which both a 8(2) and (3) are introduced.

290 As opposed to the issuer. See 5 2 3 above.

291 The Convention is silent as to how a conflict between its provisions and those of the *UCP* should be resolved. A 13(1) provides that the "rights and obligations of the guarantor/issuer and the beneficiary arising from the undertaking are determined by the

5 6 The Legal Nature of the Bank-Beneficiary Relationship from a South African Point of View: A Suggested Approach

5 6 1 Introduction

The aforegoing comparative overview has revealed a number of divergent theories as to the proper theoretical foundation for the bank's obligation under a documentary credit. It is further clear that this has been a vexing problem in most jurisdictions. To generalise somewhat, the main problems experienced in the different jurisdictions have centred on (i) the abstract or independent nature of the obligation, and (ii) the irrevocability thereof. In the common-law jurisdictions these problems are further exacerbated by the doctrine of valuable consideration, and in the civil-law jurisdictions by the necessity of bringing whatever theory is advanced within the four corners of some provision of the relevant code. Against this background, the crisp question to be considered in the South African context is whether South African law, unencumbered by the English consideration doctrine or the rigors of a code, is able to provide a satisfactory theoretical basis for the bank's obligation under a documentary credit.

One aspect is perfectly clear: South African law regards the bank-beneficiary relationship as being independent of the underlying buyer-seller relationship. This important principle was established by Goldstone J in *Phillips v Standard Bank of South Africa Ltd*,[292] followed by Streicher J in *Ex Parte Sapan Trading (Pty) Ltd*,[293] and finally entrenched by the Appellate Division (per Scott AJA) in *Loomcraft Fabrics CC v Nedbank Ltd*.[294] The doctrinal foundations for this principle in South African law are reviewed below.[295]

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terms and conditions set forth in the undertaking, including any rules, general conditions or usages specifically referred to therein, and by the provisions of this Convention". That the provisions of the *UCP* should in the case of conflict prevail is to my mind implicit in a 1 which states that the Convention shall not apply where "the undertaking excludes the application of the Convention".

292 1985 3 SA 301 (W) 304B. For a detailed discussion see par 6 5 2 below.

293 1995 1 SA 218 (W) 224A. For a detailed discussion see par 6 5 2 below.

294 1996 1 SA 812 (A) 815G-I. For a detailed discussion see par 6 5 2 below.

295 See par 5 6 2.

In no case, however, has the nature of the bank-beneficiary relationship been analysed thoroughly. There are brief *dicta* in four cases relevant in this context.

(i) In *Lendalease Finance Ltd v Corporacion de Mercadeo Agricola* the Appellate Division (per Corbett JA), with reference to Gutteridge and Megrah, stated:

> "The nature of the relationship created between banker and seller by the issue of a letter of credit is *a matter of considerable difficulty* ... but, whatever it may be, the letter does no more, in a case like the present one, than to provide the seller with the assurance that the buyer will be able and willing to implement his obligations when they become due".[296]

(ii) In the *Phillips* case Goldstone J was less careful in stating:

> "In my opinion the documentary credit issued in this case *does indeed constitute a contract* independent of the contract of purchase and sale".[297]

(iii) Streicher J, in the *Sapan Trading* case, put it thus:

> "Each of the letters of credit *is an irrevocable undertaking by the issuing bank to the beneficiary ... which gives rise to a contract* between the issuing bank and the beneficiary."[298]

(iv) In similar vein Scott AJA stated in the *Loomcraft* case:

> "The system of irrevocable documentary credits is widely used ... . Its essential feature is the *establishment of a contractual obligation* on the part of a bank to pay the beneficiary under the credit".[299]

It would appear from the last three *dicta* that, as is the case in England, our courts have accepted the contractual nature of the bank-beneficiary relationship without attempting to explain aspects such as the manner in and the moment upon which the contract comes into being, or the related question as to the

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296 1976 4 SA 464 (A) 498E (my italics).

297 304B (my italics). See also 302G.

298 223I (my italics). See also Malan F R "Letters of Credit and Attachment ad Fundandam Jurisdictionem" 1994 *Tydskrif vir die Suid-Afrikaanse Reg* 150 153.

299 815G (my italics).

moment of irrevocability. The ability of the South African law of contract to deal with these questions is reviewed below.

In concluding this introduction, however, two points need to be made. First, in investigating the theoretical basis of the bank-beneficiary relationship much can be learned from the comparative overview above. Thus, it would serve little purpose to retread in South African context the ground of the theories already discredited in common-law and civilian doctrine. This investigation is accordingly limited to two questions. (i) To what extent can the bank-beneficiary relationship be explained satisfactorily on the basis of contract - specifically in the sense of the credit constituting an offer by the bank which is accepted by the beneficiary? (ii) Can the South African doctrine relating to trade custom contribute meaningfully towards a proper understanding of the nature of the bank-beneficiary relationship? The other theories, to adopt Goode's words, "fall to the ground because, in an endeavour to produce an acceptable theoretical solution, they distort the character of the transaction and predicate facts and intentions at variance with what is in practice done and intended by the parties".[300]

Secondly, I am inclined to the view that it serves little purpose to attempt, following the example of especially some of the early civilian commentators,[301] to find a single legal institution capable of explaining all the different relationships that arise in the documentary-credit context. In this regard one may, however, take note of Stassen's view that the recognition of the Roman-law concept of non-novatory delegation would go some way towards providing such a framework.[302]

5 6 2 The Documentary Credit: An Offer by the Bank Accepted by the Beneficiary?

Introduction

It has been argued in England that the documentary credit amounts to an offer by the bank to be accepted by the beneficiary. This viewpoint has, however,

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300 (*Op cit* n 129) 987.

301 See par 5 4 1 above.

302 Stassen J C "Driepartybetalingsmeganismes in die Moderne Bankreg: Regsaard van die Verhouding tussen Bank en Begunstigde" 1980 *Modern Business Law* 123-125.

been rejected by most commentators mainly due to (i) the absence of valuable consideration, and (ii) the difficulty of constructing a time and mode of acceptance which does justice to the expectations of the different parties.[303] The extent to which these problems apply also to South African law must accordingly be investigated.

Valuable Consideration, Iusta Causa and the Documentary Credit

Despite early confusion on the point, it has long been clear that the doctrine of valuable consideration does not form part of our law.[304] Historically the role of the consideration doctrine in English law was to distinguish binding promissory transactions from those which were not binding. In Roman-Dutch law this role was played by the doctrine of *iusta causa* or *redelicke oorzaecke*.[305] The classic formulation is that of Grotius who states that "alle toezegginghen die uit eenighe redelicke oorzaecken geschieden ... recht gaven om te eisschen".[306] Thus, in Roman-Dutch law any promise based on a *iusta causa* was enforceable. This does not mean, however, that *iusta causa* must be regarded as

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303 See par 5 3 2 above.

304 This was firmly established by the Appellate Division in *Conradie v Rossouw* 1919 AD 279. The decision cleared up the then prevailing uncertainty due to diametrically opposed decisions in the Cape and Transvaal supreme courts. In the Cape Lord de Villiers had, in a series of decisions, equated the English valuable consideration with the Roman-Dutch concept of *iusta causa*, thereby importing the consideration doctrine into our law. See for instance *Alexander v Perry* (1874) 4 Buch 59; *Mtembu v Webster* (1904) 21 SC 323. In the Transvaal, in *Rood v Wallach* (1904 TS 187), Innes J refused to follow suit. In this he enjoyed the support of Sir John Kotzé as is evident from Kotze's notes to his translation *Simon van Leeuwen's Commentaries on Roman Dutch Law* (1886) Stevens & Haynes London 4 2 13. The full history of this *bellum juridicum* is contained in the comprehensive judgment of De Villiers A J A in *Conradie v Rossouw* 1919 AD 279 298-324. See also Sir John G Kotzé *Causa in the Roman and Roman-Dutch law of Contract* (1922) Juta Cape Town *passim*; Zimmermann (*op cit* n 38) 556-557. The mistake of equating valuable consideration and *iusta causa* appears to have been common also in England. See in this regard Zimmermann *supra* 557 n 79.

305 For an excellent comparative overview of the respective roles of the doctrines of valuable consideration and *iusta causa* see Zimmermann (*op cit* n 38) 549-559.

306 De Groot H *Inleidinge to de Hollandsche Rechts-Geleerdheid (met aanteekeningen van Fockema Andreae SJ)* Deel I (1910) S Gouda Quint Arnhem 3 1 52. For a discussion of different interpretations of this text see Zimmermann (*op cit* n 38) 557-559. See also Malan F R with Pretorius J T & De Beer C R *Malan on Bills of Exchange, Cheques, and Promissory Notes in South African Law* 2 ed (1994) Butterworths Durban 86-87 (par 65); Stassen J C "Causa in die Kontraktereg" (1979) 42 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 357 363-369.

a separate element of a contract.[307] In fact, according to the prevailing theory the *iusta causa* concept has become largely redundant. This is already evident in the watershed decision of the Appellate Division in *Conradie v Rossouw*,[308] the essence of which is rendered as follows in the headnote: "A good cause of action can be founded on a promise made seriously and deliberately and with the intention that a lawful obligation should be established". Thus, in requiring of a contract that it be founded on a *iusta causa*, one is in effect saying no more than that it must have been entered into seriously and deliberately, and must not be unlawful.[309]

The concept of a *iusta causa* has, however, been useful in the context of subsidiary contracts where it serves to explain the relationship between that contract and the main contract underlying it.[310] Thus, in *Froman v Robertson*, Corbett AJA had the following to say in respect of the liability of the drawer of a cheque:

> "In applying the requirements of *justa causa* to the engagements of the drawer, regard must always be had to the special characteristics of a cheque. ... Such an obligation generally arises from some transaction, contractual or otherwise, extraneous to the drawing and issue of the cheque itself but nevertheless constituting the ground or reason therefor. Accordingly, any investigation as to the existence or validity of the *causa* for the engagements of the drawer must necessarily embrace this underlying transaction."[311]

This reasoning that the *causa* for a cheque is the agreement underlying it (for instance a contract of sale) was further entrenched by the Appellate Division in

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307 As argued by Kotzé (*op cit* n 304) 45-46, and is the case in French law (on which see Zimmermann (*op cit* n 38) 553).

308 1919 AD 279.

309 *Saambou Nasionale Bouvereniging v Friedman* 1979 3 SA 978 (A) 990-993; Stassen (*op cit* n 306) 364, 371-372; Joubert D J *General Principles of the Law of Contract* (1987) Juta Cape Town 32; Kerr A J *The Principles of the Law of Contract* 4 ed (1989) Butterworths Durban 146-147. Neither Lubbe G F & Murray C M *Farlam & Hathaway - Contract - Cases, Materials, Commentary* 3 ed (1988) Juta Cape Town, nor De Wet J C & Van Wyk A H *Kontraktereg en Handelsreg*, 5 ed (1992) Butterworths Durban devote any discussion to the topic as a separate requirement.

310 Malan, Pretorius & De Beer (*op cit* n 306) 87-89 (par 65); De Wet & Van Wyk (*op cit* n 309) 90 n 43.

311 1971 1 SA 115 (A) 121H-122A.

Saambou-Nasionale Bouvereniging v Friedman.[312] The implication is that should the underlying agreement for instance be void or be cancelled, the *causa* for the cheque would fall away with the consequence that the cheque itself would be unenforceable. Although the *causa* doctrine is helpful in this type of situation, it is not indispensable. After all, generally speaking, the drawer of a cheque can hardly be said to have undertaken seriously and deliberately to be liable thereon in the event of the agreement underlying it (the *causa*) falling away. It is of course theoretically possible to conceive of such a situation where the drawer has the intention of being liable on the cheque *in abstracto* or without cause. In such a situation the drawer would be liable on the cheque contract which in this instance would not be a subsidiary contract.[313]

What is the bearing of all this on the documentary credit? Although it can be said that the contract of sale, as well as the contract between the bank and its client, gives rise to the eventual undertaking of the bank towards the seller-beneficiary under a documentary credit, it is of fundamental importance to note that neither of these agreements underlies the documentary credit in the same sense as for instance a contract of sale underlies a cheque given in payment of the purchase price. As noted above, the bank's undertaking towards the beneficiary of a documentary credit is totally independent of the contract of sale.[314]

The assumption of such an obligation *in abstracto* or without cause does not pose any problem for the theory of the South African law of contract. As noted above such an obligation, although unusual, is theoretically possible in the case of a cheque.[315] In the case of a documentary credit it is, however, a *sine qua non* conforming with the intention of all the parties. The documentary credit is therefore not a subsidiary agreement.[316] The question is simply whether the

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312 1979 3 SA 978 (A) 991F-G.

313 Malan, Pretorius & De Beer (*op cit* n 306) 87 (par 65). See also *Tobacco Manufacturers Committee v Jacob Green & Sons* 1953 3 SA 480 (A) 492H-493A; *De Jager v Grunder* 1964 1 SA 446 (A) 463C-464H.

314 See a 3(a) of the *UCP* and in general the discussion in par 5 2 2 above.

315 See n 313 above.

316 In *Lendalease Finance (Pty) Ltd v Corporacion de Mercadeo Agricola* 1976 4 SA 464 (A) 498F Corbett JA stated: "the letter does no more ... than to provide the seller with the assurance that the buyer will be able and willing to implement his obligations". This

bank seriously and deliberately intended to be liable, and whether the undertaking was lawful.

From the aforegoing one may conclude that neither the English doctrine of valuable consideration, nor its Roman-Dutch equivalent of *iusta causa*, poses any problem to the theory under consideration.

Acceptance of the Offer and the Moment of Irrevocability

If the documentary credit is to be regarded as an offer by the bank, how and when is it accepted? The answer to this question is clearly important in order to determine the moment from which the bank is bound as against the beneficiary. In this context South African law is faced with very much the same problems as are encountered in England.

There is, however, another matter requiring careful consideration. The documentary credit is normally a so-called *irrevocable* credit. How does this irrevocability arise? Theoretically there are two possible answers: (i) the offeror may be bound by his unilateral declaration that the offer is irrevocable; or (ii) the offeror can only be bound not to revoke contractually, that is by the acceptance of his offer not to revoke.[317] In England it is trite that a unilateral declaration of irrevocability cannot bind the offeror.[318] In South Africa, however, the position is less clear.

The traditional view in South African law is that an offer, before acceptance thereof, can always be revoked unless the offeror is contractually bound not to do so. It is, in other words, impossible for the offeror unilaterally to render his offer irrevocable. In a passage accepted by Van den Heever J in *Kotze v Newmont South Africa Ltd* as a correct reflection of the South African law,[319] De Wet and Van Wyk argue as follows:

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dictum unfortunately conveys an impression of subsidiarity. It is unlikely that this was his intention. However, if it was, it is, I respectfully submit, clearly wrong.

317 For a concise survey of the approach of various foreign jurisdictions to this question see Zeffertt D "Some Thoughts on Options" (1972) 89 *South African Law Journal* 152 153-155; Kahn E "Some Mysteries of Offer and Acceptance" (1955) 72 *South African Law Journal* 246 272.

318 This is precluded by the consideration doctrine (there being no consideration for the irrevocability). See Guest A G (ed) *Chitty on Contracts Vol 1 General Principles* 26 ed (1989) Sweet & Maxwell London 89; *Dickenson v Dodds* (1876) 2 Ch 463 472.

319 1977 3 SA 368 (NC) 374E-G.

> "Omdat die aanbod as aanbod steeds herroeplik is, spreek dit vanself dat 'n aanbod deur eensydige optrede van die aanbieder nie onherroeplik gemaak kan word nie. Selfs al sou die aanbieder sê 'Ek bied jou my perd vir R100 aan, en onderneem om hierdie aanbod nie voor die einde van die maand te herroep nie' is sy verklaring nog hoogstens 'n aanbod. 'n Aanbod kan egter by wyse van ooreenkoms onherroeplik gemaak word. A bied sy perd aan B te koop aan vir R100 en bied aan om die aanbod vir 'n bepaalde tyd nie te herroep nie, B neem hierdie tweede aanbod aan. A is dan kragtens ooreenkoms gebonde om die eerste aanbod nie te herroep nie."[320]

In the same vein, shortly after the *Newmont* case, the Transvaal Provincial Division in *Anglo Carpets (Pty) Ltd v Snyman* termed the principle that an offer can always be revoked before the acceptance thereof "trite" and the mere statement that an offer is irrevocable "ineffective".[321]

This line of reasoning, however, has born the brunt of the sustained criticism of Christie who takes the view that a unilateral declaration by an offeror that the offer is irrevocable is effective in South African law.[322] Christie's argument, by his own admission, is not founded on theory but stems from case law.[323] His point of departure is the case *Rose and Rose v Alpha Secretaries Ltd* in which the following letter had to be interpreted: "This serves to place on record that we have agreed to purchase from you ... [certain shares at a certain price] on the 14th August, 1946. Should you not desire to sell the shares to us at this price and on the date specified, the option is entirely with you."[324] Greenberg JA regarded the letter as "an offer by the purchaser with an obligation to keep the offer open until the 14th August".[325] Christie argues as follows:

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320 (*Op cit* n 309) 33-34. The citation in the *Kotzé* case is to the 3 ed (30) but the passage in question has remained identical. See also Van der Merwe S, Van Huyssteen L F, Reinecke M F B, Lubbe G F & Lotz J G *Contract - General Principles* (1993) Juta Cape Town 55-56; Lubbe & Murray (*op cit* n 309) 73-74.

321 1978 3 SA 582 (T) 585G-H.

322 See Christie R H *The Law of Contract in South Africa* (1981) Butterworths Durban 43, and 2 ed (1991) 56-57.

323 "Perhaps this is one of those situations where the view of the courts may be accepted and welcomed without too close an inquiry into its theoretical foundation." (Christie (*op cit* n 322 2 ed) 57.)

324 1948 1 SA 454 (A) 457.

325 460.

> "How this 'obligation to keep the offer open' was created is not stated in the judgment, but in the context it is clear that it was not a normal contractual obligation created by the acceptance of an offer to keep the offer open. It must therefore have been envisaged by the Appellate Division as an obligation created by the offeror's unilateral declaration... ."[326]

In support of his contention that an offer can by unilateral declaration of the offeror become irrevocable, Christie further cites *Phillips v Aida Real Estate (Pty) Ltd.*[327] The case was concerned with a written offer, paragraph 16 of which was a declaration that the offer would be irrevocable for a period. The purpose of this paragraph, states the court, was to "bind the offeror to keep his offer open for the period stated therein".[328] Hence, so Christie reasons, the offeror is bound by his unilateral declaration not to revoke the offer during this period.

This interpretation is not shared by other contract lawyers. Apart from the authorities already referred to in this respect,[329] Kahn,[330] Beinart,[331] Zeffertt,[332] Kerr[333] and Kritzinger[334] are all of the opinion that an offer can only become irrevocable by contract. Kritzinger, who deals specifically with Christie's argument, contends that it is based upon a misunderstanding of the *Rose* and *Phillips* decisions. In the *Rose* case, so argues Kritzinger, the court regarded the letter quoted as "the written record of a prior agreement", and therefore that there was "nothing whatever in the judgment to suggest that the obligation to keep the offer open arose in any way other than 'a normal contractual

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326 Christie (*op cit* n 322 2 ed) 57.

327 1975 3 SA 198 (A).

328 207G.

329 See n 320 above.

330 (*Op cit* n 317) 272.

331 Beinart B "Offers Stipulating a Period for Acceptance" 1964 *Acta Juridica* 200.

332 Zeffertt (*op cit* n 317) 156.

333 Kerr A J "Offers, Offers Said to be Irrevocable, Options, Rights of Pre-emption, and Double Sales" (1981) 98 *South African Law Journal* 6 12.

334 Kritzinger K M "The Irrevocable Offer" (1983) 100 *South African Law Journal* 441 449.

obligation, created by the acceptance of an offer to keep the offer open'."[335] The *Phillips* decision, according to Kritzinger, is likewise misinterpreted by Christie. In this respect he quotes the following *dictum* from the judgment: "When the seller receives the offer he accepts the right granted to him, viz. to exercise the 'option' at any time within the period stated in para. 16."[336] Hence, so argues Kritzinger, acceptance was an express requirement and the obligation not to revoke accordingly arose from contract.

This criticism appears to me to be well founded. However, Christie[337] argues that his view has recently gained some impetus from the decision *Building Material Manufacturers Ltd v Marais NO*.[338] The relevant *dictum* reads as follows:

> "[Daar] is namens verweerder aangevoer ... dat geen onherroeplike aanbod tot stand gekom het nie. Die rede hiervoor ... was dat eiser nie vir verweerder in kennis gestel het dat hy die aanbod om 'n onherroeplike aanbod te maak, aanvaar het nie. ... Na my mening was dit *nie die bedoeling van die partye* dat eiser eers vir verweerder in kennis moes stel dat die aanbod aanvaar word aleer die onherroeplikheid van die aanbod tot stand sou kom nie. *Eiser het dit duidelik gestel dat enige aanbod om aandele te neem, onherroeplik moes wees.* Hy het verweerder in kennis gestel dat slegs 'n onherroeplike aanbod om aandele te neem, oorweeg sou word. ... *Dit was nooit beoog deur die partye* dat eiser eers moes antwoord om te sê dat hy die onherroeplikheid van die aanbod aanvaar nie. 'n Onherroeplike aanbod het tot stand gekom toe die aansoekvorm deur eiser ontvang is. Kyk verder in hierdie verband Christie... ."[339]

This *dictum*, it is suggested, does not support Christie at all. The entire reasoning of the court appears to me to be that the irrevocability of the offer is based on consensus (hence the reliance on the fact that the plaintiff had made quite clear that only an irrevocable offer would be considered). The thrust of the *dictum*, it is suggested, is that the defendant's offer to take up the shares, was at the same time an acceptance of plaintiff's invitation (offer) to make an

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335 (*Op cit* n 334) 447.

336 1975 3 SA 198 (A) 207G.

337 (*Op cit* n 322 2 ed) 57.

338 1990 1 SA 243 (O).

339 248I-249C (the italics are mine).

irrevocable offer. The only discordant note to this construction is the final reference to Christie.

It is accordingly suggested that the *Kotzé* and *Anglo Carpets* decisions correctly reflect the South African positive law, and that an offer cannot by the unilateral declaration of the offeror become irrevocable. The necessary implication of this state of affairs is that the "irrevocable" documentary credit, if it is to be regarded as an offer, can, as in English law, only truly be irrevocable once accepted.

This brings me to the problem of ascertaining the manner and moment of acceptance. In this respect the first point to be made is that the general rule in the South African law of contract is that a contract comes into existence at the moment and place the offeror learns of the acceptance of his offer. This rule, known as the information theory, is explained as follows by Kahn:

> "Acceptance takes place only when it reaches the mind of the offeror. The basis is the need for mutuality of wills for contracting, requiring - according to the proponents of this theory - actual knowledge of the offeree's will by the offeror."[340]

It is abundantly clear though that the information theory is unsuited to documentary credits. The beneficiary does not inform the bank that he accepts the credit; in reliance on it he simply proceeds to arrange for the manufacture, procurement or shipment of the goods. This, however, is not fatal to the theory under consideration as it has been well established that there are exceptions to the general rule. "It is trite", states Van Blerk JA in *Driftwood Properties (Pty) Ltd v McLean,* "that an offeror can indicate the mode of acceptance whereby a *vinculum juris* will be created, and he can do so expressly or impliedly."[341] Grotius, the Roman-Dutch authority most often referred to in this context differentiates as follows between two different types of offers:

> "It is certain that we can formulate a promise in either of two ways: 'I wish that my promise shall take effect at the moment of acceptance,' or, 'I wish that my promise shall take effect at the

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340 Kahn (*op cit* n 317) 255. See also Lubbe & Murray (*op cit* n 309) 28; Joubert (*op cit* n 309) 40.

341 1971 3 SA 591 (A) 597D. See also *Rex v Nel* 1921 AD 339 344, 351-352; *McKenzie v Farmers' Co-operative Meat Industries Ltd* 1922 AD 16 22; *Smeiman v Volkersz* 1954 4 SA 170 (C) 176F-G; *Orion Investments (Pvt) Ltd v Ujamaa Investments (Pvt) Ltd* 1988 1 SA 583 (ZSC) 588A-591E. See further De Wet & Van Wyk (*op cit* n 309) 39.

> moment I know of its acceptance.' The presumption is that the promise is in accordance with the latter condition if the offeror in return stipulates for something from the offeree. But in the case of purely gratuitous promises the presumption will more readily be in accordance with the first condition unless there is something which indicates a contrary intention."[342]

With reference to the first possible construction offered by Grotius the question arises as to what must be understood by the "moment of acceptance". Is a mental acceptance sufficient, or is it necessary that the mental acceptance must in some way be manifested outwardly? Grotius himself does not provide a clear answer. The question has, however, been specifically addressed in the context of postal contracts. Having reviewed the different possible theories[343] as to the moment such contracts may come into existence, Kotzé JP, in the *Cape Explosive Works* cases,[344] rejected the information theory as being "open to practical difficulties" and then continued as follows:

> "[T]here [is] reasonable ground for holding that, as soon as the acceptance was *evidenced* by the posting of a letter of acceptance, it may be urged that there was a *consensus ad idem placitum* - the parties had come to an agreement. And I say *evidenced*, because in the practical concerns of human intercourse, and transactions, there must be some open manifestation of the exercise of his will by the acceptor, for if subsequent litigation were to arise, the matter would, otherwise, be left to the mere pleasure of the offeree to say 'I accepted the offer,' or 'I did not accept the offer,' whichever may suit him best. Such a state of things is impracticable, if not impossible, in the ordinary business of life."[345]

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342 *De Jure Belli ac Pacis* 2 11 15 as translated in Wessels Sir J W *The Law of Contract in South Africa* 2 ed (1951) (Roberts A A ed) Butterworths Durban 34 par 115. The text is referred to in *inter alia Dietrichsen v Dietrichsen* 1911 TPD 486 494; *Cape Explosive Works Ltd v South African Oil and Fat Industries Ltd; Cape Explosive Works Ltd v Lever Brothers (South Africa) Ltd* 1921 CPD 244 257; *Kergeulen Sealing and Whaling Co Ltd v Commissioner for Inland Revenue* 1939 AD 487 503; *Driftwood Properties (Pty) Ltd v McLean* 1971 (3) SA 591 (A) 597E; *Hawkins v Contract Design Centre (Cape Division) (Pty) Ltd* 1983 (4) SA 296 (T) 301A, 301F.

343 For concise overviews of the declaration, expedition, reception and information theories see Kahn (*op cit* n 317) 254-255; Joubert (*op cit* n 309) 45-46.

344 *Cape Explosive Works Ltd v South African Oil & Fat Industries Ltd; Cape Explosive Works Ltd v Lever Brothers (South Africa) Ltd* 1921 CPD 244.

345 264-265. In an earlier decision *The Fern Gold Mining Company v Tobias* (1890) 3 SAR 134 138, Kotzé CJ, although expressing a preference for the information theory as being "far more logical and scientific", nevertheless declined to choose finally between the information and expedition theories by laying down that "no contract was established until the acceptance has come to the knowledge of the offeror, or at any rate until an answer by means of a posted letter has been sent to the offeror".

This decision subsequently received the blessing of the Appellate Division in *Kergeulen Sealing and Whaling Co Ltd v Commissioner for Inland Revenue*[346] and must now, despite stringent academic criticism,[347] be regarded as settled law. In the case of postal contracts therefore, South African law does not require that the offeror must know of the acceptance. On the other hand, a mere mental acceptance does not suffice; it must be manifested outwardly by the posting of a letter containing the acceptance. In the same vein, in *Rex v Nel*, the Appellate Division laid down that if an order for goods is placed through a messenger, "the offer is accepted not by the delivery but by the despatch of the goods, and the offeror impliedly dispenses with the necessity of the acceptance being communicated to him".[348] Wessels states the general rule as follows:

> "There is no doubt that, as a general rule, our law requires some manifestation of acceptance. An unexpressed consent or *propositum in mente retentum*, is regarded in law as non-existent. ... There must be some express statement which reveals the intention of the offeree to accept the offer or else there must be some act which manifests that intention... ."[349]

Applied to documentary credits one may accordingly argue that the bank becomes bound the moment the beneficiary in some way manifests his acceptance outwardly (for instance by arranging for the manufacture, procurement or shipment of the goods). There is ample authority for such a viewpoint in our case law. Apart from the authorities just considered in this respect, contracts of suretyship provide an interesting analogy. In a series of

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346 1939 AD 487 504. And it was a strong blessing indeed, Stratford C J remarking as follows: "The case was referred for decision to the full Court, it was fully argued and, after lengthy deliberation, the judgment of the Court was delivered by the eminent Judge-President who was a masterly exponent of the Roman Dutch law. We would require potent reasons to induce us to differ from a decision of this kind. No such reasons have been submitted to us nor, after a careful consideration of the judgment, do any suggest themselves to our minds. The decision set at rest a purely theoretical controversy in which apparently the protagonists were, more or less, equal in number and quality". See also *Reid Bros (South Africa) Ltd v Fischer Bearings Co Ltd* 1943 AD 232 241.

347 See De Wet & Van Wyk (*op cit* n 309) 39-40; Joubert (*op cit* n 309) 48.

348 1921 AD 339 344.

349 Wessels (*op cit* n 342) 30 par 105.

cases over a time-span exceeding a century the Cape,[350] Natal[351] and Transvaal[352] courts have all held that communication of the acceptance of a contract of suretyship is not necessary in order to hold the surety liable.[353] The extension of credit facilities to the debtor is regarded as the manifestation of acceptance of the offer.[354]

Applied to the documentary credit this approach cannot accommodate the view favoured by most British commentators that the issuing bank is bound from an earlier moment, viz from the moment the credit has come to the knowledge of the beneficiary. In this respect, however, Kritzinger has developed an interesting thesis. He argues that there are *dicta* in certain cases which suggest that a mere mental acceptance may suffice.[355] He relies *inter alia* on the *dictum* from the *Phillips* case already referred to above:[356]

> "When the seller receives the offer he accepts the right granted to him, viz. to exercise the 'option' at any time within the period... ."[357]

But can this be reconciled with the case law requiring manifestation? These cases, so argues Kritzinger, can all be distinguished "on the grounds that they

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350 *De Villiers v Conradie* (1864) 5 Searle 68 72; *Cullinan v Union Government* 1922 CPD 33 38: "If the Government did the work, that was a sufficient acceptance of defendant's offer, and no communication of acceptance of his offer was necessary."

