

# **Using the nullity exception to combat the circulation of fraudulent documents in letters of credit transactions**

**R MOHANOE**

**28249097**

Mini-dissertation submitted in partial fulfilment of the requirements for the degree *Magister Legum* in Import and Export Law at the Potchefstroom Campus of the North-West University

Study Supervisor: Prof W Erlank

November 2016

## **ACKNOWLEDGEMENTS**

This study is dedicated to one person who will forever have a special place in my heart, my aunt Melita Pitikoe, may her beautiful soul rest in peace. This is for you aunty, I know you are with me in spirit and I hope I have made you proud.

On completion of this dissertation I will love to say glory to God, my Lord and saviour Jesus Christ. I am thankful, father, for the wonders you keep doing in my life.

I am sincerely beholden to my delightful, agreeable and courteous supervisor Prof. Wian Erlank whose thorough comments and resourceful supervision saw this study to fruition.

I am indebted to my mentor Tebello Thabane for literally imploring me to apply for the prominent Import and Export law masters programme. I am thankful to my family for their motivation and support despite being miles away. To my learned brother cum employer Tumisang Mosotho, I truly appreciate your inspiration.

Last but by no means least, a very special gratitude is due to my friends and colleagues for their academic and social support in Potchefstroom.

## **ABSTRACT**

In letters of credit transactions when the beneficiary presents apparently conforming documents before the bank, as long as the bank has exercised proper care in making payment it can disregard all disputes arising from the underlying transaction. Moreover, the bank does not have to consider whether the documents presented are as a matter of fact, proper and genuine. The exception to this principle of independence applies in circumstances where there is fraud on the part of the beneficiary. For instance, where the beneficiary has fabricated a document, a bank does not have an obligation to pay the beneficiary regardless of the fact that the documents conform on their face to the requirements of the credit.

The fraud exception is a common law exception and it is not covered by the UCP 600. This exception is based on the maxim *ex turpi causa non oritur actio*. This basically means that a court will not allow its processes to be used to aid a dishonest beneficiary. However, the fraud exception only covers fraud committed by the beneficiary. In circumstances where a third party and not the beneficiary has committed fraud and the documents are a nullity, the fraud exception will not permit a bank to withhold payment against presentment of apparently conforming documents, because the beneficiary is innocent. The study argues that this limitation of the fraud exception gives third parties a free ride. This opens a gap which allows fraudulent third parties to freely get away with fraud, which ultimately gives rise to the circulation of fraudulent documents in letters of credit transactions.

This study seeks to answer the question of how this peculiar position can be rectified by use of the nullity exception. The basis of the exception is that a null document cannot be treated as a conforming document merely because fraud has been committed by a third party. Unlike the fraud exception, it does not focus on the identity of the fraudulent party, rather its main focus is the fact that a bank should not make payment on presentment of null documents because they are invalid.

**Keywords:** Letters of credit, the fraud exception, the nullity exception, international trade, circulation.

## OPSOMMING

In dokumentêre kredietbrief ("*letters of credit*") transaksies, wanneer die begunstigde oënskynlik konformerende dokumente aan die bank voorlê, kan die bank solank voldoende sorg deur hulle toegepas was wat die betaling aanbetref, alle onderliggende dispute verontagsaam. Verder, hoef die bank nie te oorweeg of die dokumente werklik behoorlik (*proper*) en eg is nie.

Daar is een uitsondering vir hierdie beginsel, naamlik die onafhanklikheidsbeginsel wat toepassing vind in omstandighede waar daar bedrog voorkom aan die kant van die begunstigde. Byvoorbeeld waar die begunstigde die dokument vervals het. In hierdie geval word die bank nie verplig om uit te betaal nie, ongeag van die feit dat die dokumente op die oog af konformeer aan die vereistes van die krediet.

Die bedrogsbeginsel is 'n gemeenregtelike uitsondering en word nie gedek deur die UCP 600 nie. Hierdie uitsondering is gebaseer op die maxim *ex turpi causa non oritur actio*. Die uitwerking hiervan is basies dat 'n hof nie sal toelaat dat sy proses gebruik word om 'n oneerlike begunstigde te beskerm nie. Die bedrogsbeginsel dek egter net bedrog wat deur die begunstigde gepleeg is. In omstandighede waar 'n derde party, en nie die begunstigde nie, bedrog gepleeg het en die dokumente nietig is, sal die bank nie toegelaat word om tydens die aanbieding van konformerende dokumente betaling te weerhou op grond van die uitsondering nie, aangesien die begunstigde onskuldig is. In hierdie studie word geargumenteer dat derde partye 'n onregverdigde voordeel geniet as gevolg van die bedrogsbeginsel. Dit veroorsaak 'n leemte wat derde partye toelaat om vrylik met bedrog weg te kom, wat uiteindelik lei tot die sirkulasie van bedrieglike dokumente in kredietbrief transaksies.

Hierdie studie poog om die vraag te antwoord van hoe hierdie eenaardige posisie gekorrigeer kan word deur middel van die nietigheidsbeginsel. Die basis van hierdie uitsondering is die feit dat 'n nietige dokument nie as 'n konformerende dokument geag kan word bloot weens die feit dat die bedrog deur 'n derde part gepleeg is nie. In teenstelling met die bedrogsbeginsel, word daar nie gefokus op die identiteit van die bedrieënde party nie, maar eerder op die feit dat die bank nie kan uitbetaal teen aanbieding van dokumente wat nietig is omdat hulle ongeldig is nie.

**Sleutelwoorde:** kredietbriewe, bedrogsuitsondering, nietigheidsuitsondering, internasionale handel, sirkulasie.

## TABLE OF CONTENTS

<b>ACKNOWLEDGEMENTS .....</b>	<b>i</b>
<b>ABSTRACT .....</b>	<b>ii</b>
<b>OPSOMMING .....</b>	<b>iii</b>
<b>TABLE OF CONTENTS .....</b>	<b>v</b>
<b>LIST OF ABBREVIATIONS .....</b>	<b>viii</b>
<b>Chapter 1-Introduction.....</b>	<b>1</b>
<b>1.1 Problem statement.....</b>	<b>1</b>
<b>1.2 Research question.....</b>	<b>3</b>
<b>1.3 Research methodology.....</b>	<b>3</b>
<b>1.4 Relevance for the research unit .....</b>	<b>4</b>
<b>1.5 Framework of the study .....</b>	<b>4</b>
<b>Chapter 2-Letters of credit in international trade .....</b>	<b>6</b>
<b>2.1 Introduction .....</b>	<b>6</b>
<b>2.2 The main methods of payment.....</b>	<b>6</b>
2.2.1 Payment in advance .....	6
2.2.2 Open account .....	7
2.2.3 Documentary collections .....	7
2.2.4 Letters of credit.....	9
How letters of credit work .....	11
2.2.5 The contract of sale between the seller and the buyer .....	15
2.2.6 The contract between the buyer and the issuing bank .....	16
2.2.7 The contract between the issuing bank and the advising bank .....	16
2.2.8 The contract between the issuing bank and the seller.....	17
2.2.9 The contract between the advising bank and the seller .....	17
<b>2.3 The main principles underlying letters of credit .....</b>	<b>18</b>

2.3.1	<i>The principle of strict compliance</i> .....	18
2.3.2	<i>The independence principle</i> .....	21
<b>2.4</b>	<b>Conclusion</b> .....	<b>22</b>
<b>Chapter 3-The fraud exception in letters of credit transactions</b> .....		<b>24</b>
<b>3.1</b>	<b>Introduction</b> .....	<b>24</b>
<b>3.2</b>	<b>Definition of fraud</b> .....	<b>24</b>
<b>3.3</b>	<b>The rationale behind the fraud exception</b> .....	<b>26</b>
3.3.1	<i>To close a loophole in the law</i> .....	27
3.3.2	<i>To protect public policy for the control of fraud</i> .....	28
3.3.3	<i>To maintain the utility of letters of credit</i> .....	28
<b>3.4</b>	<b>The recognition and development of the fraud exception</b> .....	<b>29</b>
<b>3.5</b>	<b>Fraud on the part of the beneficiary</b> .....	<b>31</b>
3.5.1	<i>Philips v Standard Bank of South Africa</i> .....	32
3.5.2	<i>Loomcraft Fabrics CC v Nedbank Ltd and another</i> .....	33
<b>3.6</b>	<b>Third party fraud</b> .....	<b>34</b>
3.6.1	<i>The United City Merchants Judgements</i> .....	35
<b>3.7</b>	<b>Conclusion</b> .....	<b>38</b>
<b>Chapter 4-The nullity exception in letters of credit transactions</b> .....		<b>39</b>
<b>4.1</b>	<b>Introduction</b> .....	<b>39</b>
<b>4.2</b>	<b>Nullity in general law context</b> .....	<b>39</b>
<b>4.3</b>	<b>Nullity in letters of credit transactions</b> .....	<b>41</b>
4.3.1	<i>Documents serving no security for the advances of the bank</i> .....	43
4.3.2	<i>Forgery of a document in a material manner</i> .....	47
4.3.3	<i>Non-genuine documents presented for payment</i> .....	50
4.3.4	<i>Documents useless for the purpose for which they were intended to be used</i>	52

**4.4 The contemporary position of the law regarding the nullity exception ..... 53**

4.4.1 The current position under English law ..... 54

**4.5 Conclusion ..... 59**

**Chapter 5- Conclusions and recommendations ..... 61**

**5.1 Introduction ..... 61**

**5.2 Exploration of the fraud and the nullity exceptions in letters of credit transactions ..... 63**

**5.3 Final conclusions and recommendations ..... 69**

**BIBLIOGRAPHY ..... 72**

## **LIST OF ABBREVIATIONS**

SA Merc LJ	South African Mercantile Law Journal
UCP 500	Uniform Customs and Practice for Documentary Credits 500 (1993)
UCP 600	Uniform Customs and Practice for Documentary Credits 600 (2007)
UCC	Uniform Commercial Code
UNCITRAL CONVENTION	United Nations Convention on Independent Guarantees and Standby Letters of Credit

## Chapter 1-Introduction

### 1.1 Problem statement

The main parties in an international trade transaction are the buyer (importer), the seller (exporter) and the financier (usually a bank) of the buyer. An international sale is in legal principle not different from a domestic sale. However, the parties are exposed to additional risks that are less common in domestic sales.<sup>1</sup> Furthermore, the documents in relation to the sale of goods are very important, this is evident from the fact that these sales are often referred to as documentary sales.<sup>2</sup> Some eminent scholars have argued that documents are sold in contrast to purely the goods.<sup>3</sup> In international trade, the parties are exposed to a number of risks, this is mainly because of the international character of the transaction.<sup>4</sup>

The parties to the transaction are from different countries, and as a result they are subjected to different national jurisdictions.<sup>5</sup> The seller will be compelled to export goods to another country which may be located hundreds or even thousands of miles from his own place of business. In this kind of situation, the seller will normally demand that he should receive payment for the goods sold before or when he parts with the goods. Similarly, the buyer has the same interest to ensure that the seller has shipped conforming goods before making payment in terms of the sale agreement.<sup>6</sup>

When goods are exported across national borders, they are transported outside the country in which the seller has his place of business. Once the said goods have left the seller's country the seller may find it extremely difficult to recover control or possession of the goods. Furthermore, if the buyer does not pay for the goods when they are delivered, then the seller will have difficulties in suing the buyer for payment because the buyer and all his possessions will be in a different country. In most

---

1 Carr *International Trade Law* 4<sup>th</sup> ed 463.

2 Goode *Commercial Law* 4<sup>th</sup> ed 1033.

3 Bridge *The International Sale of goods* 7; See also Dimatteo *International Contracting: Law and Practice* 109.

4 Garcia and Luis 2009 *Mexican Law Review* 69.

5 Bollen 2007 *JIBLR* 381.

6 Day *The Law of International Trade* 1-4.

cases, the seller will export goods to a foreign country of which he has no knowledge of its legal system.<sup>7</sup> In most instances, the parties may agree that the law in the country of the buyer should govern many phases of the transaction. This may amongst others include the process to follow in order to get payment. In this kind of situation the seller will be obliged to seek redress from foreign courts to which he will not easily have access. Ultimately, this may prove to be problematic and costly.<sup>8</sup> By the same token, if the buyer pays for the goods before receiving delivery of the said goods and the seller does not deliver the goods, or worse, still delivers defective or goods that do not comply with the agreement, then the buyer will also be in the same situation of tracking and suing the seller in a foreign country.

These fears and concerns by the respective parties have necessitated the use of letters of credit (documentary credits) in which parties don't effect payment directly to each other, but rather use the services of the bank which undertakes to pay the beneficiary on presentment of certain documents. In summary, in letters of credit the party buying the goods (the applicant) requests their bank to issue a letter of credit in favour of the seller (beneficiary). The bank which issues a letter of credit is referred to as the issuing bank, it issues a letter of credit on behalf of its client, the applicant. In its letter of credit the issuing bank provides an irrevocable undertaking to make payment to the beneficiary on presentation of documents stipulated in a letter of credit which comply with the terms of a letter of credit.

In essence the bank undertakes to make payment against presentment of specified documents. Article 4 of the UCP 600<sup>9</sup> provides that when the bank is asked to pay, it must in principle decide on the basis of the stipulated documents alone whether or not to pay (the independence principle). The reason for this is because the UCP clearly states that the bank deals with documents, not goods.<sup>10</sup> Article 14 (b) of the UCP prevents the bank from refusing to make payment on the grounds derived from the underlying contract of sale. Letters of credit facilitate commercial trade and the only basis upon which they can be declared unlawful and unenforceable is by reason

---

7 Grassi 1995 *Pace International Law Review* 122.

8 Goode *Commercial Law* 4<sup>th</sup> ed 878-879.

9 A 4 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

10 A 5 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

of fraud on the part of the beneficiary. In essence, the issuing bank's obligation to pay the beneficiary in letters of credit transactions is absolute except in cases where the beneficiary has committed fraud. However, the fraud exception applies only where the beneficiary is personally liable, it does not cover fraud committed by third parties.<sup>11</sup> The bank will be compelled to make payment even if upon presentation of the documents, fraud by a third party comes to the attention of the bank. As long as the documents are in order on their face and the beneficiary is not involved in the said fraud, payment will be effected.<sup>12</sup> This current position allows fraudulent third parties to freely get away with fraud. Put differently, the position opens floodgates of third party fraud in letters of credit transactions. This leaves a lacuna which allows the circulation of fraudulent documents in letters of credit transactions. This dissertation seeks to answer the question of how this peculiar position can be rectified by use of the nullity exception. The basis of the nullity exception is that fraudulent documents cannot possibly be treated as conforming documents merely because fraud has been committed by a third party and not the beneficiary, the bank is concerned with the fact that the documents are invalid and not the identity of the fraudulent party.

## **1.2 Research question**

How can the nullity exception be used to combat the circulation of fraudulent documents in letters of credit transactions?

## **1.3 Research methodology**

This study is primarily based on a literature review of appropriate text books, case law, law journals, international conventions, legislation and internet sources dealing with letters of credit in international trade. This study will not be conducted by way of a comparative study, however, reference to foreign jurisdictions will be highlighted for illustration purposes if and where necessary.

---

11 *United City Merchants v Royal Bank of Canada* 1983 AC 168 HL para 184 E-F.

12 *United City Merchants v Royal Bank of Canada* 1983 AC 168 HL para 184 E-F.

#### **1.4 Relevance for the research unit**

The proposed study falls within the broad focus of the research unit namely *Development in the South African Constitutional State*. The study directly relates to letters of credit, and may accordingly contribute to legal development in the field of the law of international instruments of payment in South Africa. The study falls within the scope of the sub-project: *Trade and development* in as much as it is concerned with the development of the law pertaining to international instruments of payment.

#### **1.5 Framework of the study**

The research will be divided into five chapters. The first chapter will be an introductory chapter, it will provide the problem statement, research question, research methodology and the study outline.

Chapter two entails a discussion of letters of credit. The aim of the chapter is to discuss letters of credit as a payment method in international trade. The chapter will commence with a brief discussion of other methods of payment used in international trade such as open account, payment in advance and documentary collections. The chapter will further discuss the risks involved in using these methods of payment. Thereafter, the chapter will introduce letters of credit and how they address the parties' fears and insecurities associated with these methods of payment. Lastly, the chapter will discuss in detail how letters of credit work, the different parties involved and its underlying principles.

Chapter three will discuss the fraud exception in letters of credit transactions. The chapter will commence by defining fraud in letters of credit. The chapter will also provide a transient overview of the rationale behind the fraud exception, this will be followed by a brief discussion in relation to the recognition and development of the fraud exception from both international and domestic law perspectives. Thereafter, fraud on the part of the beneficiary will be discussed in detail. In this regard a number of cases that dealt with the fraud exception to the independence principle will merit a detailed discussion in order to ascertain how the courts normally canvass issues relating to the fraud exception in letters of credit transactions. Lastly, the

chapter will be concluded with a discussion of third party fraud in letters of credit transactions.

In the fourth chapter, the focal task is to discuss the nullity exception in letters of credit transactions. The chapter will commence by defining nullity in context of general law, it will succinctly discuss the essence and consequence of nullity in general law context. Thereafter, nullity will be discussed with specific reference to letters of credit. The chapter will attempt to provide circumstances under which a document can be treated as a nullity in letters of credit. Afterwards, cases that have dealt with the nullity exception will be discussed concisely in order to ascertain how the courts have attempted to define nullity in letters of credit and under what circumstances a document has been considered a nullity in letters of credit transactions.

The fifth chapter, being the final chapter provides transitory summaries of all the discussions and conclusions made in the preceding chapters. The chapter further provides an exploration of the fraud and nullity exceptions in letters of credit transactions. Lastly, final conclusions and recommendations will be made.

## **Chapter 2-Letters of credit in international trade**

### ***2.1 Introduction***

The sole intention of this chapter is to introduce letters of credit in international trade, in so doing, the chapter will commence with a brief discussion of other methods of payment used in international trade and the risks involved in using these methods of payment. Thereafter, the chapter will introduce letters of credit and how they address the parties' fears and insecurities associated with other methods of payment in international trade. Last but by no means least, the chapter will discuss in detail how letters of credit work, the different parties involved and its underlying principles.