351 *Evans v Oakes* 1867 NLR 34 36.

352 *Federated Timbers (Pretoria) (Pty) Ltd v Fourie* 1978 1 SA 292 (T) 297A.

353 The decision of Steyn JA in *Volkskas Spaarbank Bpk v Van Aswegen* 1990 3 SA 978 (A) should not be interpreted as overruling the case law mentioned above. Although Steyn JA pointed out that this case law was in conflict with the general principles of contract and declined to follow it, the case before the court did not concern suretyship as such. The question before the court was whether certain correspondence between the parties relating to a prescribed principal debt and the concomitant contract of suretyship, gave rise to a new obligation on the part of the released surety. There being no principal debt, this new obligation (if found to exist) clearly cannot be a contract of suretyship. The court expressly limited its decision to independent as opposed to subsidiary agreements (986J-987A).

354 Joubert (*op cit* n 309) 47 n 85.

355 (*Op cit* n 334) 452. See also Kerr (*op cit* n 309) 83, 91.

356 See n 327.

357 *Phillips v Aida Real Estate (Pty) Ltd* 1975 3 SA 198 (A) 207G.

all related to the acceptance by conduct of *non-gratuitous offers*".[358] This distinction between gratuitous and non-gratuitous offers goes back to the Grotius text already referred to.[359] Grotius distinguishes between two kinds of offers, that is (i) offers where "the offeror in return stipulates for something from the offeree", and (ii) "purely gratuitous promises" or offers which impose no obligation on the offeree if accepted. In the case of the "purely gratuitous promise" one may, according to Grotius, more readily presume that knowledge of the acceptance of the offer is not required. Thus, Kritzinger takes the view that in the case of gratuitous offers "there is nothing in our law which requires an external manifestation of acceptance" and that "a mere mental acceptance" is sufficient.[360]

Applied to documentary credits the bank would according to this theory be bound and the credit would be irrevocable once it has come to the knowledge of the beneficiary and has been accepted mentally by him. However, it must be pointed out that Kritzinger is wrong in stating that all the cases requiring manifestation were concerned with non-gratuitous offers. Some of the surety cases, for example, certainly require manifestation.[361] Furthermore, the remarks of Kotzé JP in the *Cape Explosive Works* cases quoted above[362] are of a very general import, and appear to be equally applicable to gratuitous contracts. It is accordingly suggested that Kritzinger's theory amounts to a radical departure from the existing law and is unlikely to be adopted by our courts.

There is, however, another solution which stays within the parameters of the manifestation requirement. Manifestation, according to Wessels, is the revelation of an intention to accept either by "express statement" or by "some act" of the offeree.[363] It is suggested that "some act" may in specific circumstances include an omission, specifically an omission immediately to reject the offer. Applied to the documentary credit the beneficiary, once

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358 (*Op cit* n 334) 451 (the italics are mine).

359 See n 342 above.

360 452.

361 See especially *Cullinan v Union Government* 1922 CPD 33 38. See also Joubert (*op cit* n 309) 47 n 85.

362 See the text at n 345.

363 See the text at n 349 above.

notified of the credit, manifests his acceptance thereof by not rejecting the bank's offer.

There is substantial support for this approach in the context of options. Beinart argues as follows:

> "It is submitted that there is adequate authority in Roman and Roman-Dutch Law, and in Romanistic jurisprudence generally, to support a rule that where a person makes an offer, undertaking to keep it open or not revoke it for a period ... a valid option is constituted unless the offeree in fact rejects the option. ... The concept of bilaterality of contract should not be driven too far in cases where acceptance would merely be an empty form and a foregone conclusion."[364]

Exactly the same reasoning can be adopted in regard to documentary credits. In fact, it is difficult to conceive of a situation in which Beinart's argument would be more apposite or supported by as good policy considerations.

Conclusion: The Limitations of Contract

From the aforegoing one may conclude that insofar as the documentary credit is to be regarded as an offer by the bank to the beneficiary there are essentially three possible approaches to the questions relating to acceptance and the moment of irrevocability. The first (and conservative) approach, stays within the confines of the recognised general principles of the South African law of contract. In accordance with this approach the bank is contractually bound and the credit irrevocable from the moment upon which the beneficiary's acceptance of the offer is manifested outwardly by some positive act such as starting to arrange for the manufacture or shipment of the goods.

The second (and more liberal) approach ties in with the view of Beinart that in fitting circumstances, silence, or the failure immediately to reject the offer, may be sufficient manifestation of acceptance. Thus, by not rejecting the credit the beneficiary manifests an acceptance. Although this view appears to be the most acceptable, there is, however, little support for it in existing case law.

The final (and most liberal) approach breaks with the established dogma and accepts as correct Kritzinger's contention that in the case of a gratuitous

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364 (*Op cit* n 331) 207 (the italics are mine). A similar view is expressed by Zeffertt (*op cit* n 317) 155-156.

promise (or specifically in the case of a documentary credit), the manifestation of acceptance is not necessary; in other words a mental acceptance will suffice. Thus, once the bank's undertaking has come to the knowledge of the beneficiary, and he has accepted it mentally, the bank is bound and the credit is irrevocable. This construction is comparable to the German *abstrakte Schuldversprechen*.[365]

It is clear, however, that as regards the bank-beneficiary relationship, the South African law of contract cannot be stretched to the extent of explaining the irrevocability of, or holding the bank bound to, a credit which has not yet come to the knowledge of the beneficiary. Insofar as this may be necessary, the basis of such a liability must be sought elsewhere.

5 6 3 The Possible Contribution of Trade Custom[366]

It was noted above that both the new revision of article 5 of the UCC[367] and the UNCITRAL Convention[368] regard the bank's obligation as arising from the moment of dispatch of the credit. It follows naturally that the credit would then be irrevocable from that moment. Although the *UCP* is not entirely clear on this question,[369] Del Busto has suggested strongly that its provisions should be interpreted similarly.[370] Several Dutch commentators have also put forward the view that the bank is bound from the moment of dispatch.[371] It is clear, however, that any theory by which the bank is bound as against the beneficiary from the moment of dispatch cannot be explained on the basis of the South African law of contract. A possible solution in this regard may be to resort to the doctrine of trade custom.

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365 See the text at notes 258 and 259 above.

366 On the term "trade custom" see par 4 6 2 above.

367 See par 5 3 4 above.

368 See par 5 5 above.

369 See par 5 2 3 above.

370 See the the text at n 12 above.

371 See par 5 4 3 above.

The theory of Van Delden provides an apt point of departure. As noted above[372] Van Delden regards the relationship between the bank and beneficiary as arising in two stages: (i) the issuing or confirming of the credit is a unilateral juristic act which binds the bank to both the contents and irrevocability of its promise from the moment of dispatching the credit; and (ii) the promise amounts to an offer which, once accepted by the beneficiary, becomes a contract. Transposed to South Africa the vital question relating to such a theory would be: on what basis is the bank bound (as against the beneficiary) by its unilateral juristic act? The answer, it is submitted, could only be on the basis of trade custom. Put differently: prior to acceptance by the beneficiary the bank is bound to the terms and irrevocability of its promise by operation of law in the sense of trade custom.

There may well be support for this view in the carefully formulated *dictum* of Streicher J in the *Sapan Trading* case:

> "Each of the letters of credit is an *irrevocable undertaking* by the issuing bank to the beneficiary ... *which gives rise to a contract* between the issuing bank and the beneficiary."[373]

The "*irrevocable* undertaking", so Streicher J says, "*gives rise to a contract*". This statement is susceptible to the interpretation that the irrevocability may precede the contract, and therefore not be derived from it. This may well mean that the irrevocability arises by operation of law - more specifically by trade custom. Once the beneficiary has accepted, however, the bank's obligation is purely contractual.

Although, conceptually, this theory is not unattractive, it is doubtful whether a rule holding the bank bound to the beneficiary from the moment of dispatch of the credit meets the requirements for trade custom in South African law. A trade custom, according to the classic exposition by the Appellate Division in *Van Breda v Jacobs*, must be "long established, reasonable, have been uniformly observed, and certain".[374] My reservations in this regard are twofold.

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372 *Ibid.*

373 1995 1 SA 218 (W) 223I (my italics).

374 1921 AD 330 headnote. See further par 4 6 2 above.

First, it is doubtful whether the requirements of uniformity and certainty are met. Although this view has been adopted in the new revision of article 5 of the UCC as well as in the UNCITRAL Convention, it is not inconceivable that these legislative instruments represent an *American* as opposed to an *international* consensus. Certainly, the majority view of *lawyers*[375] in both England[376] and Germany[377] is to the contrary.

In the second place, I am not convinced that the requirement of reasonableness is met. "Reasonable" means, *inter alia*, "endowed with reason", and "not irrational, absurd or ridiculous".[378] It is suggested that it is difficult to find any good reason why a bank should be held to the contents and irrevocability of its promise *as against the beneficiary*, from any time earlier than when the beneficiary acquires knowledge of the credit. If, as may well be the case, banks consider themselves bound from the moment of dispatch of the credit (or confirmation), the logical source of this obligation lies not in the still to be established bank-beneficiary relationship, but in the already established bank-client and inter-bank relationships. One may, for example, argue that it is in the best interests of the issuing bank that its client should not be entitled to order it to revoke the credit once the bank has dispatched it. The administrative and potential legal pitfalls of such a revocation are clearly evident. So viewed the issuing bank has the *right* to refuse to comply with the instructions of its client to revoke the credit, rather than an *obligation* not to revoke it. An obligation not to revoke may however possibly derive from the agreement between the bank and its correspondent. It is by no means inconceivable that the contract of mandate between the issuing bank and its correspondent contains a (tacit) term to the effect that the issuing bank will not reverse its instructions to the correspondent. Such a term will ensure that the correspondent, once instructed, can proceed with the advice or confirmation of the credit to the beneficiary in the confidence that the instructions will not be revoked.

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375 In this regard one must remain mindful of the warning of Sir William Holdsworth that commercial law must accommodate itself to business needs and not *vice versa*. See par 1 1 above.

376 See n 13 above.

377 See par 5 4 4 above.

378 Onions C T (revisor and editor) *The Shorter Oxford English Dictionary* Vol II (1933) Clarendon Press Oxford 1667.

To conclude: it is possible, perhaps even probable, that a documentary credit is "irrevocable" from the moment of dispatch. If so, however, this "irrevocability" is not an irrevocability as against the beneficiary, but an irrevocability as against the client or correspondent. In order to establish this "irrevocability" it is not necessary to resort to the doctrine of trade custom. It stems from an express or tacit term of the contract with the client or correspondent as the case may be.

5 6 4 Conclusion

The few (*obiter*) *dicta* relating to the legal nature of the bank-beneficiary relationship in South African case law (barring that in the *Lendalease*[1] case), clearly favour a contractual approach. This approach is to be welcomed. The above discussion has shown that the South African law of contract is able to provide a satisfactory theoretical framework for the bank-beneficiary relationship which essentially succeeds in giving effect to the commercial expectations of the parties. However, the discussion raises some alternatives. I accordingly conclude this chapter by briefly stating the construction which to my mind appears to be the most satisfactory:

(i) The issuing or confirmation of the credit amounts to an offer by the bank to the beneficiary.

(ii) An express acceptance of this offer by the beneficiary is the exception rather than the rule. The beneficiary manifests his acceptance of the offer tacitly by failing to reject it. From this moment the bank is contractually bound and the credit irrevocable.

(iii) Prior to acceptance of the bank's offer, there is no reason why the bank, as against the beneficiary, should not be entitled to revoke the offer. However, it is possible that the bank may be contractually bound as against its correspondent not to revoke the offer from the moment of dispatching it.

(iv) The contract established in this manner between the bank and the beneficiary is factually related to the contract between the bank and its client (the buyer) as well as to the contract between the buyer and the seller (the beneficiary). However, legally it is independent of both these contracts. The exceptions to this rule form much of the subject-matter of the following chapter.

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1 See n 296 above.

Chapter 6

The Legal Position of the Issuing and Confirming Banks: Defences, Interdicts and Attachments

6 1 Introduction

In general terms it may be said that the obligation of both the issuing and confirming bank towards the beneficiary is to perform in accordance with their respective undertakings against delivery of documents which conform on their face to the requirements stipulated in the credit. A bank's very livelihood is dependent upon it being perceived to honour its obligations. Nevertheless, in certain situations an issuing or confirming bank may decide not to honour a demand for payment by the beneficiary, or refuse acceptance of his bill, due to the existence of some or other defence. It is also possible that the bank may have every intention of honouring the credit but its client wishes to prevent this by obtaining an interdict or by attaching the beneficiary's claim against the bank. It is with these defences, interdicts and attachments that this chapter is concerned.

Any defence originating not from the documentary credit itself, but from the underlying contract of sale, or the contract between the buyer-applicant and his bank, necessarily violates the independence principle. Thus, much of the subject-matter of this chapter concerns the limits and exceptions to the independence principle.

Furthermore, it must be borne in mind that the *UCP* is of very limited assistance in this area. The resolution of these matters is largely, and purposely, left to the different national legal systems.[1] The one exception relates to the defence of non-compliance of the documents. The provisions of the *UCP* in this regard have been discussed above and are briefly referred to in context below.[2]

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1 Jack R *Documentary Credits* 2 ed (1993) Butterworths London 209.

2 See par 3 9 2 above and par 6 2 3 below.

6 2 Civil-Law Perspectives

6 2 1 Introduction

The German law relating to possible defences of and injunctions against the bank is conceptually well developed. As such it forms the point of departure for most aspects of this discussion. The position in other civil-law jurisdictions is briefly referred to on in the context of specific problems.

In Germany the conceivable defences (and bases for injunctions and attachments) are generally categorised with reference to the relationship from which they originate. On this basis it is possible to distinguish between defences arising from (i) the relationship between the bank and the seller-beneficiary (the *Akkreditivverhältnis*), (ii) the relationship between the buyer-applicant and the bank (the *Deckungsverhältnis*), and (iii) the relationship between the buyer-applicant and the seller-beneficiary (the *Valuta-* or *Grundverhältnis*).

Defences arising from the final two categories violate the independence principle. Thus, before discussing the different categories of defences, it is necessary to deal with the theoretical basis or justification for limiting the independence principle.

6 2 2 The Limitation of the Independence Principle

In German law the independent nature of the obligation of the issuing and confirming bank is securely founded, arising as it does from an *abstraktes Schuldversprechen*.[3] Thus, as a general rule, the bank can only rely on defences arising from its promise (the *abstrakte Schuldversprechen* itself)[4] and not on defences arising from the contract between the applicant and beneficiary (the *Grundverhältnis* or *Valutaverhältnis*), or from that between the applicant and the bank (the *Deckungsverhältnis*),[5] or even from both these contracts.[6] To this

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3 See par 5 4 4 above.

4 These defences do not violate the independence principle and are accordingly competent. See par 6 2 3 below.

5 See in general Canaris C-W *HGB Staub Großkommentar - Bankvertragsrecht* Vol I 4 ed (1988) Walter de Gruyter Berlin 688-706 (par 1004-1028); Zahn J C D, Eberding E & Ehrlich D, *Zahlung und Zahlungssicherung im Außenhandel* 6 ed (1986) Walter de Gruyter Berlin par 2/336-344; Eisemann F & Schütze R A *Das Dokumentenakkreditiv im internationalen Handelsverkehr* 3 ed (1989) Verlag Recht und Wirtschaft GmbH Heidelberg 198-201; Mailänder K P "Germany - Blocking of Payments and Protection

general rule, however, there are some exceptions. In Germany these exceptions are based on the concept of abuse of rights (*Rechtsmißbrauch*, *unzulässige Rechtsausübung*) founded on paragraph 242 of the BGB which reads as follows:

> "Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrsitte es erfordern."[7]

This provision (*der Grundsatz von Treu und Glauben*), as a general principle, regulates the entire German legal order. Applied in the context of documentary credits it entails *inter alia* that should the beneficiary's demand for payment be judged not to be in good faith (with due reference to trade usages) the bank may be entitled as against the beneficiary, and obliged as against its client,[8] to refuse payment on the basis of *Rechtsmißbrauch*. In German law the exceptions to the independence principle are all based upon this doctrine of *Rechtsmißbrauch*.

The position in Switzerland is similar. Although in Swiss law the bank's obligation is regarded as an *Anweisung* (the *abstrakte Schuldversprechen* being peculiar to German law) this has but a limited effect on the independence principle.[9] The doctrine of *Rechtsmißbrauch* founded upon the general good

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against Abusive Collection" in *International Bar Association Seminar on Problems of Letters of Credit and Bankers' Guarantees* (8-9 May 1984) Amsterdam 1 15-17.

6 An example of such a situation would be where a buyer who does not have contractual capacity has entered into a contract of sale with the seller and subsequently contracted with the bank for the issuing of a documentary credit. See in this regard Lücke G *Das Dokumenten-Akkreditiv in Deutschland, Frankreich und in der Schweiz - Eine rechtsvergleichende Darstellung* (1976) Christian Albrechts Universität Kiel 186-191.

7 See Rebmann K & Säcker F J (editors) *Münchner Kommentar BGB Schuldrecht Algemeiner Teil* Vol 2 3 ed (1994) C H Beck München. The paragraph is translated as follows in Forrester I S, Goren S L and Ilgen H-M *The German Civil Code* (1975) Fred B Rothman South Hackensack New Jersey 41: "The debtor is bound to effect performance according to the requirements of good faith, giving consideration to common usage."

8 In clear contradistinction to the position under the UCC (see par 6 3 3 below) the bank is obliged *vis a vis* its client to refuse payment if it is entitled, *vis a vis* the beneficiary, to do so. There is no discretion to pay or not to pay. The duty to refuse payment arises from the banker-client relationship. See in this regard Canaris (*op cit* n 5) 702 (par 1024).

9 There is one important difference. In terms of the *Anweisungsrecht* if both the *Valuta*- and *Deckungsverhältnis* were to be defective (as would be the case where the buyer-applicant lacked contractual capacity) the bank would not be bound. See in this regard Lücke (*op cit* n 6) 187 and the discussion in par 5 4 4 above.

faith provision in the Swiss code[10] is recognised as the basis upon which the exceptions to the independence principle should be founded.[11]

In the Netherlands there are divergent views. Some commentators allow a defence or injunction as a *rechtsmiddel tegen misbruik* arising from the requirement of good faith.[12] Others, as appears to be the position in France,[13] found the exceptions on the principle *fraus omnia corrumpit*.[14] Finally, there are those who do not admit any exceptions to the independence principle and argue that all defences (or injunctions) must derive from the documentary credit itself.[15]

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10 See a 2 which reads: "Jedermann hat in der Ausübung seiner Rechte und in der Erfüllung seiner Pflichten nach Treu und Glauben zu handeln. Der offenbare Mißbrauch eines Rechtes findet keinen Rechtsschutz." (I used the text Egger A, Escher A, Haab R & Oser H (eds) *Kommentar zum Schweizerischen Zivilgesetzbuch* I. Band (1930) Schultheß & Co Zürich.)

11 Schärrer H *Die Rechtsstellung des Begünstigten im Dokumenten-Akkreditiv* (1980) Dissertation Universität Bern Stämpfli & Cie Bern 134; Lücke (*op cit* n 6) 173.

12 Croiset van Uchelen A R J "Rechtsmiddelen tegen Misbruik van Bankgaranties en Documentaire Kredieten - Een Pleidooi voor het Derdenbeslag" (6 mei 1989) 5915 *Weekblad voor Privaatrecht, Notariaat en Registratie* 269; Pabbruwe H J "De Overeenkomst Bank - Begunstigde bij het Onherroepelijk Documentair Crediet" (vervolg) (26 aug 1967) 4959 *Weekblad voor Privaatrecht, Notariaat en Registratie* 325.

13 See the Canadian case *Bank of Nova Scotia v Angelica Whitewear Ltd* (1987) 36 DLR (4th) 161 (SCC) 175. See also Lücke (*op cit* n 6) 173, 184.

14 Ebbink R E "Uitzonderingen op de Betalingsplicht van de Bank onder het Documentair Crediet" (28 juli/4 aug 1984) 5705 *Weekblad voor Privaatrecht, Notariaat en Registratie* 433 434; Boon M N *Het Documentair Accreditief - De Rechtspositie van de Opdrachtgever ingevolge de UCP* (1988) Nederlands Instituut voor het Bank- en Effectenbedrijf Publikatiereeks 66 524.

15 See Van Delden R *Betalingsverkeer (Documentair Krediet/Documenten)* (1990) Kluwer Deventer 116-117; Mertens R F H "De Rechtsverhoudingen tussen Partijen bij het Documentair Krediet (Accreditief)" in Bossers G F M, Ringeling A R O & Tratnik M (eds) *Cinco Ana Na Caminda - Opstellen Aangeboden ter Gelegenheid van het Eerste Lustrum van de (Faculteit der Rechtsgeleerdheid van de) Universiteit van Aruba* (1993) Aruba 55 68-69. See also Ebbink (*op cit* n 14) 434.

6 2 3 Defences Arising from the Bank-Beneficiary Relationship (The *Akkreditivverhältnis*)

Introduction

A defence arising from the relationship between the bank and beneficiary does not violate the independence principle and is not, therefore, based on the *Rechtsmißbrauch* doctrine. In this regard Canaris distinguishes between: (i) defences arising from invalidity of the bank's undertaking (*Gültigkeitseinwendungen*); (ii) defences arising from the content of the bank's undertaking (*inhaltliche Einwendungen*); and (iii) defences extraneous to the contract but arising from the relationship between the bank and beneficiary (*unmittelbare Einwendungen*).[16]

No Enforceable Agreement (Gültigkeitseinwendungen)

The bank's undertaking is invalid if it is unlawful. The example most often cited in this regard is where the payment would be in violation of exchange-control legislation.[17] The Dutch commentator Pabbruwe[18] regards this simply as an application of the defence of *vis major*. It is also conceivable that a bank could raise the defence that it was not validly represented, where, for example, the bank official who issued the credit was not authorised to do so and the bank was unaware of his actions.[19] A material error could also provide the basis for a defence. The examples referred to include the issue of the credit to the wrong

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16 (*Op cit* n 5) 690 (par 1007-1009).

17 Wessely W *Die Unabhängigkeit der Akkreditivverpflichtung von Deckungsbeziehung und Kaufvertrag* (1975) C H Beck München 58; Canaris (*op cit* n 5) 690 (par 1007). Schärrer (*op cit* n 11) 126. Note that the question here is not whether the underlying contract is unlawful but whether the bank in complying with its undertaking would be acting unlawfully.

18 Pabbruwe H J "De Overeenkomst Bank - Begunstigde bij het Onherroepelijk Documentair Crediet" (12 aug 1967) 4959 *Weekblad voor Privaatrecht, Notariaat en Registratie* 313 316.

19 Canaris (*op cit* n 5) 690 (par 1007). See also Schärrer (*op cit* n 11) 126 who emphasises, however, that this defence will not often succeed: "der Einwand der nichtrechtmässigen Vertretung dürfte einer Bank nur selten zustehen, da sie sich im Zweifelsfall wohl das Handeln eines << Anscheinvertreters >> anrechnen lassen müsste". See also Wessely (*op cit* n 17) 59.

person (*error in personam*), or for the wrong amount.[20] Thus, essentially, the general principles of the law of contract apply.[21]

A further possibility is that the bank may be entitled to resile from the agreement. For example, under both German[22] and Swiss[23] law, if a beneficiary were to present false documents in an unsuccessful attempt at fraud, the bank would be entitled to resile from the contract, and, it would not be possible to compel the bank to pay even against a subsequent presentation of proper documents.

Defences Arising from the Contract itself (*Inhaltliche Einwendungen*)
This category embraces two main defences. The first is simply that the beneficiary is out of time. Thus, if the documents are presented[24] later than the date stipulated in the credit,[25] the bank is entitled to refuse payment.[26]

The second, and by far the most prevalent, defence in practice is that the documents presented do not comply with the requirements stipulated in the credit. In terms of the *UCP* "[b]anks 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".[27] If

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20 Lücke (*op cit* n 6) 153; Schärrer (*op cit* n 11) 126-127; Wessely (*op cit* n 17) 59. This is the case irrespective of whether the mistake was that of the bank or a transmission error (Wessely *supra*).

21 Canaris (*op cit* n 5) 690 (par 1007).

22 Wessely (*op cit* n 17) 59; Canaris (*op cit* n 5) 690 (par 1007).

23 Schärrer (*op cit* n 11) 126-127.

24 Note that it is the presentation of the documents that must be in time - and not their acceptance by the bank. See Canaris (*op cit* n 5) 684 (par 992).

25 In terms of a 42(a) of the *UCP* a documentary credit must contain an expiry date.

26 Canaris (*op cit* n 5) 690 (par 1008), 683 (par 990); Lücke (*op cit* n 6) 151-152. If the documents are presented to the paying bank before the stipulated date of expiry the presentation is timeous. However, if the presentation is to the advising bank the beneficiary must allow enough time for the documents to be passed on to the issuing bank. This is due to the fact that the paying bank (unlike the advising bank) acts as *Empfangsvertreterin* or *Empfangsbotin* of the issuing or confirming bank. See in this regard Canaris (*op cit* n 5) 678-679 (par 979), 684 (par 992). For a discussion of the Swiss law in this regard (which appears to be identical) see Schärrer (*op cit* n 11) 88-89.

27 A 13(a).

the documents do not comply the bank "may refuse to take up the documents".[28] Whether the documents comply has always been determined with reference to the doctrine of strict compliance (*Grundsatz der Dokumentenstrenge*).[29] Thus, in principle, and subject to exceptions recognised in the *UCP*,[30] if the documents do not comply exactly (strictly) with the credit, the bank is entitled to refuse payment. However, this rule is also subject to the principle of good faith in paragraph 242 of the *BGB*.[31] Thus, if a discrepancy is unimportant and not harmful to the buyer (*unerheblich und für den Auftraggeber unschädlich*) an insistence on strict compliance could constitute a *Rechtsmißbrauch*.[32] Due to the fact that strict compliance is one of the foundations of documentary-credit law and practice, the application of paragraph 242 in this context appears to be limited to extreme cases. The BGH has stated the law in this regard as follows:

> "Dieser Grundsatz der Dokumentenstrenge steht zwar wie jedes Rechtsprinzip unter der Einschrenkung von Treu und Glauben. Hierbei ist aber Zurückhaltung geboten, da die Akkreditivbedingungen anderenfalls ihren Zweck verfehlen. Die Bank darf von den Weisungen ihres Auftraggebers allenfalls abweichen, wenn sie einwandfrei beurteilen kann, daß die Abweichung unerheblich und für den Auftraggeber unschädlich ist."[33]

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28 A 14(b).

29 BGH (19. November 1959) 1960 *Wertpapier Mitteilungen* 38 39; Canaris (*op cit* n 5) 663 (par 945); Nielsen J *Aktuelle Rechtsfragen zum Dokumenten-Akkreditiv* (1984) Kommunikationsforum Recht Wirtschaft Steuern Tagungs- und Verlagsgeselschaft Köln 55.

30 See part D of the *UCP* (aa 20-38) which contains numerous provisions regarding the acceptability of different documents. One of the most important provisions is a 37(c): "The description of the goods in the commercial invoice must correspond with the description in the Credit. In all other documents, the goods may be described in general terms not inconsistent with the description of the goods in the Credit." See also par 3 9 2 above.

31 See par 6 2 2 above.

32 Canaris (*op cit* n 5) 663-664 (par 945).

33 BGH (2. Juli 1984) 1984 *Wertpapier Mitteilungen* 1214 1215. See also BGH (9. Januar 1958) 1958 *Wertpapier Mitteilungen* 291 292. The test is formulated less strictly in another decision of the BGH (19. November 1959) 1960 *Wertpapier Mitteilungen* 38 39: "[D]ie Bank dürfe sich nicht an den buchstäblichen Wortlaut der Akkreditivbedingungen klämmern. Wenn sie ohne Inanspruchnahme von Fachkennern völlig einwandfrei beurteilen könne, daß die Abweichung nicht erheblich und für den Empfänger der Ware unschädlich sei, müsse sie sich selbst über Sinn und Bedeutung der Bedingungen Gedanken machen und die Dokumente für ausreichend erklären, auch wenn sie nicht in allen Einzelheiten den Bedingungen entsprächen." This decision, which simply calls for a

Insisting on strict compliance is accordingly proper even if the discrepancy were to hold the potential of only the slightest detriment to the buyer-applicant.[34]

The position in Switzerland is very much the same. The *Dokumentenstrenge* is tempered by *Treu und Glauben*. Schärrer gives the following examples of non-conforming documents which should be accepted due to the dictates of good faith: (i) the goods are described as "Erdäpfel" instead of "Kartoffeln", or "Herrenpilze" instead of "Steinpilze" (in both instances the Latin name is identical); and (ii) the documentation of a "certificat sanitaire" and "certificat d'inspection" in one instead of two separate documents. In contrast the specific weight of diesel oil at 15 instead of 20 degrees centigrade is unacceptable due to the fact that the difference is a technical question the importance of which the bank cannot determine.[35]

The doctrine of strict compliance also forms part of the law of the Netherlands.[36] It is regarded as a simple application of the law of mandate (*lastgeving*). The BW requires of the mandatary "by zijn werksaamheden de zorg van een goed lasthebber".[37] Van Delden remarks:

> "Wat een goede lasthebber zal moeten doen of nalaten hangt af van het onderwerp, en daarmede van de aard, der lastgeving. Daar de onderhavige lastgeving moet worden uitgevoerd in het kader van het documentaire krediet, zal ... als gevolg van de 'doctrine of strict compliance' een (maatstaf van) bijzondere gestrengheid (moeten) worden aangelegd.[38]

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vernünftige Beurteilung has since been rejected by several commentators. See Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/217; Nielsen (*op cit* n 29) 62; Canaris (*op cit* n 5) 664 (par 945). For a comprehensive review of the different approaches of the German courts and commentators see Koller I "Die Dokumentenstrenge im Licht von Treu und Glauben beim Dokumentenakkreditiv" 1990 *Wertpapier Mitteilungen* 293.