### ***2.2 The main methods of payment***

It is possible to ascertain four main methods of payment in international trade. These are payment in advance, open-account, payment by documentary collection, and most importantly payment by documentary credit (letters of credit).<sup>13</sup> These methods will be explored below in more detail.

#### ***2.2.1 Payment in advance***

A seller who is in a stronger position than the buyer when negotiating a contract of sale may demand payment in advance, for instance, cash with order.<sup>14</sup> This happens more often where the seller does not have confidence in the political stability of the buyer's country, its economy or even its banking system. This method of payment puts the seller in a better position because he endures no risk. The buyer on the other hand is in the unfavourable position because he pays before receiving the goods.<sup>15</sup> The buyer is also not sure whether what he has paid for will be delivered or exported timeously or be of the quality and quantity contracted for. Some scholars

---

13 Carr *International Trade Law* 4<sup>th</sup> ed 463.

14 Wolff *The Law of Cross-Border Business Transactions* 165-167.

15 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 249.

argue that the buyer should not agree to this method of payment unless he has good information on the seller and its reputation.<sup>16</sup>

### *2.2.2 Open account*

Payment by open account can be considered the opposite of payment in advance. When using this method of payment the seller and the buyer agree that the seller will ship the goods to the buyer on the grounds that the buyer will pay for the said goods on the future date that parties will agree on.<sup>17</sup> This time around it is the seller who is in a position of risk and the buyer is in a better negotiating position. The buyer has the advantage of being in receipt of the goods and examining whether they are in good condition before meeting payment. The buyer may even sell such goods and pay the seller with the proceeds therefrom. The core detriment on the part of the seller is that he transfers the title of the goods to the buyer without being sure that the buyer will in fact meet payment. It is clear therefore, that the seller should only agree to this method of payment if it has reliance in the buyer and the steadiness of the buyer's country.

### *2.2.3 Documentary collections*

Documentary collections provide a compromise to the risks associated with payment in advance and open account by putting both the seller and the buyer in advantageous positions.<sup>18</sup> It offers a compromise by allowing the seller to remain in control of the documents until it is paid in circumstances where payment has been arranged by way of documents against payment (DP collections).<sup>19</sup> Where payment is arranged by way of documents against acceptance (DA collections), the seller remains in control of the documents until he has acquired the buyer's acceptance of a bill of exchange in favour of the seller.<sup>20</sup> In this method of payment the parties enlist the services of the bank and they do not deal directly with each other. The seller delivers the commercial documents which are needed by the buyer to the

---

16 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 249.

17 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 254.

18 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 251.

19 Wolff *The Law of Cross-Border Business Transactions* 174.

20 Wolff *The Law of Cross-Border Business Transactions* 174.

bank.<sup>21</sup> The seller's bank, which is referred to as the remitting bank, forwards the documents to the bank in the buyer's country, referred to as the collecting bank. The collecting bank will then furnish the buyer with the said documents. It is important to note, however, that the collecting bank will only furnish the buyer with the documents against payment, or against acceptance of the bill of exchange.<sup>22</sup> It is evident from the above analysis that the advantage of documents against payment on the side of the seller is that the buyer does not obtain possession of the documents before he has paid. The buyer does not therefore get to have control over the goods before he has paid. The seller has control over the documents until the documents are handed to the buyer by the collecting bank against payment.<sup>23</sup> It is important to note that even though documents against payment safeguard the interests of the seller better than payment by way of open account, it is safe to assert that this method of payment still favours the interests of the buyer. This is because the buyer may refuse to pay when the goods arrive at their destination. This may in turn leave the seller in an undesirable position of having to dispose of the goods in a foreign port.<sup>24</sup>

Conversely, the bill of exchange is the term draft; the buyer derives benefit from the period of credit, this is the period between acceptance of the bill and the maturity of the bill.<sup>25</sup> The buyer may also be able to sell the goods and pay the seller from the proceeds therefrom. On the other hand, the seller has released the commercial documents without payment from the buyer. At this juncture, the seller has two options at his disposal; he can either wait for the bill to mature and subsequently present it to the buyer for payment.<sup>26</sup> On the other hand the seller may decide to sell the bill.<sup>27</sup> In light of the foregoing, it becomes apparent that a document against acceptance is a method of payment that favours the buyer more than the seller. The analysis above reveals that the buyer attains credit while the seller on the

---

21 These commercial documents are usually the commercial invoice, transport documents and the insurance documents. In the case of documents against acceptance, a bill of lading drawn by the seller on the buyer in favour of the seller to its bank with collection instructions.

22 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 251.

23 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 251.

24 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 252.

25 Carr *International Trade Law* 4<sup>th</sup> ed 464.

26 Dimatteo *International Contracting: Law and Practice* 112.

27 Carr *International Trade Law* 4<sup>th</sup> ed 464-465.

other hand is not certain that when the bill is presented for acceptance the buyer will accept. Meaning the risk of the buyer being unable to pay the accepted bill when it falls due vests with the seller. The only advantage the seller has is that he remains in control of the documents in anticipation of acceptance of the bill of exchange by the buyer.

#### *2.2.4 Letters of credit*

As a result of the risks associated with the payment methods discussed above, the parties may enlist services of the bank which is a financially independent institution and dedicated to complying with its payment undertakings.<sup>28</sup> This type of payment method is referred to as documentary credit or letters of credit.<sup>29</sup> It is important to note that there is no single universal definition of what is meant by "letters of credit".<sup>30</sup> Letters of credit are defined according to the applicable rules to a particular letter of credit transaction.<sup>31</sup> However, some authors have attempted to define letters of credit. They have in most cases been defined as an irrevocable undertaking of the issuing bank to make payment to the beneficiary on presentation of documents stipulated in a letter of credit which comply with the terms of a letter of credit.<sup>32</sup> They have also been described as a type of mercantile currency embodying an abstract promise of payment, "which possesses a high, though not total, immunity from attack on the ground of breach of duty of the seller to the buyer".<sup>33</sup>

In international trade, letters of credit have become the most secure method of payment in timorous conditions.<sup>34</sup> This method of payment attains a considerable amount of balance between the interests of the respective parties. As a result of this state of affairs English judges have gone as far as concisely referring to letters of

---

28 Megrah's and Gutteridge *Law of Banker's Commercial Credits* 16.

29 Murray, Holloway and Hunt *Schmittoff The Law and Practice of International Trade* 189; see also Bridge *Benjamin's Sale of Goods* 1987.

30 Sanborn *Origins of the early English Maritime and Commercial Law* 347.

31 A 2 of the Uniform Customs and Practice for Documentary Credits 500 (1993) and A 2 of the Uniform Customs and Practice for Documentary Credits 600 (2007) provide a definition of credit.

32 Buckley and Nixon 2009 *JOBLFP* 16.

33 Zweigert and Drobnič *Kozolchyk Letters of Credit* 138-143.

34 Goode *Commercial Law* 4<sup>th</sup> ed 1055.

credits as "the life-blood" of international commerce.<sup>35</sup> Goode defines letters of credit in the following terms: "a documentary credit is in essence a banker's assurance of payment against presentment of specified documents".<sup>36</sup>

In most cases, letters of credit are governed by the international chamber of commerce's *Uniform Customs and Practice for Documentary Credits (UCP)*.<sup>37</sup> Some of the eminent scholars have boldly referred to this instrument as an extremely successful instrument of harmonization.<sup>38</sup> An important point to note is that the UCP does not govern all aspects of the relationship between numerous parties involved in a letter of credit transaction.<sup>39</sup> For example it does not make any provision for the exceptions to the independence principle. In this regard some commentators have put forward that matters not regulated by the UCP will be determined by reference to some or other national laws as designated by the applicable principles on international law.<sup>40</sup> The UCP 600 defines a credit as follows:

Credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.<sup>41</sup>

The bank's definite undertaking to honour a credit may take a variety of forms.<sup>42</sup> The issuing bank undertakes to make payment only if the stipulated documents are presented to it or the nominated bank, and only if the said documentation constitutes a complying presentation.<sup>43</sup> Only then will the issuing bank honour the credit if the credit is available by either sight payment,<sup>44</sup> or deferred payment.<sup>45</sup> The bank can

---

35 See *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* 1978 QB 146, 155 G; see also *Inraco Ltd Notis Shipping Corporation-The Bhoja Trader* 1981 2 Lloyd's Rep 256 CA 257.

36 Goode *Commercial Law* 4<sup>th</sup> ed 1059.

37 The Uniform Customs and Practice for Documentary Credits 600 (2007).

38 Goode *Commercial Law* 4<sup>th</sup> ed 1055; see also Hugo 1993 *SA Merc LJ* 44.

39 Fredericks 2003 *SA Merc LJ* 63-73; see also Hugo 1994 *SA Merc LJ* 143.

40 Fredericks 2003 *SA Merc LJ* 207-227.

41 A 2 of the Uniform Customs and Practice for Documentary Credits 600 (2007) (definitions).

42 A 8 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

43 A 8 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

44 A 6 (b) and 7 (a) (i) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

45 A 6 (b) and 7 (a) (i) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

also accept a time draft drawn by the seller and pay it when it matures<sup>46</sup> or even pay the bank that has purchased the documents.<sup>47</sup>

### 2.2.5 How letters of credit work

This part of the dissertation will review the main parties involved in a letter of credit and how letters of credit transactions work. Commercial letters of credit<sup>48</sup> have been aptly described as classical by Cloete J in *Scatec Solar SA Ltd Itochu Corporation v Terrafix Sued Africa Pty Ltd HBC Bank PLC*.<sup>49</sup> Firstly the parties enter into a contract of sale in terms of which they agree for payment to be effected by means of a letter of credit.<sup>50</sup> At this stage the parties may also agree to the particulars of the credit.<sup>51</sup> They may also stipulate that the advising bank will advise the said credit to the seller. The buyer will then fill in the application form with the issuing bank of its choice for the issuing of a letter of credit.<sup>52</sup> The contents of a letter of credit will be provided for in this form.<sup>53</sup> In most cases the bank may demand that the buyer provide security before it can accept the application.<sup>54</sup> If the issuing bank accepts the buyer's application, the credit will be issued and the advising bank will be notified of such acceptance by the issuing bank.<sup>55</sup> The advising bank will in turn inform the seller that the credit has been issued on his behalf and it will also furnish him with the terms of the letter of credit.<sup>56</sup> The seller will then examine the terms and conditions of the credit and if the seller is content, he will prepare the goods to be

---

46 A 6 (b) and 7 (a) (i) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

47 A 6 (b) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

48 It is important to note that there are different types of letters of credit. Commercial letters of credit are used mainly as a payment method and every time the author talks of a letter of credit in this dissertation he is referring particularly to commercial letters of credit; Kelly-Louw *Selective Aspects of Bank demand Guarantees* 81, who gives a detailed discussion of commercial letters of credit and how they differ from other letters of credit such as standby letters of credit.

49 *Scatec Solar SA Ltd Itochu Corporation v Terrafix Sued Africa Pty Ltd HBC Bank PLC*. (Unreported) case Number 449/2014.

50 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 257.

51 Murray *et al Schmitthoff's Export Trade* 208.

52 Goode *Commercial Law* 4<sup>th</sup> ed 1062.

53 Goode *Commercial Law* 4<sup>th</sup> ed 1062; for example this form may provide the documents that the seller is to provide before it can obtain payment from the advising bank. The credit must also comply with the agreement of the parties in the contract of sale, if it does not, then the seller is free to reject it and claim damages; see Goode *Commercial Law* 4<sup>th</sup> ed 1062.

54 Goode *Commercial Law* 4<sup>th</sup> ed 1062.

55 Goode *Commercial Law* 4<sup>th</sup> ed 1065.

56 Goode *Commercial Law* 4<sup>th</sup> ed 583.

exported to their required destination.<sup>57</sup> In a nutshell, there are at least three parties typically involved in a letter of credit transaction.<sup>58</sup> The party buying the goods is referred to as the Applicant.

It is the Applicant who requests his bank to issue a letter of credit in favour of the Seller (Beneficiary).<sup>59</sup> The bank which issues a letter of credit is referred to as the issuing bank, it issues a letter of credit on behalf of its client, the Applicant.<sup>60</sup> In its letter of credit the issuing bank provides an irrevocable undertaking to make payment to the beneficiary on presentation of documents stipulated in a letter of credit which comply with the terms of a letter of credit. The beneficiary is the party in whose favour a letter of credit is issued, the beneficiary is typically the seller in a letter of credit transaction.<sup>61</sup> Apart from the three parties described, the applicant, the issuing bank and the beneficiary, a letter of credit transaction may also have the involvement of an advising bank, the nominated bank and in some cases the confirming bank.<sup>62</sup> An advising bank is the bank to which the issuing bank sends the letter of credit and it is the bank that notifies the beneficiary that a letter of credit has been issued in their favour.<sup>63</sup> The advising bank authenticates whether a letter of credit has been sent by the issuing bank and provides the beneficiary with a copy of a letter of credit.

Conversely, the nominated bank is the bank that is authorised by the issuing bank to pay, accept or purchase the drafts and/documents presented by the beneficiary. Finally the confirming bank is the bank that at the request of the issuing bank provides its own undertaking in addition to that of the issuing bank to make payment to the beneficiary on presentation of the documents which comply with the terms

---

57 Important to note is that if the seller is not satisfied with the conditions of the credit then it must let other parties know of its rejection; see *W J Alan & Co Ltd v El Nasr Export and Import Co* 1972 2 QB 189 a case in which the court held that if the seller does not communicate his rejection to the other parties then he will be taken to have varied the contract of sale. The Court also held that the seller may be understood to have waived his right to insist upon compliance with the terms of the contract of sale.

58 Goode *Commercial law* 978.

59 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 257.

60 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 257.

61 Jack *Documentary Credits* 35.

62 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 260.

63 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 260.

and conditions of a letter of credit.<sup>64</sup> How does issuance of a letter of credit work? Firstly, the buyer and seller enter into a sales contract and agree to use a letter of credit as a payment instrument. Secondly, the buyer applies to his bank with which he has a credit facility for a letter of credit to be issued in favour of the seller. Thirdly, the issuing bank issues and transmits the letter of credit to the advising bank, the advising bank is usually located in the same country as the seller. Fourthly, the advising bank authenticates whether the letter of credit has been issued by the issuing bank and provides a copy of the letter of credit to the beneficiary.

The beneficiary then ships the goods and prepares the documents as required by the letter of credit, these are primarily shipping and trade documents which represent the goods in a trade transaction. Secondly the beneficiary presents the documents stipulated in the letter of credit to the nominated bank for examination against the terms of the letter of credit. Thirdly the nominated bank examines the documents for compliance with the terms and conditions of the letter of credit, if the documents comply, the nominated bank which has agreed to act as per its nomination will pay the beneficiary.<sup>65</sup> The nominated bank will then forward the documents to the issuing bank. The issuing bank will examine these documents for compliance with the terms and conditions of the letter of credit. If the documents constitute a complying presentation, the issuing bank will debit the Applicant's account and pay the nominated bank, the issuing bank will then forward the documents to the Applicant. It is important to note that payment by the nominated bank and the issuing bank is based on examination of documents alone, payment is not linked to the status of the underlying goods or shipment. This is known as the independence principle and will be discussed in detail later on in this chapter.

From the discussion above, it becomes apparent that a letter of credit transaction gives rise to five contractual relationships.<sup>66</sup> In *Bank of Credit & Commerce Hong Kong Ltd (in Liquidation) v Sonali Bank* the court classified the contractual relationships as follows:

---

64 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 260.

65 Hugo "Letters of Credit" 8; see also *Soproma S.p.A. v. Marine & Animal By-Products Corporation* 1966 1 Lloyd's Rep 367; see also *Shamsher Jute Mills Ltd. V Sethia* (London) Ltd. 1987 1 Lloyd's Rep 388; see further *Pavia & Co. S.P.A. v. Thurmann-Nielsen* 1952 2 QB 84 CA.

66 Goode *Commercial law* 978.

The five contractual relationships which arise in a typical transaction involving an irrevocable credit are: (1) a contract of sale between the buyer (the applicant for the credit) and the seller (the beneficiary),(2) a contract between the buyer and the issuing bank containing the terms on which the letter of credit is opened, (3) a contract between the issuing bank and the bank which confirms or advises the credit (the confirming or advising bank) embodying the advising or confirming bank’s mandate to advise and/or confirm the credit, collection of documents and payment on acceptance or negotiation, (4) a contract between the issuing bank and the seller containing the issuing bank’s undertaking to the seller to pay him or accept or negotiate his draft(s) provided that the seller has presented the stipulated documents in accordance with the terms of the credit and (5) a contract between the confirming bank and the seller containing the confirming bank’s additional undertaking to the seller to pay him or accept or negotiate his draft(s) provided that the seller has presented the stipulated documents in accordance with the terms of the credit.<sup>67</sup>

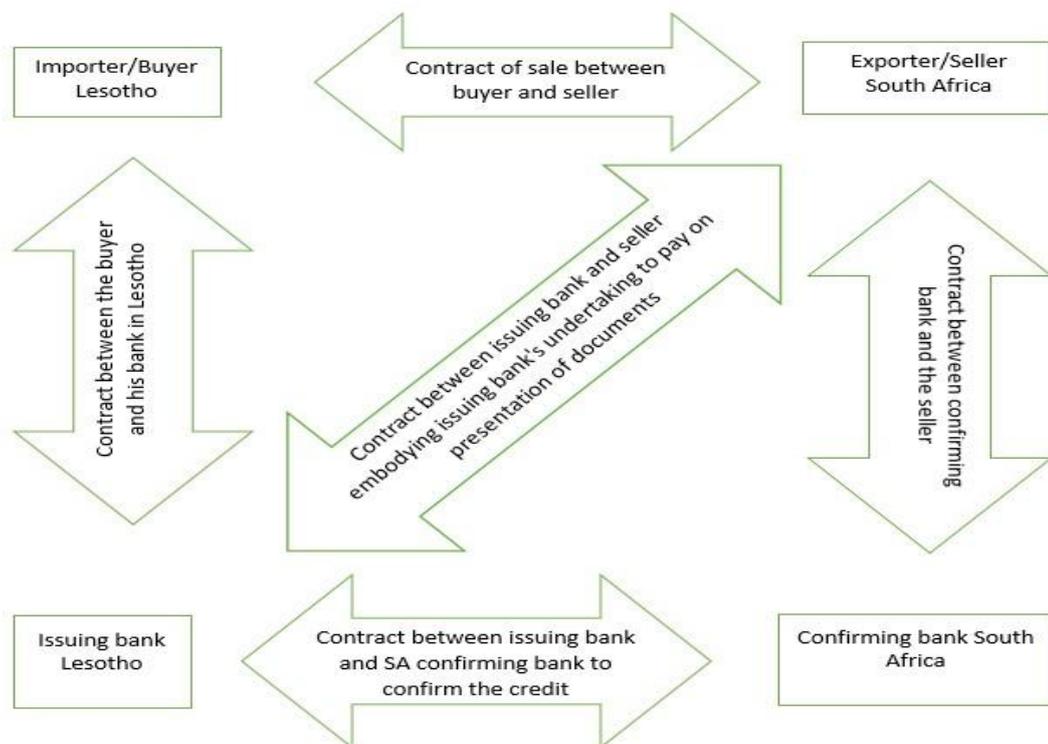


Figure 1: The diagram provides an illustration of the five contracts concluded between different parties to the transaction (this is the author's own diagram)

67 *Bank of Credit & Commerce Hong Kong Ltd (in Liquidation) v Sonali Bank* 1995 1 Lloyd’s Rep 227; see also *Standard Chartered Bank v Pakistan National shipping corporation* (No 2) 1998 1 Lloyd’s Rep 218 and 2001 1QB 167; see further Megrah’s and Gutteridge *Law of Banker’s Commercial Credits* 55-100.

### 2.2.6 *The contract of sale between the seller and the buyer*

The starting point in the whole transaction is the conclusion of a contract of sale between the seller and the buyer. This is the contract from which all other subsequent contracts emanate. The seller will deliver the goods provided he is satisfied that the terms and conditions of the letter of credit comply with what was agreed on between him and the buyer in the underlying contract of sale.<sup>68</sup> If the seller rejects the letter of credit on the grounds that it does not conform to the underlying contract of sale, then the buyer within the specific time limits may be given the opportunity to rectify the defect and furnish the seller with a conforming letter of credit.<sup>69</sup> It has been held that if the buyer fails to rectify this inaccuracy on time or fails to rectify it at all, then his conduct will amount to repudiation and the seller may set aside the contract and claim damages.<sup>70</sup>

An important point to note is that in circumstances where the seller accepts the non-conforming letter of credit as it stands he cannot later demand rectification.<sup>71</sup> However if the credit is dishonoured, the seller regains his right to take legal action against the buyer.<sup>72</sup> If the underlying contract provides that documents will be tendered to the issuing bank, and this is reflected in a letter of credit, then the seller is obliged to tender such documents to no other institution other than the issuing bank.<sup>73</sup> Under a contract of sale, parties also have autonomy to contract on their own terms.<sup>74</sup> In conclusion, an important point to note is that if the buyer accepts the documents when they are presented to him by the issuing bank, the buyer is not prohibited from rejecting the goods, if upon the inspection of such goods on their arrival they do not comply with the requirements of the contract of sale between the parties.

---

68 *Garcia v Page & CO Ltd* 1936 55 LIL. Rep 391, see also *Establishments Chinbaux SARL v Harbourmaster Ltd* 1955 1 Lloyd's Rep 303.

69 *Forbes, Campbell & Co* 1992 9 LIL Rep 202.

70 *Trust SPRL v Danubian Trading Co Ltd* 1952 1 Lloyd's Rep 348; see also Goode *Commercial Law* 4<sup>th</sup> ed 1062; see further Carr *International Trade Law* 4<sup>th</sup> ed 422-493.

71 *WJ Alan & Co v L Nasr Export* 1972 1 Lloyd's Rep 313.

72 Ellinger *Does an irrevocable Credit Constitute Payment* 40.

73 Goode *Commercial Law* 3<sup>rd</sup> ed 980.

74 *Diamond Cutting Works Federation v Triefus & Co Ltd* 1956 1 Lloyd's Rep 216, 225.

### 2.2.7 *The contract between the buyer and the issuing bank*

After the buyer and seller have entered into a contract of sale, the buyer will then go to the bank in his own country to issue a letter of credit in favour of the seller. The buyer in this way becomes the customer of the issuing bank. The bank provides the buyer with an application form and the buyer completes the form. Under the English law, which has a great influence on South Africa's law of documentary credits, when the buyer furnishes the bank with his application, he is taken to make an offer to the bank and when the issuing bank issues a letter of credit it is taken as having accepted the offer.<sup>75</sup> Upon conclusion of the contract between the parties, the issuing bank's undertaking is to act in its capacity as the principal and does not in any way act as an agent.<sup>76</sup>

If the issuing bank makes payment against non-complying documents, this will amount to a breach of mandate on the part of the issuing bank.<sup>77</sup> In *Hadley v Baxendale*<sup>78</sup> the Court held that in such circumstances the issuing bank will become liable for any loss incurred by the buyer that was reasonably foreseeable. However, the buyer may decide to waive his right to claim damages incurred as a result of such breach.<sup>79</sup>

### 2.2.8 *The contract between the issuing bank and the advising bank*

The contract between these two parties is concluded when the issuing bank in the buyer's country requests another bank in the seller's country to advise the seller of the credit issued on his behalf. The contract is finalised and comes into being the moment when the advising bank accepts the request of the issuing bank. The mandate of the advising bank is to act as an agent of the issuing bank.<sup>80</sup> The advising bank is bound to comply exactly with the instructions enshrined in the letter of credit. By advising the beneficiary of the issuance of a credit on his behalf by the

---

75 Goode *Commercial Law* 4<sup>th</sup> ed 1089.

76 Goode *Commercial Law* 3<sup>rd</sup> ed 982.

77 Goode *Commercial Law* 4<sup>th</sup> ed 1090.

78 *Hadley v Baxendale* 1854 9 Exch 341.

79 Goode *Proprietary Rights and Insolvency in Sales Transactions* 2<sup>nd</sup> ed 879; see also Goode *Proprietary rights and Insolvency in Sales Transactions* 3<sup>rd</sup> ed 980.

80 *Credit Agricole Indosuez v Muslim Commercial Bank Ltd* 2002 1 All ER (Com) 172.

issuing bank, the advising bank is discharging its mandate as an agent of the issuing bank.<sup>81</sup> The contract exists only between the advising bank and the issuing bank, no contract exists between the advising bank and the buyer. This is due to the fact that when the issuing bank contracts with the advising bank it does so in its personal capacity and does not act as the agent of the seller.<sup>82</sup>

### *2.2.9 The contract between the issuing bank and the seller*

At this juncture, the issuing bank undertakes to pay the seller upon presentment of conforming documents.<sup>83</sup> In *Christopher Staughton in Credit Agricole Indosuez v Muslim Commercial Bank* the Court had the following to say:

The undertaking given by the issuing bank, though given in response to the buyer's request, is given by the issuing bank as principal or at best a commission agent.<sup>84</sup>

Where the seller presents documents that do not conform to the credit the issuing bank may inform the buyer of this state of affairs in order to ascertain whether the buyer will be keen to waive the discrepancy, conversely, the issuing bank may reject such documents.<sup>85</sup> An important point to note is that if the issuing bank rejects the documents presented by the seller for lack of non-conformity with the terms and conditions of a letter of credit it must inform the seller of such rejection.<sup>86</sup> Such notice must state clearly the basis upon which the bank rejects the documents.<sup>87</sup>

### *2.2.10 The contract between the advising bank and the seller*

In circumstances where the advising bank does not properly advise the seller of the letter of credit that has been issued on his behalf by the issuing bank, or where the advising bank pays the seller against non-conforming presentation, then the buyer's only recourse is against the issuing bank and not the advising bank as there is no

---

81 Ellinger *et al* *The Law and Practice of Documentary Letters of credit* 177.

82 Ellinger *et al* *The Law and Practice of Documentary Letters of credit* 178.

83 *Mahonia Ltd v J P Morgan Chase* 2003 2 Lloyd's Rep 911; see also Hugo 1994 *Annual Banking Law Update* 8.

84 *Christopher Staughton in Credit Agricole Indosuez v Muslim Commercial Bank* 2000 1 Lloyd's Rep 87.

85 *Bankers Trust Co v State Bank of India* 1991 2 Lloyd's Rep 443; see also A 16 (b) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

86 A 13 (b) of the Uniform Customs and Practice for Documentary Credits 600 (2007); See also A 14 (d) (ii) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

87 A 16 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

privity of contract between the buyer and the advising bank.<sup>88</sup> By providing its own confirmation the advising bank undertakes to honour the presentation upon presentation of conforming documents by the seller. The advising bank establishes a different undertaking in its personal capacity and does not act as an agent of the issuing bank. Therefore, the advising bank and the issuing bank have independent undertakings. In a nutshell, the advising bank undertakes an independent obligation to pay the seller.

### **2.3 The main principles underlying letters of credit**

The main principles that govern a letter of credit transaction are the principle of strict compliance and the independence principle. These principles govern, serve and protect the commercial purpose of letters of credit transactions. These principles also promote trade efficacy in international trade. The significance of these principles merit a detailed discussion for purposes of this dissertation. In *United City Merchants (Investment) Limited v Royal Bank of Canada* Lord Diplock had the following to say:

The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give to the seller an assured right to be paid before he parts with control of the goods.<sup>89</sup>

#### **2.3.1 The principle of strict compliance**

Strict compliance is one of the core principles of letters of credit. An important point to note is that in context of letters of credit, South African case law has not as yet had an occasion to closely analyse the principle.<sup>90</sup> However, this doctrine is acknowledged in South African law, in *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd*<sup>91</sup> Nugent JA had the following to say:

A bank that establishes a letter of credit at the request and on the instructions of a customer thereby undertakes to pay a sum of money to the beneficiary against the presentation to the issuing bank of stipulated documents. The documents that are to be presented are stipulated by the customer and the issuing bank generally has no interest in their nature or in their terms. Its interest is confined to ensuring that

---

88 *GKN Contractors Ltd v Lloyds Bank PLC* 1985 30 BLR 48.

89 *United City Merchants (Investment) Limited v Royal Bank of Canada* 1982 2 All E.R. 725.

90 Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 295-200.

91 *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd* 2002 3 SA 688 (SCA); see also Oelofse *The Law of Documentary Letters of Credit in Comparative Perspective* 288-290.

the documents that are presented conform to its client's instructions (as reflected in the letter of credit) in which event the issuing bank is obliged to pay the beneficiary. If the presented documents do not conform to the terms of the letter of credit the issuing bank is neither obliged nor entitled to pay the beneficiary without its customer's consent.<sup>92</sup>

As noted earlier, English case law has a great influence on South African law with regard to the law that regulates letters of credit transactions and the decisions of the English courts are regarded as highly influential in South African law in this regard.<sup>93</sup> The doctrine of strict compliance dates from way back in English law. In *Equitable Trust Company of New York v Dawson Partners Ltd*<sup>94</sup> a case before the house of lords, Lord Sumner held that "there is no room for documents which are almost the same or which will do just as well". Fifty years later in *Gian Singh & Co Ltd v Banque del Indochine*<sup>95</sup> Lord Diplock speaking for the privy council reaffirmed the above decision. In *New Braunfels National Bank v Odiorne*<sup>96</sup> the court correctly pointed out that the application of the doctrine should not lead to "oppressive perfectionism". Furthermore, in *Banque de l'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd*<sup>97</sup> Parker J had the following to say:

I also accept that Lord Sumner's statement cannot be taken as requiring rigid meticulous fulfilment of precise wording in all cases. Some margin must and can be allowed, but it is slight, and banks will be at risk in most cases where there is less than strict compliance. They may pay on a reasonable interpretation where instructions are ambiguous, but where instructions are clear they are obliged to see to it that the instructions are complied with and entitled to refuse payment to the beneficiary unless they are.<sup>98</sup>

In *Seaconsar Far East Ltd v Bank Markazi Jomhuri Islami Iran*<sup>99</sup> the court had to decide whether the absence of the number of the letter of credit and the buyer's name on every document that was presented in terms of it was trivial. In deciding the matter Lloyd LJ had the following to say:

---

92 *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd* 2002 3 SA 688 (SCA) para 697 G-698 C.

93 Adodo *Letters of Credit- the Law and Practice of Compliance* 154-173; see also Malek, Guest and Jack *Documentary Credits* 184.

94 *Equitable Trust Company of New York v Dawson Partners Ltd* 1926 27 LI L Rep 49 HL 52.

95 *Gian Singh & Co Ltd v Banque del Indochine* 1974 2 Lloyd's Rep 1 PC at 12.

96 *New Braunfels National Bank v Odiorne* 780 2d 313 1989 para 316-317.

97 *Banque de l'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd* 1983 1 QB 711 CA.

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

99 *Seaconsar Far East Ltd v Bank Markazi Jomhuri Islami Iran* 1993 1 Lloyd's Rep 236 CA.

I cannot regard as trivial something which, whatever may be the reason, the credit specifically requires, it would not help to attempt to define the sort of discrepancy which can properly be regarded as trivial.<sup>100</sup>

The doctrine of strict compliance presents a number of hardships in practice, Adodo also asserts that the doctrine is "very stringent because it does not grant recovery on compassionate grounds or have a sympathetic ear".<sup>101</sup> His basis for such an assertion is that the doctrine may and often will cause a number of difficulties on the side of the beneficiary who presents the documents before the bank for payment 'against tendered but less faultless documents'. From the above analysis it becomes clear that there is conflict between whether documents should strictly comply with the requirements of the letter of credit and whether there should be room for discrepancies so minor that they can be ignored. Goode is of the opinion that this conflict is aggravated by the fact that most of the documents presented are non-conforming.<sup>102</sup>

Some of the eminent scholars are of the view that the revision of the UCP which led to the promulgation of the UCP 600 was a way of trying to lessen an increasing number of refutations of documents by banks.<sup>103</sup> This therefore, merits a detailed discussion of some provisions of the UCP 600. In accordance with Article 14 (a) of UCP 600 the bank involved must:

Examine the documents to determine on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.<sup>104</sup>

Article 2 defines a complying presentation as:

A presentation that is in accordance with the terms and conditions of the credit and the applicable provisions of this rules and international standard banking practice.<sup>105</sup>

It has been asserted by some authors that the issuing of *International Standard for Banking and Practice for Examination of Documentary Credits* may help to overcome some of the problems. Paragraph 25 of the 2007 revision states:

---

100 *Sea consar Far East Ltd v Bank Markazi Jomhourī Islami Iran* 1993 1 Lloyd's Rep 236 CA para 240.

101 Adodo *Letters of Credit- the Law and Practice of Compliance* 160.

102 Goode *Commercial Law* 4<sup>th</sup> ed 1033.

103 Hugo "Documentary Credits and Independent Guarantees" 178.

104 A 14 (a) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

105 A 2 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

A misspelling or typing error that does not affect the meaning of a word or the sentence in which it occurs, does not make a document discrepant. For example, a description of the merchandise as "mashine" instead of "machine", "fountan pen" instead of "fountain pen" or "modle" instead of "model" would not make the document discrepant. However, a description as "model 123" instead of "model 321" would not be regarded as a typing error and would constitute a discrepancy.<sup>106</sup>

Paragraph 6 of the 2007 revision<sup>107</sup> provides a list of abbreviations and states that their usage will not make the documents discrepant. It is submitted that Article 14 (d) of the UCP 600 is also a way to relax the rigid strict compliance. The said Article states that:

A document when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit.<sup>108</sup>

From the wording of this article, especially the part which states that the document "need not be identical" to the credit, one is able to ascertain that this article simplified the standards of compliance, as a result, it is safe to conclude that a number of documents which were rejected for non-conformity before the promulgation of this rules could be acceptable under the current law.

### *2.3.2 The independence principle*

The second principle of letters of credit is the independence principle. This principle is to the effect that payment under letters of credit is independent from any other transaction such as the contract of sale and the contract between the issuing bank and the applicant.<sup>109</sup> Article 4 of the UCP 600 states that "banks are in no way concerned with or bound by the underlying contract, even in circumstances where a letter of credit contains reference to the underlying contract". Article 4 is read together with Article 5 of the UCP 600 which is found under the title "Documents v goods, services or performances". The article states that under letters of credit, banks deal with documents and not with goods, services or other performances to which the goods may relate. According to the principle of independence, the issuing

---

106 As quoted by Malek, Guest and Jack *Documentary Credits* 189.

107 As discussed by Malek, Guest and Jack *Documentary Credits* 188-189.

108 A 14 (d) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

109 *Lombard Insurance Co Ltd v City of Cape Town* 2008 2 SA 423 SCA; see also *Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others* NNO2011 1 SA 70 SCA.

bank relies mainly on the information that is contained in the documents alone as presented by the beneficiary in determining whether the beneficiary has complied with the terms of a letter of credit. If the documents comply with the terms and conditions of a credit then payment must be effected.

Furthermore, article 14 (a) of the UCP 600 states that the nominated bank must examine the presentation on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation. The principle of independence fortifies the importance of letters of credit as an independent and separate undertaking by the bank to pay the beneficiary.<sup>110</sup> The issuing bank is not concerned with any dispute arising out of the possible breach of the underlying transaction between the seller and the buyer. Where payment is due the seller will be paid irrespective of any controversy that may arise from the underlying contract of sale. Excluding cases where the beneficiary has committed fraud, the obligation of the issuing bank to pay the beneficiary is absolute.<sup>111</sup> In a nutshell, the independence principle entails that the contract between the issuing bank and the seller under a letter of credit is independent from other contracts between the seller, the buyer and the issuing bank.

## **2.4 Conclusion**

The chapter introduced letters of credit as a method of payment in international trade. The chapter also discussed how letters of credit work, the obligations of different parties involved and how letters of credit provide a safer payment method as opposed to other methods of payment that were also discussed in this chapter. These are open account, payment in advance, and documentary collections. The chapter also showed that the issuing bank's obligation to pay the beneficiary in letters of credit transactions is absolute except in cases where the beneficiary has committed fraud. Fraud is therefore, the only exception to the independence

---

110 *Ex parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 W; see also *Philips & Another v Standard Bank of South Africa Ltd & Others* 1985 3 SA 301 W.

111 *Union Carriage & Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W); see also *Vitrorefuerzos S.A. and Banco Continental S.A.* 1979 1 Lloyd's Rep 267.

principle,<sup>112</sup> this exception therefore merits a detailed discussion, and it will be a topic for discussion in the next chapter.