34 Canaris (*op cit* n 5) 664 (par 945); BGH (9. Januar 1958) 1958 *Wertpapier Mitteilungen* 291 292.

35 Schärrer (*op cit* n 11) 95-96.

36 De Rooy F P *Documentair Kredieten* (1980) Kluwer Deventer 114-123; Van Delden (*op cit* n 15) 47-51.

37 A 7 7 1 2.

38 (*Op cit* n 15) 49.

As a consequence the *de minimis* rule does not apply in this context. The bank would be acting with the required care if it interprets unclear or ambiguous instructions reasonably even though a court of law on proper construction would have favoured a different interpretation.[39]

Defences Arising Directly from the Relationship between the Parties (Unmittelbare Einwendungen)

A vexing question in the civil-law jurisdictions is whether a bank which has a claim against the beneficiary may set this claim off against that of the beneficiary under the documentary credit. The German commentators are divided.[40] The main consideration relied upon for disallowing set-off is that from the point of view of the beneficiary the very essence of the documentary credit is the security of knowing that he will be paid.[41] Thus Angersbach concludes that the bank's undertaking includes a tacit renunciation of the benefits of set-off.[42] Canaris in turn argues that set-off can only be disallowed in exceptional circumstances such as where the beneficiary did not have the opportunity to influence the choice of the issuing or confirming bank.[43] It is also well established that the bank cannot as the cessionary of the buyer set off a claim of the buyer against the seller originating from the contract of sale.[44]

Lücke argues in favour of the position in Switzerland where the competence to rely on set-off is dependent upon the wording of the bank's undertaking. If the bank has promised payment (*Zahlung*), this is to be interpreted as renunciation of set-off; but if the bank has merely informed the beneficiary that it has opened an irrevocable credit in his favour, set-off is competent.[45]

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39 Van Delden (*op cit* n 15) 50.

40 See Angersbach U *Beiträge zum Institut des Dokumenten-Akkreditivs* (1965) Dissertation Julius Maximilians Universität Würzburg 150-151; Lücke (*op cit* n 6) 159-163; Graf von Westphalen F *Rechtsprobleme der Exportfinanzierung* 3 ed (1987) Verlag Recht und Wirtschaft Heidelberg 261-262; Canaris (*op cit* n 5) par 1009.

41 Lücke (*op cit* n 6) 161; Canaris (*op cit* n 5) par 1009.

42 Angersbach (*op cit* n 40) 151.

43 Canaris (*op cit* n 5) par 1009.

44 BGH (18. September 1958) 1959 *Wertpapier Mitteilungen* 25. See also the other authorities cited in n 55 below.

45 Lücke (*op cit* n 6) 162-163.

Whether set-off must be raised or applies *ipso iure* (as is the case in France)[46] should not materially affect the question whether it is competent in this context. In either case this will be determined with reference to the presence or absence of a tacit renunciation of set-off.[47]

6 2 4 Defences Arising from the Bank-Client Relationship (The *Deckungsverhältnis*)

Can a bank raise as a defence that were it to pay out it would not be able to recover from its client? In an early case the German Reichsgericht was confronted with precisely this question.[48] The facts were that a German bank had issued a credit to a German seller on application by a Hungarian buyer. Subsequent exchange-control regulations made it impossible for the issuing bank to be reimbursed by the Hungarian buyer. The bank refused to pay. On the basis of paragraph 242 of the *BGB* the court found that the bank's promise was based on the freedom of Hungarian exchange and that state intervention into this freedom could not leave the payment obligation unaffected. This case has been rejected by most German commentators as an impermissible violation of the independence principle and cannot be regarded as a true reflection of German law today.[49] Similarly, defences arising from the relationship between the bank and the buyer-applicant are regarded as impermissible in France,[50] Switzerland[51] and the Netherlands.[52]

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46 Lücke (*op cit* n 6) 159-160.

47 Lücke (*op cit* n 6) 159-160.

48 RGZ 144 133.

49 Wiele G *Das Dokumenten-Akkreditiv und der anglo-amerikanische Documentary Letter of Credit* (1955) Schiffahrts Verlag Hamburg 58-59; Liesecke R "Die neuere Rechtsprechung, insbesondere des Bundesgerichtshofes, zum Dokumentenakkreditiv" 1966 *Wertpapier Mitteilungen* 458 467; Lücke (*op cit* n 6) 163-166; Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/338; Wessely (*op cit* n 17) 11-12; Canaris (*op cit* n 5) 692 (par 1010); Raith R T *Das Recht des Dokumentenakkreditivs in den USA und in Deutschland* (1985) Stollfuß Verlag Bonn 154. But see also Angersbach (*op cit* n 40) 140 who supports the decision arguing that the availability of cover is the basis of the bank's promise and that the defence accordingly arises not from the *Deckungsverhältnis* but from the *Akkreditivverpflichtung* itself, and accordingly does not violate the independence principle.

50 Lücke (*op cit* n 6) 164 who cites a decision of the Cour de Cassation.

51 Schärrer (*op cit* n 11) 127-128.

52 See for example Ebbink (*op cit* n 14) 434; Mertens (*op cit* n 15) 68.

6 2 5 Defences Arising from the Relationship between the Buyer-Applicant and the Seller-Beneficiary (The *Valutaverhältnis*)

Introduction

The availability, or non-availability, to the bank of defences originating in the contract between the buyer-applicant and the seller-beneficiary is both the most problematic and most the important issue regarding the position of the bank in practice. There is wide consensus in Germany that in principle a demand for payment by the beneficiary may constitute a *Rechtsmißbrauch* due to some defect in the underlying contract of sale. However, apart from agreeing that such a qualification of the independence principle by the doctrine of *Rechtsmißbrauch* should be limited to extreme cases,[53] commentators differ on specific applications of the doctrine in this context.

Defective Performance and Fraud

As in other jurisdictions it is generally accepted that the invalidity of the underlying contract of sale or the deficiency of the goods (in quality, quantity or kind) *per se* will not entitle the bank to refuse payment.[54] In accordance with a decision of the *BGH* this is the case even when the applicant-buyer has ceded his rights against the seller-beneficiary under the contract of sale to the bank.[55] It is also well established in German law that fraud by the beneficiary may provide an exception to the independence principle. Founded as it is on

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53 OLG Frankfurt am Main (23. März 1981) 1981 *Wertpapier Mitteilungen* 445 "nur in extremen Ausnahmefällen"; Nielsen (*op cit* n 29) 88 ("extreme Fälle"); Mailänder (*op cit* n 5) 16 "exceptional cases"; Canaris (*op cit* n 5) 694 (par 1016) "kann nur unter Anlegung strengster Maßstäbe in äußerst seltenen Ausnamefälle zugelassen werden"; Eisemann & Schütze (*op cit* n 5) 198 "[nur] eine restriktive Handhabung der Einwendung ist mit der Funktion des Dokumentenakkreditivs zu vereinbaren"; Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/337.

54 OLG Frankfurt am Main (23. März 1981) 1981 *Wertpapier Mitteilungen* 445; OLG Stuttgart (25. Januar 1979) 1979 *Wertpapier Mitteilungen* 733 735; Liesecke R "Das Dokumentenakkreditiv in der neueren Rechtsprechung des Bundesgerichtshofs" 1960 *Wertpapier Mitteilungen* 210 212; Lücke (*op cit* n 6) 172, 181; Mailänder (*op cit* n 5) 16; Nielsen (*op cit* n 29) 89; Canaris (*op cit* n 5) 700-701 (par 1021-1022).

55 BGH (18. September 1958) 1959 *Wertpapier Mitteilungen* 25. See also Canaris (*op cit* n 5) 693 (par 1014); Liesecke R "Neuere Theorie und Praxis des Dokumentenakkreditivs" 1976 *Wertpapier Mitteilungen* 258 267; Raith (*op cit* n 49) 155; Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/338. The exclusion of this defence can be based upon either a tacit *pactum de non petendo* in the letter of credit itself (the *Akkreditivverhältnis*), or a tacit *pactum de non petendo* in the underlying contract of sale. See in this regard Raith *supra*.

Rechtmißbrauch the exception is necessarily limited to fraud by the beneficiary and does not extend to fraud by a third party.[56]

As was the experience in other jurisdictions, German law has struggled to establish clear boundaries between breach of contract (which does not entitle the bank to refuse payment) and fraud (which may constitute a *Rechtsmißbrauch*). This is well illustrated by what has become known as the Turkish-egg case. In this case the seller had undertaken to deliver fresh eggs. Proper documents were presented but it was determined on arrival of the eggs that they were at least 8-12 weeks old. The court found that the goods delivered were completely unsuitable (*gänzlich ungeeignete Ware*), and that the grossness of the seller's violation of the contract of sale was a clear indication of an intention to defraud (*arglistig*). The demand for payment therefore constituted a *Rechtsmißbrauch* and the court ruled that the bank was not bound to perform as against a revealed defrauder (*offenbaren Wirtschaftsschädling*).[57]

It would appear that this case draws a fundamental distinction between the delivery of defective goods (*mangelhafter Ware*) and totally useless goods (*völlig unbrauchbarer/ gänzlich ungeeignete Ware*). Whilst the second constitutes a *Rechtsmißbrauch*, the first does not.[58] Canaris[59] regards this as an unfortunate distinction in violation of the principle that the bank deals in documents and not in goods. The test in his view is whether the seller's conduct was criminal, for example by intentionally shipping the wrong goods or no goods at all.[60] Wessely[61] and Lücke[62] occupy the middle ground by arguing that the bank may refuse payment in the case of totally useless goods provided the

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56 Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/340 (especially n 265). Fraud by the beneficiary includes fraud by a third party of which the beneficiary has knowledge.

57 BGH (23. März 1955) 1955 *Wertpapier Mitteilungen* 465 468. See also OLG Schleswig (10. April 1980) 1980 *Wertpapier Mitteilungen* 48 50.

58 Raith (*op cit* n 49) 181-184. See also Eisemann & Schütze (*op cit* n 5) 200: "Es genügt aber nicht, daß der Begünstigte qualitativ minderwertige Ware liefert, es muß vielmehr eine Anderslieferung vorliegen (Jeans statt Smoking), die zur Vertragserfüllung offenbar ungeeignet ist."

59 (*Op cit* n 5) 700 (par 1021). See also Wiele (*op cit* n 49) 59; Nielsen (*op cit* n 29) 89.

60 (*Op cit* n 5) 701 (par 1021). This is also the view of Nielsen (*op cit* n 29) 90.

61 (*Op cit* n 17) 67-68.

62 (*Op cit* n 6) 182-184.

uselessness of the goods has been established by an objective third party. Lücke puts it thus:

> "Die Einrede des Rechtsmißbrauchs sei deshalb nur dann gerechfertigt wenn sich dieser nicht erst aus einer Wertung der Parteibehauptung ergebe, sondern objektiv feststehe. Die völlig fehlende Eignung der Ware müsse von Personen oder Stellen bescheinigt werden, die an der Auszahlung des DA kein eigenes interesse hätten und deren Aussage vertrauenswürdig sei."[63]

The position relating to fraud in Switzerland and France is very much the same as in Germany. If the beneficiary has defrauded the buyer the bank is entitled to refuse payment. In Switzerland this is a consequence of the doctrine of *Rechtsmißbrauch* whilst in France it is based upon the rule *fraus omnia corrumpit*. Commentators differ only on matters of proof.[64]

As regards defences arising from the buyer-seller relationship in general, however, the Swiss commentator Schärrer proposes a wider test:

> "Steht die Nichtberechtigung des Verkäufers aus dem Kaufvertrag bereits vor der Auszahlung so eindeutig fest, dass sich daran selbst bei einer ihm günstigen Prozesslage nichts ändert, hat die Bank die Honorierung des Akkreditivs zu verweigern."[65]

Thus, if it is clearly evident that the beneficiary is not entitled to payment in terms of the contract of sale, for whatever reason, the bank is entitled to refuse payment. He emphasises, however, that it is not sufficient that the *Nichtberectigung* of the beneficiary is known, it must be immediately provable (*sofort beweisbar*).[66]

In the Netherlands there is strong support[67] for a different approach to the issue of fraud in terms of which fraud by the beneficiary is not regarded as constituting an exception to the independence principle. Van Delden puts it thus:

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63 (*Op cit* n 6) 183.

64 Lücke (*op cit* n 6) 174-175.

65 (*Op cit* n 11) 130-132.

66 Schärrer (*op cit* n 11) 130.

67 Van Delden (*op cit* n 15) 116-117; Mertens (*op cit* n 15) 68-69. Ebbink (*op cit* n 14) 434 terms it the "orthodoxe leer".

> "De hier bedoelde uitzondering op de afwikkelingsverplichtingen van de accreditiefstellende bank worden veelal beschouwd als de enige inbreuken op de onafhankelijkheid van het accreditief ten opzichte van de basisovereenkoms dan wel de achterliggende rechtsverhoudingen. Het staat echter te bezien, of dit een juist karakterisering van deze situasies is. *Het gaat immers uitsluitend om de nietigheid van het accreditief zelf resp. om de fraude van de begunstigde jegens de bank, welke fraude uitsluitend de documenten betreft.* ... Dat de fraude doorwerkt in de basisovereenkomst en daarmede een achterliggende rechtsverhouding raakt, doet er niet aan af, dat deze primair in de rechtsverhouding bank/begunstigde gepleegd, dan wel gepoogd wordt."[68]

Thus, according to Van Delden the fraud defence arises from the relationship between the bank and beneficiary and does not violate the independence principle.[69] The acceptance of this construction of the fraud defence is by no means unanimous. Ebbink[70] points out that it may often be impossible to determine whether the documents are fraudulent without reference to the "'werkelijkheid' van de uitvoering der overeenkomst koper-verkoper", and that in a growing number of cases courts have been willing to allow banks a defence on the basis of fraud in the underlying transaction without investigating whether the fraud is discernable from the documents. Pabbruwe, too, appears to regard the fraud defence as fraud in the execution of the contract of sale.[71]

Dismissal of the Claim for Payment under the Contract of Sale

The German *BGH* has ruled that should there be a legally binding decision to the effect that the seller-beneficiary is not entitled to payment in terms of the contract of sale (a *rechtskräftige Abweisung der Kaufpreisforderung*),[72] the bank

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68 (*Op cit* n 15) 116-117 (my italics).

69 Van Delden's view stems from his construction of the bank-beneficiary relationship as a bilateral contract in terms of which the beneficiary is obliged to deliver proper documents (see par 5 4 3 above). Thus, the delivery of forged or fraudulent documents is "ernstige wanprestatie t.a.v. de wederkerige rechtsverhouding tussen de bank en de begunstigde" (Van Delden (*op cit* n 15) 120) which entitles the bank to resile from the contract. Whether the forgery or fraud is that of the beneficiary or a third party is accordingly irrelevant. In both instances presentation of the documents will amount to malperformance.

70 (*Op cit* n 14) 434.

71 (*Op cit* n 12) 326.

72 Such as a court judgment or arbitration award. See Wessely (*op cit* n 17) 65 who refers to an *Urteil*, *Schiedspruch* or *gerichtliche Eilverfügung*.

is entitled to refuse payment despite the tender of proper documents.[73] In such circumstances the demand for payment is regarded as being *rechtsmißbräuchlich* due to the fact that the seller would have to pay back the money received to the buyer immediately in any event.[74] This, according to a decision of the Swiss *Bundesgericht*, is also the position in Switzerland.[75] As Lücke points out, however, this exception is not likely to arise often due to the fact that the documentary-credit transaction will generally be completed before the finalisation of any dispute arising from the underlying contract.[76]

Illegality

Most commentators also regard the beneficiary's demand for payment as *rechtsmißbräuchlich* in the event of the contract of sale being illegal or *contra bonos mores* (*Gesetzes- oder Sittenwidrigkeit des Kaufvertrages*).[77] This view is also supported by an early decision of the *Reichsgericht*.[78] The examples generally cited in this regard are illegal arms and drug transactions and the illegal export of capital. Eisemann and Schütze argue, however, that this viewpoint should be rejected for placing an unacceptable duty upon the bank:

> "Diese Ansicht ist nicht zu billigen. Sie bürdet der Bank Prüfungspflichten auf, die diese nict erfüllen kann. Wie soll die Bank wissen, ob ein Waffengeschäft erlaubt oder unerlaubt ist,

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73 BGH (24. April 1958) 1958 *Wertpapier Mitteilungen* 696 697. The decision enjoys wide support amongst the commentators. See Liesecke (*op cit* n 49) 467-468; Canaris (*op cit* n 5) 697 (par 1018); Lücke (*op cit* n 6) 176.

74 Lücke (*op cit* n 6) 176 states the reasoning of the *BGH* thus: "Der Akkreditierte würde arglistig handeln, wenn er trotz rechtskräftiger Abweisung seiner Kaufpreisforderung den Akkreditivbedrag verlangen wollte, den er dem Käufer, für dessen Rechnung die Bank zahle, sofort wieder erstatten müste." See also Liesecke (*op cit* n 54) 212.

75 See Ulrich C M *Rechtsprobleme des Dokumentenakkreditivs* (1989) Schweizer Schriften zum Handels- und Wirtschaftsrecht Band 126 Schulthess Polygraphiser Verlag Zürich 123: "Nach der Ansicht des Bundesgerichtes darf sich die zur Zahlung verpflichtete Bank nur dann auf das rechtsmissbräuchliche Verhalten des Begünstigten berufen, wenn es bei Fälligkeit ihrer Verpflichtung bewiesen ist. 'Dazu bedürfte es wohl einer rechtskräftigen einstweiligen Verfügung des zuständigen Gerichts auf Untersagung der Zahlung oder sogar eines rechtskräftigen Urteils in der Sache selber'." (BGE 100 II 151.) See also Schärrer (*op cit* n 11) 129.

76 (*Op cit* n 6) 176.

77 Canaris (*op cit* n 5) 697 (par 1019); Lücke (*op cit* n 6) 184-186; Wiele (*op cit* n 49) 58; Raith (*op cit* n 49) 157; Nielsen (*op cit* n 29) 91; Wessely (*op cit* n 17) 69; Liesecke (*op cit* n 54) 212; Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/237.

78 RGZ 106 307.

> wie soll sie prüfen, ob die Drogen für medizinische Zwecke oder ungesetzlichen Drogenhandel bestimmt sind."[79]

Wessely's answer to this objection is convincing. He argues that there is no duty on the bank to investigate the legality of the underlying contract. However, if the bank becomes aware of the illegality of the contract, a duty to dishonour the credit may arise.[80] Several commentators regard the basis of this exception to the independence principle as being the fact that a bank which pays despite knowing of the illegality of the sale, could itself be committing a crime.[81]

Schärrer's analysis of the Swiss law relating to defences arising from the *Grundverhältnis* (in terms of which the bank has a defence whenever the *Nichtberechtigung* of the seller-beneficiary is beyond question)[82] would clearly also include this situation. The *Nichtberechtigung* of the beneficiary can be as a consequence of the illegality of the contract of sale.[83]

6 2 6 Procedural Aspects: Defences, Injunctions and Attachments

It is evident from the above that an issuing or confirming bank may on the basis of *Rechtsmißbrauch* (or simply the rule *fraus omnia corrumpit*) have a defence against an action of the beneficiary. However, in all jurisdictions, a high degree of proof is required. In the German legal literature the term "*liquide Beweisbarkeit*" is generally employed in this regard.[84] The emphasis falls on documentary proof, but other forms of objective proof, such as the evidence of a neutral party, are also acceptable.[85] The position in Switzerland[86] and the Netherlands[87] is similar.

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79 (*Op cit* n 5) 200.

80 (*Op cit* n 17) 69.

81 Nielsen (*op cit* n 29) 91; Zahn Eberding & Ehrlich (*op cit* n 5) par 2/337; Wiele (*op cit* n 49) 58.

82 See the text at n 65 above.

83 (*Op cit* n 11) 133. Whether a particular contract of sale is illegal or not may, of course, be a difficult question. Therefore, according to Schärrer, a court will generally require a binding decision of a court or arbitration tribunal to this effect. So viewed the defence falls into the ambit of the *rechtskräftige Abweisung* discussed above.

84 Canaris (*op cit* n 5) 694 (par 1016). See also Liesecke (*op cit* n 49) 468; Nielsen (*op cit* n 29) 90; Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/337.

85 Canaris (*op cit* n 5) 694 (par 1016).

Very often, however, the bank will prefer playing a passive role by indicating to its client that it intends paying despite indications of, for example, fraud by the beneficiary. It is therefore left to the buyer to take the initiative in an attempt to block payment. A speedy procedure is essential.[88] In Germany the possible remedies are the temporary injunction (*einstweilige Verfügung*) and attachment (*Arrest*).[89] Similar remedies are available in both Switzerland[90] and the Netherlands.[91]

Dietl describes an *einstweilige Verfügung* as follows:

> "The temporary injunction is a provisional order obtained from a Court (on application from a party). It may be issued in order to prevent a threatening change of existing conditions which may render impossible or substantually [sic] more difficult the realization of a right of one of the parties..."[92]

The question arises, however: against whom is the injunction to be sought? Theoretically there are two possibilities: (i) an injunction against the bank prohibiting it from paying; and (ii) an injunction against the beneficiary prohibiting a demand for payment. Most of the German commentators are not in favour of allowing an injunction against the bank.[93] This view has also been

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86 Schärrer (*op cit* n 11) 132-133.

87 Van Delden (*op cit* n 15) 121.

88 Wessely (*op cit* n 17) 72-73; Mailänder (*op cit* n 5) 20: "Useful remedies to protect the customer against abusive collection are only those which will be available within approximately 48 hours, from courts in the customer's country, and without raising insurmountable difficulties from service requirements abroad."

89 Wessely (*op cit* n 17) 73-74. See also Mailänder (*op cit* n 5) 20-23.

90 Schärrer (*op cit* n 11) 135-139; Lücke (*op cit* n 6) 210-215.

91 In regard to the *verbodsactie* and *conservatoir derdenbeslag* see Van Delden (*op cit* n 15) 121-126; Ebbink (*op cit* n 14) 435; Croiset van Uchelen (*op cit* n 12) 271-275.

92 Dietl C-E *Wörterbuch für Recht, Wirtschaft und Politik Teil II Deutch English* 2 ed (1986) C H Beck München 216.

93 Liesecke (*op cit* n 49) 468; Lücke (*op cit* n 6) 205 who states somewhat prematurely that unanimity has been achieved in this regard; Nielsen (*op cit* n 29) 99 ("überwiegend abgelehnt"); Eisemann & Schütze (*op cit* n 5) 228 ("[ü]berwiegend ... generel verneint"). But see also Von Westphalen (*op cit* n 40) 289 who as a general rule regards the remedy as competent. See also Mailänder (*op cit* n 5) 21 who favours a "less fundamental and more

followed by the *Oberlandesgericht* (OLG) in Düsseldorf.[94] The argument is basically that German law requires the applicant to have a right (*Verfügungsanspruch*) as against the respondent. The *Verfügungsanspruch* of the buyer, however, typically derives from the contract of sale and cannot be relied on in proceedings against a third-party bank. Moreover, if the bank is bound as against its client not to pay, and nevertheless does pay, the client has a remedy against the bank: he can simply refuse reimbursement.[95] It would appear though that in Switzerland an injunction against the bank may well succeed. Schärrer regards the *Anspruch* as arising from the contract between the buyer-applicant and the bank in terms of which the bank is bound to refuse payment on proof of *Rechtsmißbrauch*.[96] Similarly, the Dutch commentators appear to have no objection in principle to allowing such an injunction.[97]

Several German commentators are of the view that the proper remedy of the buyer in principle is to seek an injunction against the seller-beneficiary.[98] In this case the *Verfügungsanspruch* would arise from the contract of sale which is subject to the good faith requirements of paragraph 242 of the BGB. Thus, if the demand for payment is *rechtsmißbräuchlich*, the beneficiary can be enjoined

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practical approach" in terms of which the relief is to be granted "in the exceptional situations where apparent abuse or fraud would lead to untenable shifting of risks".

94 OLG Düsseldorf (13. Februar 1978) 1978 *Wertpapier Mitteilungen* 359 361. Mailänder (*op cit* n 5) 21 cites several other decisions in support of the Düsseldorf case. However, the case law in this regard is not unanimous. See LG Aachen (10. Februar 1987) 1987 *Wertpapier Mitteilungen* 499 501 in which the court took the view that such an injunction was possible but only "in seltenen Ausnahmefällen" such as where the applicant has no other possible remedy.

95 Eisemann & Schütze (*op cit* n 5) 229; OLG Düsseldorf (13. Februar 1978) 1978 *Wertpapier Mitteilungen* 359 361;

96 (*Op cit* n 11) 136. For criticism of the greater leniency of the Swiss law in this regard see Lücke (*op cit* n 6) 212.

97 In fact, according to Ebbink (*op cit* n 14) 435 this is the remedy most often sought in practice. See also Van Delden (*op cit* n 15) 122-123; Croiset van Uchelen (*op cit* n 12) 272. However, there is some uncertainty as to the basis of this injunction. Both Van Delden and Croiset van Uchelen seek it in delict. The argument, as stated by Van Delden (*supra* 122), is that "de bank door kennelijk (bewijsbaar) valse documenten te honoreren wanprestatie jegens de opdrachtgever zou plegen in het kader van de lastgevingsovereenkomst, althans daardoor een onrechtmatige daad jegens de opdrachtgever zou plegen".

98 Canaris (*op cit* n 5) 720-721 (par 1065); Nielsen (*op cit* n 29) 95; Von Westphalen (*op cit* n 40) 286; Eisemann & Schütze (*op cit* n 5) 230; Mailänder (*op cit* n 5) 21-22; Liesecke (*op cit* n 49) 468; See also LG Düsseldorf (17. Dezember 1975) 1975 *Wertpapier Mitteilungen* 67 67-68.

from making it. The position is similar in Switzerland.[99] In Germany the injunction must be directed at preventing the demand for payment,[100] and not at preventing the presentation of the documents, for, by enjoining the presentation of the documents the buyer could effectively prevent the beneficiary from presenting the documents in time.[101] However, in the Netherlands an injunction against the beneficiary to prevent him from presenting the documents appears to be possible.[102]

To allow an injunction whenever it is clear that the seller is not entitled to payment in terms of the contract of sale, would fundamentally undermine one of the main purposes of the documentary credit embodied in the maxim pay first then proceed.[103] It is accordingly essential to limit the availability of the injunction. This was recognised in a decision of the Düsseldorf *Landesgericht* (LG) in which the principle was stated as follows:

> "Die Untersagung der Inanspruchname eines Akkreditivs im wege der einstweiligen Verfügung widerspricht dem Wesen und Zweck eines Akkreditivs, die in der Vorleistungspflicht des Käufers und der Sicherung des Verkäufers bestehen. *Der Erlaß einer einstweiligen Verfügung ist daher auf Ausnahmefälle zu beschränken*, etwa bei der Ausnutzen eines Akkreditivs in betrügerische Absicht durch einen in wirtschaftlicher Hinsicht dubiosen Gläubiger."[104]

As a theoretical framework for this problem Lücke[105] (following Erman) suggests that the documentary-credit clause in the contract of sale contains a tacit undertaking by the buyer that he will not by an *einstweilige Verfügung* frustrate the purpose of the documentary credit (a *pactum de non petendo*). The

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99 Schärrer (*op cit* n 11) 136. But see also the contrary view of Lücke (*op cit* n 6) 212 who states that in Switzerland the injunction must be against the bank.

100 According to Mailänder (*op cit* n 5) 21 the injunction can take the form of an order to the beneficiary to "cease and desist, or even withdraw his call" or not to "collect or accept any payments".

101 Nielsen (*op cit* n 29) 95-96; Eisemann & Schütze (*op cit* n 5) 230; Canaris (*op cit* n 5) 720-721 (par 1065); Von Westphalen (*op cit* n 40) 286.

102 Ebbink (*op cit* n 14) 435; Van Delden (*op cit* n 15) 122.

103 Canaris (*op cit* n 5) 694 (par 1016).

104 LG Düsseldorf (17. Dezember 1975) 1975 *Wertpapier Mitteilungen* 67 (my italics).

105 (*Op cit* n 6) 207.

pactum is, however, subject to the good faith provision of paragraph 242, and can therefore not apply in the case of *Rechtsmißbrauch*.

The *einstweilige Verfügung* directed against the beneficiary keeps the dispute between the buyer and seller and as such avoids interference with legal relations of third parties. In principle it is therefore the most appropriate solution. In practice, however, there would usually still be the major obstacle of process serving on a foreign beneficiary.[106] Jurisdiction is not a problem due to what Mailänder terms "the exorbitant property jurisdiction" in Germany in terms of which the beneficiary's right of action is considered to be located at the debtor bank.[107]

Finally, in the event of the buyer having a damages claim (*auf Geld gerichtete Schadensersatzanspruch*) arising from, for example, the seller's breach of the contract of sale, the buyer may be entitled, as security for this claim, to attach the seller-beneficiary's right to payment (*Zahlungsanspruch*) under the documentary credit.[108] This possibility is rejected by some commentators on the basis of an inherent contradiction. They contend that if the beneficiary's claim against the bank has been attached, the buyer suffers no damages. Therefore the *auf Geld gerichtete Schadenersatzanspruch* required for an attachment is absent.[109] Eisemann and Schütze reject this line of reasoning as too formal and would allow attachment in a situation of *Rechtmißbrauch*. Several other commentators are also in favour of allowing attachment in clear cases of *Rechtsmißbrauch*.[110] This difference of opinion is also reflected by conflicting

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106 Mailänder (*op cit* n 5) 21-22.