---

112 An important point to note is that the above proposition is only applicable in South African law as there has been no court case which has recognised any other exception except the fraud exception in South Africa. In English law in *Mahonia Ltd v JP Morgan Chase Bank* 2003 2 Lloyd's Rep 911, the court, on considerations of public policy, recognised in principle that illegality of the underlying transaction may constitute an exception to the independence principle.

## **Chapter 3-The fraud exception in letters of credit transactions**

### ***3.1 Introduction***

The fraud exception in letters of credit transactions plays an important part in circumstances where the documents presented by the party who claims payment strictly comply with the terms and conditions of the credit on their face but have in fact been forged or are fraudulent. This part of the dissertation discusses the fraud exception to the independence principle in letters of credit transactions. To expedite the discussion, the dissertation begins by defining and providing a brief overview of what is meant by fraud in the context of letters of credit. The dissertation will then proceed to provide a transient overview of the rationale behind fraud as an exception to the independence principle which will be followed by a brief discussion in relation to recognition and development of the fraud exception from both international and domestic law perspective. Thereafter, fraud on the part of the beneficiary will be discussed in detail, in this regard a number of cases that dealt with the fraud exception to the independence principle will merit a detailed discussion in order to ascertain how the courts normally canvass issues relating to the fraud exception in letters of credit transactions. Finally, the chapter will be wrapped up by a detailed discussion of third party fraud in letters of credit transactions.

### ***3.2 Definition of fraud***

The requirements for common law fraud where one claims damages in the delict of fraud are (i) a material representation which is false, (ii) the presenter knows it is false or is recklessly careless as to whether it is true or false, (iii) the false representation is addressed to the claimant, is relied on by the claimant and the claimant suffers loss as a result.<sup>113</sup> The requisites of fraud in letters of credit are almost the same but there are certain dissimilarities. In *United City Merchants*

---

<sup>113</sup> Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 99; see also *Standard Chartered Bank v Pakistan National Shipping Corp* (No 2) 2001 1 ALL (Comm) 1.

*(Investments) Ltd v Royal Bank of Canada*<sup>114</sup> which dealt with letters of credit, the Judge held that the fraud exception is applicable where:

The beneficiary for purposes of drawing on a credit fraudulently presents to the confirming bank documents that contain, expressly or by implication material representations of fact that to his knowledge are untrue.<sup>115</sup>

In circumstances where the seller has been unscrupulous towards the buyer, the issuing bank will not pay the seller due to the fraudulent conduct on his part.<sup>116</sup> Fraud is the only recognised exception to the independence principle in South Africa.<sup>117</sup> The exception is to the effect that the bank can refuse to make payment or can be stopped from making payment if upon presentation of the documents specified in the letter of credit, the seller does not tell the truth about a fact which would render the documents discrepant.<sup>118</sup> This will enable the bank to refuse making payment on the credit. This means if the seller had been honest when presenting the documents, he would have presented documents that do not conform to the requirements of the letter of credit.<sup>119</sup> In a nutshell, the documents presented by the beneficiary under a letter of credit strictly comply on their face with the terms and conditions of the letter of credit, but are in fact forged or fraudulent.<sup>120</sup>

More often, fraud in letters of credit transactions is perpetrated by the seller (beneficiary), in this case the fraud exception will obviously apply.<sup>121</sup> Even when fraud is not committed by the beneficiary himself, the fraud exception will be applicable if the beneficiary has knowledge of the said fraud or took part in it. In *Contronic Distributors Pty Ltd v Bank of New South Wales*<sup>122</sup> the court applied the fraud exception because the buyer and the seller conspired to acquire a letter of credit. The fraud exception can be invoked as a defence and banks can use it to reject claims for payment if the party presenting documents for payment does not

---

114 *United City Merchants (Investments) Ltd v Royal Bank of Canada* 1983 1 AC 168.

115 *United City Merchants (Investments) Ltd v Royal Bank of Canada* 1983 1 AC 168 para 183.

116 Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 96.

117 *Loomcraft Fabrics CC v Nedbank Ltd and another* 1996 1 SA 812 A; see also *Philips v Standard Bank of South Africa* 1985 3 SA 301 W.

117 Xiang 2001 UNSWLJ 6.

118 Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 96.

119 Brindle *Law of Bank Payments* 835.

120 Xiang 2001 UNSWLJ 1.

121 Xiang 2001 UNSWLJ 2.

122 *Contronic Distributors Pty Ltd v Bank of New South Wales* 1984 3 NSWLR 110.

fall within a particular class of protected persons.<sup>123</sup> The exception can also be used to get an injunction or interdict which can be acquired by a party to stop the bank from paying the beneficiary of the letter of credit.<sup>124</sup>

The typical requirement is that the party who alleges fraud must be able to establish a clear case of fraud on the part of the beneficiary and the bank must know of the said fraud before it has paid the seller on the credit.<sup>125</sup> In *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank*<sup>126</sup> the court held that the party should not just make an allegation of fraud, but he should also tender evidence, which is normally in the form of contemporary documents in order to support his allegation. It is important to note that despite of this famous approach, different legal systems differ in their approach to the fraud exception. English case law with regard to the fraud exception is to a great extent influenced by the American jurisdiction. In the land mark decision of *United City Merchants (Investments) Ltd v Royal Bank of Canada*<sup>127</sup> the court was influenced to a great extent by the *dicta* encapsulated in the American case of *Sztejn v J. Henry Schroder Banking Corporation*.<sup>128</sup> Due to an overlap of various jurisdictions on the issue of fraud as an exception to the independence principle, and due to the great influence that English law has on the South African law in this area, various jurisdictions will also be discussed in this part of the dissertation where necessary. It is important to note however that this study will not be conducted by way of a comparative study.

### **3.3 The rationale behind the fraud exception**

The fraud exception is to the effect that the bank may be stopped from paying the beneficiary if, before payment is made fraud is discovered on the part of the beneficiary.<sup>129</sup> Payment will not be made despite the fact that documents presented

---

123 Xiang 2001 *UNSWLJ* 1.

124 *Edward Owen Engineering Ltd v Barclays Bank International Westminster Bank Ltd and others* 1978 1 Lloyd's Rep 166 at 170.

125 *Bolivinter Oil SA v Chase Manhattan Bank* 1984 1 Lloyd's Rep 544 at 560.

126 *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank* 1985 2 Lloyd's Rep 554, 560.

127 *United City Merchants (Investments) Ltd v Royal Bank of Canada* 1979 1 Lloyd's Rep 267.

128 *Sztejn v J. Henry Schroder Banking Corporation* 31 N.Y.S 2d 631.

129 Xiang *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* 29.

for payment constitute a complying presentation.<sup>130</sup> Xiang says the rationale for the fraud exception is "to close a loophole in the law, to protect public policy for the control of fraud and to maintain the commercial utility of letters of credit".<sup>131</sup>

### *3.3.1 To close a loophole in the law*

In letters of credit, the parties to the transaction deal primarily with documents alone, they are not concerned with the underlying contract of sale or the status of the underlying goods. As long as the documents presented for payment comply strictly with the terms and conditions of the credit, the issuing bank will be compelled to make payment on the credit regardless of any disputes parties may have with regard to the underlying transaction. This is referred to as the independence principle.<sup>132</sup> However, the bank that accepts the documents must exercise reasonable care to ensure that the documents presented for payment appear on their face to comply with the terms and conditions of the credit.<sup>133</sup>

The independence principle aids the commercial utility of letters of credit, however, the opposite is true where fraud takes place in the transaction.<sup>134</sup> The severance of the documents from the underlying transaction forms a loophole in law because only documents that conform with the terms and conditions of the credit are required in order for payment to be made, this is despite the fact that the beneficiary presenting documents for payment did not comply with the terms and conditions required by the underlying contract.<sup>135</sup> The fraud exception attempts to close this lacuna, nevertheless it does not wholly close this loophole but it does reduce its negative impacts.<sup>136</sup>

---

130 Fellingner 1990 *JBFL* 4.

131 Xiang *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* 30.

132 Carr I *International Trade Law* 478.

133 Hugo 2001 *SA Merc LJ* 595.

134 Xiang *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* 30.

135 Carr I *International Trade Law* 447.

136 Xiang *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* 30.

### 3.3.2 To protect public policy for the control of fraud

In most legal systems crime is the main target that is fought against. Fraud is one of these crimes and public policy dictates that fraud should also be combated.<sup>137</sup> In the matter of *Dynamics Corporation of America v Citizens and Southern National Bank*<sup>138</sup> it was correctly stated that "there is as much public interest in discouraging and limiting fraud as there is in encouraging and promoting the use of letters of credit". In a nutshell, the rationale behind the fraud exception is that the interests of justice dictate that an unscrupulous seller who perpetrates fraud should not be allowed to claim payment based on the independence principle.<sup>139</sup> Furthermore, in *United City Merchants v Royal Bank of Canada*<sup>140</sup> the court held that where the beneficiary is guilty of fraud the Bank is entitled to refuse to pay the beneficiary based on the maxim *ex turpi causa non oritur actio*. This is a legal principle which provides that a plaintiff will not be able to get a legal remedy if it arises from his own illegal act (from a dishonourable cause an action does not arise).<sup>141</sup> The court held that as a matter of public policy a claimant would not be entitled to use the independence principle to derive a benefit from his own fraud.

### 3.3.3 To maintain the utility of letters of credit

Fraud creates a probable hazard to the commercial significance of letters of credit.<sup>142</sup> Letters of credit have become popular and useful over the years due to the fact that it provides a fair balance with regard to the conflicting interests of the buyer and seller.<sup>143</sup> Xiang says:

If one party defrauds the other, it harms the other parties to the contract and undermines the balance of the conflicting interests of the buyer and the seller, as the seller may abscond leaving the buyer with no recourse. The bank's interest may also be jeopardised since banks often agree to issue a letter of credit with a perquisite that the goods will serve as security. Should the buyer abscond without

---

137 Xiang *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* 31.

138 *Dynamics Corporation of America v Citizens and Southern National Bank* 356 F Supp 991 ND Ga 1973 1000.

139 Enonchong 2006 *LMCLQ* 404.

140 *United City Merchants v Royal Bank of Canada* 1981 1 Lloyd's Rep 604, 620.

141 *United City Merchants (Investment) Limited v Royal Bank of Canada* 1981 1 Lloyd's Rep 604, 620.

142 *United City Merchants (Investment) Limited v Royal Bank of Canada* 1982 2 All ER 720.

143 See discussions at 2.1 above.

forwarding any goods, the bank's security interest is compromised meaning the interest of the bank is damaged.<sup>144</sup>

In light of the foregoing, it becomes apparent that the reputation and usefulness of letters of credit is due to good faith on the part of the parties to the transaction, this reputation will vanish if fraud is prevailing and if there is no solution provided. In conclusion, it is evident that the fraud exception facilitates the effectiveness of letters of credit by restraining the ease with which fraudulent parties to the transaction may misemploy letters of credit.

### ***3.4 The recognition and development of the fraud exception***

An important point to note is that even though the UCP 600 governs letters of credit transactions from an international perspective, the UCP is silent with regard to the fraud exception to the independence principle.<sup>145</sup> In both England and South Africa, the fraud exception has been developed tremendously through court cases. It has its foundation from the common law, which provides that "a person should not benefit from his or her own fraudulent conduct".<sup>146</sup> In America on the other hand the fraud exception was recently codified in the *Uniform Commercial Code* (UCC).<sup>147</sup> Nevertheless, a definite proviso dealing with fraud in letters of credit transactions is only provided for in Article 5 of the UCC.<sup>148</sup> The *United Nations Commission on International Trade Law* (UNCITRAL) promulgated the Convention on Independent Guarantees and Stand-by Letters of Credit (UNCITRAL Convention) which deals with fraud in letters of credit transactions from an international perspective.<sup>149</sup>

---

144 Xiang *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* 32.

145 Mueller *Letters of Credit with focus on the UCP 600 and the Exceptions to the Principle of Autonomy* 74.

146 *United City Merchants (Investment) Limited v Royal Bank of Canada* 1981 1 Lloyd's Rep 604, 620.

147 A 5 of *the Uniform Commercial Code* (1995); An important point to note is that A 5 focuses on the nature of the documents presented for payment and not the identity of the party who has committed fraud.

148 A 5 of *the Uniform Commercial Code* (1995).

149 See A 19 of the United Nations Convention on Independent Guarantees and standby letters of credit (1995), which provides that the fraud exception can be raised where "any document is not genuine or has been falsified; where no payment is due on the basis asserted in the demand and the supporting document; or where, judging by the type and purpose of the undertaking, the demand has no conceivable basis". In terms of A 19 the fraud exception is applicable if the documents presented for payment are non-genuine, contain false statements or have been forged, this exception applies regardless of who the perpetrator of the said fraud is.

One of the very first cases which applied and recognised the fraud exception to the independence principle was the American land mark decision of *Sztejn v J. Henry Schroder Banking Corporation*<sup>150</sup> in this case the buyer was awarded an injunction which stopped the bank from paying the seller on the letter of credit upon presentment of the specified documents. Prior to presenting the said documents for payment to the bank, the seller had packed a number of cases with rubbish and not the goods which were bought in terms of the underlying contract of sale. This was done for purposes of getting hold of a bill of lading from the carrier which would indicate that the goods bought had been shipped and delivered for carriage. This constituted fraudulent conduct on the side of the seller. The issue before the court was whether the allegation of fraud by the buyer was enough ground upon which the court could stop payment on the credit.

Conversely, the seller contended that the court should not consider the issue of fraud in arriving at its decision, he further argued that what the court had to do was to focus only on the issue of whether the documents presented appeared on their face to conform to the terms of the credit. In essence the seller's contention was to the effect that he should receive payment regardless of fraudulent conduct on his part so long as the documents presented for payment appeared to comply on their face with the terms of the credit.<sup>151</sup> In making its ruling, the court upheld and maintained the independence principle, however, the court also differentiated between circumstances in which the seller was in breach of certain stipulations and cases in which the seller was palpably fraudulent in trying to demand payment for the goods he did not ship. In delivering his judgement, Shlentag J had the following to say:

It is well established that a letter of credit is independent of the primary contract between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary to preserve the letter of credit as an instrument for financing of trade. It would be a most unfortunate interference with business transactions if a bank before honouring drafts drawn upon it was obliged or even allowed to go behind the documents, at the request of the buyer and enter

---

150 *Sztejn v J. Henry Schroder Banking Corporation* 31 N.Y.S2d 631.

151 *Sztejn v J. Henry Schroder Banking Corporation* 31 N.Y.S2d 634.

into controversies between the buyer and the seller regarding the quality of the merchandise shipped.<sup>152</sup>

The court however held that the seller's fraud was enough ground to grant an injunction which stopped the bank from paying the seller, converse to the independence principle. The judge differentiated this case from a matter which concerned a breach of contract of sale, in which the seller has intentionally omitted to ship the goods bought by the buyer. The court further stated that "the principle of independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller". On this basis, the court stopped the bank from making payment on the documentary credit, the court's decision was based on the maxim *ex turpi causa*. This decision laid down a precedent which has since been followed in different jurisdictions which amongst others include South African law and the English law.<sup>153</sup>

### **3.5 Fraud on the part of the beneficiary**

Fraud on the part of the applicant may be committed either by the applicant himself, or by the applicant together with another party or the beneficiary.<sup>154</sup> Conversely, where fraud is committed by the applicant in conjunction with the beneficiary or, still in cases where the beneficiary does not take part, if he has knowledge of the said fraud he will in law be considered to be fraudulent and the fraud rule will apply in this regard.<sup>155</sup> The English law with regard to the fraud exception constitutes the basis for the South African law on the facet of the law with regard to letters of credit. South African law on this area is muddy and English law is of great assistance in this regard as it has shown to have some firm cases upon which to attain assistance and support. In particular, the land mark decision of *United City Merchants (Investment) Limited v Royal Bank of Canada*<sup>156</sup> will be discussed in detail because it is fundamental to the development of the law in relation to letters of credit and the fraud exception thereto in both England and South Africa. Despite the importance of

---

152 *Sztejn v.J. Henry Schroder Banking Corporation* 31 N.Y.S 2d 663.

153 See *United City Merchants (Investment) Limited v Royal Bank of Canada* 1981 1 Lloyd's Rep 604, 620; see also *Loomcraft Fabrics CC v Nedbank Ltd and another* 1996 1 SA 812 A; see further *Phillips v Standard Bank of South Africa* 1985 3 SA 301 W.

154 Xiang 2001 UNSWLJ 6.

155 *Contronic Distributors Pty Ltd v Bank of New South Wales* 1984 3 NSWLR 110.

156 *United City Merchants (Investment) Limited v Royal Bank of Canada* 1982 2 All ER 720.

this part of the law to international trade, only four cases have been reported in South Africa regarding the independence principle.<sup>157</sup> For purposes of this dissertation, these cases merit a detailed discussion and they will be canvassed in detail below.

### *3.5.1 Philips v Standard Bank of South Africa*<sup>158</sup>

The beneficiary purportedly delivered the goods (shoes) which did not conform to the terms of the letter of credit. The buyer informed the seller of the defect and refused to make payment on that account. The beneficiary however, wanted to be paid immediately. As a result of this state of affairs, the buyer launched an application to court, seeking an interdict to be granted against Standard Bank, to prohibit the bank from making payment on the credit. The Judge held that the applicant did not raise the issue of fraud, in that it was relatively unswerving that the demeanour of the beneficiary was due to a mistake on its part. There was no evidence before the court which pointed to any fraudulent conduct on the part of the beneficiary and the applicant did not allege fraud. In light of the foregoing, the court refused to allow the relief sought by the applicant.

An important point to note is that the court in making its ruling made reference to the American case of *Sztejn v J. Henry Schroder Banking Corporation*<sup>159</sup> and the English case of *United City Merchants (Investment) Limited v Royal Bank of Canada*,<sup>160</sup> and strongly re-affirmed the scope of the fraud exception as encapsulated in these cases. The court further pointed out that South African law would pursue the prevailing movement internationally, in particular the movement in English and American law in maintaining that the only exception to the independence principle was the fraud exception as devised by Lord Diplock in *United City Merchants*.

The matter of *Ex Parte Sapan Trading (Pty) Ltd*<sup>161</sup> re-affirmed that the independence principle is part of South African law. The court cited the English case of *Power*

---

157 Oelofse *The Law of Documentary Letters of Credit in Comparative Perspective* 463.

158 *Philips v Standard Bank of South Africa* 1985 3 SA 301 W.

159 *Sztejn v J. Henry Schroder Banking Corporation* 31 N.Y.S 2d 631.

160 *United City Merchants (Investment) Limited v Royal Bank of Canada* 1982 2 All ER 720.

161 *Ex Parte Sapan Trading (Pty) Ltd* 1994 CLD 200 W.

*Curber International Ltd v National Bank of Kuwait SAK*<sup>162</sup> in re-affirming the said principle. For purposes of this dissertation, the case will not be discussed in detail because it did not deal with the issue of the fraud exception.

### 3.5.2 *Loomcraft Fabrics CC v Nedbank Ltd and another*<sup>163</sup>

In this case the applicant wanted to stop Ned bank from paying the beneficiary on a letter of credit. The applicant alleged fraud on the part of the beneficiary and mainly that the beneficiary had fraudulently tainted the date of the shipment on the shipping documents. The court cited numerous English cases with regard to the independence principle which amongst others included *Edward Owen Engineering Ltd v Barclays Bank International Ltd*<sup>164</sup> in so doing, the court showed its intention to regard the English law as a prominent guide to the development of the law in relation to letters of credit in South Africa.<sup>165</sup> Referring to *Tukan Timber Ltd v Barclays Bank Ltd*<sup>166</sup> the court held that the fraud should be clearly established for the fraud exception to be called up. The court further stated that the onus of prove is a civil one, that is, on the preponderance of probabilities and it is not to be lightly inferred. However, the Judge confined the holding of the court to fraud that subsisted in the documents, the court held that in order to be successful on the grounds of fraud, the appellant was required to attest that the beneficiary with the intention of drawing on the credit, presented the bills of lading to the bank with full knowledge that they enclosed material misrepresentations of fact, knowing the banks were going to depend on such representations and which contained false information.<sup>167</sup>

In light of the foregoing, it becomes perceptible that South African courts follow the narrow approach to the fraud exception followed by the English courts in cases such as *United City Merchants (Investment) Limited v Royal Bank of Canada*<sup>168</sup> what this

---

162 *Power Curber International Ltd v National Bank of Kuwait SAK* 1981 3 ALL ER 607.

163 *Loomcraft Fabrics CC v Nedbank Ltd and another* 1996 1 SA 812 A.

164 *Edward Owen Engineering Ltd v Barclays Bank International Ltd* 1978 2 ALL ER 976 CA.

165 *Edward Owen Engineering Ltd v Barclays Bank International Ltd* 1978 2 ALL ER 976 CA para 816 A to 817 G.

166 *Tukan Timber Ltd v Barclays Bank Ltd* 1987 1 Lloyd's Rep 171 QB para 175.

167 *Tukan Timber Ltd v Barclays Bank Ltd* 1987 1 Lloyd's Rep 171 QB para 822 H.

168 *United City Merchants (Investment) Limited v Royal Bank of Canada* 1982 2 All ER 720.

means is that South African courts will not follow the broad application of the fraud exception, meaning the exception will only apply where fraud occurred on the documents, put differently, they will not call up the exception when fraud occurred in the underlying transaction and not the documents. In this case, the appellant failed to establish a clear case of fraud, as a result his application for an injunction was not successful. The judge pointed out that when documents are presented before the bank for payment, "the bank will escape liability only on proof of fraud on the part of the beneficiary". By finding as such it is apparent that the Court re-affirmed the judgement of the House of Lords in *United City Merchants (Investment) limited v Royal Bank of Canada*.<sup>169</sup>

In light of the discussions above, it is safe to conclude at this juncture that the only exception possible under South African law is the one which is based on fraud on the part of the beneficiary, in presenting fraudulent documents with full knowledge that they contain fraudulent misrepresentations. In South Africa fraud by the beneficiary is therefore the only recognised exception to the independence principle.<sup>170</sup>

### **3.6 Third party fraud**

As discussed in chapter 2, a usual letter of credit transaction comprises of at least three parties.<sup>171</sup> These are the buyer, the seller and the issuer. Nonetheless, letters of credit transactions may also have the involvement of more parties. They can be divided into two groups, the first group consists of the parties who are involved directly in the letter of credit transaction, and this include the banks.<sup>172</sup> The second group consists of the parties who do not directly take part in the letter of credit transaction. Nevertheless, they take part in other activities thereto. These include, amongst others, parties such as carriers and loading brokers.<sup>173</sup> They are not directly involved but they take part in arranging documents for payment on the letter of

---

169 *United City Merchants (Investment) limited v Royal Bank of Canada* 1982 2 All ER 168.

170 In *KNS Construction (Pty) Ltd v Mutual Federal Insurance Co* 2015 JDR 0082 the court considered the scope of the fraud exception in demand guarantees. At para 64 the court held that the fraud exception does not recognise third party fraud in demand guarantees.

171 See discussions at 2.2.5 above.

172 Xiang 2001 *UNSWLJ* 10.

173 Xiang 2001 *UNSWLJ* 10.

credit.<sup>174</sup> For purposes of this dissertation the parties who participate in the second group will be referred to as third parties and where fraud has been committed by this parties it will be referred to as "third party fraud".

An important point to note is that, there is a significant lack of authority on the issue of third party fraud in letters of credit transactions.<sup>175</sup> In *United City Merchants v Royal Bank of Canada* Stephenson LJ before the court of appeal had the following to say:

There is no authority, English or American, directly deciding that the fraud of a third party such as the maker of a false document is or is not a good defence to a claim to be paid in accordance with the terms of a letter of credit. Most of the cases of fraud are cases of fraud by a seller hoping to be paid for rubbish or, at the least, defective goods before the true state of affairs was known which his own mis-description had concealed.<sup>176</sup>

Nonetheless, the issue arose and was canvassed in *United City Merchants*. For this reason the case calls for a detailed discussion. For purposes of this dissertation, all three judgements of this case will be discussed, from the Queen's Bench Division, The Supreme court of Appeal to the House of Lords.

### *3.6.1 The United City Merchants Judgements*

The background of the facts of the case was as follows. The confirming bank rejected the documents that were presented by the seller's assignee on the grounds that the bill of lading was forged. The said bill of lading showed shipment to have taken place on 15 December, which was the last day parties to the transaction agreed for shipment under the credit. Before the bank could make payment, it discovered that shipment did not take place on 15 December but in fact it took place on 16 December. On this basis the bank refused to meet payment. In the Queen's Bench Division, Mocatta J found for the Plaintiff, the court held that the fraud exception to the independence principle was not applicable in circumstances where the seller (beneficiary) was not guilty. In making its ruling the court had the following to say:

---

174 Xiang 2001 *UNSWLJ* 10.

175 Goode 1980 *JBL* 291-294.

176 *United City Merchants v Royal Bank of Canada* 1981 1 Lloyd's Rep 604, para 620.

Mr Baker an employee of the loading broker was not the plaintiff's agent for making out the bills of lading and there was no fraud on the part of the plaintiff's in presenting them. Where there has been personal fraud or unscrupulous conduct by the seller presenting 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*. But here there was no fraud on the part of the plaintiff's.<sup>177</sup>

In light of the foregoing, it becomes apparent that the Judge approached the matter before him by application of the fraud exception to the independence principle. The court came to the conclusion that because the seller was not the perpetrator of fraud, the fraud exception was not applicable.

The decision was appealed against. On appeal, three judges delivered separate judgements. All of these judgements set aside the Judgement of the Court *a quo*. Lord Stephenson emphasised that it was crucial to bear a distinction between a document that has been forged, a document that has been fraudulently changed and one that contains false information in that it is inaccurate. The court held that under English law a document will be said to have been forged if:

It tells a lie about the maker, that is to say if the signature of the maker is forged or, if it tells a lie about the time and place of making, where either is material.<sup>178</sup>

Hugo asserts that the first type of falsification makes a document a nullity while the second one does not.<sup>179</sup> The court further held that the document may also contain false information regarding its contents, in such a situation the document will not be considered to have been forged but the perpetrator may be guilty of fraud on criminal basis. The court further held that the document can contain false information by having as part of its contents, a mistake but with no intention to commit fraud.<sup>180</sup> The court held that in the present case the bill of lading contained false information about itself, that is was completed on 15 December and about its contents by stating that the goods were received on board on 15 December.<sup>181</sup> The Judge did not address the issue regarding whether a document was a nullity.

---

177 *United City Merchants v Royal Bank of Canada* 1979 1 Lloyd's Rep 267 QB para 278.

178 *United City Merchants v Royal Bank of Canada* 1982 1 QB 208 CA para 246 G.

179 Hugo 2001 *SA Merc LJ* 597.

180 *United City Merchants v Royal Bank of Canada* 1982 1 QB 208 CA para 231 E-H.

181 *United City Merchants v Royal Bank of Canada* 1982 1 QB 208 CA para 232 A.

He was of the view that in either case the seller's assignee was not entitled to payment.<sup>182</sup>

Conversely, Lord Ackner held that the bill of lading in the present case did not constitute a nullity because the falsification was with regard to the date on which the goods were shipped and this did not go to the essence of the contract.<sup>183</sup> The judge further pointed out if the bill was a nullity then the bank would not be compelled to pay because the bill was conforming on its face. The court held that:

A banker ought not to be under an obligation to accept or pay against documents which he knows to be waste paper. To hold otherwise would be to deprive the banker of that security for his advance, which is a cardinal feature of the process of financing carried out by means of the credit.<sup>184</sup>

Lastly, Lord Griffiths held that:

It would be a strange rule that required a bank to refuse payment if the documents reflected the correct date, 16 December, but oblige the bank to pay if it knew that the document falsely showed the date of shipment as 15 December. The right of the bank to refuse payment does not rest upon the application of the maxim *ex turpi causa non oritur actio*, but upon the fact that the bank's obligation is to pay upon the presentation of genuine documentation accordance with the requirements of the letter of credit. If the documents presented are fraudulently false, they are not genuine conforming documents and the bank has no obligation to pay.<sup>185</sup>

The judge further held that it is "the fact that the documents are worthless that matters to the bank and not the identity of the forger".<sup>186</sup> The decision of the appeal court was also appealed against to the House of Lords. Lord Diplock speaking for the house, set aside the appeal court's decision and re-affirmed the Judgement of the court *a quo*. Lord Diplock emphasised the significance of the independence principle, he stated that:

The whole commercial purpose of the documentary credit is to give the seller an assured right to payment before it parts with control of the goods and that no dispute with the buyer as to performance of the contract of sale can be used as a ground for non-payment.<sup>187</sup>

---

182 *United City Merchants v Royal Bank of Canada* 1982 1 QB 208 CA para 239 B.

183 *United City Merchants v Royal Bank of Canada* 1982 1 QB 208 CA para 246 H-247 A.

184 *United City Merchants v Royal Bank of Canada* 1982 1 QB 208 CA para 246 G.

185 *United City Merchants v Royal Bank of Canada* 1982 1 QB 208 CA para 253 G.

186 *United City Merchants v Royal Bank of Canada* 1982 1 QB 208 CA para 254 B.

187 *United City Merchants v Royal Bank of Canada* 1983 AC 168 HL para 183 D-G.

In light of the above *dictum* Lord Diplock came to the conclusion that the issuing bank has a duty to pay as against the buyer, upon presentment of documents that are apparently conforming. The Judge further held that the duty owed by the issuing bank and confirming bank to honour the credit on presentation of apparently conforming documents arose even in circumstances where the documents are forged as long as the seller (beneficiary) was not the fraudulent party.<sup>188</sup>

### **3.7 Conclusion**

The chapter defined and discussed the fraud exception in letters of credit transactions. The chapter also provided an insight into the rationale behind the fraud exception in letters of credit transactions and the recognition and development of the fraud exception. In this regard, the domestic and international frame work of the fraud exception to the independence principle was concisely discussed. Lastly, cases dealing with the application of the fraud exception to the independence principle were also discussed in detail, in particular, fraud on the part of the beneficiary and third party fraud. From the discussions of this chapter, it became apparent that the fraud exception can only apply where the beneficiary is personally liable, it does not cover fraud committed by third parties. The current law as reflected in this chapter is to the effect that the bank will be compelled to make payment even if upon presentation of the documents, fraud by a third party is discovered. As long as the documents are in order on their face and the beneficiary is not involved in the said fraud, payment will be effected. The question of how this peculiar position can be rectified by adoption of the nullity exception goes to the heart of this dissertation, the nullity exception will therefore be a topic for discussion in the next chapter.

---

188 *United City Merchants v Royal Bank of Canada* 1983 AC 168 HL para 184 E-F.

## **Chapter 4-The nullity exception in letters of credit transactions**

### **4.1 Introduction**

The last chapter discussed the fraud exception in letters of credit transactions. There is another exception although not widely recognised in letters of credit. This exception is referred to as the nullity exception. The sole intention of this chapter is to discuss the nullity exception to the independence principle in letters of credit transactions. The chapter will commence by defining nullity in context of general law, it will concisely discuss the gist and consequence of nullity in a general law context. Thereafter, nullity will be discussed with specific reference to letters of credit. In order to yield a fruitful discussion, the dissertation will endeavour to provide examples of circumstances under which a document can be treated as a nullity in letters of credit. Thereafter, cases that have dealt with the nullity exception will be discussed succinctly in order to ascertain how the courts have attempted to define nullity in letters of credit and under what circumstances a document has been considered a nullity in letters of credit transactions.

### **4.2 Nullity in general law context**

Black's law dictionary defines "nullity" as something that is legally void from the inception, it makes an example of a forged commercial transfer as to what constitutes a nullity.<sup>189</sup> In law, nullity is observed to arise in different ways. It can happen through "illegality,<sup>190</sup> forgery, incapacity, lack of consent or even through mistake".<sup>191</sup> Nullity has also been defined as:

---

189 Garner *Black's Law Dictionary* 1173.

190 If one undertakes to give something under the condition that the promisee performs an illegal act, the contract will be regarded as null and void, this may be due to the fact that an agreement is contrary to statute law, public policy or the agreement defeating the administration of justice to name but a few; see Du Bois "Contracts in General" 761-764.

191 Amaefule *The Exceptions to the Principle of Autonomy of Documentary Credits* 91. An example of a mistake can be common mistake, this is where parties reach an agreement operating under the same misunderstanding regarding their rights and obligations, it is asserted that such contract is concluded under a common mistake and a contract is void *ab initio*; see Kerr *The Principles of the Law of Contract* 255.

Nothing, an act or proceeding in a cause which the opposite party may treat as though it had not taken place or which has absolutely no legal force or effect.<sup>192</sup>

In addition, in the law of contract, a contract has to be concluded accurately in order to be of legal force and effect.<sup>193</sup> When a contract is void it is invalid, it is null from the inception and the parties are not bound by the terms of such a contract.<sup>194</sup> This contract has no legal implications, the courts will not recognise it, and it is unenforceable as it lacks some important elements of a valid contract.<sup>195</sup> A contract can be null because one of the parties to the said contract was forced to enter into the contract under duress,<sup>196</sup> where the terms of the contract are illegal or where performance of the terms of the contract is not possible,<sup>197</sup> this is to name but a few.<sup>198</sup> For illustration purposes, a contract will be void<sup>199</sup> in circumstances where A works as an employee of B and the terms of their employment contract contain illegal acts that are to be carried out by A in the course and scope of his employment. The terms of this contract are illegal and as a result the contract is void. Put differently, the contract will be considered to be null and void, it will attract no legal implications and the courts will treat it as though it has never existed.<sup>200</sup>

In light of the foregoing, it becomes apparent that nullity is observed as synonymous to the legal expression null and void. This expression when used in a particular

---

192 Garner *Black's Law Dictionary* 1173.

193 Desmit 2015 <http://blog.lawdepot.com>.

194 Desmit 2015 <http://blog.lawdepot.com>.

195 Huntley, Blackie and Cathcart *Contract Cases and Materials* 239; see also Trietel *The Law of Contract* 364.

196 Christie *The Law of Contract in South Africa* 349, fear is an important element here, the fear of the person being forced to enter into a contract affects his consent. However, for a contract to be void *ab initio* there should be use of physical force, for example, where one signs a contract with his hand physically forced; see Christie *The Law of Contract* 349; see also Kahn *Contract and Mercantile Law Through Cases* 147; see further Sharrock *Business Transactions Law* 128.

197 If performance is subjectively impossible this will not render a contract void, this only gives rise to breach of contract, however if the performance is objectively impossible when the parties enter into a contract then no rights and obligations arise in connection with such a contract, it is null and void; see Van Der Merwe *et al Contract General Principles* 163.

198 Treitel *An Outline of The Law of Contract* 188-198.

199 A contract is void if it is invalid and unenforceable from the inception. On the other hand a contract is voidable if by operation of law or through a term in the contract it may be made unenforceable in the future.

200 Treitel *The Law of Contract* 442; see also *Phoenix General Insurance Co of Greese S.A Halvanon General Insurance Co.* 1988 QB 216 at 249; see further *Hughue v Asset Management plc* 1995 3 All ER 996.

legislation or any legal authority designates that the lawful significances will not be conferred upon the act in connotation with which they are used. Put differently a contract is void *ab initio*, meaning that "what may appear to be a contract is not a contract at all".<sup>201</sup> The expression is the opposite of the maxim "full force and effect". In light of the foregoing, it is safe to conclude that generally, from the moment nullity is established it will render the purported rights and responsibilities of the parties invalid and of no force and effect.

### **4.3 Nullity in letters of credit transactions**

The nullity exception's objective is to recognise situations under which the beneficiary is not the perpetrator of fraud but the documents presented before the bank for payment are null<sup>202</sup> for the reason that they are forged by a third party or have been completed without approval.<sup>203</sup> In letters of credit the question of nullity normally arises in circumstances where documents have been forged, have no value or contain false information so as to extinguish the essence of the documents.<sup>204</sup> In letters of credit a document has been said to be a nullity if because of a certain deficiency it is void from the inception, as a result it is a worthless piece of paper.<sup>205</sup> This may be due to the fact that a document is forged or because it was completed by a miscalculation without there being any intention to defraud.<sup>206</sup> An example of the former is a situation where a credit necessitates a document to be issued and signed by a certain individual but a document which is tendered for payment is issued and signed by a different individual under the pretence that he is the postulated signatory.<sup>207</sup> An example of the latter is a situation where a document is

---

201 Christie *The Law of Contract* 349.

202 Dora and Neo 2004 *SJOLS* 71.

203 Hooley 2002 *CLJ* 61.

204 Wong and Chin 2004 *LMCLQ* 14.

205 Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 145; see also *Egyptian International Foreign Trade Co v Soplex Wholesale Supplies* 1984 1 Lloyd's Rep 102 in which the learned Judge referred to a bill of lading that was assigned an incorrect date and which also had an incorrect statement regarding the name of the boat that was used to ship the goods, as "a sham piece of paper".