107 (*Op cit* n 5) 22. See also Nielsen (*op cit* n 29) 96; Von Westphalen (*op cit* n 40) 287. This jurisdiction is founded upon par 23 of the ZPO.

108 The relevant provisions of the ZPO are paragraphs 916 and 917. Par 916(1) provides: "Der Arrest findet zur Sicherung der Zwangserstreckung in das bewegliche oder unbewegliche Vermögung wegen einer Geldforderung oder wegen eines Anspruchs statt, der in eine Geldforderung übergehen kann." Par 917 reads: "(1) Der dinglichen Arrest findet statt, wenn zu besorgen ist, daß ohne dessen Verhängung die Vollstreckung des Urteils vereitelt oder wesentlich erschwert werden würde. (2) Als ein zureichender Arrestgrund ist es anzusehen, wenn das Urteil im Ausland vollstreckt werden müßte."

109 Von Westphalen (*op cit* n 40) 293; Wessely (*op cit* n 17) 75. See also Eisemann & Schütze (*op cit* n 5) 231 who, although not supporting this theory do discuss it. They ascribe the theory to Pleyer and Borggrefe.

110 Canaris (*op cit* n 5) 720-722 (par 1065); Lücke (*op cit* n 6) 209-210; Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/358-361; Nielsen (*op cit* n 29) 101-102.

decisions of two district courts.[111] Due to the "prevailing uncertainty"[112] in this regard attachment is not a reliable remedy to block the payment of a documentary credit in Germany.[113]

If one accepts, though, that in principle an attachment is possible in this context, the theoretical framework suggested by Lücke for an *einstweilige Rechtsverfügung* is equally suitable here. The documentary-credit clause contains a tacit term prohibiting the buyer from attaching the seller's claim. Being itself subject to the good faith provision of paragraph 242, this *pactum de non petendo* cannot, however, be enforced in a situation of *Rechtmißbrauch*.[114]

The position in the Netherlands is equally uncertain. Several commentators are in favour of allowing attachment (*derdenbeslag*).[115] According to a decision of the Amsterdamse President, however, *derdenbeslag* should not be allowed due to irreconcilability "met de rechtskarakter van die betrokke garantie op grond van de daaraan verbonden abstractie".[116] This view has the support of Ebbink who raises the argument (also encountered in Germany)[117] "dat de beslaglegger een innerlijk tegenstrijdige handeling pleegt als hij beslag legt op het vorderingsrecht van de begunstigde, welk recht hij nu juist niet aanwezig acht".[118]

As is evident from the above there is still much difference of opinion within different civil-law jurisdictions as to whether injunctions and attachments should be allowed in the documentary-credit context. However, in so far as any

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111 See Mailänder (*op cit* n 5) 22-23 who refers to unpublished decisions of the Frankfurt and Kempten courts.

112 Mailänder (*op cit* n 5) 23.

113 *Ibid*.

114 Raith (*op cit* n 49) 112; Lücke (*op cit* n 6) 210.

115 See especially Croiset van Uchelen (*op cit* n 12) 273-276. See also Pabbruwe (*op cit* n 12) 326; De Rooy (*op cit* n 36) 157-159; Van Delden (*op cit* n 15) 123-124.

116 14-5-1981 KG 81 71. Both the citation and quotation are taken from Croiset van Uchelen (*op cit* n 12) 273. Although this case was concerned with a banker's guarantee and not a documentary credit, the principles in this regard are the same.

117 See the text at n 109 above.

118 (*Op cit* n 14) 435. Ebbink ascribes this argument to Pabbruwe - an indication that Pabbruwe has changed his opinion on this point. See n 115 above.

of these remedies may be applicable the legal literature is clear on the point that a high degree of proof is required. Thus, in Germany, the normal *prima facie* proof (*Glaubhaftmachung*) prescribed by the ZPO[119] for both *einstweilige Verfügung* and *Arrest* (which can be established by an affidavit of the applicant),[120] will not suffice. As in the case of *Rechtsmißbrauch* raised as a defence by the bank, the rule is *liquide Beweisbarkeit*.[121] The position in both Switzerland[122] and the Netherlands[123] is substantially the same.

6 3 Common-Law Perspectives

6 3 1 Introduction

The English and American commentators have taken a less systematic approach to the broad issue of defences available to and injunctions available against an issuing or confirming bank. However, the issue has arisen in five important contexts: (i) fraud as basis for a defence or injunction; (ii) illegality as basis for a defence or injunction; (iii) the defence of documentary non-compliance; (iv) unauthorised credits; and (v) the possibility of the bank raising set-off as a defence. The approach in English law and under Article 5 of the UCC to these questions is reviewed below.

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119 Par 920(2) provides with reference to *Arrest*: "Der Anspruch und der Arrestgrund sind glaubhaft zu machen." This provision is made applicable also to *einstweilige Verfügung* by par 936: "Auf die Anordnung einstweiliger Verfügung und das weitere Verfahren sind die Vorschriften über die Anordnung von Arresten und über das Arrestverfahren entsprechend anzuwenden, soweit nicht die nachfolgenden Paragraphen abweichende Vorschriften enthalten."

120 Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/361; Eisemann & Schütze (*op cit* n 5) 234.

121 Canaris (*op cit* n 5) 722-723 (par 1065a-1066); Zahn, Eberding & Ehrlich (*op cit* n 5) par 2/361; Wessely (*op cit* n 17) 80; Eisemann & Schütze (*op cit* n 5) 234. Justification for the departure from the norm is sought by some in the "(hypotetischen) Parteiwillen und einem aus diesem ... abzuleitenden pactum de non petendo" and by others simply "aus der Funktion des Akkreditivs und somit aus der 'Natur der Sache'". See in this regard especially Canaris as well as Eisemann & Schütze *supra*.

122 Schärrer (*op cit* n 11) 137-139.

123 Croiset van Uchelen (*op cit* n 12) 272; Van Delden (*op cit* n 15) 122-123.

6 3 2 Fraud (The English Law)

Introduction

Fraud as a defence available to a bank or as a basis for an injunction is generally dealt with as constituting an exception to the independence principle. Thus, typically, the question addressed is whether the facts justify a departure from the independence principle. Only if this is the case does the possibility of a defence or injunction arise.

The fraud exception to the independence principle was introduced into the common-law systems in the American case *Sztejn v J Henry Schroder Banking Corporation.*[124] The applicant for the credit applied for an injunction to restrain the issuing bank from accepting and paying out against documents tendered by the beneficiary. The applicant alleged that although the documents described the goods in accordance with the credit as "bristles", that the beneficiary in fact had shipped "rubbish". Shientag J, having set out the independence principle, continued:

> "I believe that a different situation is presented in the instant action. This is not a controversy between the buyer and seller concerning a mere breach of warranty regarding the quality of the merchandise; on the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller. ... The distinction between a breach of warranty and active fraud on the part of the seller is supported by authority and reason."[125]

The injunction was granted. The *Sztejn* case has subsequently been cited with approval and applied in English case law[126] and is generally regarded, in

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124 (1941) 31 NYS 2d 631 (Supreme Court Special Term New York County).

125 634-635.

126 See for example *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 WLR 315 318H-319E ([1975] 1 Lloyd's Rep 444 446-447); *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159 169D-H ([1978] 1 Lloyd's Rep 166 171). The latter case concerned not a documentary credit but a performance bond.

England as well as in the United States, as the *locus classicus*[127] on the fraud exception to the independence principle.

Fraud as a Defence

The leading English case on the fraud defence is undoubtedly *United City Merchants (Investments) Ltd v Royal Bank of Canada*. This case is extremely important and requires detailed consideration. The decisions of the Queen's Bench,[128] Court of Appeal[129] and the House of Lords[130] were all reported, and generated substantial academic interest.[131] The facts relating to the fraud issue were as follows: the assignees of the beneficiary of a credit presented documents to the defendant (the confirming bank) which refused to pay on the basis that the bill of lading was fraudulent; the shipment date was stated to be 15 December 1976 (the last day allowed for shipment under the credit) while the goods were in fact only shipped on the 16th. The date was inserted by an employee of the loading brokers without the knowledge of the sellers or their assignees (plaintiffs). Finding for the plaintiffs Mocatta J argued as follows:

> "Mr Baker [the employee of the loading brokers] was not the plaintiffs' agent for making out the bills of lading and ... there was no fraud on the part of the plaintiffs in presenting them. The case is, therefore vitally different from the *Sztejn v. Schroder* case ... . Where there has been personal fraud or unscrupulous

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127 Lord Diplock termed it "the leading or 'landmark' case" in *United City Merchants (Investments) Ltd v Royal Bank of Canada* 1983 AC 168 183H. See further Jack (*op cit* n 1) 209 ("foundation stone of English law in this area"); Lewin Smith G W "Irrevocable Letters of Credit and Third Party Fraud: The *American Accord*" (1983) 24 *Virginia Journal of International Law* 55 62 ("landmark *Sztejn* case"); Van Houten S H "Letters of Credit and Fraud: A Revisionist View" (1978) 62 *Canadian Bar Review* 371 379 ("seminal decision").

128 [1979] 1 Lloyd's Rep 267.

129 [1982] QB 208 (CA).

130 [1983] 1 AC 168 (HL).

131 For discussions of the case see *inter alia* Dolan J F "Documentary Credit Fundamentals: Comparative Aspects" (1989) 3 *Banking & Finance Law Review* 134; Van Houten (*op cit* n 127) 372, 382; Lewin Smith (*op cit* n 127) 57, 63; Sarna L "Letters of Credit: Bankruptcy, Fraud and Identity of Parties" (1986) 65 *Canadian Bar Review* 303 318; Miller G P "Fraudulent Documents and Bank Liability: A Hong Kong Perspective" 1993 4 *The Company Lawyer* 146 147; Goode R "Reflections on Letters of Credit - I" 1980 *Journal of Business Law* 291 294; Ellinger E P "Fraud in Documentary Credit Transactions" 1981 *Journal of Business Law* 258 261; Arora A "False and Forged Documents under a Letter of Credit" (1981) 2 *The Company Lawyer* 66 67, and "Documentary Fraud: The United City Merchants Case" (1984) 5 *The Company Lawyer* 131. See also the thorough analysis in Jack (*op cit* n 1) 210.

> conduct by the seller presenting the documents under the letter of credit, it is right that a bank should be entitled to refuse payment against apparently conforming documents on the principle ex turpi causa non oritur actio."[132]

The decision was, however, reversed on appeal. In the Court of Appeal judgments were delivered by Stephenson LJ, Ackner LJ and Griffiths LJ, all of whom took the view that fraud by a third party did entitle the bank to refuse payment. The precise basis of Stephenson LJ's judgment is not very clear. He appears, however, to have been influenced considerably by the following comments of Goode with reference to the judgment of the court *a quo*:

> "[The beneficiary] himself has a duty to tender documents which are in order, and the fact that he acted in good faith in tendering forged documents is thus irrelevant. This fundamental point appears to have been overlooked by Mocatta J ... . The beneficiary under a credit ... is only entitled to be paid if the documents are in order. A fraudulently completed bill of lading does not become a conforming document merely because the fraud is that of a third party."[133]

Similarly, Ackner LJ in his judgment took the view that the *ex turpi causa* principle could not be the "exhaustive explanation"[134] of the fraud exception to the independence principle. Therefore, a different "acceptable basis for the exception"[135] had to be sought:

> "In order to do so it is necessary to go back to first principles. The buyer has arranged with the bank to provide finance for the seller, in the seller's country, on delivery of certain documents. The banker's authority or mandate is to pay against genuine documents and that is what the bank has undertaken to do. It is the character of the document, not its origin, that must decide whether or not it is a 'conforming' document, that is a document which complies with the terms of the credit."[136]

He also stressed that the banker takes possession of the bills of lading as security for its advances, and therefore "ought not to be under an obligation to

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132 278.

133 238C. See Goode (*op cit* n 131) 294.

134 246F.

135 247C.

136 247C-D.

accept or pay against documents which he knows to be waste paper".[137] The judgment of Griffiths LJ likewise rests on a rejection of the *ex turpi causa* rule as the basis for the fraud exception, and the view that "the bank's obligation is to pay upon presentation of genuine documents in accordance with the requirements of the letter of credit".[138] It would appear further that the Court of Appeal regarded forged or fraudulently completed or altered documents as "not genuine" in this respect irrespective of whether the fraud or forgery rendered them null and void.[139]

The essence of the judgments delivered in the Court of Appeal can be stated thus: (i) the bank's obligation is to pay upon presentation of genuine documents; (ii) documents forged or fraudulently completed, whether by the beneficiary or by a third party, are not genuine documents; (iii) to compel a bank to pay upon presentation of such documents may seriously diminish its security; and (iv) therefore the fraud exception does not rest solely upon the *ex turpi causa* rule but includes fraud by a third party.

The matter was once again taken on appeal. In the House of Lords the decision of the Court of Appeal was overturned. In his speech Lord Diplock supported Mocatta J by finding that the fraud exception was "a clear application of the maxim ex turpi causa non oritur actio"[140] and was therefore not applicable to the facts of this case. The contention of the appellant that a bank should be entitled to reject documents containing a material misrepresentation in the absence of knowledge on the part of the beneficiary (termed by Lord Diplock the "broad proposition") was rejected for two reasons.

In the first place, Lord Diplock pointed out that as between the confirming and issuing bank, and as between the issuing bank and the buyer it has never been doubted that the contractual duty of each bank was to examine all documents presented with reasonable care to ascertain that they appear on their face to be

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137 246G.

138 254D.

139 "A document will be a nullity if it is forged or fraudulent in such a way as to destroy its essence." See Jack (*op cit* n 1) 217.

140 184A. Lord Diplock uses the term in the sense that "[t]he courts will not allow their process to be used by a dishonest person to carry out a fraud".

in accordance with the terms of the credit. This is clearly stated in the *UCP*.[141] He then continued:

> "It would be strange from the commercial point of view ... if the contractual duty owed by confirming and issuing banks to the buyer to honour the credit on presentation of apparently conforming documents despite the fact that they contain inaccuracies or even are forged, were not matched by a corresponding contractual liability of the confirming bank to the seller/beneficiary (in the absence, of course, of any fraud on his part) to pay the sum stipulated in the credit upon presentation of apparently conf[o]rming documents."[142]

However, Lord Diplock pointed out that if the bank as against the beneficiary were to be entitled to reject documents containing material misrepresentations irrespective of whether the beneficiary had knowledge of the misrepresentations, the contractual duties would not match. As against the beneficiary the bank would only be bound to pay "upon presentation of documents which not only appear on their face to be in accordance with the terms of the credit but also do not in fact contain any material statement that is inaccurate".[143]

In the second place Lord Diplock pointed out that the very concept "material misrepresentation" was problematic in this context as it "invites the query: 'material to what?'"[144] The appellant's contention that this meant "a misstatement of a fact which if the true fact had been disclosed would have entitled the buyer to reject the goods" was firmly rejected by Lord Diplock:

> "[T]his is to destroy the autonomy of the documentary credit which is its raison d'être; it is to make the seller's right to payment by the confirming bank dependent upon the buyer's

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141 See a 13(a) of the 1994 Revision. See also *Gian Singh & Co v Banque de l'Indochine* [1974] 2 All ER 754 (PC) 757-758 in which Lord Diplock had found that the fact that a document was forged did not preclude the bank from being reimbursed by its client.

142 184H-185A. But see also the thought provoking comments of Goode R *Commercial Law* 2 ed (1995) Penguin Harmondsworth 1008-1009 who states that the notion of a "contractual duty owed by the bank to *the buyer*" to honour the credit on presentation of apparently conforming but forged or fraudulent documents "is surely bizarre!"

143 185B. See also Todd P *Bills of Lading and Bankers' Documentary Credits* (1990) Lloyd's of London Press Ltd London 137 who interprets the *United City Merchants* case as laying down that the positions under both contracts (i e the contracts between the bank and its client, and the bank and the beneficiary) are the same.

144 185D.

> rights against the seller under the terms of the contract for the sale of goods, of which the confirming bank will have no knowledge."[145]

However, the position adopted by the Court of Appeal differed somewhat from the appellant's "broad proposition". The Court of Appeal's judgment, as interpreted by Lord Diplock, was not that any material misrepresentation in the documents entitled the bank to refuse payment (the "broad proposition"), but only "a material misrepresentation of fact that was *false to the knowledge of the person who issued the document* and intended by him to deceive persons into whose hands the document might come".[146] This proposition (the so called "half-way house")[147] was, however, also rejected by Lord Diplock:

> "[I]f the broad proposition for which the confirming bank has argued is unacceptable for the reasons I have already discussed, what rational ground can there be for drawing any distinction between apparently conforming documents that, unknown to the seller, in fact contain a statement of fact that is inaccurate where the inaccuracy was due to inadvertence by the maker of the document, and the like documents where the same inaccuracy had been inserted by the maker of the document with intent to deceive".[148]

He pointed out that the Court of Appeal had reached this "half-way house" by starting from the premiss that a bank could refuse to pay against a document that it knew to be forged due to the fact that forgery deprived the document of all legal effect. From this premiss they argued that a fraudulent alteration of the document should have the same consequence. Lord Diplock, however, questioned and specifically distanced himself from the premiss that a bank could refuse to pay against a document which was a nullity. The issue was left open on the basis that the fraudulent bill of lading in this case was not a nullity but "a valid transferable receipt for the goods giving the holder a right to claim them at their destination".[149] He pointed out, however, that even if the Court of

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145 185E-F.

146 187B.

147 186F.

148 187C-D.

149 188B.

Appeal's premiss were correct, this did not mean that "fraud by a third party which does not render the document a nullity has the same consequence".[150]

The essence of the judgment of the House of Lords is therefore: (i) a bank confronted with documents conforming on their face with the requirements of the credit, but which due to forgery or fraud contain material[151] misrepresentations, but which are not null and void,[152] may only refuse payment if the beneficiary had knowledge[153] of the forgery or fraud; (ii) the reason for this state of affairs is that the basis of the fraud exception is the *ex turpi causa* rule; and (iii) the position as to documents which are null and void is left open expressly.[154]

Although the interpretation of the fraud exception in the *United City Merchants* case has not been accepted by all,[155] it can hardly be doubted that the decision of the House of Lords represents the substantive English law in this regard.

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150 188C.

151 According to Jack (*op cit* n 1) 215 a misrepresentation would be material if it is "material to the bank's duty to pay, so that if the documents stated the truth the bank would be obliged to reject the documents".

152 See n 139 above.

153 "Knowledge", according to Jack ((*op cit* n 1) 215), is not necessarily actual knowledge; "something less" may well do. In this respect he refers to the fact that in the tort of deceit the following states of mind are sufficient: "(i) knowing the representation to be false; (ii) without any belief in its truth; or (iii) recklessly, careless whether it be true or false".

154 It is suggested, however, that the thrust of Lord Diplock's speech is to the effect that the law relating to forged documents which are null and void should be the same. His argument relating to the matching of the bank's obligation towards its client and its liability towards the beneficiary (see n 142 above) is equally applicable to such documents. This is further strengthened by Lord Diplock's citation of *Gian Singh & Co Ltd v Banque de l'Indochine* [1974] 1 WLR 1234 (PC) ([1974] 1 Lloyd's Rep 56) in which the customer was held liable to reimburse the issuing bank for honouring a documentary credit upon presentation of an apparently conforming but forged certificate which the bank was not negligent in failing to detect.

155 Goode's view that forged documents cannot be conforming has already been referred to. This view is reiterated in the latest edition of *Commercial Law* (*op cit* n 142) 1008-1010. He nevertheless regards the decision as "supportable on the ground that the bill of lading was a genuine document in that it was issued by the party by whom it purported to be issued without unauthorized alteration of its terms, so that what was false was simply the information in it". See further Lewin Smith (*op cit* n 127) 70 who regards the case as protecting "shrewd sellers who utilize the services of third parties discreet enough to keep their fraudulent practices to themselves" and as "[encouraging] sellers not to inquire into the details of the activities of third parties involved in their transactions". Similarly Arora

On a formal level, a further question which has received the attention of the courts relates to the standard of proof. Being a civil matter proof on a balance of probabilities is indicated. However, the degree of probability depends upon the subject-matter,[156] and it is clear that a very high degree of probability is required in this context. In *Rafsanjan Pistachio Producers Co-Operative v Bank Leumi (UK) Plc* (a case in which the bank successfully raised the defence of fraud) Hirst J remarked that "a very heavy burden of proof rests upon the defendants to establish their case to the highest level of probability".[157]

Fraud as a Basis for Injunctive Relief

Should the buyer be unsuccessful in persuading the bank not to pay, it is theoretically possible for him to prevent payment by means of an injunction.[158] This route is, however, fraught with difficulties, and very seldom succeeds. Once again the courts insist on an extremely high standard of proof.[159] In addition the buyer is confronted with two further problems of some magnitude.

(*op cit* n 131) 134 states that the decision moves the burden to ensure that the documents tendered are not fraudulent, from the seller to the purchaser.

156 Jack (*op cit* n 1) 214.

157 [1992] 1 Lloyd's Rep 513 (QB) 525.

158 On injunctions in English law in general see Casson D B *Odgers on High Court Pleading and Practice* 23 ed (1991) Sweet & Maxwell London 78-84. The *locus classicus* is *American Cyanamid Co v Ethicon Ltd* [1975] 1 All ER 504 (HL) in which the principles which should govern the granting of interlocutory injunctions was restated by Lord Diplock. In this case the House of Lords jettisoned one of the traditional requirements for interlocutory injunctions in English law namely that of the plaintiff having to establish a *prima facie* case. Instead the House stressed the requirement that the balance of convenience should favour the plaintiff. In other words, the cardinal question is whether more harm would be done by refusing or granting the injunction. If the refusal of the injunction would be the more harmful, the injunction will be granted. For a detailed discussion of the *Cyanamid* case, its background and reactions to it see Prest C B *The Law and Practice of Interdicts* (1996) Juta Cape Town 81-102.

159 The test in this regard has not yet been clearly established. In *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 All ER 351 (CA) 352 Donaldson MR remarked in this regard: "[T]he evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer". See also *Tukan Timber Ltd v Barclays Bank Plc* [1987] 1 Lloyd's Rep 171 (QB) 175. In *United Trading Corporation SA & Murray Clayton Ltd v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554 (CA) 560-561 it was stated: "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 of fraud". This "only realistic inference" test was questioned in both *Deutsche Ruckversicherung AG v Walbrook Insurance Co Ltd, Group Josi Re (formerly known as Group Josi Reassurance SA) v Walbrook Insurance Ltd* [1994] 4 All ER 181 (QB) 195H and *Themehelp Ltd v West* [1995] 3 WLR 751 (CA) 764F, 766F.

First, the buyer must decide whom to enjoin, and, secondly, he must decide on the related question as to the basis of the injunction.

Prior to the presentation of the documents it may be possible to acquire an injunction restraining the beneficiary from presenting the documents. Injunctions against the beneficiary were refused in *Hamzeh Malass & Sons v British Imex Industries Ltd*[160] and *Deutsche Ruckversicherung AG v Walbrook Insurance Co Ltd, Group Josi Re (formerly known as Group Josi Reassurance SA) v Walbrook Insurance Ltd.*[161] However, in *Themehelp Ltd v West*[162] the Court of Appeal recently granted an injunction of this nature in a case concerning a performance guarantee. On behalf of the appellant (the beneficiary of the guarantee) it was alleged that the remedy was incompetent - that in the context of the fraud exception the only possible injunction is against the guarantor *after presentation of the notice of default* (the document). To allow an injunction against the beneficiary prior to presentation of the notice "would deprive the guarantor of the right which the law accords to it of appraising the element of fraud for itself" and would be an "unwarranted invasion of the integrity of a performance guarantee".[163] This argument received the support of Evans LJ who rendered a minority judgment, but was rejected in the majority judgment. Waite LJ stated:

> "In a case where fraud is raised between the parties to the main transaction at an early stage, before any question of the enforcement of the guarantee, as between the beneficiary and the guarantor, has yet arisen at all, it does not seem to me that the slightest threat is involved to the autonomy of the performance guarantee if the beneficiary is injuncted from enforcing it in proceedings to which the guarantor is not a party."[164]

It is of interest to note that the majority judgment necessarily implies that the fraud does not have to relate to the documents. At the stage of the proceedings

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160 [1958] 2 WLR 100 (CA).

161 [1994] 4 All ER 181 (QB).

162 [1995] 3 WLR 751 (CA). For discussions of the case see Oelofse A N "Developments in the Law of Documentary Letters of Credit" 1996 *Annual Banking Law Update* Rand Afrikaans University Research Unit for Banking Law 10-12; Goodliffe J "Court of Appeal Restrains the Making of a Demand on a Bond" 1995 *Journal of International Banking Law* 405-406.

163 763D-H.

164 764B-C.

there was no notice of default. It follows that there was no fraudulent document. The fraud averred by the applicant (buyer) was that the beneficiary (seller) had made misrepresentations in the contract of sale between them. Thus, the fraud was clearly fraud in the underlying transaction.[165] The fraud exception as formulated by the House of Lords in the *United City Merchants* case, however, would appear to be restricted to fraud in the documents.[166] The *Themehelp* case is currently under appeal to the House of Lords.[167]

After presentation of the documents the only possible injunction is clearly against the bank. Generally, however, more than one bank is involved which raises the question of which bank to enjoin. The buyer's best chance at success would be to move against the first bank to pay, for, once it has paid its right to be indemnified will arise[168] - a right with which the courts are most unlikely to interfere.[169] In the event of the first bank to pay being the nominated bank,[170] an injunction against the issuing bank will be effective also against its agent (the nominated bank). In the case of a confirmed credit, however, the confirming bank in paying the credit acts in discharge of its own obligations and not as the agent of the issuing bank.[171] Therefore, in this instance, the confirming bank itself must be enjoined.

In order to succeed with an injunction the buyer will have to persuade the court that the party he wishes to enjoin owes him a duty not to pay.[172] If the injunction is sought against the seller such a duty may derive from the contract of sale. Similarly, if the party to be enjoined is the issuing bank, the duty may

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165 See Oelofse (*op cit* n 162) 11.

166 See the discussion of the case above. The fraud exception ("the one established exception") was formulated by Lord Diplock as follows: "where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue". ([1983] AC 168 HL 183G.)

167 Goodliffe (*op cit* n 162) 406.

168 See a 14 of the *UCP*.

169 See Jack (*op cit* n 1) 225.

170 See par 1 3 4 above.

171 See par 1 3 4 above.

172 Jack (*op cit* n 1) 225.

derive from the contract between the bank and the buyer. However, there is clearly no contractual relationship between the confirming bank and the buyer.[173] Thus, in order to succeed against the confirming bank the buyer will have to establish the existence of a duty of care in the tort of negligence. Whether such a duty of care does in fact exist is yet to be established. Remarks of Ackner LJ in *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd* (a case dealing not with documentary credits but with performance bonds), lend some impetus to the argument in favour of such a duty:

> "[I]t is arguable that a bank owes a duty of care to the party ultimately liable at the end of the chain not to pay out on a performance bond if, on the information then available to it, there is clear evidence that the beneficiary's demand is fraudulent, because it is the party at the end of the chain who may have to bear the ultimate loss."[174]

Furthermore, having established whom to enjoin and the basis of the injunction, the buyer faces another formidable problem - the well established principle of the balance of convenience.[175] In accordance with this principle the court must consider whether more harm will be done by granting or refusing the injunction. If damages would be a sufficient remedy this would imply that an injunction would ordinarily not be granted.[176] The *dictum* regularly quoted[177] in this regard is that of Kerr J in *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd*:

> "The plaintiffs ... face what seems to me to be an insuperable difficulty. They are seeking to prevent the bank from paying and debiting their account. It must then follow that if the bank pays and debits the plaintiffs' account, it is either entitled to do so or not entitled to do so. To do so would either be in accordance with the bank's contract with the plaintiffs or a breach of it. If it is in accordance with the contract, then the plaintiffs have no

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173 Jack (*op cit* n 1) 225. See also *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554 (CA) 559-560.

174 [1985] 2 Lloyd's Rep 554 (CA) 560.

175 *American Cyanamid Co v Ethicon Ltd* [1975] 1 All ER 504 (HL) 510-511. See also Casson (*op cit* n 158) 79-81; Jack (*op cit* n 1) 226.

176 *American Cyanamid Co v Ethicon Ltd* [1975] 1 All ER 504 (HL) 510; Casson (*op cit* n 158) 80.

177 *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554 (CA) 565; Jack (*op cit* n 1) 226.

> cause of action against the bank and, as it seems to me, no possible basis for an injunction against it. Alternatively, if the threatened payment is in breach of contract, ... then the plaintiffs would have good claims for damages against the bank. In that event the injunctions would be inappropriate, because they interfere with the bank's obligations ..., because they might cause greater damage to the bank than the plaintiffs could pay on their undertaking as to damages, and because the plaintiffs would then have an adequate remedy in damages. The balance of convenience would in that event be hopelessly weighted against the plaintiffs."[178]

From the above it is clear that in England an injunction against a bank is seldom likely to succeed. Donaldson MR in *Bolivinter Oil SA v Chase Manhattan Bank* stated that in the documentary-credit and performance-bond context an injunction would only be granted against the bank in a "wholly exceptional case".[179] Injunctions against the beneficiary were, however, granted in two cases concerning performance bonds.[180] It is suggested that the balance of convenience is generally more likely to favour the buyer where he attempts to enjoin the beneficiary as opposed to the bank.[181]

A final remedy which deserves consideration in this context is the Mareva injunction.[182] The Mareva injunction, which derives from the case *Mareva*

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178 [1978] QB 146 (QB) 155.