206 *Montrod Ltd v Grundkötter Fleishvertriebs GmbH* 2002 1 ER 257.

207 Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 146.

signed and issued by someone without having any authority to act as such, but under an honest misunderstanding regarding his authority.<sup>208</sup>

Notwithstanding the non-existence of fraud on the part of the beneficiary of a letter of credit, the application of the nullity exception is to the effect that the issuing or confirming bank is authorized to decline to pay the beneficiary by reason of the fact that a document presented for payment is a nullity.<sup>209</sup> This is because it was forged by a third party or because it was completed in the absence of authority of the person by whom it claims to be issued.<sup>210</sup>

In a nutshell, "a document in which the forgery destroys the whole or essence of the instrument is null".<sup>211</sup> However, it is important to note that it is not yet clear under what circumstances a document will be considered a nullity in letters of credit transactions. There is no universal definition of nullity in letters of credit transactions, it is also not clear to what extent a document has to be forged in order to be treated as a nullity. Whether a document is a nullity or not is determined by the factual matrix of each individual case. For example in *Kwei Tek Chao v British Traders and Shippers*<sup>212</sup> the court held that a bill of lading which reflected an incorrect date was "valueless but not a complete nullity".<sup>213</sup> Conversely, in *Egyptian International Foreign Trade Co v Soplex Wholesale Supplies*<sup>214</sup> the Judge referred to a bill of lading which was assigned an incorrect date and which also had an incorrect statement regarding the name of the boat that was used to ship the goods, as "a sham piece of paper".<sup>215</sup> Furthermore, in *United City Merchants (Investment) Ltd v*

---

208 *Montrod Ltd v Grundkötter Fleishvertriebs GmbH* 2002 1 ER 257.

209 Hugo 2001 *SA Merc LJ* 601; see also Hooley 2002 *CLJ* 61; see further Dora and Neo 2004 *Sing JLS* 49.

210 Hooley 2002 *CLJ* 279.

211 Todd 2008 *LMCLQ* 547-552; see also Lu Lu *The Exceptions in Documentary Credits in English Law* 238.

212 *Kwei Tek Chao v British Traders and Shippers* 1954 2 QB 459.

213 *Kwei Tek Chao v British Traders and Shippers* 1954 2 QB 459 para 476.

214 *Egyptian International Foreign Trade Co v Soplex Wholesale Supplies* 1984 1 Lloyd's Rep 102.

215 *Egyptian International Foreign Trade Co v Soplex Wholesale Supplies* 1984 1 Lloyd's Rep 102 para 116.

*Royal Bank of Canada*<sup>216</sup> Lord Griffiths struggled to differentiate between a forged document that is a nullity and a forged document that is not a nullity.

Nevertheless, it is the submission of this dissertation that a document is a nullity where (a) a document presented before the bank for payment under the credit provides no security for the advances of the bank, (b) where a document presented before the bank for payment has been forged in a material manner, (c) where a document is useless for the purpose for which it was intended to be used, and (d) where a document presented for payment is non-genuine. These circumstances call for a detailed discussion, for that reason they will be analysed in detail below.

#### *4.3.1 Documents serving no security for the advances of the bank*

In letters of credit the documents in relation to the sale of goods play a very important part, this is evident from the fact that these sales are often referred to as documentary sales.<sup>217</sup> As a result it has been argued that documents are sold in contrast to purely the goods.<sup>218</sup> A Letter of credit transaction is a documentary transaction. The UCP 600 states that "banks deal with documents and not with goods, services or performance to which the documents may relate".<sup>219</sup> The documents are very important to the banks. For the seller to receive payment from the nominated bank he must present strictly complying documents, for the nominated bank to be reimbursed it must also deliver strictly complying documents to the issuing bank,<sup>220</sup> and lastly for the issuing bank to be reimbursed by the buyer it must furnish the buyer with strictly conforming documents.<sup>221</sup>

In *Vereins und Westbank AG v Veren Investments and Others*<sup>222</sup> the nominated bank prematurely paid the seller who was fraudulent on a deferred payment credit. The nominated bank after paying the seller on the credit tried to seek reimbursement

---

216 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1982 1 QB 208 CA 208 para 255 B.

217 Goode *Commercial Law* 4<sup>th</sup> ed 1033.

218 Bridge *The International Sale of Goods* 7; See also Dimatteo *International Contracting: Law and Practice* 109.

219 A 5 of the Uniform Customs and Practice for Documentary Credits 600 (2007); see also Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 291.

220 A 7 (c) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

221 Bridge *Benjamin's Sale of Goods* 2101.

222 *Vereins und Westbank AG v Veren Investments and Others* 2000 4 SA W para 238.

from the issuing bank but it was unsuccessful because the documents presented by the seller had been forged, therefore, they were not a complying presentation. Following this decision was an English case of *Banco Santander SA v Bayfern Ltd & others*<sup>223</sup> the court held that:

The nominated bank by paying the seller prematurely in effect made an advance to the seller in exchange for cession of his rights against the issuing bank.<sup>224</sup>

However, the documents presented by the seller to the nominated bank had been forged, as a result of this state of affairs the court held that the seller could not cede any rights to the nominated bank because he did not have any rights against the issuing bank. Furthermore, the UCP 600 provides for the issuing bank's reimbursement obligations by stating that:

An issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the issuing bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity.<sup>225</sup>

In light of the foregoing, it becomes apparent that the nominated bank can make an advance to the seller, and the seller in return relinquishes his rights of payment against the issuing bank to the nominated bank. The foregoing discussion reveals that for the nominated bank to be reimbursed by the issuing bank it must present documents that comply with the terms and conditions of the credit. It is very important for the nominated bank to examine the documents carefully in order to determine whether they constitute a complying presentation in accordance with the terms and conditions of the credit.<sup>226</sup> The bank has to examine such documents with reasonable care.<sup>227</sup> For the nominated bank to be reimbursed by the issuing bank, the seller must present proper documents to the nominated bank.<sup>228</sup> If a document that is presented by the seller to the nominated bank for purposes of cession of rights is forged or counterfeit then it is not a complying presentation.

---

223 *Banco Santander SA v Bayfern Ltd & Others* 1999 CLC 1321.

224 *Banco Santander SA v Bayfern Ltd & Others* 1999 CLC para 59.

225 A 7 (c) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

226 Hugo 2001 *SA Merc LJ* 595.

227 Hugo 2001 *SA Merc LJ* 595.

228 Hugo 2001 *SA Merc LJ* 595.

It is the submission of the dissertation that such a document is null in that it does not give the seller any rights against the issuing bank. Therefore, he cannot transfer any rights to the nominated bank for the reason that he cannot transfer the right that he himself does not have. The nominated bank cannot use that document for purposes of being reimbursed by the issuing bank because a document does not attract any legal implications, it is worthless, nothing but waste paper and therefore a nullity.

In addition it has been maintained that because a forged document is a nullity and thus worthless, to expect the bank to accept and pay against such a document knowing such a document to be waste paper is:

To deprive the bank of the security for its advances which is a cardinal feature of financing by means of letters of credit.<sup>229</sup>

In a letter of credit transaction, the issuing bank debits the applicant's account after it has made payment on the credit. However, the bank may reinforce its position by keeping the documents as security in case the applicant is not able to meet payment when it is due. Some eminent scholars say because bills of lading are documents of title, they play an essential part for purposes of the bank's security interest as a result they are extensively utilised by the bank's for purposes of security.<sup>230</sup> The documents serve as security in that the issuing bank gets to exercise control over the goods, ownership of such goods can only pass on to the applicant if the bank furnishes him with the said documents. The issuing bank also has an obligation to examine the documents presented by the nominated bank with reasonable care in order to determine whether such documents constitute a complying presentation. If the documents have been forged or do not strictly comply with the terms and conditions of the credit, the issuing bank is not entitled to reimbursement from the buyer.<sup>231</sup>

It has also been contended that since the bank will keep the documents as security for the advances it gives to the buyer, mainly paying the seller upon presentation of

---

229 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR 597 at 31; see also *United City Merchants v (Investment) v Royal Bank of Canada* 1982 QB 208 para 256.

230 Malek, Guest and Jack *Documentary Credits* 433.

231 Hugo 2001 *SA Merc LJ* 596.

complying documents, it is not easy to vindicate a rule which obliges the bank to honour a presentation upon presentment of the documents it knows to be worthless. This is irrational because worthless documents will afford no security to the bank.<sup>232</sup> In *Sztejn v J Henry Schroeder Banking Corporation*<sup>233</sup> Shientag J held that "the bank is vitally interested in assuring itself that there are some goods represented by the documents".<sup>234</sup> Furthermore, in *Mees Pierson NV v Bay Pacific Pte. Ltd*<sup>235</sup> Rajendran J held:

To require the bank to make payment when the bank knows that the bills of lading are a nullity is to require the bank to knowingly forgo its security. That will be tantamount to requiring the bank to honour the credit on terms less favourable to the bank than envisaged under the credit arrangement.<sup>236</sup>

Likewise, in *United City Merchants (Investment) Ltd v Royal Bank of Canada*<sup>237</sup> the Court held that in circumstances where a document is a nullity, it was strange to expect the bank to make payment simply because the document presented for payment appeared on its face to be a complying presentation. The court went further to say:

If a document is a nullity, a banker ought not to be under an obligation to accept or pay against a document which he knows to be waste paper. To hold otherwise would be to deprive the banker of that security for his advance, which is a cardinal feature of the process of financing carried out by means of the credit.<sup>238</sup>

This assertion was also reinforced by Lord Griffiths before the same court who pointed out that it would be strange to expect the bank to make payment against documents which it knows to be worthless and hence nothing but a blank piece of paper. The Judge further held that "it is the fact that the documents are worthless that matters to the bank rather than the identity of the forger".<sup>239</sup> The purpose of letters of credit "is to pay against documents of value".<sup>240</sup>

---

232 Malek, Guest and Jack *Documentary Credits* 101.

233 *Sztejn v J Henry Schroeder Banking Corporation* 1941 31 N.Y.S. 2d. 631.

234 *Sztejn v J Henry Schroeder Banking Corporation* 1941 31 N.Y.S. 2d. 631.

235 *Mees Pierson NV v Bay Pacific Pte. Ltd* 2000 4 SLR 393.

236 *Mees Pierson NV v Bay Pacific Pte. Ltd* 2000 4 SLR 393 para 408.

237 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1982 1 QB 208 CA para 246 H-247 A.

238 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1982 1 QB 208 CA para 246 G.

239 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1982 1 QB 208 CA para 254 B-C.

240 Hooley 2002 *CLJ* 279.

In light of the foregoing discussion, it is safe to conclude that banks do not just deal with any documents, they deal with documents of value and if a document has been forged it does not have any value because it does not represent any goods. The bank cannot use such document as security for its advances because a document is worthless and hence null. Hooley says:

Since a null document is worth only the paper that is written on, a paying bank might be risking its right of reimbursement if it pays against such document.<sup>241</sup>

In summary, it is evident from the foregoing discussion that if a document presented before the bank for payment is forged or counterfeit, it becomes invalid and useless to the bank because it is nothing but a piece of paper which does not attract any legal implications. For example a bill of lading which has been forged cannot afford the issuing bank control over the goods because it is invalid and worthless. Put differently, it is nothing but waste paper and cannot be used by the bank for security purposes, it is therefore a nullity. Conversely, a nominated bank which accepts a document of title that is counterfeit from the seller does not have the right to claim reimbursement from the issuing bank. This is because the document is null due to fraud on the part of the seller. The seller cannot cede his rights to the nominated bank because the document does not have any legal implications, it is worthless and hence null.

#### *4.3.2 Forgery of a document in a material manner*

A document will also be considered to be a nullity if it has been forged in a material manner. Put differently, a document will be treated as a nullity if forgery of such a document "extinguishes the whole essence of the credit contract between the parties".<sup>242</sup> In *United City Merchants (Investment) Ltd v Royal Bank of Canada*<sup>243</sup> Lord Ackner held that the bill of lading in that case could not be treated as a nullity for the reason that the date of shipment which had been forged did not go to the essence of the credit contract. When dealing with materiality of a document, the issue will be whether a document has been forged to the point where its whole

---

<sup>241</sup> Hooley 2002 *CLJ* 279.

<sup>242</sup> *American accord* 1979 Lloyd's Rep 267.

<sup>243</sup> *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1982 1 QB 208 CA para 246 H-247 A.

essence is destroyed. For instance in circumstances where a credit states as one of its conditions that a bill of lading should be tendered in order for payment to be met, the issue would be whether a document that appears to be a bill of lading on its face, "is so defective that it cannot be regarded as a bill of lading in a real sense so as to be capable of being described as a nullity".<sup>244</sup>

In *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank*<sup>245</sup> the general nullity exception that was recognised is one where the documents have been forged and are material. The major problem with this approach is that there has been no method provided in order to determine what documents are material and what documents are not.<sup>246</sup> In *American Accord*<sup>247</sup> the bill of lading which reflected an incorrect date of loading was said not to be a nullity. The Judge in the case asserted that the date of loading which was not correct did not stop the bill of lading from being useful for purposes of carrying out its intended purpose of assigning to the holder of the bill the right of title over the goods where they are stationed. The court in determining whether a document was a nullity, looked at whether the essence of a document was destroyed.

In some instances the courts have considered how crucial a document purported to be a nullity is in connection with the letter of credit. The issue becomes whether the bank should be stopped from making payment where every document required by the credit is a nullity, or whether the bank should only be stopped from making such payment where important documents such as the bill of lading are a nullity. In some cases, Judges have considered how crucial a document is for it to be considered a nullity, the word crucial has been used as tantamount to the word material.<sup>248</sup> In light of the foregoing one may ask what is it that materiality should be linked to. Some authors affirm that materiality is linked to the credit.<sup>249</sup> Should this be the case, then every document required under the credit will be material.

---

244 Amaefule *The Exceptions to the principle of Autonomy of Documentary Credits* 136.

245 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR 597.

246 Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 151.

247 *American Accord* 1979 Lloyd's Rep para 267.

248 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR 257.

249 Dora and Neo 2004 *Sing JLS* 46.

In *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank*<sup>250</sup> a letter of credit had been issued for purposes of financing the sale of certain electronic machineries. The credit included a certain certificate of inspection as part of its conditions for payment. However, the court when examining the documents held that such an inspection certificate was not material, conversely it held that a set of clean way bills was a document which caused a letter of credit to be issued and therefore it was material. In this case the court seems to have assessed the materiality of the documents on the basis of whether such documents offer security to the bank for the advances the bank has made.<sup>251</sup> Some authors argue that:

This approach to limiting materiality to documents that caused the issue of letter of credit has the potential of setting a high standard of materiality, since not all documents required under the credit would have the potential of satisfying the requirement of being the cause of the issue of letter of credit. It would therefore undermine precision and certainty<sup>252</sup>

In light of the foregoing, one scholar whom this dissertation totally agrees with, have submitted that the method that considers every document required by the credit as material, is desirable; and that the nullity of such documents should pierce the principle of independence.<sup>253</sup> It is submitted that when parties agree that certain documents are to be presented before the bank in order to trigger payment, then parties consider such documents as material. If any of such documents is a nullity then the bank should not pay against such documents. In a nutshell, if any document required by the credit is counterfeit, so as to render the said document a nullity, then the nullity exception will be applied to pierce the principle of independence. The fact that the parties agreed on presentation of certain documents before payment can be effected by the bank makes such documents material. In addition, UCP 600 states that "a document presented but not required by the credit will be disregarded and may be returned to the presenter".<sup>254</sup> What can be ascertained from this provision is that only documents which have been agreed upon are essential and thus material

---

250 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR 597.

251 Amaefule *The Exceptions to the principle of Autonomy of Documentary Credits* 138.

252 Amaefule *The Exceptions to the principle of Autonomy of Documentary Credits* 138.

253 Amaefule *The Exceptions to the principle of Autonomy of Documentary Credits* 138.

254 A 14 (g) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

under the credit, if a document is not required by the credit then it is not material and banks have no use for it.

#### 4.3.3 *Non-genuine documents presented for payment*

The essential question that has to be analysed herein is what is meant by genuine or conforming documents in contrast to documents conforming on their face. In the mainstream of cases this has been treated as amounting to one and the same thing. In *Vereins und Westbank AG v Veren Investments*<sup>255</sup> a case in which two Mercedes Benz cars were imported from Germany to South Africa, Stegmann J reasoned as follows regarding a forged bill of lading which was presented by the seller to the nominated bank:

It has not been suggested that these documents were not, on their face, in order or that they did not appear to comply with the requirements of the letter of credit. It must be accepted that they were conforming documents in the sense that on their face they conformed to the requirements set out in the letter of credit.<sup>256</sup>

This *dicta* was reaffirmed in *Loomcraft Fabrics CC v Nedbank Ltd*<sup>257</sup> where Scott AJA held:

The liability of the bank to the beneficiary to honour the credit arises upon presentment to the bank of the documents specified in the credit, including typically a set of bills of lading, which on their face conform strictly to the requirements of the credit.<sup>258</sup>

However, Hugo argues that there is a difference between conforming documents and documents conforming on their face.<sup>259</sup> The UCP designates the issuing, nominated and confirming bank's responsibility under a letter of credit as an assured undertaking as long as the required documents are tendered to the appropriate bank and the bank must examine the documents to ascertain whether they appear on their face to comply with the requirements of the credit.<sup>260</sup> Therefore, the bank has the right to decline to make payment if the documents tendered do not comply with the conditions of the credit. Whether the bank makes payment or not will depend on

---

255 *Vereins und Westbank AG v Veren Investments* 2000 4 SA 238 W.

256 *Vereins und Westbank AG v Veren Investments* 2000 4 SA 238 para 254.

257 *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 A.

258 *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA para 854.

259 Hugo 2001 *SA Merc LJ* 594.

260 A 14 (a), 15 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

whether the seller has tendered proper documents.<sup>261</sup> Furthermore the UCP provides that "the bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document".<sup>262</sup>

In light of the foregoing, Hugo contends that the requirement is not for documents that conform on their face to be presented to the bank, rather the requirement is that the specified documents be presented.<sup>263</sup> In *United City Merchants (Investment) Ltd v Royal Bank of Canada*<sup>264</sup> Lord Diplock held that the issuing bank had the duty to pay the buyer on presentment of documents that conformed on their face.<sup>265</sup> It has been argued that this line of reasoning was not correct, the bank has no responsibility against the buyer to pay against "apparently conforming documents despite knowing that they have been forged".<sup>266</sup>

In *Gian Singh & Co Ltd v Banquede l'Indochine*<sup>267</sup> the issuing bank paid the seller upon presentment of documents that were apparently conforming on their face. In actual fact, the documents had been forged, however the issuing bank was not aware of this state of affairs when the seller presented the documents. Consequently, it came to the attention of the issuing bank that the documents were forged, this was after it had paid the seller. The court held that the issuing bank had paid against the forged documents without negligence, as a result it ordered that the seller should reimburse the bank. Hugo contends that this is precisely what the UCP<sup>268</sup> wanted to achieve:

A bank which has examined the documents presented to it with reasonable care, and which has paid against them in good faith, will be entitled to reimbursement provided the documents conform on their face, even if they are forged. However, this does not mean that a bank is duty bound as against its customer to pay against apparently conforming documents which the bank knows have been fraudulently altered or forged. Put differently, the purpose of these provisions of the UCP is to protect the bank that has paid against apparently conforming documents, and not

---

261 Hugo 2001 *SA Merc LJ* 595.

262 A 34 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

263 Hugo 2001 *SA Merc LJ* 595.

264 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1983 AC 168 HL.

265 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1983 AC para 184.

266 Hugo 2001 *SA Merc LJ* 599.

267 *Gian Singh & Co Ltd v Banquede l'Indochine* 1974 1 WLR 1234 PC.

268 Hugo 2001 *SA Merc LJ* 599 refers to Articles 7 and 9 of the Uniform Customs and Practice for Documentary Credits 500 (1993). These Articles are similar to Articles 14 (a), 15 and 34 of the Uniform Customs and Practice for Documentary Credits 600 (2007).

to place the bank under a duty as against the buyer, and an obligation as against the seller, to pay against apparently conforming documents.<sup>269</sup>

It has also been contended that a forged or null document "can still qualify as an apparently conforming document",<sup>270</sup> as a result if the bank is bound to pay against such a document it will be paying against waste paper that does not have any security for its advances.<sup>271</sup> Thus for documents to constitute a complying presentation, the documents should be genuine documents that comply with the conditions of the credit. If the documents are non-genuine in the sense that the information they contain is counterfeit, then the bank is not compelled to pay against such documents despite their apparent conformity because they are worthless, therefore a nullity.

#### *4.3.4 Documents useless for the purpose for which they were intended to be used*

Letters of credit deal primarily with shipping and commercial documents which represent the goods in a trade transaction instead of dealing with the underlying goods themselves. In letters of credit, documents are more crucial than any other mechanism in the transaction.<sup>272</sup> A letter of credit transaction deals with documents alone. In light of the foregoing, it is apparent that documents play a major part in a letter of credit transaction. It is therefore safe to maintain that in order to facilitate letters of credit as an efficient payment mechanism, documents that are used in the transaction should be in a state in which they can perform their intended purpose or function when presented for payment. If a document cannot perform its function due to the fact that it has been forged or it is counterfeit then such document has no value, it is useless and therefore, a nullity.

For instance, assuming the seller has just shipped the goods that were well-ordered by the buyer, in order for the seller to prove that the goods have been shipped, he will have to tender the appropriate transport documents before the bank.<sup>273</sup> The purpose of such documents is to prove that the goods have been shipped, if such

---

269 Hugo 2001 *SA Merc LJ* 599.

270 Hugo 2001 *SA Merc LJ* 599.

271 Hugo 2001 *SA Merc LJ* 599.

272 Eker 2010 <http://www.letterofcreditdocuments.html>.

273 Eker 2010 <http://www.letterofcreditdocuments.html>.

documents are counterfeit then they prove nothing as they cannot be relied on for purposes of determining whether indeed the goods have been shipped. They are useless and therefore a nullity. In *Vereins und Westbank AG v Veren Investments*<sup>274</sup> one of the requirements under a letter of credit was that an original forwarder's bill of lading be tendered by the seller before the bank in order for payment to be effected. The said bill of lading was presented by the seller to the nominated bank in Germany. The bill of lading showed that the shippers had received the two motor vehicles which were to be transported from Germany to South Africa. Nevertheless, the bank discovered that the bill of lading was forged and the motor vehicles were on no occasion shipped at all. In light of the foregoing, Stegmann J held:

It has not been suggested that these documents were not, on their face, in order or that they did not appear to comply with the requirements of the letter of credit. It must be accepted that they were conforming documents in the sense that on their face they conformed to the requirements set out in the letter of credit.<sup>275</sup>

In this case conforming documents and documents conforming on their face were considered to be one and the same. However, as discussed above<sup>276</sup> these concepts are basically different.<sup>277</sup> The documents should not just conform on their face but they should be genuine documents. In the present case a bill of lading was forged, it was useless for purpose of showing that the shippers had indeed received the cars which were to be shipped. It was non-genuine and could not serve its intended purpose. It was therefore waste paper and a nullity.

#### **4.4 The contemporary position of the law regarding the nullity exception**

In South Africa, the issue of the nullity exception in letters of credit transactions has not ascended before the courts, as a result it has never been canvassed. This part of the dissertation will thus discuss the law in relation to the nullity exception with reference to other common law jurisdictions, in particular, English law and Singapore where the issue has come before the courts on several occasions.

---

274 *Vereins und Westbank AG v Veren Investments* 2000 4 SA 238 W.

275 *Vereins und Westbank AG v Veren Investments* 2000 4 para 254.

276 See discussions above at 4.3.3.

277 Hugo 2001 *SA Merc LJ* 594.

#### 4.4.1 *The current position under English law*

In circumstances where a document presented before the bank gives the impression on its face to conform to the requirements of the letter of credit but it is a nullity, it is not clear whether the bank is permitted to discard such a document and decline to make payment by reason of a document being a nullity. There is no South African or English decision in that respect. Nonetheless there are differing legal views on the issue. In *United City Merchants (Investment) Ltd v Royal Bank of Canada*<sup>278</sup> the Appeal court held that the bank is authorised to decline payment in such a situation. Akner LJ made an example of a bill of lading on which the signature has been forged and the beneficiary does not know that it has in fact been forged when he presented the documents for payment. However, the bank knew of this state of affairs before it could pay the beneficiary. The court held that there was no sound basis upon which the bank should be authorised to pay and debit the account party. The court further held that:

A banker cannot be compelled to honour a credit unless all the conditions precedent have been performed, and he ought not to be under an obligation to accept or pay against documents which he knows to be waste paper. To hold otherwise would deprive the banker of that security for his advances, which is a cardinal feature of the process of financing carried out by means of the credit.<sup>279</sup>

Nevertheless, Lord Diplock speaking for the House of Lords set aside the court of appeal's decision which stated that a bank was authorized to withhold payment where the beneficiary presented a document which on its face appeared to conform to the credit but was in fact forged. The appeal court stated that the fact that a document is forged takes away its legal force and effect and renders it a nullity, which is so "valueless to the confirming bank as security for its advances to the buyer".<sup>280</sup>

In support of his stance Lord Diplock postulated that there was no sound reason why the beneficiary who did not know of the forgery should be prejudiced since he did not negotiate the draft before it was presented. Nonetheless, the issue with regard

---

278 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1982 1 QB 208 CA.

279 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1982 1 QB para 246.

280 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1983 AC para 187.

to circumstances where a document in question was a nullity did not arise before the House of Lords, as a result of this state of affairs Lord Diplock decided to leave open the question of the rights of innocent seller/beneficiary against confirming bank when a document presented by him is a nullity because unknown to him it was forged by some third party.<sup>281</sup>

The question of nullity which was left open by Lord Diplock has been answered by Potter LJ before the court of appeal in *Montrod Ltd v Grundkötter Fleischvertriebs GmbH*.<sup>282</sup> The case dealt with a fraud that was committed by a buyer from Russia on a company that was situated in England (Montrod), which it had involved for purposes of expediting the sale process. The seller in this case was from Germany and he was not guilty of fraud on his part. The English company Montrod was the applicant for a credit which was issued in favour of the German seller. The credit stated that payment would be facilitated by drafts 45 days after tendering of the stipulated documents. The credit had as one of its requirements that Motrod should tender inspection certificates which it signed personally. The buyer told the seller that one of its personnel must sign the inspection certificates on behalf of Montrod. However, the seller decently operating under the impression that he was allowed by Montrod to sign went ahead to sign the certificates and presented them as such. The goods were delivered to the buyer. Nevertheless, when the documents were presented for payment, it was discovered that Montrod had not granted the permission to the seller to sign the certificates. The beneficiary was paid by the issuing bank. Montrod was not happy with this state of affairs and he claimed repayment.

In his judgement, the judge held that in English law there was and there should be no general nullity exception founded on the notion of a document being fraudulent on itself or wanting of commercial value. The judge further held that there are strong policy reasons against recognising the general nullity exception. In light of the foregoing, it is apparent that if the decision in *Montrod* is followed, the law will be that in circumstances where a beneficiary tenders documents which have been forged by a third party to a bank and a document is a nullity because of a forgery,

---

281 *United City Merchants (Investment) Ltd v Royal Bank of Canada* 1983 AC para 188.

282 *Montrod Ltd v Grundkötter Fleischvertriebs GmbH* 2002 1 All ER 9 (Comm) para 56.

then a bank is obliged to make payment if the beneficiary was unaware of the forgery and the documents appear on their face to conform to the requirements of the credit.<sup>283</sup> In other words, the beneficiary may tender documents that are non-genuine. Non-genuine in the sense that they contain false information and have no commercial value, nonetheless he is eligible for payment under the credit unless he was personally fraudulent.<sup>284</sup>

#### 4.4.2 *The position in Singapore*

In Singapore, the courts took a different route from that taken by the English courts in *Montrod* and recognised the nullity exception. However, the nullity exception recognised by the courts in Singapore is very limited. Meaning the courts take a narrow approach in applying the nullity exception. The exception is applicable only where a null document is forged and material.<sup>285</sup> Furthermore, the exception does not apply in circumstances where the bank has already accepted a document that is a nullity. As a result, where a credit is governed by the UCP the exception will only apply where:

The Bank becomes aware that the document is a nullity within the time period allowed for examination under UCP, and the bank gives the presenter a valid notice of rejection under UCP. The exception does not apply where the bank has already accepted the document and has not given the presenter a notice of rejection specifying nullity of a document as a discrepancy.<sup>286</sup>

The decision in *Mees Pierson NV v Bay Pacific (S) pte Ltd*<sup>287</sup> is highly relevant in demonstrating the above proposition. In this case, a credit which was subject to the UCP 500 included as part of its conditions for payment a health certificate. The certificate was presented by the beneficiary. However, the certificate that was presented was not known to the beneficiary, it was a forgery, null and void. When the certificate was presented to the confirming bank, it did not come to the attention

---

283 Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 147; see also Hooley 2002 *CLJ* 279.

284 Hooley 2002 *CLJ* 279.

285 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR para 34; *Beam Technology* case limited the application of the nullity exception in stating that the exception is not applicable to all documents under the credit. The exception has been limited to only those documents which are material.

286 Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 151.

287 *Mees Pierson NV v Bay Pacific (S) pte Ltd* 2000 4 SLR 393.

of the bank that the certificate was forged. As a result of this state of affairs the bank accepted the document and paid the amount as per a credit. Consequently, the bank discovered that a document was forged and it brought a claim against the beneficiary to recover the money that was paid. However, the high court dismissed the claim on the grounds that the bank had by then accepted the documents and did not give a notice of rejection within the period indicated by the UCP. The court further held that since the bank which has accepted the document is required to pay after acceptance of the document it does not have a right to recover payment from the beneficiary by a claim of restitution.<sup>288</sup>

To understand the extent to which the courts in Singapore have applied the exception, it is important to have a quick look at cases in which a document was treated as a nullity due to the fact that it was forged. Thereafter, a discussion of how the courts treated a document that was a nullity due to an honest error by the maker will follow.

#### 4.4.1.1 A forged document that is a nullity

In *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank*<sup>289</sup> the appeal court recognised the nullity exception in circumstances where a document tendered for payment as required by a credit has been forged. The court held that this will apply where the bank knows of the nullity prior to the acceptance of the document. In this case, a letter of credit had been issued for purposes of financing the sale of certain electronic machinery. The letter of credit included as part of its requirements that a set of clean air waybills be presented before payment could be made. The seller was informed by the buyer that the said air waybills were going to be issued by their freight forwarders. The seller then went to present the documents as required by the credit. However, the confirming bank did not accept such documents contending that the said freight forwarder did not exist. The seller wanted to present the documents again but the bank did not allow him to make additional representations. As a result of this state of affairs the seller sued the bank for payment under the credit. The

---

<sup>288</sup> *Mees Pierson NV v Bay Pacific (S) pte Ltd* 2000 4 SLR 393.

<sup>289</sup> *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR 597.

court presumed that the air way bill was forged as a result a nullity, the beneficiary was not guilty of the falsification of the document and that it was presented by the beneficiary in good faith.

The issue was whether in this situation the bank which was aware and knew that a document was forged and a nullity was entitled to not accept the document and decline to make payment even though the document appeared on its face to conform to the requirements of the credit. Important to note is that this is exactly the same issue that was left open by Lord Diplock in *United City Merchants*. The court of appeal held that there was no obligation on the part of the bank to make payment in terms of the credit. This is if it has established upon examination of the documents within the period of examination of such documents as enshrined in the UCP that a document necessary under the credit has been forged and a nullity and had given notice of refusal within such period. It was held that the requirement that the beneficiary should present conforming documents implied that a document presented should be true and genuine.<sup>290</sup> The court came to the conclusion that because a document that has been forged and a nullity was not a genuine document, such a document was not a conforming presentation and the bank was entitled to reject it as non-conforming.

In light of the foregoing it is evident from the discussions in Chapter 3 that the *United Nations Convention on Independent Guarantees and Standby Letters of Credit*<sup>291</sup> is different in its application and scope from the nullity exception recognised in Singapore.<sup>292</sup> Article 19(1) (a) of the said convention comprises an exception which deals with non-genuine documents. The bank has the right to refuse to pay the beneficiary if it is obvious and clear that any document is "non-genuine or has been forged". It is crystal clear that the exception under the convention is broader than the exception recognized in Singapore. First and foremost, it is not restricted to circumstances where a document is a nullity as it seems to encompass all cases where a document has been forged. It is also not limited to circumstances in which a document has been forged but encompasses situations like *Mondrod* where a

---

290 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR para 33.

291 United Nations Convention on Independent Guarantees and Standby Letters of Credit (1996).

292 See discussions at 3.4 above.

document is a nullity because it has been signed by someone who honestly believed that he had the authority to sign the document when in actual fact he was mistaken and there was no such authority.

#### 4.1.1.2 A document that is a nullity due to an honest mistake

The *Beam Technology case* as discussed above limited the nullity exception to circumstances where a document is a nullity due to the fact that it has been forged. The question of whether the exception should also cover a document that is a nullity because it was produced and issued by a person who operated under an honest mistake with regard to his authority was not addressed in this case. Nonetheless, the case recognised the nullity exception on the grounds that a document that is a nullity is not a complying presentation. In light of the foregoing, some renowned scholars have argued that the cause of the nullity is not relevant and the exception should apply equally to any document that is a nullity.<sup>293</sup>

### **4.5 Conclusion**

The chapter defined and discussed the nullity exception in a general law context and in letters of credit transactions. From the discussions of this chapter it transpired that the nullity exception, unlike the fraud exception is not concerned with the identity of the fraudulent party, rather its main concern is the fact that a document presented for payment is a nullity and as a result a worthless piece of paper. The chapter also revealed that the beneficiary has the right to be paid only if he tenders a complying presentation and that a document which is a nullity is not a complying presentation because it is not a valid document. In a nutshell, the idea behind the nullity exception is that fraudulent documents cannot possibly be treated as conforming documents merely because fraud has been committed by a third party and not the beneficiary, the bank is concerned with the fact that the documents are non-conforming and not the identity of the fraudulent party. The quintessence of this dissertation is that if the bank pays against forged documents merely because the beneficiary is not the fraudulent party, this will instigate circulation of fraudulent

---

293 Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* 152.

documents in international trade. The question of how the nullity exception can be used to combat the circulation of fraudulent documents in international trade, particularly under letters of credit transactions forms the crux of this dissertation, as a result the next chapter analyses how this goal can be achieved by use of the nullity exception. The chapter will also draw conclusions and recommendations designed to improve the position of the law in South Africa.

## **Chapter 5- Conclusions and recommendations**

### ***5.1 Introduction***

The fundamental pursuit in this research work was to ascertain how letters of credit work, the main parties involved and the key principles underlying letters of credit transactions. The study focused mainly on the fraud exception to the independence principle, which is the exception generally recognised in letters of credit transactions. The study also focused predominantly on the nullity exception which is another exception to the independence principle although not generally recognised in letters of credit transactions.

The first chapter to this research provided the problem statement, research question, research methodology and the study outline.

The second chapter discussed the law pertaining to letters of credit as a payment mechanism. The primary goal of the chapter was to present and provide an overview of the legal principles applicable to letters of credit transactions and the obligations of different parties involved in a letter of credit transaction. In addition, other methods of payment used in international trade such as payment in advance, open account and documentary collections were also explored in detail. The chapter demonstrated that there are numerous risks associated with these payment methods, as a result the parties may find it necessary to effect payment by way of letters of credit in which parties don't deal directly with each other in effecting payment. Instead parties enlist the services of the bank which is a financially independent institution and dedicated to complying with its payment undertakings. The chapter further demonstrated how letters of credit provide a safer payment method as opposed to these methods of payment.

Moreover, it was shown that the principle of strict compliance and the independence principle are the main principles underlying letters of credit transactions. Lastly, the chapter revealed that in South African law the issuing bank's obligation to pay the beneficiary in letters of credit transactions is absolute except in cases where the beneficiary has personally committed fraud.