179 [1984] 1 All ER 351 352 (CA). In *Deutsche Ruckversicherung AG v Walbrook Insurance Co Ltd, Group Josi Re (formerly known as Group Josi Reassurance SA) v Walbrook Insurance Ltd* [1994] 4 All ER 181 (QB) 196A Phillips J stated: "The difficulty of analysing in terms of legal principle this area of law is compounded by the fact that, so far as I am aware, there is no reported case where the court, in *inter partes* proceedings, has approved the grant of an injunction on the basis of the fraud exception." Jack (*op cit* n 1) 220 mentions that applications for injunctions have been successful at the *ex parte* stage but not ultimately. For an example of one successful application at *ex parte* stage see *Intraco Ltd v Notis Shipping Corporation, The Bhoja Trader* [1981] 2 Lloyd's Rep 256 (CA).

180 *Elian and Rabbath v Matsas and Matsas* [1966] 2 Lloyd's Rep 495 (CA); *Themehelp (Ltd) v West* [1995] 3 WLR 751 (CA). Note, however, that the *Elian* case was decided prior to the restatement of the law on injunctions in the *American Cyanamid* case (see n 158 above) and that the *Themehelp* case has been taken on appeal to the House of Lords (see the text at n 167 above).

181 An action for damages against the beneficiary may entail suing in a foreign jurisdiction. Furthermore, the financial security of the beneficiary is unlikely to be as strong as that of the bank.

182 On this remedy in general see Casson (*op cit* n 158) 84-94, and in the context of documentary credits Jack (*op cit* n 1) 227-228; Goode R M "Reflections on Letters of Credit- II" 1980 *Journal of Business Law* 378.

Compania Naviera SA v International Bulkcarriers SA[183] and has since been statutorily entrenched in England,[184] provides a means whereby a debtor may be prevented from removing his assets from the jurisdiction of the court before judgment. Its application in the documentary-credit context is explained as follows by Jack:

> "Instead of trying to prevent the bank paying ... the buyer may consider an application for a Mareva injunction. Because the order does not interfere with the operation of the credit, but restrains the use of the proceeds of its operation, the buyer does not have to bring himself within the fraud exception to the autonomy rule to claim a Mareva order. The claim for a Mareva order may be supported by a simple claim by the buyer against the seller for breach of contract."[185]

The Mareva injunction is clearly a valuable remedy to a buyer suing the seller on the contract of sale. It may ensure that an eventual judgment against the seller will be effective. However, in *Intraco Ltd v Notis Shipping Corporation of Liberia - The Bhoja Trader* it was established that the proceeds of a documentary credit or guarantee could not be frozen by means of a Mareva injunction if the obligation of the bank was not to pay in England but abroad. In that case a Mareva injunction restraining the beneficiaries from removing the proceeds of a bank guarantee from the jurisdiction of the court was granted by the court *a quo*. The bank's obligation, however, was to pay not in England but in Greece. Reversing this decision the Court of Appeal stated:

> "It is the natural corollary of the proposition that a letter of credit or bank guarantee is to be treated as cash that when the bank pays and cash is received by the beneficiary, it should be subject to the same restraints as any other of his cash assets. Enjoining the beneficiary from removing the cash asset from the jurisdiction is not the same as taking action, whether by injunction or an order staying execution, which will prevent him obtaining the cash ... . If therefore this bank guarantee had provided for payment in

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183 [1975] 2 Lloyd's Rep 509; [1980] 1 All ER 213 (CA).

184 S 37(1) of the Supreme Court Act 1981 (c 54).

185 (*Op cit* n 1) 228. In *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 All ER 351 352 (CA) Donaldson MR stated that although an injunction restraining a bank from paying in terms of a documentary credit or guarantee would only succeed in a "wholly exceptional case", restrictions could be imposed "on the freedom of the beneficiary to deal with the money after he has received it". This is clearly a reference to the Mareva injunction. See also *Z Ltd v A-Z and AA-LL* [1982] QB 558 (CA) 574 where Lord Denning MR remarked: "The injunction does not prevent payment under a letter of credit or under a bank guarantee...; but it may apply to the proceeds as when received by or for the defendant."

> London, we should have agreed wholly with the learned Judge's judgment".[186]

The bank's obligation in a documentary credit is very often to pay abroad. In these cases the Mareva injunction will accordingly not be available to a buyer suing the seller on the contract of sale.[187]

6 3 3 Fraud (The Law in the United States of America)

Introduction

The fraud exception to the independence principle, as first recognised in the pre-code *Sztejn* case,[188] has been incorporated in both the current and new revisions of the UCC. However, the interpretation of this exception has proved to be problematic.

The Position under the Current Article 5

The fraud exception to the independence principle forms part of § 5-114 of the UCC. The article first sets out the independence principle by stating that the issuing bank must honour a demand for payment complying with the terms of the credit "regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary".[189] The fraud exception is then codified in § 5-114(2) as follows:

> "Unless otherwise agreed when documents appear on their face to comply with the terms of a 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 certificated security (Section 8-306) 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 negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3-302) and in an appropriate case would

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186 [1981] 2 Lloyd's Rep 256 (CA) 258.

187 See Barclay A J D "Court Orders against Payment under First Demand Guarantees Used in International Trade" (1989) 3 *Journal of International Banking Law* 110 114 who notes, however, that "continued expansion of the Mareva jurisdiction may put this conclusion in doubt".

188 See the discussion of the case in par 6 3 2 above.

189 § 5-114(1).

> make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a certificated 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."

Thus, the article proceeds from the basis that if on their face the documents conform, the bank must pay. It does not *explicitly* state any exceptions to this principle. What the article does state, however, is that despite the fact that in a particular case the documents (i) do not conform to statutory warranties made on negotiation or transfer of certain documents, or are (ii) forged, or (iii) fraudulent, or (iv) if there is "fraud in the transaction", the bank must nevertheless honour the credit as against a *bona fide* holder for value of the documents.[190] Therefore, by "*negative implication*",[191] as against the beneficiary himself, the bank may refuse to honour the credit in these specific instances. However, the bank is not compelled (merely entitled) to refuse payment in these circumstances. In fact, as against its client, the article specifically authorises the bank to honour the demand provided it does so in good faith. The bank may, however, be enjoined from paying under these circumstances.

Therefore, in the case of non-conformance with the statutory warranties, or in the event of a document being forged or fraudulent, or when there is "fraud in the transaction" the issuing bank may dishonour or be enjoined from honouring a credit.[192] However, the precise meaning of and distinctions between these different exceptions are by no means clear.

The first exception (the statutory warranties) relates to documents of title and securities. The warranties that arise on presentation of documents of title include "a warranty to the issuer that the document is genuine, that the

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190 This could be either a negotiating bank, a holder in due course of the draft, a person to whom a document of title (for example a bill of lading) has been duly negotiated; or a *bona fide* purchaser of a security. See White J J & Summers R S *Handbook of the Law under the Uniform Commercial Code* (1980) West Publishing St Paul Minnesota 734.

191 The term is taken from White & Summers (*op cit* n 190) 734 (my italics).

192 Sarna (*op cit* n 131) 317 explains the effect of § 114(2) as "creating a right of elective dishonour in favour of the issuer and a right to force dishonour by the applicant".

presenting party has no knowledge of any fact that would impair its validity or worth, and that negotiation and transfer is rightful and effective". In the case of the presentation of a security the presenter warrants in addition "that the security has not been altered materially".[193] The second exception relates to forged documents. A forged document is one "that includes a forged signature".[194] There is a clear overlap with the first exception as the presentation of a forged document of title (for example a bill of lading) or security would clearly not conform to the warranties.[195] However, the second exception extends also to documents other than documents of title and securities such as commercial invoices or certificates of inspection.[196]

The third exception relates to fraudulent documents. A "fraudulent document", according to White and Summers, is "one that is specious, conjured up out of whole cloth, or one that has been materially altered".[197] The authors add, however, that the line between "fraudulent documents" and "fraud in the transaction" is not always clear as "a 'fraudulent transaction' may be held to generate what would also qualify as 'fraudulent documents'".[198] The *Sztejn* case, for example, has been regarded both as a case involving fraudulent documents and fraud in the transaction.[199]

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193 Dolan J F *The Law of Letters of Credit - Commercial and Standby Credits* 2 ed (1991) Warren, Gorham & Lamont Boston par 7.04[3].

194 White & Summers (*op cit* n 190) 735 regard a document "that includes forged signatures" as forged.

195 Dolan (*op cit* n 193) par 7.04[3].

196 *Ibid.*

197 (*Op cit* n 190) 735. As an example the authors cite *Dynamics Corporation of America v Citizens and Southern National Bank* (1973) 356 F Supp 991 (US District Court ND Georgia). In this case the beneficiary of a standby letter of credit presented a certificate of default and claimed payment. The customer sought an injunction against the court on the basis that it was not in default, that the beneficiary knew this and that his frustrations stemmed from factors which could not be attributed to the customer (an embargo imposed by the United States due to the Indo-Pakistani war). The court held that the certificate of default was "a *pro forma* declaration" with "absolutely no basis in fact" and as such a fraudulent document. (999.)

198 (*Op cit* n 190) 736. For good expositions of this problem see Krimm J J Jr "U.C.C. - Letters of Credit and 'Fraud in the Transaction'" (1986) 60 *Tulane Law Review* 1088 1097-1098; Getz H A "Enjoining the International Standby Letter of Credit: The Iranian Letter of Credit Cases" (1980) 21 *Harvard International Law Journal* 189 208-209.

199 Krimm (*op cit* n 198) 1097-1098; Dolan (*op cit* n 193) par 7.04[3]; White & Summers (*op cit* n 190) 736.

The fourth exception, "fraud in the transaction", is especially problematic due to a diversity of opinion as to the precise meaning of the term. Generally speaking, two different approaches, a narrow approach and a broad one,[200] can be identified.[201] The narrow approach as favoured by *inter alia* Harfield[202] and Dolan[203] requires the fraud to be "in the letter of credit transaction or in a transaction so intimately related to the letter of credit transaction as to be an implied term of it".[204] The broad approach, as favoured by *inter alia* Van Houten[205] and Krimm,[206] takes a less strict view and accepts that fraud in the underlying transaction may be sufficient.[207] There is also a diversity of opinion as to the standard of fraud required. There is much support for the view that only egregious fraud, that is "fraud which taints the entire transaction"[208] will suffice. There is, however, also support for the standard of "ordinary or 'intentional' fraud",[209] as well as for the even broader, more flexible "constructive fraud" standard.[210]

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200 This is the terminology of Dolan (*op cit* n 193) par 7.04[3][b]. See also Getz (*op cit* n 198) 206 who differentiates between a "strict" and a "more flexible equitable approach".

201 The most comprehensive review of the many American cases in this regard is that of Dolan (*op cit* n 193) par 7.04[a]-[e]. See further Harfield H *Bank Credits and Acceptances* 5 ed (1974) Ronald Press Co New York 80-83; Sarna (*op cit* n 131) and *Letters of Credit* 3 ed (1989) (loose-leaf edition) par 5(3)(c); Krimm (*op cit* n 198); Symons E L Jr "Letters of Credit: Fraud, Good Faith and the Basis for Injunctive Relief" (1980) 54 *Tulane Law Review* 338; Lewin Smith (*op cit* n 127); Van Houten (*op cit* n 127); Getz (*op cit* n 198) 189.

202 (*Op cit* n 201) 82-83.

203 (*Op cit* n 193) par 7.04[3][b].

204 *Bank of Nova Scotia v Angelica-Whitewear Ltd* (1987) 36 DLR 4th 161 (SCC) 170.

205 (*Op cit* n 127) 384-388.

206 (*Op cit* n 198) 1101.

207 One of the arguments encountered in this regard is that the other exceptions cover all forms of fraud in the documentary-credit transaction. Therefore, for "fraud in the transaction" not to be redundant in the context of § 5-114 it must necessarily also refer to fraud in the underlying transaction. See Getz (*op cit* n 198) 208. See however Dolan (*op cit* n 193) par 7.04[3] for a different view.

208 Krimm (*op cit* n 198) 1099.

209 Symons (*op cit* n 201) 339. This is fraud "in the sense of common law deceit requiring scienter".

210 See Getz (*op cit* n 198) 207; Krimm (*op cit* n 198) 1099-1100; Symons (*op cit* n 201) 340.

Analyses of the vast array of American case law dealing with these issues have not led to anything approaching a *communis opinio*. Getz remarked aptly that "a precise resolution ... is neither possible nor justifiable on the basis of the litigated cases".[211] The diversity of opinion can be demonstrated sufficiently with reference to three of the most frequently cited fraud cases. The first is the case *N M C Enterprises Inc v Columbia Broadcasting Systems Inc.*[212] In this case the customer sought a preliminary injunction restraining the bank from honouring a draft drawn in terms of a documentary credit. The underlying contract was for the purchase of a large number of stereo receivers. The receivers were delivered but the customer alleged that they were substantially less powerful than specified in brochures which, according to the customer, were the basis upon which it had contracted. Furthermore, there was evidence before the court that the beneficiary had been aware of this fact prior to the conclusion of the contract. The court found that these allegations established "a substantial prima facie case of *fraud in the inducement of the contract*", because although the quality of the goods could not form the basis for an injunction, "where the documents *or the underlying transaction* are tainted with *intentional fraud*, the draft need not be honored by the bank, even though the documents conform on their face".[213]

In *United Bank Ltd v Cambridge Sporting Goods Corporation*[214] the beneficiary had shipped old, unpadded, ripped and mildewed boxing gloves instead of the new ones ordered. This was regarded by the court as "fraud in the transaction". The following *dictum* is instructive:

> "It should be noted that the drafters of section 5-114, in their attempt to codify the *Sztejn* case and in utilizing the term 'fraud in the transaction', have eschewed a dogmatic approach and

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211 (*Op cit* n 198) 209.

212 (1974) 14 UCC Rep 1427 (NYSC). The report was not available to me. I have relied on the following discussions of the case: *Bank of Nova Scotia v Angelica-Whitewear Ltd* (1987) 36 DLR 4th 161 (SCC) 171; Symons (*op cit* n 201) 375-376; Justice J B "Letters of Credit: Expectations and Frustrations - Part 2" (1977) 94 *Banking Law Journal* 493 502-503; Dolan (*op cit* n 193) par 7.04[3][b] n 150, par 7 04[4][c]; White & Summers (*op cit* n 190) 737.

213 1429 (my italics).

214 (1976) 360 NE 2d 943 (New York Court of Appeals). For discussions of the case see *Bank of Nova Scotia v Angelica-Whitewear Ltd* (1987) 36 DLR 4th 161 (SCC) 171-172; Krimm (*op cit* n 198) 1097; Symons (*op cit* n 201) 374-375; Sarna (*op cit* n 131) par 5(3)(c)(i).

> adopted a flexible standard to be applied as the circumstances of a particular situation mandate."[215]

While both the *NMC Enterprises* and *United Bank* decisions are clear indications that fraud in the underlying transaction may form the basis for injunctive relief, the approach of the court in *Intraworld Industries Inc v Girard Trust Bank*[216] was substantially different. The lessee of a Swiss hotel had arranged for a standby letter of credit to be issued to guarantee payment of one year's rent in advance as liquidated damages for its nonperformance under the lease. The beneficiary demanded payment under the credit. The lessee (customer) sought an injunction to restrain the bank from paying. It alleged that the demand was fraudulent because: (i) no rent was due as the contract had been terminated by the lessor (beneficiary); and (ii) that the claim was not one for rent but for a stipulated penalty under the lease. The court did not attempt to determine whether in fact rent was due (a question it considered to be a matter for a Swiss court). Refusing the injunction the court stated:

> "[W]e think that the circumstances which will justify an injunction against honor must be *narrowly limited* to situations of fraud in which the wrongdoing of the beneficiary has so *vitiated the entire transaction* that the legitimate purpose of the independence of the issuer's obligation would no longer be served."[217]

This *dictum* is often cited as a classic exposition of the narrow or strict approach. As a matter of legal theory the approach of the court is attractive due to the fact that it "de-emphasises abstract concepts of 'fraud' and 'transaction' that offer little guidance to courts" and focuses rather on the policy consideration of the purpose of the independence principle.[218]

It would further appear from this *dictum* that the "fraud in the transaction" exception is to be limited to fraud by the beneficiary as opposed to that by a third party. There is also additional support for this view in American case

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215 949.

216 (1975) 336 A 2d 316 (Supreme Court of Pennsylvania). For discussions of the case see Justice (*op cit* n 212) 500-501; Symons (*op cit* n 201) 370-371; Getz (*op cit* n 198) 209; Dolan (*op cit* n 193) par 7.04[4][d].

217 324-325 (my italics).

218 See Getz (*op cit* n 198) 209.

law.[219] In the event of a forged or fraudulent document, however, the beneficiary, due to certain statutory warranties, will seldom be able to rely on the fact that the forgery or fraud was that of a third party. In addition to the warranties relating to documents of title and securities under § 5-114 itself, in terms of § 5-111 "the beneficiary by transferring or presenting a documentary draft or demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with".[220] It is clear that the *United City Merchants* case would have been decided differently under Article 5.

The requirements for injunctive relief are not set out in Article 5. It would appear though that the customer has to satisfy the traditional rules for extraordinary relief. This normally includes: (i) a reasonable probability of ultimate success; (ii) a necessity to preserve the status quo; and (iii) irreparable harm or an inadequate remedy.[221] Dolan states that these prerequisites "provide a significant threshold for the account party to cross in order to obtain injunctive relief".[222] Nevertheless, it would be safe to conclude from the many successful suits that injunctive relief has generally been substantially easier to obtain in the United States than in England.

The New Revision of Article 5

The consequences of fraud and forgery in documentary credits have been substantially revised in § 5-109 of the new revision. The section deals in the first place with the position of the issuer who is confronted by a situation of forgery or fraud (§ 5-109(a)), and in the second place with injunctions by the applicant against the issuer in situations of forgery and fraud (§ 5-109(b)). The revision is not yet in force and many of its merits or demerits must therefore still be exposed. However, there are some significant changes which deserve comment.

The general rule against which the fraud and forgery exceptions must be viewed reads:

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219 See Krimm (*op cit* n 198) 1095-1096.

220 See Dolan (*op cit* n 193) par 7.04[4][a].

221 Dolan (*op cit* n 193) par 7.04[1].

222 *Ibid.*

> "Except as otherwise provided in Section 5-109, an issuer shall honour a presentation that ... appears on its face strictly to comply with the terms and conditions of the letter of credit."[223]

§ 5-109(a) admits three exceptions to this general rule: (i) where a required document has been forged; (ii) where a required document is materially fraudulent; and (iii) where honour of the presentation "would facilitate a material fraud by the beneficiary on the issuer or applicant". As in the case of its predecessor[224] the article then states that despite the fact that the presentation falls within one of the above exceptions, the issuer is nevertheless obliged to honour the presentation as against third parties who have given value in good faith.[225] In any other instance a forged or fraudulent presentation may be honoured or dishonoured by the issuer acting in good faith.[226]

The new revision differs from its predecessor in several important respects. First, breach of the statutory warranties relating to documents of title and securities no longer forms part of the exceptions. Warranties are dealt with in § 5-110 of the new revision. As against the issuer, any other party to whom presentation is made, and the applicant the beneficiary warrants that there is no fraud or forgery as described in § 5-109. However, these warranties only become operative if the presentation is honoured.[227] Thus, as pointed out in the Official Comment, "no warranty ... can ever be a defense to dishonor by the issuer" under the new revision.[228]

Secondly, the "fraud in the transaction" concept has been abandoned. Instead the section refers to a situation where "honor of the presentation would facilitate

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223 § 5-108(a).

224 See the text at n 190 above.

225 § 5-109(a)(1). These are: (i) "a nominated person who has given value in good faith"; (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 was taken after acceptance by the issuer or nominated person"; and (iv) "an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice or material fraud after the obligation was incurred by the issuer or nominated person".

226 § 5-109(a)(2). The election to honour or dishonour in these circumstances is not expressly stated in the current § 5-114 although present by negative implication. See the text at n 191 above. See also par 2 of the Official Comment to § 5-109 of the new revision.

227 § 5-110(a).

228 Par 1 of the Official Comment to § 5-109.

a material fraud by the beneficiary on the issuer or applicant". This exception is phrased very widely and, it is submitted, clearly includes fraud in the underlying transaction. This viewpoint is strengthened by the third innovation namely the introduction of the requirement that the fraud must be "material". In this respect the Official Comment reads:

> "The use of the word requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction. ... One must examine the underlying transaction when there is an allegation of material fraud, for only by examining that transaction can one determine whether a document is fraudulent or the beneficiary has committed fraud and, if so, whether the fraud was material."[229]

Although "the breadth and width" of materiality is left for the courts to decide, the Official Comment states that material fraud by the beneficiary occurs only when he has "no colorable right to expect honor and where there is no basis in fact to support such a right to honor". As such the section is regarded as indorsing articulations such as that in *inter alia* the *Intraworld Industries*[230] case.[231]

The applicant's right to injunctive relief is set out as follows in § 5-109(b):

> "If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:
>
> (1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;
>
> (2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;
>
> (3) all the conditions to entitle a person to the relief under the law of this State have been met; and

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229 Par 1.

230 See the discussion at n 216 above.

231 Par 1 of the Official Comment.

> (4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (a) (1)."

Unlike its predecessor § 5-109 specifies the requirements to be met for injunctive relief. Moreover, it is stated in the Official Comment that the standard for injunctive relief is high, and that the burden remains on the applicant "to show by evidence and not by mere allegation" that the relief is warranted.[232] Finally, it must be noted that § 5-109(b) does not restrict itself to injunctions against honor but refers also to "similar relief". Therefore, in terms of the Official Comment, "the same principles apply when the applicant or issuer attempts to achieve the same legal outcome by injunction against presentation ..., interpleader, declaratory judgment, or attachment" as "these devices could threaten the independence principle just as much as injunctions against honor".[233]

6 3 4 Illegality

The illegality of a documentary credit may constitute a valid defence.[234] The most important application of this principle relates to exchange control. The English positive law in this regard was also clearly established in the *United City Merchants* case discussed in a different context above.[235] The facts pertaining to the illegality aspect were that the beneficiary was requested to invoice the goods it was selling to the Peruvian buyer at double the contract price, with the understanding that the beneficiary would deposit the excess funds in an American bank to the buyer's account. Thus, the credit was utilised as a device to move currency out of Peru in contravention of Peruvian exchange-control legislation. The Royal Bank of Canada (confirming bank) raised as defences: (i) that the credit was "illegal and or unenforceable as contrary to public policy" in English law because it contravened Peruvian exchange-control regulations; and (ii) that it was "unenforceable by reason of the Bretton Woods Agreement Order in Council 1946".[236] The first defence was

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232 Par 5.

233 *Ibid.*

234 Goode (*op cit* n 142) 1008.

235 Par 6 3 2.

236 *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1979] 2 Lloyd's Rep 498 (QB) 499.

not dealt with due to the fact that the second was successful. The relevant provision of the Bretton Woods Agreement reads as follows:

> "Exchange contracts 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 unenforceable in the territories of any member".[237]

The main question to be determined in this regard was therefore whether the credit did in fact amount to an "exchange contract" as contemplated by the Bretton Woods Agreement. Mocatta J accepted the definition in *Wilson, Smithett & Cope Ltd v Terruzi*[238] that an "exchange contract" was "a contract to exchange a currency of one country for that of another and that contracts involving securities or merchandise were not exchange contracts, except where they were monetary transactions in disguise".[239] He concluded that the documentary credit *in casu* was a "monetary transaction in disguise" and as such an "exchange contract" unenforceable in its entirety under the Bretton Woods Agreement.[240]

The Court of Appeal indorsed the finding that the documentary credit contained an exchange contract which was unenforceable due to the provisions of the Bretton Woods Agreement. However, all three judges were of the opinion that not the entire documentary credit was contaminated by this fact, but only that portion which did not represent goods. The House of Lords took the same view as the Court of Appeal in this regard. Lord Diplock stated:

> "I avoid speaking of "severability", for this expression is appropriate where the task upon which the court is engaged is construing the language that the parties have used in a written contract. The question whether and to what extent a contract is unenforceable under the Bretton Woods Agreements ... because it is a monetary transaction in disguise is *not* a question of construction of the contract, but a question of the substance of a transaction to which enforcement of the contract will give effect. ... [T]he task on which the court is engaged is to penetrate any disguise presented by the actual words the parties have used, to identify any monetary transaction ... which those words were

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237 Bretton Woods Agreement Order in Council, 1946, a VIII s 2(b) (quoted from Lord Diplock's speech in the *United City Merchants* case ([1983] AC 168 (HL) 188F).

238 [1976] QB 683 (CA) 714.

239 503.

240 504-505.

> intended to conceal and to refuse to enforce the contract to the extent that to do so would give effect to the monetary transaction."[241]

The decision received a mixed response. Mann was highly critical of it. He argued that although the contract of sale clearly constituted an "exchange contract" for the purposes of the Bretton Woods Agreement, the same cannot be said of the documentary credit:

> "It is ... difficult to see how a letter of credit confirmed by a London bank to a London seller, providing for payment in London to the seller and constituting an independent and autonomous contract can properly be described as an exchange contract."[242]

Thus, he regarded the decision as a clear violation of the independence principle. Dolan, on the other hand, regarded it as striking "a sensible balance between the policy of credit law and that of the IMF Agreement".[243]

In the broad context of illegality the existence of certain American statutes is also noteworthy. By virtue of the Trading With the Enemy Act[244] the president may in the interest of national security limit commerce with foreign governments and nationals. This includes the blocking of letter-of-credit payments. Such action has in the past affected payments to Iran,[245] Cuba, Panama and Libya. Dolan remarks that "[t]hese exercises of federal power undoubtedly affect the acceptability of credits issued by U.S. banks

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241 189G-190B.

242 Mann F A "Documentary Credits and Bretton Woods" (1982) 98 *Law Quarterly Review* 526 527-528.

243 (*Op cit* n 193) par 9.06[4][d]. See also Kalson D J "The International Monetary Fund Agreement and Letters of Credit: A Balancing of Purposes" (1983) 44 *University of Pittsburgh Law Review* 1061 1073: "It appears that the Court of Appeals and the House of Lords ... have accomplished a balancing of international trade and monetary stability". These sentiments underlie the following *dictum* from Stephenson LJ's judgment in the Court of Appeal: "International trade requires the enforcement of letters of credit but international comity requires the enforcement of the Bretton Woods Agreement. I do not see why a court should shut its eyes to the object of the contract and with its eyes shut fall over backwards to avoid complying with the demands of international comity." ([1982] 1 QB 208 227D-E.)

244 50 USC app 5(b) (1982). (I rely here on Dolan (*op cit* n 193) par 9.06[4][b].)

245 See in general on the effect of the US-Iran diplomatic crisis on standby letters of credit Getz (*op cit* n 198).

negatively".[246] Similarly, in terms of the Export Administration Act no issuer may be obligated to pay a letter of credit the terms of which violate anti-boycott provisions.[247]

6 3 5 Strict Compliance

Introduction

The presentation of non-conforming documents is a valid defence, recognised in the *UCP*,[248] available to a bank against the beneficiary. As is the case in the civil-law jurisdictions the question whether the documents conform is mostly determined with reference to the doctrine of strict compliance. However, a different standard, that of "substantial compliance", has also emerged in American jurisprudence.

English Law

The doctrine of strict compliance is well established in English law. It is seen as governing not only the bank-beneficiary relationship but also inter-bank as and the issuing bank-applicant relationships.[249] The classic *dictum* in this regard is that of Viscount Sumner in *Equitable Trust Co of New York v Dawson Partners*:

> "It is both common ground and common sense that ... the accepting bank can only claim indemnity if the conditions on which it is authorised to accept are in the matter of the accompanying documents strictly observed. *There is no room for documents which are almost the same, or which will do just as well*. Business could not proceed securely on any other lines. 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."[250]

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246 (*Op cit* n 193) par 9.06[4][b].

247 50 USC app § 2407(a)(1)(F) (1982). (I rely here on Dolan (*op cit* n 193) par 9.06[4][e].)

248 See n 30 and par 3 9 2 above.

249 Ellinger E P "Documentary Credits and Finance by Mercantile Houses" in Guest A G (general editor) *Benjamin's Sale of Goods* 3 ed (1987) Sweet & Maxwell London 1442 (par 2271); Goode (*op cit* n 142) 992-993.

250 [1926] 27 Ll L Rep 49 (HL) 52 (my italics). See also *English, Scottish and Australian Bank Ltd v Bank of South Africa* [1922] 13 Ll L Rep 21.

Thus, where the credit called for a certificate of quality "by experts" and the bank paid out against a certificate of quality "by expert" it was held that the bank was not entitled to be reimbursed. Subsequently this *dictum* has been cited with approval and applied in several cases.[251] In *Gian Singh & Co Ltd v Banque de l'Indochine* Lord Diplock remarked that it "has never been questioned or improved upon".[252] More recently, in *Banque l'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd*, Parker J commented as follows on Viscount Sumner's statement:

> "I also accept ... that Lord Sumner's statement cannot be taken as requiring rigid meticulous fulfilment of precise wording in all cases. *Some margin must and can be allowed*, but it is slight, and banks will be at risk in most cases where there is less than strict compliance. They may pay on a reasonable interpretation ... where instructions are ambiguous, but where the instructions ... are clear they are obliged to see to it that the instructions are complied with and entitled to refuse payment to the beneficiary unless they are."[253]

It would accordingly appear that Parker J accepts that in principle there may exist a discrepancy in the documents so trivial that it may be ignored. However, it has subsequently become clear that English courts favour a restrictive interpretation of this *dictum*. It clearly does not mean that the rule *de minimis non curat lex* is applicable in this context.[254] In *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran* the letter of credit required that the number of the letter of credit and the buyer's name were to appear on all documents. They did not, however, appear on a certain document. Having been referred to the remarks of Parker J quoted above Lloyd LJ refused to regard the discrepancy as trivial:

> "I cannot regard as trivial something which, whatever may be the reason, the credit specifically requires. It would not, I think, help to attempt to define the sort of discrepancy which can properly be regarded as trivial. But one might take, by way of example, *Bankers Trust Co. v. State Bank of India*, [1991] 2 Lloyd's Rep.

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251 See, for example, *J H Rayner & Co Ltd v Hambros Bank Ltd* [1943] KB 37 (CA) 40; *Bank Melli Iran v Barclays Bank* [1951] 2 Lloyd's Rep 367 (KB) 374; *Moralice (London) Ltd v E D & F Man* [1954] 2 Lloyd's Rep 526 (QB) 532.

252 [1974] 2 Lloyd's Rep 1 (CA) 12.

253 [1983] 1 QB 711 (CA) 721E-G (my italics).

254 Jack (*op cit* n 1) 152; Ellinger (*op cit* n 249) 1442 (par 2271). See also *Moralice (London) Ltd v E D & F Man* [1954] 2 Lloyd's Rep 526 (QB); *Soproma SpA v Marine and Animal By-Products Corporation* [1966] 1 Lloyd's Rep 367 (QB) 390.

> 443 where one of the documents gave the buyer's telex number as 931310 instead of 981310. The discrepancy in the present case is not in that order."[255]

Thus, in English law, strict compliance "is indeed strict!"[256] Clearly, however, the rule cannot be absolute. As pointed out by Gutteridge and Megrah it would be ludicrous to extend the rule to the dotting of i's or the crossing of t's, or to obvious typographical errors,[257] but it is impossible to define precise limits. Each case must be considered in its own circumstances. A dogmatic generalised approach must be rejected.[258]

It is further clear that for the defence of non-compliance to be raised successfully in English law, good faith is not a requirement. In this regard Ellinger states:

> "One result of the doctrine of strict compliance is that the person to whom the documents are tendered may raise any lawful objections against the documents, *even if in fact his objection is purely technical and the true motive for his rejection of the tender is to be found in a falling market or in some other extraneous circumstances.*"[259]

It would therefore appear that the defence of non-compliance is likely to succeed in England in situations where it may fail in Germany.

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255 [1993] 1 Lloyd's Rep 236 (CA) 240.

256 Todd (*op cit* n 143) 146. But see Goode (*op cit* n 142) 993 who remarks that "the degree of strictness varies according to the particular circumstances and the parties involved". It appears from the context, however, that this statement probably reflects the global position rather than that in England.

257 Jack (*op cit* n 1) 153 refers to the Hong Kong case *Hip Hing Fat Co Ltd v Daiwa Bank* [1991] 2 HKLR 35 in which the name "Cheergoal Industrial Limited" appeared on a document instead of "Cheergoal Industries Limited". Kaplan J, with reference to the statement of Gutteridge & Megrah under consideration, held that this was an obvious typographical error which had caused no confusion and could not be relied upon as a discrepancy.

258 Gutteridge H C & Megrah M *The Law of Bankers' Commercial Credits* (1984) Europa Publications London 120-121. See also Jack (*op cit* n 1) 153.

259 (*Op cit* n 249) 1443 (par 2272) (my italics). See also Jack (*op cit* n 1) 151 who states that technicalities "may be the buyer's best chance of avoiding taking up documents where he suspects that the goods do not comply with the contract". Due to the narrow confines of the fraud defence in English law, this is no doubt correct.

The Law in the United States of America

In terms of Article 5 of the UCC (the revision currently in force) an issuer must honour a draft or demand for payment "which complies with the terms of the relevant credit".[260] However, both the Code and Official Commentary are silent on the standard to be applied for determining whether a document "complies". Furthermore, the courts' interpretations differ widely in this regard. White and Summers[261] differentiate between the so-called "New York rule" where the standard is "one of strict compliance" (the majority view)[262] and the rule of "substantial compliance" which, inspired by notions of equity, is favoured in some other jurisdictions.[263] Issuers have also argued that the standard is in fact bifurcated: that in the beneficiary bank relationship the standard is strict compliance whilst in the bank-applicant relationship substantial compliance will do.[264]

There is a vast array of American case law relating to documentary compliance.[265] If one accepts the majority view that the proper standard is that of strict compliance, the most problematical question is probably where to draw the line. In this regard two instructive cases deserve attention. In the first,

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260 A 5-114(1).

261 (*Op cit* n 190) 729-732.

262 Dolan (*op cit* n 193) par 6.03. For a review the extensive case law supporting the strict rule see also par 6.04.

263 The leading case on the doctrine of substantial compliance doctrine is arguably *Banco Espanol de Credito v State Street Bank and Trust Co* (1967) 385 F 2d 230 (US Court of Appeals 1st Circuit). The defendant bank refused to honour the draft of the plaintiff on the basis that the credit called for an inspection certificate stipulating "that the goods are in conformity with the order" whilst the certificate received stated that based on a 10% sample "the whole ... [was] found conforming to the conditions estipulated [sic] on the Order-Stock-sheets" (233). The court referred to the doctrine of strict compliance but then found that there was "some leaven in the loaf of strict compliance" and that the differences amounted to "semantic myopia" (237). See also the decision of the same court in *Flagship Cruises Ltd v New England Merchants National Bank of Boston* (1978) 569 F 2d 699 (US Court of Appeals 1st Circuit). For a comprehensive review of these and other cases supporting or influenced by the substantial compliance rule see Dolan (*op cit* n 193) par 6.05. See also McLaughlin G T "On the Periphery of Letter-of-Credit Law: Softening the Rigors of Strict Compliance" (1989) 106 *Banking Law Journal* 4.

264 Dolan J F "Letter-of-Credit Disputes between the Issuer and its Customer: The Issuer's Rights under the Misnamed 'Bifurcated Standard'" (1988) 105 *Banking Law Journal* 380 383.

265 For a comprehensive review see Dolan (*op cit* n 193) par 6.03 - 6.05.

Tosco Corporation v Federal Deposit Insurance Corporation,[266] the credit called for drafts "drawn under Bank of Clarksville Letter of Credit Number 105" whilst the legend of the draft presented stated "Drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105"[267] The United States Court of Appeals held that the standard of conformity was by no means settled in the law of Tennessee and that "the district court did not err in concluding that the 'strict compliance' defense [was] not controlling under the facts of the present case".[268] Commenting on this decision Dolan stated:

> "The court need not have rejected strict compliance... . Under the strict rule, this draft is clearly conforming. *The reason for the strict rule is to protect the issuer from having to know the commercial impact of a discrepancy in the documents*. Under the strict rule, a bank document examiner does not [for example] need to judge whether dried grapes are the same as raisins[269] and does not need to know that 'C.R.S.' stands for Coromandel groundnuts.[270] The legend in question, and most such legends, are for the issuer's benefit. Such legends assist the banker in identifying the credit, and it would not offend the strict rule to require bankers to understand that minor discrepancies of this sort do not offend the reason of the strict compliance rule."[271]

This reasoning of Dolan was subsequently referred to with approval and applied in *New Braunfels National Bank v Odiorne*.[272] In this case the bank refused to honour the draft because the draft's legend referred to "Irrevocable Letter of Credit No. 86-122-5" whilst the credit specified "Irrevocable Letter of Credit No. 86-122-S".[273] The court in rejecting the bank's refusal remarked that maintaining the integrity of the strict compliance rule was important to the

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266 (1983) 723 F 2d 1242 (US Court of Appeals 6th Circuit).

267 1247 (my underlining).

268 1248.

269 A reference to *Bank of Italy v Merchants Nat Bank* (1923) 140 NE 211 (Court of Appeals of New York) 212: "'Raisins' and 'dried grapes' may or may not be the same article. We do not know."

270 A reference to *J H Rayner & Co Ltd v Hambros Bank Ltd* 1942 2 All ER 694 (CA) 703D: "[I]f the customer says: 'I require a bill of lading for Coromandel groundnuts,' the bank is not justified, in my judgment, in paying against a bill of lading for anything except Coromandel groundnuts".

271 (*Op cit* n 193) par 6.04[3] (my italics).

272 (1989) 780 SW 2d 313 (Court of Appeals of Texas).

273 315-316 (my underlining).

continued usefulness of letters of credit, but that this did not mean "that strict compliance demands an oppressive perfectionalism". With reference to Dolan's argument quoted above the court found that there is a "logical distinction between discrepancies that relate to the business of the underlying transaction and those that relate to the banker's own business".[274]

According to this approach strict compliance does not mean a blind adherence. It can be expected of a banker, where he is able to do so, to determine the relevance of a particular discrepancy. Generally this means that if the requirement relates to the underlying transaction it must be complied with meticulously due to the fact that it cannot be expected of a banker to determine the relevance of such a discrepancy. On the other hand a banker ought to be able to determine the relevance of a discrepancy relating to the banker's own business.[275] So viewed, it would be fair to say that, even under the New York rule, the American approach to strict compliance under the current revision of Article 5 has been less strict than that of the English courts.[276]

The new revision of Article 5 has succeeded in clarifying much of the uncertainty regarding documentary compliance. The principle is stated thus:

> "Except as otherwise provided in Section 5-109 [the exceptions clause[277]], an issuer shall honor a presentation that, *as determined by the standard practice* referred to in subsection (e), appears on its face *strictly* to comply with the terms and conditions of the letter of credit."[278]

Thus, the substantial compliance doctrine is clearly rejected. However, to employ Mclaughlin's phrase "the rigors of strict compliance" are "softened"[279]

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274 316-317.

275 Mclaughlin (*op cit* n 263) 9 similarly relates the limits of strict compliance to relevance: "Obvious typographical errors (Smithh for Smith) or obvious alternative phrasings ('debtor Q has not repaid the $1 million loan due on June 1' for 'debtor Q has not repaid the $1 million loan maturing on June 1') should not affect payment. But, realistically, *whenever there is any doubt about the relevance of a discrepancy*, the issuing bank should adopt a conservative stance." (My italics.)

276 See the discussion above, especially that of the *Seaconsar* case.

277 See n 223 above.

278 § 5-108(a) (my italics).

279 (*Op cit* n 263) title.

by the provision that what amounts to "strict compliance" must be determined with reference to "standard practice". In this regard subsection (e) provides:

> "An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice."

The standard of strict compliance is applicable both to the beneficiary's right to payment and the bank's right to reimbursement. Thus, the new revision also rejects the bifurcated standard. However, it is pointed out in the Official Comment that it is possible for an issuer to restrict contractually its liability to the applicant. In such a case "the beneficiary would have to meet a more stringent standard of compliance as to the issuer than the issuer will have to meet as to the applicant".[280]

The effect of adopting standard practice as a way of measuring strict compliance is that "[s]trict compliance does not mean slavish conformity to the terms of the credit". In this regard the Official Comment with express reference[281] indorses the findings in the *New Braunfels* and *Tosco* cases discussed above.[282] The Official Comment also gives the fictional example of a document addressed by a foreign person to "Jeneral Motors" instead of "General Motors" which, in the absence of other defects, it considers as conforming.[283]

6 3 6 Unauthorised Credits

In principle it must clearly be competent for a bank to raise the defence that it did not issue the credit, in other words that it was issued by an unauthorised person.[284] This matter has not received much attention in English legal literature. However, it recently came to the fore in *Standard Bank London Ltd v The Bank of Tokyo Ltd*; *Sudwestdeutsche Handelsbank Girozentrale v The Bank*

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280 Official Comment to § 5-108 par 1.

281 *Ibid.*

282 See the text at nn 266-274 above. It also expressly rejects the approach in the *Banco Espanol* case (see n 263 above).

283 Official Comment to § 5-108 par 1.

284 See the text at n 19 above.

of Tokyo Ltd.[285] The Bank of Tokyo was sued on certain credits. Its defence was that the signature on the credits was forged, and that they were therefore not authorised (issued) by the bank. This was not denied by the plaintiff. The plaintiff's case, however, was that it had relied on a so-called "tested telex". Chatterjee describes the tested telex as follows:

> "A tested telex is a device for sending messages by codes or tests which are secret between a sender (a bank) and a recipient (another bank) so that the latter recognises with reference to the code or test that the message has been sent by and with the authority of the bank which purported to send it. ... This device is used between banks in order to transact business swiftly."[286]

The plaintiff led expert evidence to the effect that "the banking system relies with complete confidence on tested telexes" and that "the system is meant to avoid arguments in relation to authority".[287] This evidence was not challenged by the defendant. It was also not disputed that if the plaintiff had had actual knowledge that the credit was forged, the plaintiff would not have been able to rely on the tested telex. The dispute centred on defendant's contention that certain factors should have put the plaintiff on notice that the telexes were not what they purported to be. The court stressed in this regard that the duty to inquire would depend upon the circumstances: the more unusual the circumstances are the greater the duty would be. However, "some want of probity should be necessary as opposed to carelessness".[288] Thus "willful blindness is the only basis on which knowledge of fraud or facts to put on inquiry as to fraud, is normally imputed". Negligence does not suffice.[289] Such "willful blindness" was not found to be present and the defendant was held liable on the unauthorised credits.

In the absence of an appropriate agreement between all participating banks, however, the legal basis for limiting the issuing bank's defence of absence of authority in circumstances such as these is unclear. There are some indications

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285 [1995] 2 Lloyd's Rep 169 (QB). For discussions of the case see Chatterjee C "Legal Aspects of Tested Telex in Transnational Banking Transactions" 1995 *Journal of International Banking Law* 62-68; Oelofse (*op cit* n 162) 5-7.

286 Chatterjee (*op cit* n 285) 62.

287 173.

288 174-175.

289 175.

in the judgment that it may be estoppel.[290] However, as Oelofse points out, it is difficult to construe a misrepresentation on the part of the bank. His contention that trade usage would be a sounder basis is convincing.[291]

6 3 7 Set-off

The question whether set-off can be raised as a defence by an issuing or confirming bank against the beneficiary has received comparatively little attention in common-law literature.[292] Jack states that "[i]t will very rarely happen that the factual situation between a paying bank and the beneficiary will be such as to enable the bank to raise a set-off".[293] This is undoubtedly true. Nevertheless, the matter has arisen in a few cases.

The American case *Banco Nacional de Cuba v Chase Manhattan Bank*[294] serves as a good example of a factual situation in which the defence of set-off could arise. In this case the beneficiary drew a draft on the issuing bank and deposited it for collection at the Banco Nacional. In the interim the Cuban government had expropriated property of the issuer. The issuer, arguing that the Banco Nacional was simply an *alter ego* of the Cuban government, attempted to set-off its losses from the expropriation against the amount of the draft. The court accepted that for the purposes of this case the Banco Nacional and Cuban government were in effect the same person, but ruled that set-off was incompetent due to the fact that the Banco Nacional was not collecting payment of the draft on its own behalf, but as the agent of the beneficiary. Thus, one could argue, that if the Banco Nacional had collected in own right (for example as negotiating bank), set-off would have succeeded.

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290 185, 186. See also points (6) and (8) in the headnote at 170-171.

291 Oelofse (*op cit* n 162) 6-7.

292 Jack (*op cit* n 1) 112-113 refers to the question briefly, whilst Gutteridge & Megrah (*op cit* n 258) and Ellinger (*op cit* n 249) do not refer to it at all. The best analysis is that of Mugasha A "Set-Off and Letters of Credit: *Hongkong and Shanghai Banking Corp. v. Kloeckner & Co.*" (1991-1992) 7 *Banking & Finance Law Review* 307. For a brief overview of relevant case law see Dolan (*op cit* n 193) par 9.06[3].

293 (*Op cit* n 1) 112.

294 (1980) 505 F Supp 412 (US District Court SD New York).

Another factual situation in which set-off could arise came to the fore in *Etablissement Esefka International Anstalt v Central Bank of Nigeria*.[295] Lord Denning suggested (*obiter*) that a bank may set off a claim to recover payments made under a credit in respect of fraudulent shipments against a claim by the beneficiary under the credit for demurrage incurred for other shipments.

However, the main case relating to set-off in this context is undoubtedly *Hongkong and Shanghai Banking Corporation v Kloeckner & Co AG*.[296] This case addresses important issues and requires detailed consideration. The dispute arose from a complicated financial arrangement between the Hongkong and Shanghai Banking Corporation (the bank), its customer (Gatoil) and the defendant (Kloeckner). The financial arrangement involved two types of transactions encountered in the oil trade, that is so-called "wet-cargo" and "dry-cargo" transactions. A "wet-cargo" transaction relates to "presold physical cargoes of oil".[297] The arrangement in these transactions was that the supplier shipped cargo to Gatoil (an intermediary) and was paid by the bank against delivery of the shipping documents to the bank. The bank in turn delivered the shipping documents to Kloeckner against Kloeckner's undertaking to pay them. This arrangement accordingly comprised the following relationships: (i) the relationship between the supplier and bank in terms of which the bank paid the supplier against delivery of the documents; (ii) the relationship between the bank and its client Gatoil in terms of which Gatoil pledged the documents to the bank thereby obtaining payment for the cargo; (iii) the relationship between Gatoil and Kloeckner whereby Gatoil sold the cargo to Kloeckner; and (iv) the relationship between Kloeckner and the bank in terms of which Kloeckner irrevocably undertook to pay the bank the invoice price of the oil.

"Dry cargo" transactions are forward contracts, that is agreements "to sell a commodity at a fixed future date but at a price set at the time the contract is made".[298] The arrangement in these cases was that Gatoil would enter into a

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295 [1979] 1 Lloyd's Rep 445 (CA).

296 [1990] 2 QB 514, [1989] 3 All ER 513 (QB). This case has generated considerable interest. For a thorough analysis see Mugasha (*op cit* n 292). See also Gillespie S "Letters of Credit - Set-off" (1989) 4 *Journal of International Banking Law* N161; Dolan (*op cit* n 193) par 9.06[3].

297 Mugasha (*op cit* n 292) 308.

298 *Ibid*.

forward contract with Kloeckner, and assign its rights in regard to these contracts to the bank. The bank, in turn, would advance money to Gatoil and at the same time issue a standby letter of credit to Kloeckner to secure Gatoil's obligations to Kloeckner under the forward contracts (delivery of the cargo). Thus, the relationships in this arrangement were: (i) the forward contract between Gatoil and Kloeckner; (ii) the relationship between the bank and Gatoil in terms of which the bank advanced money against assignment to it of the proceeds of the forward contracts and undertook to secure Gatoil's performance of the forward contracts by means of standby credits; (iii) the relationship between the bank and Kloeckner - the standby credit.

The particular dispute arose from various transactions of both types. The bank instituted an action against Kloeckner for $8 million arising from a payment undertaking of Kloeckner in respect of a wet cargo transaction. Kloeckner denied liability and instituted a counterclaim for $10 million against the bank. The counterclaim was based on a standby letter of credit given by the bank to Kloeckner to secure performance of a dry cargo transaction. Kloeckner argued that if necessary the counterclaim could be raised in set-off against the bank's claim. The bank accepted liability on the standby credit but argued that Kloeckner was barred from raising set-off as its payment undertaking was to pay "without any discount, deduction, offset or counterclaim whatsoever".[299] Kloeckner's response was that it was legally impossible to contract out of set-off. The bank further raised an indebtedness of Kloeckner to it totalling $10,2 million in set-off against Kloeckner's counterclaim. This amount reflected the total of the proceeds of forward contracts assigned to the bank by Gatoil and certain payment undertakings by Kloeckner. Kloeckner's response was that "there can in law be no set-off by a bank against a beneficiary of a cross-claim in response to a claim by the latter under a letter of credit".[300]

The court was accordingly faced with two questions relating to set-off: (i) whether it was possible to contract out of set-off; and (ii) whether it was possible to raise set-off against a claim based on a documentary credit. With reference to the first question Hirst J declined to follow two early authorities in

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299 518F (QB), 516H (All ER).

300 521H (QB), 519D (All ER).

support of Kloeckner's contention.[301] Based on the judgment of Lord Denning in *Halesowen Presswork and Assemblies Ltd v Westminster Bank Ltd*[302] that the right of a banker to combine the accounts of a customer (a set-off of accounts in debit and credit) could be excluded by an express or implied agreement, the court ruled that Kloeckner had effectively waived its right to set-off in its payment undertaking.

On the second question Kloeckner's argument was that to allow set-off against a documentary credit obligation would violate the independence principle. Particular reliance was placed on the decision of the Court of Appeal in *Power Curber International Ltd v National Bank of Kuwait SAK* in which Lord Denning MR said:

> "The bank is in no way concerned with any dispute that the buyer may have with the seller. The buyer may say that the goods are not up to contract. Nevertheless the bank must honour its obligations. The buyer may say that he has a cross-claim in a large amount. Still the bank must honour its obligations. A letter of credit is like a bill of exchange given for the price of goods. It ranks as cash and must be honoured. *No set-off or counterclaim is allowed to detract from it ... . [A] letter of credit is given by a bank to the seller with the very intention of avoiding anything in the nature of a set-off or counterclaim.*"[303]

Hirst J rejected this reasoning. He pointed out that the basis of the *Power Curber dictum* was that the bank's obligation towards the beneficiary was independent of that between the applicant (the bank's customer) and the beneficiary. Thus, the court found that Lord Denning's statement should be "interpreted [as prohibiting] a set-off or counterclaim by the buyer against the seller and not one by the bank against the seller".[304] The set-off raised by the bank against Kloeckner's standby-credit claim was accordingly found to be competent.

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301 *Lechmere v Hawkins* (1798) 2 Esp 626 (170 ER 477) and *Taylor v Okey* (1806) 13 Ves 180 (33 ER 263). Hirst J also refers to Halsbury's interpretation of these decisions as authority for the view that the right to set-off "cannot be waived" (521A QB, 518G All ER).

302 [1971] 1 QB 1 (CA).

303 [1981] 1 WLR 1233 (CA) 1241B-C (my italics).

304 525H-526A (QB), 522E (All ER).

The striking feature of Hirst J's judgment is that although the bank raised its own and not its customer's rights against Kloeckner in set-off, these rights were assigned to the bank by Gatoil. The factual situation in the *Kloeckner* case therefore differs from that in the *Banco Nacional* and *Etablissement Esefka* cases. As noted above[305] it has been clearly established in Germany that set-off by an issuing bank of rights assigned to it by its customer against the bank's documentary-credit obligation constitutes an unacceptable violation of the independence principle. This view is shared by the American commentator Dolan.[306] It is suggested that the German position is preferable and that the decision in the *Kloeckner* case is wrong.[307]

6 4 The UNCITRAL Convention

6 4 1 Introduction

The primary object of the UNCITRAL Convention is the regulation of standby letters of credit and demand guarantees. As explained above,[308] however, it has the potential of also regulating the conventional commercial documentary credit. Due to the fact that a standby credit or demand guarantee often becomes payable on the presentation of a simple documentary demand, it stands to reason that these instruments are even more susceptible to fraud than commercial documentary credits. In fact, the regulation of fraud in standby credits and demand guarantees was the main motivating factor in the adoption of the Convention.[309] In this regard it both defines certain exceptions to the payment obligation and regulates the availability of injunctions. The Convention also contains a noteworthy provision relating to set-off.

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305 See n 44 as well as nn 294 and 295 above.

306 (*Op cit* n 193) par 9.06[3]: "It is axiomatic as a matter of credit law ... that the letter of credit be independent of the underlying transaction, and it would destroy the credit if the account party that discovered defective goods were able to assign its claim in recoupment against the beneficiary to the issuer with the idea that the issuer would use the claim as a set-off in the credit transaction."

307 See Mugasha (*op cit* n 292) 320.

308 See par 3 10 3.

309 This, in any event, was my understanding of an unpublished address by members of the UNCITRAL Secretariat at the 6th UNCITRAL Symposium held in Vienna (22-26 May 1995).

6 4 2 Exceptions to the Bank's Obligation to Pay

In terms of article 17 the guarantor or issuer must pay in accordance with its undertaking against presentation of a conforming demand. The interpretation of "conformity" is left open. In terms of article 16, however, the guarantor or issuer shall in determining "facial conformity with the terms and conditions of the undertaking ... have due regard to the applicable international standard of independent guarantee or standby letter of credit". Thus, the Convention does not shed much light on the doctrine of strict compliance.

The principle that a conforming demand must be honoured is expressly subjected to the exceptions contained in article 19 which reads:

> "(1) If it is manifest and clear that:
>
> (a) Any document is not genuine or has been falsified;
>
> (b) No payment is due on the basis asserted in the demand and the supporting documents; or
>
> (c) Judging by the type and purpose of the undertaking, the demand has no conceivable basis,
>
> the guarantor/issuer, acting in good faith, has a right, as against the beneficiary, to withhold payment."

In addition, in terms of article 15(3) the beneficiary, when demanding payment "is deemed to certify that the demand is not in bad faith and that none of the elements referred to in subparagraphs (a), (b) and (c) of paragraph 1 of article 19 are present. The Convention amplifies sub-paragraph (c) by listing five types of situations in which "a demand has no conceivable basis".[310] They are: (i) where the "contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialized"; (ii) where the underlying obligation "has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking"; (iii) where the underlying obligation "has undoubtedly been fulfilled to the satisfaction of the beneficiary"; (iv) where the fulfilment of the underlying obligation "has clearly been prevented by wilful misconduct of the beneficiary"; and (v) where in the case of a demand under a counter-guarantee, "the beneficiary of the counter-guarantee has made payment in bad faith as guarantor/issuer of the undertaking to which the counter-guarantee relates".

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310 A 19(2)(a)-(e).

These provisions will of course have to be interpreted by the courts in the jurisdictions in which the convention may one day apply. However, it can hardly be doubted that in most jurisdictions fraudulent demands (widely interpreted) are less likely to succeed under the Convention than under the prevailing law.

6 4 3 Provisional Measures

Where it is shown on application by the bank's customer (applicant for the credit or guarantee) that there is a "high probability" that the beneficiary's demand (whether already made or expected to be made) is contaminated by any of the circumstances described in article 19(1)(a)-(c),[311] the court may "on the basis of immediately available strong evidence":

> "(a) Issue a provisional order to the effect that the beneficiary does not receive payment, including an order that the guarantor/issuer hold the amount of the undertaking, or
>
> (b) Issue a provisional order to the effect that the proceeds of the undertaking paid to the beneficiary are blocked, taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm."[312]

Thus, the Convention makes provision both for injunctions preventing payment and for attachment or *Mareva*-type injunctions where there is "a high probability" shown by "immediately available strong evidence". Although the precise meaning of these two crucial phrases will have to be determined by the courts in the different jurisdictions, it appears that one may safely conclude that the position of the bank's customer would in most jurisdictions be significantly better under the Convention than under the prevailing law.

6 4 4 Set-off

Finally, as to the availability of set-off the Convention provides that the obligation of an issuer or guarantor may be discharged in this manner except as regards "any claim assigned to it by the principal/applicant or the instructing

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311 See par 6 4 2 above.

312 A 20(1).

party".[313] Thus, in this regard, the convention follows the case law in Germany[314] and rejects the *Klöeckner*[315] judgment.

6 5 South African Perspectives

6 5 1 Introduction

South African jurisprudence regarding defences, interdicts and attachments that may affect the legal position of the issuing or confirming bank is still very much in its initial stages of development. The autonomous nature of the bank's obligation towards the beneficiary in terms of a documentary credit is the one aspect that has been securely entrenched in South African case law. In this regard it has been stated expressly that the bank's obligation is independent of both the contract of sale and the contract between the bank and buyer.[316] It is equally clear, however, that the independence principle has boundaries and is not absolute. In this regard fraud by the beneficiary is regarded as the "one established exception".[317]

The boundaries of the independence principle have been explored in a trilogy of cases decided in the period 1985-1996. In *Phillips v Standard Bank of South Africa Ltd*[318] the buyer-applicant sought an interlocutory interdict against the issuing bank on the basis of the seller-beneficiary's breach of the contract of sale. In *Loomcraft Fabrics CC v Nedbank Ltd*[319] the buyer applied for a final interdict against the issuing bank on the basis of the seller-beneficiary's fraud. In *Ex Parte Sapan Trading (Pty) Ltd*[320] the buyer-applicant attempted to frustrate payment in an entirely different manner, namely by attaching the

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313 A 18.

314 See n 44 above.

315 See par 6 3 7 above.

316 *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W) 302G; *Ex Parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W) 223J-224A; *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A) 815G, 816C.

317 *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W) 304A. See also *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A) 816 (A).

318 1985 3 SA 301 (W).

319 1996 1 SA 812 (A).

320 3 CLD 200 (W) (court *a quo*); 1995 1 SA 218 (W) (full bench).

beneficiary's right against the bank in order to found or confirm jurisdiction. The availability of these measures in the documentary-credit context is explored below.

Before dealing with these important South African cases, however, a few remarks need to be made regarding defences. There has been no reported South African case in which a bank has raised any defence against the beneficiary's demand for payment. The cases have all concerned attempts by the buyer to block payment. Valuable guidance on the issue of defences is, however, available in other jurisdictions.

6 5 2 Defences

Introduction

The conceptually valuable German approach[321] of differentiating between defences arising from the bank-beneficiary relationship itself (which therefore do not impact upon the principle of independence), and defences emanating from other relationships (which therefore violate or qualify the principle of independence) has been adopted for the purposes of the discussion below.

Defences Arising from the Bank-Beneficiary Relationship

Any defence which arises from the relationship between the bank and the beneficiary itself, does not interfere with the independence principle, and as such ought to be permissible. Generally speaking, the question whether a defence of this nature will succeed can be determined simply by applying the ordinary principles of the law of contract. Four defences of this nature that have arisen in foreign case law are: (i) the unauthorised issuing or confirmation of a credit; (ii) set-off; (iii) illegality; and (iv) non-compliance with the conditions of the credit.

(i) *Unauthorised credits*:[322] If the credit was issued or confirmed by an unauthorised individual on behalf of the bank in circumstances in which the bank cannot be held bound by such unauthorised conduct,[323] the bank would

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321 See par 6 2 1 above.

322 See also par 6 2 3 (n 19) and 6 3 6 above.

323 The qualification allows for, in the first place, the application of the principles of estoppel. Thus, were the bank to make a culpable misrepresentation to the effect that the individual

have a valid defence. In this regard, however, it is evident from the case *Standard Bank London Ltd v The Bank of Tokyo Ltd; Sudwestdeutsche Handelsbank Girozentrale v The Bank of Tokyo Ltd*,[324] that banks consider themselves bound to the contents of a so-called "tested telex".[325] This implies that if a credit is advised by tested telex, the bank is precluded from raising the fact that the credit was unauthorised as a defence against the recipient of the telex. If this is a correct reflection of the law, it is suggested that the bank's inability to raise this defence must stem from trade custom or trade usage.[326]

(ii) *Illegality*:[327] It has been firmly established in both the common-law and civil-law jurisdictions that if the bank's undertaking is illegal, for example for contravening exchange-control regulations, this would constitute a valid defence. The general principles of the South African law of contract support this contention. If the bank's undertaking is illegal from its inception, no obligation arises.[328] If performance of a legal undertaking becomes illegal, the existing obligation is extinguished due to supervening impossibility of performance.[329] The doctrine of severance may be of importance in this regard. In other words, it may be possible to identify a legal and illegal part of the

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did in fact have the necessary authority to issue or confirm the credit and the recipient acted on the representation to its detriment, the bank could be held to its representation. In the second place the principles of the *Turquand* rule may possibly apply. Thus, if it is consistent with the public documents of the company (the bank) that a particular individual may issue or confirm credits on behalf of the bank subject to some internal act of management, the bank is precluded from raising the absence of authority due to the fact that the internal act of management did not take place, as a defence. On estoppel in general see Rabie P J *The Law of Estoppel in South Africa* (1992) Butterworths Durban. On the *Turquand* rule see Meskin P M (assisted by Kunst J A, Schmidt K E) *Henochsberg on the Companies Act* Vol 1 5 ed (loose leaf) Butterworths Durban 130-132 (notes to s 69).

324 [1995] 2 Lloyd's Rep 169 (QB). For a discussion of the case see par 6 3 6 above. See further Chatterjee (*op cit* n 285) 62-68; Oelofse (*op cit* n 162) 5-7.

325 See, on the concept "tested telex", par 6 3 6 above.

326 On the terms "trade custom" and "trade usage" see par 4 6 2 above. See further par 6 3 6 above.

327 See also par 6 2 3 (at nn 17 -18) and par 6 3 4 above.

328 De Wet J C & Van Wyk A H *Die Suid-Afrikaanse Kontraktereg en Handelsreg* 5 ed (1992) 84-85; Van der Merwe S, Van Huyssteen L F, Reinecke M F B, Lubbe G F & Lotz J G *Contract - General Principles* (1993) Juta Cape Town 139.

329 Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 328) 384; De Wet & Van Wyk (*op cit* n 328) 172, 309.

obligation to pay, in which case the legal part could possibly be enforced despite the illegality of the other part.[330]

It must be stressed, however, that the above remarks apply to situations in which the bank's obligation to pay is illegal, and not to situations where the contract of sale is illegal. A defence based on the illegality of the underlying contract of sale is an apparent violation of the independence principle. The extent to which this defence may be permissible, is considered below.[331]

(iii) *Set-off*:[332] In the event of the issuing or confirming bank having a claim against the beneficiary, the possibility of set-off may arise. Set-off (or compensation) in South African law was defined as follows by Innes CJ in *Schierhout v Union Government (Minister of Justice)*:

> "When two parties are mutually indebted to each other, both debts being liquidated and fully due, then the doctrine of compensation comes into operation. The one debt extinguishes the other *pro tanto* as effectually as if payment had been made."[333]

The dominant view[334] in South Africa, for which support is to be found *inter alia* in this *dictum*, is that set-off occurs automatically by operation of law and need not specifically be raised by one of the parties.[335] One of the requirements for set-off is that it must not be against public policy. There is, for example, Roman-Dutch authority (referred to with approval in the *Schierhout* case)[336] to

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330 The doctrine of severability has been well established in our case law. For a review of the cases see Lubbe G F & Murray C M *Farlam & Hathaway - Contract - Case, Material and Commentary* 3 ed (1988) Juta 281-289. See further Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 328) 147, 226-230. See also the illegality issue in the *United City Merchants (Investments) Ltd v Royal Bank of Canada* litigation discussed in par 6 3 4 above.

331 See below at n 352 *et seq*.

332 See also par 6 2 3 (at nn 40-47) and 6 3 7 above.

333 1926 AD 286 289. See also Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 328) 387-388; De Wet & Van Wyk (*op cit* n 328) 272-284.

334 For an analysis of the different views in this regard, and the support for each in the Roman-Dutch law, see De Wet & Van Wyk (*op cit* n 328) 272-274, 281-284; Lubbe & Murray (*op cit* n 330) 749.

335 See Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 328) 192.

336 291.

the effect that set-off does not operate against claims for taxes or maintenance.[337]

It is suggested that in the unlikely event of an issuing or confirming bank having a *totally unrelated* due and liquidated claim against the beneficiary, there is no reason why set-off may not occur. It is necessary to stress, however, that the claims must be unrelated. If, for example, the buyer-applicant has a claim against the seller-beneficiary arising from the contract of sale, it would be highly undesirable for the bank to be able to rely on set-off as cessionary of the buyer's claim. To allow set-off in such circumstances would seriously undermine the system of documentary credits and be harmful to international trade. It is suggested that the principle that set-off must not be against public policy can be invoked to disallow set-off in circumstance such as these. One could also argue, as do some German commentators,[338] that the bank tacitly renounces any benefits arising from a set-off of this nature. Moreover, the approach suggested here necessarily proceeds from the basis that the judgment of Hirst J in the *Kloeckner* case[339] is wrong.

(iv) *Non-compliance*:[340] The liability of the bank is a conditional liability. It depends upon the presentation of conforming documents within the stipulated period. Late presentation and the presentation of non-conforming documents are therefore clearly valid defences which are in no way concerned with the independence principle. Although the presentation of non-conforming documents has been a prolific defence elsewhere, the defence has not been considered directly[341] in any South African court. The South African law relating to the doctrine of strict compliance is therefore still unsettled.

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337 See Lubbe & Murray (*op cit* n 330) 748; Van der Merwe, Van Huyssteen, Reinecke, Lubbe & Lotz (*op cit* n 328) 192.

338 See nn 42-47.

339 [1990] 2 QB 514, [1989] 3 All ER 513 (QB). See the discussion in par 6 3 7 above.

340 See also par 6 2 3 (nn 24-39) and 6 3 5 above.

341 However, the doctrine of strict compliance formed the background to litigation on other aspects in *Nedcor Bank Ltd v Hartzer* 1993 4 CLD 278 (W) and *Delfs v Kuene & Nagel (Pty) Ltd* 1990 1 SA 822 (A). In the *Nedcor* case the question was whether a nominated bank which had paid the beneficiary against non-conforming documents could reclaim payment from the beneficiary on the grounds of unjustified enrichment, whilst the *Delfs* case was concerned with the extent to which a forwarding agent was bound by contract to the beneficiary of a documentary credit to ensure that the conditions set in the credit were met.

The comparative survey does not provide clear guidance in this regard. To generalise somewhat, it would appear that English law requires a stricter standard of compliance than does that of, for example, Germany. Based on the fact that our courts have in the past been guided virtually exclusively by English judgments in documentary-credit issues, the English approach is also likely to prevail here. There are good reasons for adopting the English approach. Successful documentary-credit practice depends on maintaining a delicate balance between protecting the interests of the different parties. In England injunctive relief is hardly ever granted at the instance of the buyer.[342] Instead, the buyer's interests are protected by a truly strict interpretation of documentary compliance.[343] In Germany, on the other hand, the dictates of good faith temper both the independence principle[344] and the doctrine of strict compliance.[345] Therefore, injunctions at the instance of the buyer are more often successful in Germany than in England, whilst a defence based on a trivial discrepancy in the documents is less likely to succeed. The South African courts have followed the English approach regarding injunctive relief.[346] It is submitted that against this background they will be well advised to adhere to the route they have chosen and to insist upon truly strict documentary compliance. A liberal interpretation of strict compliance will load the scales too much in favour of the beneficiary.

Defences Arising from Other Relationships

It is well established that a bank cannot raise as defence the fact that were it to pay it would not be able to recover.[347] Thus, the fact that the buyer has become insolvent cannot be put forward as a defence by the issuing bank, nor can the confirming bank rely on the insolvency of the issuing bank. These defences emanate from the relationship between the issuing bank and its client, or the

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342 See par 6 3 2 (n 158 *et seq*) above.

343 See par 6 3 5 (n 256) above.

344 See par 6 2 2 above.

345 See par 6 2 3 (n 31) above.

346 See par 6 5 3 below.

347 See a 3 (a) of the *UCP* as well as the discussion in par 6 2 4 above.

confirming bank and the issuing bank,[348] from which the bank's relationship with the beneficiary is totally independent.

Similarly, the issuing or confirming bank cannot, *in principle*, raise a defence which arises from the relationship between the buyer and the seller.[349] Thus, it has been well established in foreign jurisdictions that breach of the contract of sale by the beneficiary does not entitle the bank to refuse payment.[350] This principle in effect underlies the decision of the court in *Phillips v Standard Bank of South Africa Ltd* to refuse an interdict against the bank at the instance of the buyer on the basis of the seller's malperformance of the contract of sale.[351]

Although there is a general and clear consensus in the law of the different jurisdictions surveyed above that defences arising from the contract of sale are impermissible, it is equally clear that this principle is *not absolute*. In other words, there are situations in which a bank may successfully raise a defence essentially derived from the contract of sale. In this regard, however, the law in the different jurisdictions lacks uniformity. All systems appear to regard fraud by the beneficiary as a valid defence. In England this appears to be the only, or at least the "one established exception".[352] On the European continent, in contrast, the majority of commentators recognise other defences as well. These include the illegality of the contract of sale as well as the existence of a binding decision to the effect that the seller-beneficiary is not entitled to payment in terms of the contract of sale. In this regard the South African Appellate Division has expressly aligned itself with the English stance. In *Loomcraft Fabrics CC v Nedbank Ltd* Scott AJA, in an *obiter dictum*, stated that upon presentation of conforming documents the bank can escape liability "*only* upon proof of fraud on the part of the beneficiary".[353]

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348 I e the *Deckungsverhältnis* of German law. See par 6 2 4 above.

349 See a 3(a) of the *UCP*.

350 See par 6 2 5 above.

351 1985 3 SA 301 (W). The case is discussed in detail in par 6 5 3 below.

352 *United City Merchants Investments Ltd v Royal Bank of Canada* [1983] 1 AC 168 (HL) 183G.

353 1996 1 SA 812 (A) 815J. See also *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W) 303J-304A .

It is a problem of some nicety to find a theoretical basis upon which the permissibility of certain violations of the independence principle can be explained. In German law the good-faith principle of paragraph 242 of the *BGB* fulfils this role.[354] The question has not been closely investigated in any English case. In the *United City Merchants* case Lord Diplock simply stated:

> "The exception of fraud on the part of the beneficiary is a clear application of the maxim ex turpi causa non oritur actio or, if plain English is to be preferred, 'fraud unravels all.' The courts will not allow their process to be used by a dishonest person to carry out a fraud."[355]

A possible approach from a South African point of view would be to argue that the bank's defence is derived from the contract between it and the beneficiary. One could argue that a term is incorporated into this contract, by operation of law on considerations of public policy, to the effect that the seller-beneficiary will not by means of the documentary credit attempt to perpetrate a fraud. Breach by the beneficiary of this material term entitles the bank to resile from the contract.[356] So viewed the boundaries of the independence principle are basically determined by considerations of public policy.

Finally, it appears to me unnecessarily restrictive to limit the exceptions to the independence principle to the defence of fraud. Public policy dictates that a fraudulent beneficiary should not be able to succeed in an action against the bank. Other illegal conduct on the part of the beneficiary, for example drug or illegal arms trafficking, could be equally or even more reprehensible. It is suggested that the argument put forward in relation to fraud is equally applicable to cases such as these.

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354 See par 6 2 2 above.

355 *United City Merchants Investments Ltd v Royal Bank of Canada* [1983] 1 AC 168 (HL) 184A-B.

356 On the implication of terms by operation of law on considerations of public policy see par 4 6 2 above. See also Jack (*op cit* n 1) 216 who advocates this approach for England.

6 5 3 Interdicts in the Documentary-Credit Context

Introduction

A detailed discussion of the South African law regarding interdicts falls beyond the scope of this thesis. However, it is necessary to comment briefly on certain aspects in order to evaluate the South African cases dealing with interdicts in the documentary-credit context. Moreover, it must be borne in mind that whilst our courts have in all the documentary-credit cases relied heavily and virtually exclusively on English precedents,[357] the South African law regarding interdicts differs in some respects from the English law relating to injunctions.

Final and Interlocutory Interdicts in South African Law

South African law draws a basic distinction between interlocutory and final interdicts. A final interdict is normally granted without any limitation as to time "in order to secure a permanent cessation of an unlawful course of conduct or state of affairs".[358] The well settled requirements for the granting of a final interdict are: (i) a clear right on the part of the applicant against the respondent; (ii) an injury already committed or reasonably apprehended; and (iii) the absence of any other satisfactory remedy on the part of the applicant.[359] The jurisprudence regarding the clear-right requirement is anything but clear.[360] There is, however, substantial support for the view that it means a *legal* right[361] proven by the applicant on a *balance of probabilities*.[362]

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357 The *Phillips*, *Sapan Trading* and *Loomcraft* judgments collectively refer to 8 English cases and 2 English textbooks relating to documentary credits. There is one reference only to an American case and no references to either case law or textbooks from any other country.

358 Erasmus H J & Breitenbach A M (consulting editor Van Loggerenberg D E) *Superior Court Practice* (1994) (loose-leaf edition) Juta Cape Town E8-3.

359 Erasmus (*op cit* n 358) E8-6. The *locus classicus* is *Setlogelo v Setlogelo* 1914 AD 221. For a recent rendition by the Appellate Division see *Sanachem (Pty) Ltd v Farmers Agri-Care (Pty) Ltd* 1995 2 SA 781 (A) 789C.

360 In *Welkom Bottling Co (Pty) Ltd v Belfast Mineral Waters (OFS) (Pty) Ltd* 1967 3 SA 45 (O) 56F Erasmus J stated: "Selde vind mens 'n regsbegrip wat meer onduidelik is as dié van 'n 'duidelike reg' in interdikprosedure."

361 Prest (*op cit* n 158) 52 states: "Interdicts are based upon rights, that is rights which in terms of the substantive law are sufficient to sustain a cause of action. Such right may arise out of a contract, or a delict; it may be founded in the common law or on some or other statute; it may be a real right or a personal right. ... It must not be a mere moral right; it must be a strict legal right."

362 *Nienaber v Stuckey* 1946 AD 1049 1053-1054; *Cresto Machines (Edms) Bpk v Die Afdeling Speuroffisier, SA Polisie, Noord Transvaal* 1972 1 SA 376 (A) 396H; *Welkom*

The role of interlocutory interdicts is explained as follows by Erasmus:

> "An interlocutory interdict is one which is granted *pendente lite*. It is a provisional order designed to protect the rights of the complainant party pending an action or application to be brought by him to establish the respective rights of the parties. Its effect is to 'freeze' the position until the court decides where the right lies, at which point it ceases to operate."[363]

The requirements for an interlocutory interdict "have been stated and restated in numerous cases".[364] In *Eriksen Motors (Welkom) Ltd v Protea Motors, Warrenton* Holmes JA put it thus:

> "In general the requisites are -
> (a) a right which, 'though *prima facie* established, is open to some doubt';
> (b) a well grounded apprehension of irreparable injury;
> (c) the absence of ordinary remedy.
>
> In exercising its discretion the Court weighs, *inter alia*, the prejudice to the applicant, if the interdict is withheld, against the prejudice to the respondent if it is granted. This is sometimes called the balance of convenience."[365]

It is well established, however, that the above considerations are not individually decisive, but interrelated. This is especially true of the considerations of a *prima facie* right and the balance of convenience. The classic *dictum* in this regard is that of Holmes J in *Olympic Passenger Service (Pty) Ltd v Ramlagan*:

> "Usually [the court's decision] will resolve itself into a nice consideration of the prospects of success and the balance of convenience - the stronger the prospects of success, the less need for such balance to favour the applicant: the weaker the prospects

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Bottling Co (Pty) Ltd v Belfast Mineral Waters (OFS) (Pty) Ltd 1967 3 SA 45 (O) 56D. For citations to further cases see Erasmus (*op cit* n 358) E8-6; Prest (*op cit* n 158) 43 n 14.

363 (*Op cit* n 358) E8-3 - E8-4.

364 Prest (*op cit* n 158) 50. See also Erasmus (*op cit* n 358) E8-8.

365 1973 3 SA 685 (A) 691C-E.

of success, the greater the need for the balance of convenience to favour him."[366]

The requirements for an interlocutory interdict so viewed differ in two important respects from those set for final interdicts. First, for a final interdict the applicant must establish a clear right whilst a *prima facie* right[367] will suffice for an interlocutory interdict. Secondly, the balance of convenience is only relevant in the case of interlocutory interdicts.

The traditional approach of the South African courts towards interlocutory interdicts has been that before the court will apply its mind to the balance of convenience, the applicant must have satisfied the "threshold test" namely proof of at least a *prima facie* right.[368] This was initially the case in England as well. However, in *American Cyanamid Co v Ethicon Ltd*[369] the House of Lords jettisoned the requirement of a *prima facie* right as threshold for applying the balance of convenience. The only threshold recognised in Lord Diplock's speech is that the claim must not be frivolous or vexatious, in other words, that there must be a serious question to be tried.[370] In *Beecham Group Ltd v B-M Group (Pty) Ltd* Franklin J found that this approach was not in accordance with our law and ought not to be followed.[371] However, a change of direction towards the *American Cyanamid* rule in some recent cases[372] has led Erasmus to

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366 1957 2 SA 382 (D) 383F. This has been the approach of the court in many cases, most recently in *Dorbyl Vehicle Trading & Finance Co (Pty) Ltd v Klopper* 1996 2 SA 237 (N) 243G. See further in this regard Erasmus (*op cit* n 358) E8-11.

367 The test for a *prima facie* right in this context has had an arduous history. See Prest (*op cit* n 158) 52-61; Erasmus (*op cit* n 358) E8-9 - E8-10. A standard approach has, however, evolved. It was stated thus by Corbett J in *L F Boshoff Investments (Pty) Ltd v Cape Town Municipality* 1969 2 SA 256 (C) 267E: "[T]he Court's approach ... is to take the facts as set out by the applicant, together with any facts set out by the respondent which the applicant cannot dispute, and to consider whether, having regard to the inherent probabilities, the applicant should on those facts obtain final relief at the trial of the main action... ."

368 Erasmus (*op cit* n 358) E8-1; Prest (*op cit* n 158) 57.

369 [1975] 1 All ER 504 (HL). See also n 158 above.

370 510D.

371 1977 1 SA 50 (T) 53E.

372 *Tsabalala v Minister of Health* 1987 1 SA 513 (W); *Ferreira v Levin* 1995 2 SA 813 (W) 825A-B, 836A. See also Prest (*op cit* n 158) 101-102 who argues in favour of the more flexible approach applied in the *American Cyanamid* case.

describe the present South African law in this regard as "rather ambivalent".[373] It is submitted that, due to the uncertainty regarding the threshold test in South Africa, an interlocutory interdict may well be more difficult to obtain in South Africa than in England; it certainly cannot be easier.

A form of interlocutory interdict akin to the English *Mareva* injunction requires special consideration. This remedy by which the respondent can be restrained from moving his assets out of the jurisdiction of the court, was considered exhaustively in two judgments of Stegmann J in the *Knox D'Arcy Ltd v Jamieson* litigation.[374] Stegmann J stressed the fact that an interdict of the *Mareva* nature has long been part of our law and is based on civilian sources. He argued that the adoption of the English terminology in this regard was best avoided as it was likely only to "invite confusion". As to the name of this interdict he stated:

> "[The interdict] suffers the minor disability of lacking a distinctive name. ... The measure is in substance an interdict *in securitatem debiti*; but if the need is felt for a more descriptive name, it could appropriately be called, say, an 'anti-dissipation interdict'. That name emphasises its purpose of forestalling a *prima facie* intention to defeat due execution of an anticipated judgment by the dissipation of assets."[375]

The legal requirements for an anti-dissipation interdict[376] were held to be "no different from the legal requirements for any other interlocutory interdict".[377] However, as Erasmus points out, an anti-dissipation interdict may have a devastating effect on the affairs of the respondent and has a considerable potential for abuse. Courts should therefore not grant such interdicts lightly, but "should exercise care and circumspection in granting such interdicts, i e the balance of convenience should be carefully weighed."[378]

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373 (*Op cit* n 358) E8-2.

374 1994 3 SA 700 (W); 1995 2 SA 579 (W).

375 1994 3 SA 700 (W) 705I-706E.

376 The name has taken hold: see Erasmus (*op cit* n 358) E8-5.

377 *Knox D'Arcy Ltd v Jamieson* 1995 2 SA 579 (W) 600B.

378 (*Op cit* n 358) E8-5. See also Prest (*op cit* n 158) 172. In *Knox D'Arcy Ltd v Jamieson* 1995 2 SA 579 (W) 582D Stegmann J termed an anti-dissipation interdict he himself had granted earlier in the litigation between the parties "a Draconian interlocutory interdict".

Phillips v Standard Bank of South Africa Ltd[379]

The *Phillips* case was the first in which a South African court had the opportunity to consider the "legal effect and consequences" of documentary credits.[380] The facts were briefly as follows. The applicant (Phillips) had purchased a number of shoes from an Italian firm. In terms of the contract of sale payment was to be effected by means of an irrevocable documentary credit. Such a credit was duly issued by Standard Bank. It appears from the facts that payment in terms of the credit was deferred to a date a number of days after that upon which Phillips took delivery of the goods.[381] When, prior to payment in terms of the credit, it was discovered that some of the shoes were materially defective, Phillips sought an interlocutory interdict directing Standard Bank to stop payment of the credit to the seller's bank in Italy.[382]

The court had little hesitation in dismissing the application. Relying mainly[383] on the cases *Sztejn v J Henry Schroder Banking Corporation*[384] and *United City Merchants (Investments) Ltd v Royal Bank of Canada*[385] Goldstone J stressed that the credit "constitute[s] a contract independent of the contract of purchase and sale"[386] and therefore that "the purchaser may not go behind the documents and cause payment to be stopped or suspended *because of complaints concerning the quality of goods or other alleged breaches of a contract by the seller*".[387] Although the court quoted (and implicitly approved) Lord Diplock's

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379 1985 3 SA 301 (W). For a discussion of the case see Hugo C "Documentary Letters of Credit: Reflections on Recent Developments" 1993 *Annual Banking Law Update* Rand Afrikaans University Research Unit for Banking Law 4.

380 302I.

381 On deferred payment credits in general see par 1 6 4 and 3 8 2 above.

382 It does not appear from the report whether the Italian bank had confirmed the credit or not. This, however, can have no bearing on the position of the issuing bank.

383 The court also cited *Hamzeh Malass and Sons v British Imex Industries Ltd* [1958] 2 WLR 100 (CA); *R D Harbottle (Mercantile Ltd) v National Westminster Bank Ltd* [1978] 1 QB 146 (QB); and *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159 (CA).

384 31 NYS 2d 631 (1941). For a discussion of the case see par 6 3 2 above.

385 [1983] AC 168 (HL). The case is discussed extensively in par 6 3 2 above.

386 304B.

387 304E (my italics).

rendition of the fraud exception in the *United City Merchants* case,[388] consideration of the extent of this "one established exception" and the circumstances in which it may be applicable was deemed unnecessary due to the fact that the allegations made by the applicant were "quite consistent with an *innocent* breach of contract" by the seller.[389] The implication of specifying that the breach was innocent, is that different considerations may well apply in the case of a fraudulent breach of the contract of sale. So interpreted this *dictum* offers limited (*obiter*) authority for the view that fraud in the underlying transactions (as opposed to fraud in the documents) may constitute a valid basis for an interdict in South African law.

The judgment in the *Phillips* case is clearly in accordance with the law in both the civilian and common-law jurisdictions and is to be welcomed as such. The case has established firmly that mere breach of the contract of sale by the seller does not entitle the buyer to block payment by acquiring an interdict against the bank.

Although the court, in reaching its decision, did not expressly apply the principles of South African law regarding interlocutory interdicts, the result is clearly in accordance with those principles. The fact that the bank's obligation to pay is independent of the contract of sale means, it is submitted, that the applicant could not meet the "threshold test" of a *prima facie* right. In fact, even if one were to adopt the lower threshold of the *American Cyanamid* approach, it is to be doubted whether there was a serious question to be tried. Furthermore, the applicant clearly had another remedy namely an action against the seller-beneficiary for breach of the contract of sale. This, in turn, implies that the requirement of irreparable harm could also not be met. Insofar as the balance of convenience may have arisen it, too, did not favour the applicant.

Loomcraft Fabrics CC v Nedbank Ltd[390]

The judgment in the *Loomcraft* case is the first and only reported judgment of the Appellate Division relating to documentary credits. It is also the first and only case in which an interdict was sought against the issuing bank on the basis of fraud. As such its importance is self-evident.

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388 303G-I. See also par 6 3 2 above.

389 303J-304A (my italics).

390 1996 1 SA 812 (A).

The facts were as follows: Loomcraft purchased a quantity of fabric from Perfel (a Portuguese manufacturer). In terms of their contract payment was to be effected by means of a documentary credit in favour of Perfel. The credit was duly issued by Nedbank and transmitted to Perfel's bank in Lisbon which served as advising bank. In terms of the credit payment was deferred to 90 days after the date of the bills of lading. On arrival of the goods they were inspected by Loomcraft who was dissatisfied with their quality. Loomcraft thereupon applied successfully for an interlocutory interdict restraining Nedbank from paying on the basis that the bills of lading contained a fraudulent misrepresentation as to the date of shipment. However, the final interdict was refused. Loomcraft appealed.

Before dealing specifically with the facts of the case, Scott AJA took the opportunity of stating certain fundamentals of the law of documentary credits.

(i) The relationship between the issuing bank and beneficiary is contractual.[391]

(ii) The "essential feature" of this contract is that it is "wholly independent of the underlying contract of sale between the buyer and seller".[392]

(iii) On presentment of the proper documents the bank will escape liability "only upon proof of fraud on the part of the beneficiary".[393] This is regarded as an "established exception".[394]

(iv) An interdict restraining a bank from paying in terms of a credit will accordingly not be granted "save in the most exceptional cases".[395] In this regard it is now "well established" that a court will grant an interdict restraining a bank from paying "in the event of it being established that the beneficiary was

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391 815G. See also par 5 6 2 above.

392 815G-H, 816C.

393 815J.

394 816A. In this regard the court refers to *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] AC 168 (HL). See the discussion in par 6 3 2 above.

395 816D.

a party to fraud in relation to the documents presented to the bank for payment".[396]

(v) For the interdict to be granted the fraud must be "clearly established".[397] This means that whilst the "*onus* ... remains the ordinary civil one which has to be discharged on a balance of probabilities ..., as in any other case where fraud is alleged, it will not lightly be inferred".[398]

Thus, for the appeal to succeed, Loomcraft had to establish clearly that Perfel was a party to fraud in relation to the documents. The credit *in casu* indicated "any main port in Portugal" as the place of loading or taking in charge of the goods. The bill of lading (a combined transport document) indicated "Leixoes CY [Container Yard]" as the place where the goods were taken in charge, and "Lisbon" as the port of loading. The vessel and voyage number were stated to be "Nuova Europa 219". The document was dated 8 May 1992 which was the latest day permitted for shipment under the credit. It further bore the undated stamp "actually on board". Loomcraft argued that the goods could not have been on board the Nuova Europa on 8 May since the vessel did not call at the port of Lisbon in the course of voyage 219. It contended that the goods were actually loaded on board the Nuova Europa on 12 May in the course of her northbound voyage (no 175) to La Spezia in Italy, and from there carried on

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396 817E. In support of this contention the court relies heavily on English case law. *Dicta* from the following cases are quoted: *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] 1 QB 146 (QB); *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 1 WLR 1233 (CA); and *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 All ER 351 (CA). The court also cites *Deutsche Rückversicherung AG v Walbrook Insurance Co Ltd; Group Josi Re (Formerly Known as Group Josi Reassurance SA) v Walbrook Insurance Co Ltd* [1994] 4 All ER 181 (QB).

397 Here, too, the court relies on English case law namely *Tukan Timber Ltd v Barclays Bank plc* [1987] 1 Lloyd's Rep 171 (QB).

398 817G-H. This approach to the proof of fraud in general has been firmly established in South African case law. See especially *Gates v Gates* 1939 AD 150 in which Watermeyer JA stated: "It is true that in certain cases more especially in those in which charges of criminal or immoral conduct are made, it has repeatedly been said that such charges must be proved by the 'clearest' evidence, or 'clear and satisfactory' evidence, or 'clear and convincing' evidence, or some similar phrase. There is not, however, in truth any variation in the standard of proof required in such cases. The requirement is still proof sufficient to carry conviction to a reasonable mind, but the reasonable mind is not so easily convinced in such cases because in a civilised community there are moral and legal sanctions against immoral and criminal conduct and consequently probabilities against such conduct are stronger than they are against conduct which is not immoral or criminal." (155.) See also *Gilbey Distillers & Vintners (Pty) Ltd v Morris NO* 1990 2 SA 217 (SE) 226A.

her southbound voyage (no 219) to Durban. Loomcraft alleged that Perfel had "procured" the issuing of the fraudulent bill of lading in order to create the impression that it had met the deadline of 8 May 1992.

Perfel's explanation of the facts was that Leixoes is a main port in northern Portugal, that the goods were delivered there on 7 May 1992 where they passed through customs and were taken in charge by the carrier's agents. They were railed to Lisbon on the following day and loaded on board the Nuova Europa on 12 May 1992. On 13 May the carrier's agents had stamped the date on the bills as well as the notation "on board", for, on that date, the goods were actually on board. It was noticed subsequently that the bills were not correct as the goods had been taken in charge by the carrier earlier. The date was accordingly corrected to 8 May. However, "unfortunately" and "in error"[399] the "on board" notation was not deleted. In support of this explanation Perfel correctly pointed out that in terms of the credit the deadline was met provided the goods had been taken in charge at a major port by 8 May. It did not require the goods to be on board a vessel by that date. Therefore, there was no reason for Perfel to be party to a fraud to the effect averred by Loomcraft.

Although the court found features of Perfel's explanation "less than satisfactory"[400] the appeal was dismissed. Scott AJA reasoned as follows:

> "In order to succeed on the grounds of fraud, the appellant had to prove that Perfel, acting through its agents, and with the purpose of drawing on the credit, presented the bills of lading to the bank knowing that they contained material representations of fact upon which the bank would rely and which they (the agents of Perfel) knew were untrue ... . Mere error, misunderstanding or oversight, however unreasonable, cannot amount to fraud ... . Moreover, ..., fraud will not lightly be inferred, particularly ... in motion proceedings. ... [T]he appellant sought a final order. To succeed it accordingly had to show that it was entitled to an order on the basis of the facts alleged by Perfel, together with the admitted facts in the affidavits filed on its own behalf, subject only to any denial by Perfel being insufficient to raise 'a real, genuine or *bona fide* dispute of fact' ... . I am unpersuaded that on the papers the appellant succeeded in discharging the burden of proving the falsity of the explanation given by Perfel in

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399 821G.

400 821J. Perfel's explanation did not disclose when and where the bills were signed, nor why, if the carrier had taken charge of the goods at Leixoes, the bills were not issued to Perfel at that stage. The court was also dissatisfied with the fact that the much of the explanation was couched in the passive, without, for example, any indication as to who noticed the error on the bill and at what stage.

> respect of the notation 'actually on board' or, in other words, that the bills of lading contained a fraudulent misrepresentation."[401]

As to the wrong voyage number the court held that "there [was] nothing in the papers to suggest that Perfel was in any way a party to this apparent misstatement".[402]

Thus, applying the requirements for a final interdict to this decision, it is clear that the interdict was refused due to the fact that the applicant could not prove on a balance of probabilities that it had a right as against the bank that the bank must not pay the beneficiary.

An alternative argument raised by the appellant was that if the "on board" notation was indeed to be ignored, the interdict should have been granted as the bill of lading would then not have conformed with the requirements of the credit. Appellant's premiss that bills in the absence of the "on board" notation did not conform (which it is submitted is clearly wrong)[403] was not examined by the court. Instead the court simply relied on the requirement that for a final interdict to succeed the applicant must prove that he has no alternative remedy.[404] The obligation of the issuing bank as against its client (the applicant for the credit) is to pay only against conforming documents. Thus, if the bank were to pay against non-conforming documents the applicant's remedy would be an ordinary contractual one. In the circumstances the court found it "difficult

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401 822G-823B.

402 822F.

403 It is not clear from the report on which precise basis the appellant regarded the bills as non-conforming. It would appear that the "on board" notation was regarded as essential. However, the documents called for were combined transport documents. The credit was issued subject to the 1983 Revision of the *UCP*. Thus, in terms of a 25(a) the bank was obliged to accept "a transport document which; (i) appears on its face to have been issued by a named carrier, or his agent, and (ii) *indicates dispatch or taking in charge of the goods, or loading aboard, as the case may be,* and consists of the full set of originals issued to the consignor". (My italics.) In addition a 25(b) provides that "unless otherwise stipulated in the credit" the bank was not entitled to reject a document which "indicates a place of taking in charge different from the port of loading". These requirements certainly appear to have been met *in casu*.

404 823J.

to see" on what grounds Loomcraft could obtain an interdict to restrain the bank from paying against non-conforming documents.[405]

Observations and Conclusions relating to Interdicts in the Documentary-Credit Context

(i) *Interdicts against the bank*: It is clear from the principles and cases discussed above that although it is possible, in principle, for a buyer to obtain an interdict against the bank prohibiting it from paying the beneficiary, such an application will seldom succeed. It was expressly stated in the *Loomcraft* case that an interdict of this nature will not be granted "save in the most exceptional cases".[406] The "established exception" recognised in the *Phillips*,[407] *Loomcraft*[408] and *Sapan Trading*[409] cases is fraud by the beneficiary. It has further been clearly established that an interdict restraining the bank from paying will not be granted at the instance of the buyer on the basis of a mere breach of the contract of sale;[410] nor will an interdict be granted on the basis that the documents presented are non-conforming as, in this case, the buyer has an alternative remedy against the bank in the form of an action for breach of contract.[411] It would accordingly appear that fraud by the beneficiary is the one established, if not the only,[412] basis for an interdict against the bank.

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405 823I.

406 1996 1 SA 812 (A) 816D.

407 1985 3 SA 301 (W) 303I-304A.

408 1996 1 SA 812 (A) 815J, 816C-817H.

409 1995 1 SA 218 (W) 224H.

410 *Phillips v Standard Bank of South Africa Ltd* 1985 3 301 (W). See the discussion at n 379 *et seq* above.

411 *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A) 823D-J. See the discussion at n 390 *et seq* above, especially at n 404.

412 In the *Loomcraft* case Scott AJA stated that on the presentation of conforming documents the bank can escape liability "*only* upon proof of fraud on the part of the beneficiary" (815J my italics). It is respectfully submitted that this *obiter dictum* is wrong. It overlooks other established defences such as the illegality of the credit. See par 6 2 5 and 6 3 4 above.

The main obstacle confronting a buyer who seeks a final interdict is that he must prove the existence of a right.[413] This implies that the bank he wishes to interdict must have a corresponding duty towards the buyer not to pay.[414] It is suggested that such a duty may well arise in the event of proven[415] fraud by the beneficiary. If the bank is the issuing bank, the source of the duty is the contract between the bank and its client (the buyer): in other words, there is a (unexpressed) term in the contract by which the bank is bound not to pay in the event of proven fraud on the part of the beneficiary.[416] However, if the bank is the confirming bank there is no contract, and the origin of the duty not to pay must lie elsewhere.[417] The recognition of a duty of care on the confirming bank towards the buyer, the breach of which may give rise to delictual liability, may provide a possible solution.[418] The recognition in South African case law[419] that a bank collecting payment of a cheque for a customer is under a similar duty of care towards the true owner of a cheque (with whom he enjoys no privity of contract) may well have paved the way for the recognition of a duty of this nature.

It is a noteworthy and sobering fact that in no reported English or South African case has a final interdict been granted against an issuing or confirming bank at the instance of the buyer. Although the principle is clearly established that such interdicts are available in principle, Scott AJA's statement that they will not be granted "save in the most exceptional cases" must be given very serious consideration by a buyer contemplating litigation.

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413 See the text at n 361 above.

414 See n 172 above.

415 See n 398 above.

416 One could argue that this term represents the unexpressed consensus of the parties and is therefore a tacit term of the contract. One could also argue that the term is implied by law on considerations of public policy. On the implication of terms in a different context see *Ex Parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W) (discussed in par 6 5 4 below). See also the text at nn 105 and 114 above.

417 See the text at nn 172 and 173 above.

418 There is some support for the recognition of a duty of this nature in English law. See *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554 560 (CA) and the text at n 174 above.

419 See *Indac Electronics (Pty) Ltd v Volkskas Bank Ltd* 1992 1 SA 783 (A); *KwaMashu Bakery Ltd v Standard Bank of South Africa Ltd* 1995 1 SA 377 (D).

In the event of the buyer seeking an interlocutory interdict the major obstacle (apart from the threshold of a *prima facie* right required in terms of the traditional approach)[420] faced by the buyer is to convince the court that the balance of convenience favours him: in other words that the refusal of the interdict will be more harmful than the granting of it. In this regard the words of Kerr J in *R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* sound an ominous note to buyers:

> "The plaintiffs ... face what seems to me to be an insuperable difficulty. They are seeking to prevent the bank from paying and debiting their account. It must then follow that if the bank pays and debits the plaintiffs' account, it is either entitled to do so or not entitled to do so. To do so would either be in accordance with the bank's contract with the plaintiffs or a breach of it. If it is in accordance with the contract, then the plaintiffs have no cause of action against the bank and, as it seems to me, no possible basis for an injunction against it. Alternatively, if the threatened payment is in breach of contract, ... then the plaintiffs would have good claims for damages against the bank. In that event the injunctions would be inappropriate, because they interfere with the bank's obligations ..., because they might cause greater damage to the bank than the plaintiffs could pay on their undertaking as to damages, and because the plaintiffs would then have an adequate remedy in damages. The balance of convenience would in that event be hopelessly weighted against the plaintiffs."[421]

It must nevertheless be noted that interlocutory interdicts against issuing banks at the instance of buyers have been successful both in South Africa[422] and in England.[423]

(ii) *Interdicts against the beneficiary*: There is no reported South African case in which an interdict was sought at the instance of the buyer against the seller-beneficiary prohibiting either the presentation of the documents or the making of a demand for payment. In England, however, interdicts of this nature have

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420 See the text at n 368 above.

421 [1978] QB 146 (QB) 155.

422 This appears from the earlier history of the *Loomcraft* case as described in the judgment of the Appellate Division on whether a final interdict ought to be granted (815C-D). However, the decision granting the interlocutory injunction was not reported and the *ratio decidendi* is unknown.

423 See n 179 above.

been relatively more successful than interdicts against the banks.[424] There is also substantial support for this type of interdict in the civilian jurisdictions.[425]

It is suggested that in legal principle there is no reason why such interdicts should not be possible under South African law. Moreover, at the interlocutory stage the balance of convenience is more likely to favour the buyer than in the case where the interdict is sought against the bank. In this regard an important factor in the buyer's favour is that the beneficiary's financial standing is not likely to be as good as that of a bank. Thus, an action for damages against the seller-beneficiary for breach of the contract of sale is not as secure an alternative as an action for damages against the bank.

The disadvantage of this remedy, however, is that it will often entail suing in a foreign court. However, due to the fact that several jurisdictions appear to be more favourably inclined towards interdicting the beneficiary than the bank, buyers will be well advised to give serious consideration to this possibility. An interdict against the beneficiary further has the advantage of restricting the litigation between the true parties to the dispute.

(iii) *Anti-dissipation interdicts*: Anti-dissapation interdicts have not yet been considered by our courts in the context of documentary credits. However, the potential availability of the *Mareva* injunction has excited substantial comment in England. In this regard it has been argued that the buyer, instead of seeking an injunction to block payment, may in suitable circumstances apply for a *Mareva* injunction by which the beneficiary is restrained from moving the proceeds of the credit from the jurisdiction of the court.[426] The advantage of this procedure from the buyer's point of view is that the injunction does not interfere with the operation of the credit. The independence principle, therefore, does not come into play.[427] This argument is equally applicable to the South African anti-dissipation interdict.

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424 See par 6 3 2 above at nn 160-167, 179-181.

425 See par 6 2 6 above at nn 98-102.

426 See the text at n 185 above.

427 See par 6 3 2 above at nn 182-187. See further *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 All ER 351 (CA) 352; *Z Ltd v A-Z and AA-LL* [1982] QB 558 (CA) 574.

A possible application is the following. The buyer-applicant has received defective goods and sues the seller-beneficiary for breach of the contract of sale. Simultaneously the buyer applies for an anti-dissipation interdict which could conceivably relate to the proceeds of the credit.

It was pointed out above that anti-dissipation interdicts are open for abuse and should not be granted lightly. Courts should therefore consider the balance of convenience with great circumspection before granting this interdict.

It must further be borne in mind that the dissipation prohibited by the court must relate to property within the jurisdiction of the court.[428] In South African law the *situs* of a claim for payment is ordinarily regarded as the area of which the debtor is an *incola*.[429] Applied to documentary credits this rule means that the beneficiary's claim against the bank is located at the bank. However, in *Ex Parte Sapan Trading (Pty) Ltd* Stegmann J, although expressly refraining from deciding the issue, nevertheless questioned the applicability of the ordinary rule to documentary credits.[430] Two important English cases heard in 1981 are noteworthy in this regard. First, in *Power Curber International Ltd v National Bank of Kuwait SAK* Lord Denning MR and Griffiths LJ (Waterhouse J dissenting) found that although an obligation to pay was ordinarily regarded by English law as being located in the area of jurisdiction of the debtor, the position regarding a documentary-credit debt was different, and that such a debt was "situate in the place where it is in fact payable".[431] Secondly, in *Intraco Ltd v Notis Shipping Corporation of Liberia - The Bhoja Trader* the Court of Appeal held that a claim for payment under an independent performance guarantee could not be the object of a *Mareva* injunction if the obligation was to pay abroad.[432]

This direction of the English courts is to be commended. To allow anti-dissipation interdicts directed at obligations to pay abroad would seriously

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428 Prest (*op cit* n 158) 164.

429 Pistorius D *Pollock on Jurisdiction* 2 ed (1993) Juta Cape Town 106.

430 3 CLD 200 (W) 222.

431 [1981] 1 WLR 1233 (CA) 1240F, 1242G.

432 [1981] 2 Lloyd's Rep 256 (CA) 258. See the *dictum* quoted at n 186 above.

undermine the integrity of documentary credits and performance guarantees and be harmful to international trade.[433]

6 5 4 Attachment to Found or Confirm Jurisdiction: *Ex Parte Sapan Trading (Pty) Ltd*[434]

The *Phillips* case clearly established the principle that a mere breach of the contract of sale could not provide the basis for blocking payment in terms of a documentary credit by a prohibitory interdict against the bank. In the *Sapan Trading* case the buyer attempted to circumvent the *Phillips* decision by blocking payment in a completely different and ingenious manner. This is an important case which requires detailed consideration. The material facts were as follows. Sapan Trading (Pty) Ltd had imported goods from Finetrade Vermittlungs GmBH (a German exporter). In terms of their contract payment was to be effected by irrevocable documentary credits. Several credits were subsequently issued by Rand Merchant Bank Ltd and advised to Finetrade by a German bank. The credits were freely negotiable.[435] Sapan Trading employed the services of Walon (Pty) Ltd to attend to the release of the goods from the Durban docks, payment of import duties and other administrative costs, and the delivery of the goods to Johannesburg. A dispute subsequently arose between Sapan Trading and Finetrade as to who was responsible to pay Walon. Sapan Trading alleged that Finetrade had undertaken to pay these costs, and, in order to found (or alternatively confirm)[436] jurisdiction for an action in this regard sought an *ex parte* order for the attachment of Finetrade's claims to the proceeds of four documentary credits.

The application was dismissed by Stegmann J on four main grounds.

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433 See also *Ex Parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W) which, by necessary implication, supports this view. The case is considered in detail in par 6 5 4 below.

434 3 CLD 200 (W) (court *a quo*); 1995 1 SA 218 (W) (full bench). For discussions of the case see Malan F R "Letters of Credit and Attachment ad Fundandam Jurisdictionem" 1994 *Tydskrif vir die Suid-Afrikaanse Reg* 150; Oelofse A N "Developments in the Law of Documentary Letters of Credit" (1996) 8 *South African Mercantile Law Journal* 56 65-68; Hugo C "Letters of Credit: Reflections on Recent Developments" 1994 *Annual Banking Law Update* Rand Afrikaans University Research Unit for Banking Law; Van Wyk A "Letters of Credit and Attachment Proceedings" December 1995 *De Rebus* 575.

435 On the term "negotiable credit" see par 1 6 6 above.

436 The distinction between founding and confirming jurisdiction by attachment was not of importance in this case. See the judgment of Stegmann J in the court *a quo* 3 CLD 200 (W) 202-203.

(i) In order to succeed with an application to found jurisdiction the applicant must show, *inter alia*, that *prima facie* he has a cause of action.[437] This means that the applicant must produce "evidence which, if accepted, will show a cause of action".[438] The mere fact that it is contradicted or improbable will not disentitle the applicant to the remedy. Only where it is "quite clear" that he has "no cause of action or that it cannot succeed"[439] will the attachment be refused. The applicant's evidence was that Finetrade had undertaken to pay Walon. No documentary evidence of such an agreement was provided by the applicant. However, it was averred that the agreement was confirmed in the letter of credit itself which referred to the sale as "C & F". This term was clearly understood by the applicant to mean "carriage and freight" instead of the normal meaning of "cost and freight". Stegmann J concluded:

> "In my judgment Mr Cattich's sworn allegations about the meaning of the expression "C & F", when used in a letter of credit ... are so far-fetched, and so obviously wrong, that this is a case in which it is quite clear that the applicant ... relies on evidence which cannot be accepted as correct."[440]

(ii) The court reasoned that the application could alternatively be dismissed on a different ground. Should one accept that a *prima facie* case had been established, Sapan Trading would still have had to show on a balance of probabilities that Finetrade was "the owner of attachable property situated within the area of jurisdiction of the WLD".[441] This Sapan Trading had not succeeded in doing for several reasons. First, Sapan Trading relied on the claims of Finetrade arising from the letters of credit issued by the South African banks to Finetrade. In the court's view, however, it was by no means evident from the letters of credit on their own that Finetrade had claims against the issuing banks. Stegmann J stated:

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437 203. The applicant must further show on a balance of probabilities: (i) that he is an *incola* of the area of jurisdiction of the court; (ii) that the intended defendant is a *peregrinus* not only of the court but of the country; and (iii) that the intended peregrine defendant is the owner of attachable property situated within the area of jurisdiction of the court.

438 *Bradbury Gretorex Co (Colonial) Ltd v Standard Trading Co (Pty) Ltd* 1953 3 SA 529 (W) 535A.

439 *Ibid.*

440 209-210.

441 203. See also *Ewing McDonald & Co Ltd v M & M Products Co* 1991 1 SA 252 (A).

> "To be able to understand the rights and obligations evidenced by a letter of credit ... it is ... essential to read it together with the contract between the applicant for the credit and the bank which issued it. In the present matter, as the four documents which have been relied upon [i e the letters of credit] are not entirely comprehensible without reference to [these] contracts ... I consider that on that ground alone the applicant has failed to show that Finetrade has claims against [the issuing banks] ... ."[442]

Secondly, the court argued that even if one were to accept that the letters of credit in themselves did evidence claims against the issuing banks, this did not necessarily mean that Finetrade was still the owner of the claims. The *UCP* expressly recognises that the beneficiary has the freedom to assign its right to receive the proceeds of a documentary credit to any third party.[443] Stegmann J took the following view:

> "That Finetrade would retain its claims until the maturity of these instruments is not inherently any more likely than that Finetrade would exchange its rights for money, and in so doing leave a banker, or an assignee, to collect the proceeds from the issuing banks at maturity."[444]

Finally in this regard, the court pointed out that it was by no means clear that the *situs* of any such claim would be within the area of jurisdiction of the court. The credits in question were freely negotiable. Thus, the undertakings of the issuing banks were to pay any bank which saw fit to purchase the documents. Such a bank in this case would most likely have been a German bank. On the basis of developments in English law[445] the court raised the point that although the *situs* of a claim for payment in South African law is ordinarily regarded to be the area of which the debtor is an *incola*,[446] "there is some reason to doubt whether the ordinary rule does apply with regard to documentary credits".[447] However, Stegmann J expressly refrained from deciding this issue.

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442 213.

443 The court in this regard refers to a 55 of the 1983 revision (220-221). See also a 49 of the 1993 revision.

444 221.

445 See nn 431 & 432 above.

446 Pistorius (*op cit* n 429) 106.

447 222. See further par 6 5 3 at n 431.

(iii) The court further raised (as a second alternative basis for dismissing the application) the point that Sapan Trading had implicitly waived the right to attach these claims. Stegmann J stated:

> "It seems to me to be a necessary implication ... that when a buyer such as the applicant promises to be bound irrevocably by the principles embodied in articles 3 and 4 of the [1983] UCP [i e the independence principle and the principle that the parties deal in documents and not in goods], he implicitly waives in advance any right which he may otherwise have acquired afterwards, on any ground (other than fraud on the part of the seller), to stop payment of the documentary credit by the issuing bank, or to interfere with the payment by attaching the seller's claim to payment on the part of the issuing bank."[448]

(iv) Finally, the court took the view that the interests of the banks involved were materially affected by the application. The application, therefore, was not properly brought *ex parte*.[449]

Sapan Trading appealed against the dismissal of its application to the full bench. Streicher J, who delivered the main judgment of the full bench, took the view that the court *a quo* had erred in finding that the applicant had not made out a *prima facie* cause of action against Finetrade. He stated that although the applicant was clearly mistaken in its view that confirmation of Finetrade's undertaking to pay Walon was to be found in the letters of credit (the misinterpretation of the "C & F" clause), the court did not consider this to be "a sufficient reason for rejecting the applicant's allegations as to what the agreement was and how the agreement had in the past been performed by the applicant and Finetrade".[450] Thus, the court held that a *prima facie* case had been made out.

The court also disagreed with the finding of the court *a quo* that the obligations of the issuing banks in terms of the documentary credits could not be determined without reference to the applications for the establishment of the credits. Streicher J stated:

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448 224.

449 226.

450 *Ex Parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W) 223H-I.

> "Each of the letters of credit is an irrevocable undertaking by the issuing bank to the beneficiary, Finetrade, which gives rise to a contract between the issuing bank and the beneficiary. [This] agreement ... is the result of a contract between the applicant and Finetrade in terms of which the credit had to be established, and of a contract between the applicant and the issuing bank, *but is separate from, and independent of, such underlying contracts*. The beneficiary is advised of the terms of the letter of credit and not of the terms of the application to the issuing bank. It is therefore the letter of credit and not the application that embodies the agreement between the issuing bank and the beneficiary. Should the letter of credit not be in accordance with the application that fact would be relevant insofar as the contract between the applicant and the issuing bank is concerned, not insofar as the contract between the issuing bank and the beneficiary is concerned."[451]

The court did not, however, deem it necessary to address the questions whether it was competent to accept that Finetrade was in fact still the owner of the rights,[452] or that the *situs* of the rights was within its jurisdiction.[453] For the purposes of its judgment the court accordingly accepted that Finetrade had rights against the issuing banks in terms of the letters of credit and that these rights were situated within the court's jurisdiction. The crucial question, therefore, was whether these rights could be attached to found or confirm jurisdiction. In addressing this question the court stressed the typical function of the documentary credit as a mechanism "used to reduce ... problems and risks by introducing predictability and security into international sales transactions".[454] With reference to important English[455] and American[456] case law, as well as the judgment of Goldstone J in the *Phillips* case,[457] Streicher J adopted the following *dicta* from *Power Curber International Ltd v National Bank of Kuwait SAK*:

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451 223I-224B (my italics).

452 See the text at nn 441-443 above.

453 See the text at n 447 above.

454 224G.

455 *Intraco Ltd v Notis Shipping Corporation of Liberia - The Bhoja Trader* [1981] 2 Lloyd's Rep 256 (CA); *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 1 WLR 1233 (CA); and *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159.

456 *Sztejn v J Henry Schroder Banking Corporation* (1941) 31 NYS 2d 631 (Supreme Court Special Term New York County).

457 See the discussion in par 6 5 3 above.

> "The whole purpose of this form of payment is that a seller should not be kept out of his money by litigation against him at the suit of the buyer",[458]

and,

> "[i]f the court of any of the countries should interfere with the obligations of one of its banks (by ordering it not to pay under a letter of credit) it would strike at the very heart of that country's international trade."[459]

In response to this line of reasoning the applicant argued that although the issuing bank could not be interdicted from paying, this did not rule out an attachment to found jurisdiction as the effect of such an attachment would merely be that instead of paying the proceeds to the beneficiary they are paid to the deputy sheriff who receives them on behalf of the beneficiary and holds them as security for the plaintiff's claim. Thus, by paying the deputy sheriff the bank would still be honouring its contractual obligation to the beneficiary under the letter of credit.[460] The applicant in this regard relied on the English case *Intraco Ltd v Notis Shipping Corporation of Liberia - The Bhoja Trader*[461] in which was said:

> "It is a natural corollary of the proposition that a letter of credit ... is to be treated as cash that when the bank pays and cash is received by the beneficiary, it should be subject to the same restraints as any other of his cash assets. Enjoining the beneficiary from removing the cash asset from the jurisdiction is not the same as taking action ... which will prevent him from obtaining the cash".[462]

Streicher J rejected this argument.[463] He pointed out that from the beneficiary's point of view there is no difference between preventing the issuing bank from effecting payment of the credit in a foreign country by interdicting it from doing so, or preventing it from paying in a foreign country by effectively ordering it to pay locally to the deputy sheriff who would be receiving it on

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458 [1981] 1 WLR 1233 (CA) 1243D (per Griffiths LJ).

459 1241E (per Lord Denning MR).

460 225H-J.

461 [1981] 2 Lloyd's Rep 256 (CA). For a discussion of the case see the text at n 186 above.

462 258.

463 226A-H.

behalf of the beneficiary. In neither instance would the beneficiary receive his money abroad until a local court had decided upon a counterclaim. The court regarded the *Intraco* reasoning as inapplicable due to the fact that the bank had not paid the beneficiary in South Africa.[464]

Thus, the court held that the general international understanding of letters of credit was at odds with the granting of an application such as the present. However, the fact remains that in terms of South African law an *incola* plaintiff may attach the right of a peregrine defendant to found or confirm jurisdiction. This problem was dealt with as follows by Streicher J:

> "In the light of the purpose of a letter of credit, the fact that it is a valuable instrument of international trade, the very serious consequences to banks in general and to South African banks in particular should the term not be implied, I am of the view that a term should be implied by law into the agreement between the applicant and Finetrade that the applicant would establish an irrevocable letter of credit, and that the applicant would not, by attachment to found or confirm jurisdiction in order to prosecute a counterclaim against Finetrade, prevent the payment of the letter of credit in accordance with its terms."[465]

In a nutshell, therefore, the court's finding was that Sapan Trading's application could not succeed due to the implication by law, on considerations of policy, of a term in the contract between Sapan Trading and Finetrade to the effect that no such application would be brought. In general terms, therefore, Streicher J agreed with the third basis for the decision of the court *a quo*.

In a short concurring judgment[466] Schutz J expressed the opinion that the same term implied into the contract between the buyer-applicant and the seller, should, for the same reasons, be implied into the contract between the buyer-applicant and the issuing bank. He further stated that as the reputation of the issuing banks was involved, they should have been joined. Streicher J in turn concurred in the judgment of Schutz J. Thus, the court agreed also with the fourth basis for the decision of the court *a quo*.

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464 226H.

465 227D-E.

466 228B-G.

Whilst the outcome of the *Sapan Trading* case is to be welcomed, the main rationale of the decision raises a difficult question. The court was faced with a problem of some nicety. On the one hand there were strong policy considerations for refusing the application. On the other hand it has been firmly established in our law that once the applicant has made out a *prima facie* case, the court must order the attachment.[467] It has no discretion in this regard.[468] Moreover, in *Longman Distillers Ltd v Drop Inn Group* the Appellate Division stressed that considerations of policy did not come into play. Nicholas AJA stated:

> "I cannot see how public policy can be at all involved in a question whether a particular incorporeal right should be attached *ad fundandam* ... . The question does not raise any important moral issue, or any principle affecting the fundamental assumptions of the community."[469]

It is highly unlikely that Nicholas AJA in formulating this broad statement had envisaged the attachment of a documentary-credit claim. It is suggested that in the context of documentary credits the question does indeed raise a "principle affecting the fundamental assumptions of the community" namely that interference with the payment obligation of a bank should not, save in exceptional circumstances, be tolerated. It is therefore respectfully submitted that the principle negating a discretion in applications of this nature is not absolute. Recognition of this viewpoint would prevent the somewhat tortuous reasoning which the court was compelled to adopt in the *Sapan Trading* case. The effect of the case, after all, is that the court does have a discretion to refuse an attachment - albeit in the sense of a discretion whether to imply (on considerations of policy) a term into the underlying contracts preventing an application for attachment.

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467 *Longman Distillers Ltd v Drop Inn Group* 1990 2 SA 906 (A) 914E-F. See further Erasmus (*op cit* n 358) A1-29; Pollak W *The South African Law of Jurisdiction* (1937) Horters Johannesburg 64. This point, as far as I could ascertain, is not dealt with in the second edition (Pistorius (*op cit* n 429)). The rule derives from Roman-Dutch law and was applied in the early cases *McBride and Thompson v Vause* (1889) 3 SAR 3 and *Lecomte v W and B Syndicate of Madagascar Ltd* 1905 TS 696.

468 This was expressly noted by Schutz J (228C-D) as well as by Stegmann J in the court *a quo* (203).

469 1990 2 SA 906 (A) 914A-B.

One may conclude that the main importance of the *Sapan Trading* case is that it provides a clear indication of the great lengths to which our courts are willing to go to protect the integrity of documentary credits. As such it is certainly to be welcomed.

6 5 5 Conclusion

The South African courts have in the few opportunities givem them clearly manifested an intention of protecting the integrity of the system of documentary credits. This is to be welcomed. In so doing they have ably demonstrated the ability of the South African law to give effect to the international consensus regarding these instruments, as well as to the commercial expectations of the parties involved. Although some questions still need to be resolved it would be fair to conclude that our law regarding documentary credits is on a sound footing.

Case Register

1 South African Cases

2 British Cases

3 American Cases

4 German Cases

5 Cases from Other Jurisdictions

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