The third chapter defined and discussed the fraud exception in letters of credit transactions. The chapter also discussed the rationale behind the fraud exception and its development. Furthermore, the chapter dealt with the legal framework applicable to fraud on the part of the beneficiary and third party fraud in letters of credit transactions. The chapter demonstrated that the fraud exception is applicable only in circumstances where the beneficiary is personally liable. Put differently, the fraud exception is applicable only in circumstances where the beneficiary is the perpetrator of fraud. In essence, the exception does not cover fraud committed by third parties. The chapter further demonstrated that the bank will be compelled to make payment even if upon presentation of the documents, fraud by a third party comes to the attention of the bank, as long as the beneficiary is not personally liable and the documents conform on their face.

In chapter four the main goal was to define and discuss the nullity exception. The chapter investigated nullity in both general law context and in letters of credit transactions. The chapter revealed that the nullity exception is distinct from the fraud exception. Unlike the fraud exception, the nullity exception is not concerned with the identity of the fraudulent party, rather its primary concern is the fact that a document presented for payment is a nullity and as a result, a worthless piece of paper. In addition, the chapter also revealed that the beneficiary has the right to be paid only if he tenders a complying presentation and that a document which is a nullity is not a complying presentation for the reason that it is not a valid document. Furthermore, the chapter demonstrated that there is no universal definition of nullity in letters of credit transactions and the courts normally struggle in differentiating between a forged document that is a nullity and a forged document that is not a nullity. As a result of this state of affairs, the chapter made submissions on circumstances under which a document can be treated as a nullity. These are where (a) a document presented before the bank for payment under the credit provides no security for the advances of the bank, (b) where a document presented before the bank for payment has been forged in a material manner, (c) where a document is useless for the purpose for which it was intended to be used, and (d) where a

document presented for payment is non-genuine.<sup>294</sup> Lastly, the chapter demonstrated that the idea behind the nullity exception is that fraudulent documents cannot possibly be treated as conforming documents merely because fraud has been committed by a third party and not the beneficiary, the bank is concerned with the fact that the documents are invalid<sup>295</sup> and not the identity of the fraudulent party.

## ***5.2 Exploration of the fraud and the nullity exceptions in letters of credit transactions***

Letters of credit have become the most popular means of financing international trade. However, there is a growing distress for the whole international trading community, this is due to a noticeable increase in the number of frauds committed in letters of credit transactions. Parties who use letters of credit as a payment instrument lose billions of their hard-earned money each and every year because of fraud.<sup>296</sup> Some authors have asserted that:

A disturbing phenomenon of recent years is the noticeable increase in the number of frauds occurring in documentary credit transactions. The type of fraud that is becoming familiar is directly related to the documents. In some cases these are forged or fraudulently altered after their execution. In other cases the documents are signed or executed by the proper party but their contents are false.<sup>297</sup>

It has been said that letters of credit fraud is increasing like a "cancer alarm for international trade".<sup>298</sup> Recent occurrences of letters of credit fraud have been found to be as follows:

An ICC publication in 1995 shows that documentary credit fraud runs into hundreds of millions of pounds every year (ICC, 1995). A statistic of 1999 shows that banks are assumed to have lost millions of pounds, among them Citibank is said to have lost £30 million, ABN Amro £16 million and Barclays £13 million (Lloyds List, Nov 15, 1999). In one case, the Central Bank of the United Arab Emirates suffered losses of some US\$650 million (Demir-Araz, 2002). The Mumbai branch of the Centurion Bank in India lost in 2002 RS 400 Million by discounting forged Ls/C. A similar incident happened in the same year with the Kolkata branch of State Bank of India who has

---

294 See discussions at 4.3 above.

295 For purposes of this dissertation, the documents are invalid if they provide no security for the advances of the bank, if they have been forged in a material manner, if they are useless for their intended purpose and where they are non-genuine; see discussions at 4.3 above. The invalidity of such documents renders them a nullity.

296 Islam 2008 <http://dspace.daffodilvarsity.edu>.

297 Ellinger *et al* *The Current Problems of International Trade* 185.

298 Islam 2008 <http://dspace.daffodilvarsity.edu>.

reportedly lost RS 1,000 Million for extending credit facility against fake Ls/C (The Hindu Business Line, Jan 30, 2002). On the 19<sup>th</sup> September, 2003, the Old Bailey in London sentenced a man two years imprisonment for his part in a L/C fraud that is estimated to have cost international banks US\$200 Million (Financial times, September 20, 2003). Very recently in India on the 31<sup>st</sup> December, 2006 the court of Central Bureau of Investigation (CBI) Special Judge sentenced a man to five years rigorous imprisonment for a RS 4,000 million L/C scam with the Assam Veterinary Department (The Hindu, Sunday, Dec 31, 2006).<sup>299</sup>

In light of the foregoing, it is safe to assert that fraud in letters of credit transactions is constantly on the rise. One of the main reasons why fraud has risen tremendously throughout the years is because the fraud exception does not recognise third party fraud. This leaves a somewhat disturbing lacuna which allows circulation of fraudulent documents in letters of credit transactions. In chapter 3 it was demonstrated that the law is to the effect that the bank has an obligation to pay against apparently conforming documents which it knows to be falsified where a third party and not the beneficiary is fraudulent.<sup>300</sup>

As a result of this state of affairs, there is a compelling need for a legal framework which will prohibit fraudulent third parties from getting a free ride. One way of doing this is by use of the nullity exception. It is the submission of this dissertation that if this current position is endured it will amount to condoning trade by way of fraudulent documents in letters of credit transactions. This is due to the fact that banks will be mandated to make payment on presentation of fraudulent documents merely because the beneficiary is not the fraudulent party. At first sight it would appear as if the fraud exception is sufficient to combat fraud in letters of credit transactions. However, it is the submission of this dissertation that its effectiveness is largely limited since it only covers fraud committed by the beneficiary. Furthermore, a fraudulently completed document should not be treated as a valid document simply because fraud has been perpetrated by a third party.<sup>301</sup> conversely, the issue before the court should be whether valid documents that conform to the requirements of the credit have in fact been delivered.<sup>302</sup>

---

299 Islam 2008 <http://dspace.daffodilvarsity.edu>.

300 See discussions at 3.6.1 above.

301 Goode 1980 *JBL* 294.

302 Goode 1980 *JBL* 291.

It is further contended that a bank is without a doubt not under any obligation as against its customer to pay against apparently conforming documents despite knowing that they have been fraudulently altered or even forged.<sup>303</sup> The documents that are required to be presented before the bank should not merely conform on their face, they should be valid documents without any misrepresentations.<sup>304</sup> In light of the foregoing, it is apparent that documents play a vital role in letters of credit transactions. It is therefore, the submission of this dissertation that the standard and requirements of the documents must be high and strictly regulated. The documents must not only meet the terms and conditions of the credit but must also be valid and reflect the facts of the transaction involved.<sup>305</sup> This is due to the fact that validity of the documents is the groundwork for the effectiveness of letters of credit.<sup>306</sup>

Furthermore, there is a relationship of trust between the applicant and the issuing bank and if the bank is mandated to pay the beneficiary against invalid documents in cases where fraud has been committed by a third party, it will jeopardise this relationship. The applicant will not have confidence in the bank that does not protect and have his best interests at heart as the customer. He cannot trust the bank that goes on to pay against invalid documents even though this is likely to be prejudicial on his part. For that reason, it is the submission of this dissertation that irrespective of who perpetrates fraud, the fraud rule should apply if the documents presented for payment are fraudulent. Put differently, it should be the fact that the documents are invalid that matters to the bank and not the identity of the fraudulent party in order for the fraud rule to apply. This is because the purpose of letters of credit is to pay against documents of value.<sup>307</sup>

It is further submitted that fraud by third parties is no better than fraud committed by the beneficiary, once again what should matter to the bank is the fact that the documents are invalid and the identity of the forger should be of no relevance. There is no sound basis for differentiating between perpetrators of fraud and affording them different treatment since they have both committed the same act. To maintain

---

303 Ellinger *et al Current problems of international trade* 205.

304 Hugo 2001 *SA Merc LJ* 593-601.

305 Xiang 2001 *UNSWLJ* 15.

306 Xiang 2001 *UNSWLJ* 15.

307 See discussions at 4.3.1 above.

this bizarre position would be condoning, not to mention promoting trade by way of fraudulent documents, something which is forbidden in international trade. In order to combat this state of affairs, it is contended that the courts should use the nullity exception. This exception aims at accepting cases in which the beneficiary is not guilty of fraud, but the documents will nonetheless be null, because they have been forged by a third party or have been executed without authorisation.<sup>308</sup> However, numerous arguments against the application of the nullity exception have been put forward. It has been said that the nullity exception generates uncertainty for the reason that it cannot be precisely defined, it impends the doctrine of apparent conformity and places banks in a dilemma as they have to consider whether to investigate if the facts warrant the application of the exception.<sup>309</sup>

Regarding the issue of apparent conformity, it is the submission of this dissertation that there is a distinction between a conforming document and a document conforming on its face.<sup>310</sup> A document which has been forged is not a conforming document, the banks undertake to make payment on presentment of conforming documents and not documents that merely conform on their face.<sup>311</sup> For documents to constitute a complying presentation, they should be valid documents that conform to the terms and conditions of the credit.<sup>312</sup> It is further submitted that the requirement of apparent conformity is applicable only to protect the bank that has paid against apparently conforming documents, the bank has no obligation to pay against apparently conforming documents which it knows to be counterfeit.<sup>313</sup> Therefore, the bank will be entitled to reimbursement if the documents were apparently conforming and before making payment the bank exercised reasonable care and paid against such documents in good faith.<sup>314</sup> It is further submitted that for a document to be conforming, it must be true and genuine.<sup>315</sup> If the information contained in a document is counterfeit then a document is not true and genuine, and

---

308 See discussions at 4.4.1.1 above.

309 *Montrod Ltd v Grundkötter Fleischvertriebs GmbH* 2002 1 All E.R. (Comm.) 257.

310 See discussions at 4.3.3 above.

311 See discussions at 4.3.3 above.

312 See discussions at 4.3.3 above.

313 See discussions at 4.3.3 above.

314 See discussions at 4.3.3 above.

315 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR para 33.

the bank is not obliged to pay against such a document despite its apparent conformity. In a letter of credit transaction, the bank undertakes to pay on presentation of conforming documents and not documents that appear to conform.

Regarding the issue of investigation, in chapter 3 it was demonstrated that for the fraud exception to be invoked, a party who alleges must show a clear case of fraud.<sup>316</sup> It is the submission of this dissertation that to protect the banks from a quandary of whether to investigate, the same rule should also be applicable to the nullity exception. In *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank*<sup>317</sup> a case in which the nullity exception was recognised, the court opined that a bank has no duty to investigate, the only duty a bank has is to inspect the documents for apparent conformity. Therefore, the invocation of the nullity exception would mean that as soon as it comes to the attention of the bank by any means that a document required under the credit is undoubtedly a nullity, the bank should not pay even if a document is apparently conforming.<sup>318</sup> This will prevent the banks from having to undertake their own investigations regarding the allegations of nullity, as a party that wishes to establish that a demand is null will have to tender before the bank evidence of clear and obvious nullity. In essence, a bank will not be in a dilemma of whether or not to investigate because the bank will be certain that a material document is a nullity.

Regarding the issue of uncertainty, some of the reasons advanced in favour of the lack of certainty argument are that it is difficult to define with accuracy when a document is a nullity, and that it is difficult to define what constitutes nullity in the first place. However, these arguments disregard what is significantly part of the legal process. Many legal processes are uncertain and some of the uncertainty and strangeness of the legal process are understood based on the factual matrix of each individual case.<sup>319</sup> In *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank*<sup>320</sup> the court held that questions of nullity are not that much more difficult to answer than the question whether something is reasonable, an assessment that courts are

---

316 See discussions at 3.2 above.

317 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR para 34.

318 Dora and Neo 2004 *Sin JOBS* 58.

319 Amaefule *The Exceptions to the principle of Autonomy of Documentary Credits* 107.

320 *Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR para 36.

used to making. Similarly, banks are already faced with a measure of uncertainty when applying the fraud exception, as a result, they can approach the nullity exception the same way they approach the fraud exception in dealing with issues of uncertainty. Lastly, since there is no universal definition of nullity, which makes it difficult to define with accuracy when a document is a nullity, to elucidate this hurdle the dissertation endeavoured to define nullity and provided circumstances under which a document may be treated as a nullity.<sup>321</sup> These can be used as a starting point for purposes of determining when a document is a nullity and what document constitutes a nullity.

In chapter 3 it was demonstrated that the fraud exception is justified on the basis of the maxim *ex turpi causa non oritur actio*.<sup>322</sup> The chapter demonstrated that the rationale behind the fraud exception is that the courts will not allow fraudulent beneficiaries to use their process to perpetrate fraud.<sup>323</sup> In light of the foregoing, it is safe to conclude that the main justification for the fraud exception cannot apply to the nullity exception because the beneficiary is not the fraudulent party. It is the submission of this dissertation that in dealing with the question of nullity the issue should not be one in relation to the realm of the fraud exception, instead the first issue for determination should be whether the documents are as a matter of fact valid documents that conform to the terms and conditions of the credit.<sup>324</sup>

The second issue should be with regard to the worth of a document presented for payment before the bank. This is because the purpose of letters of credit is to pay against documents of value.<sup>325</sup> This means the bank will only have an interest in the documents presented for payment and not the underlying transaction because it makes payment against documents which provide it with some form of security. If a document presented before the bank is a worthless piece of paper in a sense that it offers no security to the bank which has made payment under the credit, then such a document is a nullity.<sup>326</sup> In chapter 4 it was mentioned that the issue of nullity has

---

321 See discussions at 4.3 above.

322 See discussions at 3.3.2 above.

323 See discussions at 3.3.2 above.

324 See discussions at 4.3.3 above.

325 See discussions at 4.3.1 above.

326 See discussions at 4.3.1 above.

never been raised before South African courts. However, *Vereins und Westbank AG v Veren Investments and Others*<sup>327</sup> is a case in which South African courts missed an opportunity to address the issue of nullity. In this case, the court held that a bill of lading which had been forged was a conforming document because it was apparently conforming. However, it is the submission of this dissertation that the court should have considered the nullity of such a document. The bill of lading in this case was forged, it was therefore worthless for its intended purpose. It could not be used for purposes of proving that the shipment had been received by the shippers, it was worthless and therefore a nullity.

Last but by no means least, the issue of materiality of a document should also be taken into consideration for purposes of ascertaining whether a document presented before the bank for payment is a nullity. It is the submission of this dissertation that every document required by the credit should be treated as material and nullity of such a document should pierce the principle of independence in letters of credit transactions.<sup>328</sup> This is because it is reasonable to surmise that when parties agree that certain documents are to be presented before the bank in order to trigger payment, they consider such documents to be material. Another reasonable inference can be drawn from the provisions of the UCP 600 which provides that "a document presented but not required by the credit will be disregarded and may be returned to the presenter".<sup>329</sup> In interpreting this provision, it is the submission of this dissertation that this provision means only documents which have been agreed upon by the parties are essential and thus material.<sup>330</sup>

### ***5.3 Final conclusions and recommendations***

Recommendations for using the nullity exception must be made in light of the recognised deficiency of the fraud exception. On that basis, it is recommended that the nullity exception should be adopted as an extension of the fraud exception. Alternatively, the adoption of a separate nullity exception is recommended.

---

327 *Vereins- und Westbank AG v Veren Investments and Others* 2000 4 SA 238 W.

328 See discussions at 4.3.2 above.

329 A 14 (g) of the Uniform Customs and Practice for Documentary Credits 600 (2007).

330 See discussions at 4.3.2 above.

The deficiency of the fraud exception is the fact that it does not recognise third party fraud. This is problematic in that it allows fraudulent third parties to freely get away with fraud. Put differently, the fraud exception gives third parties freedom to fabricate letters of credit which allows circulation of fraudulent documents in letters of credit transactions. This happens without the law taking the necessary precautions to combat this state of affairs. As noted earlier, the current position of the law is that the bank is obliged to make payment if fraud on the documents has been committed by a third party and not the beneficiary. This opens the floodgates of third party fraud in letters of credit transactions. It is accordingly recommended that South African law should adopt the nullity exception as an extension of the fraud exception. Meaning that the nullity exception should take over where the fraud exception ends by recognising third party fraud even in cases where the beneficiary is not the fraudulent party. However the dissertation concedes that this recommendation is very difficult to justify because it is extremely difficult to find solid grounds for joining the fraud and nullity exceptions as their basis are not the same.<sup>331</sup>

In light of the foregoing, it is recommended in the alternative that a separate nullity exception which considers the fact that documents are invalid and not the identity of the fraudulent party be adopted in South African law. Put differently, the study recommends that the nullity exception should be adopted as an independent exception over and above the fraud exception that would allow a bank to withhold payment against apparently conforming document that is a nullity.

On the other hand, since there is no universal definition of nullity in letters of credit transactions, it is recommended that for purposes of certainty and in order to achieve a successful and effective implementation of the above recommendations, a starting point may well be to treat a document as a nullity where (a) a document presented before the bank for payment under the credit provides no security for the advances of the bank, (b) where a document presented before the bank for payment has been forged in a material manner, (c) where a document is useless for the

---

<sup>331</sup> Fraud is based on the maxim *ex turpi causa non oritur actio* whereas nullity is based on whether documents are valid and conform to the requirements of the credit. The grounds on which the nullity and the fraud exceptions could be merged are not easy to ascertain and can lead to a very broad discussion of a subject matter, as a result they will not be addressed in this dissertation. However, this is a matter that could be covered in a doctoral thesis.

purpose for which it was intended to be used, and (d) where a document presented for payment is non-genuine.<sup>332</sup>

It is important to note that these recommendations are not meant to establish a one size fits all model as each and every case will have to be treated on its own merits. They are nonetheless, a humble way of establishing how the nullity exception can be used effectively to combat the circulation of fraudulent documents, which has become a cancer for international trade. Put differently, the recommendations will help to restrain the ease with which third parties get away with fraud in letters of credit transactions.

---

<sup>332</sup> See discussions at 4.3 above.

## **BIBLIOGRAPHY**

### ***Literature***

Adodo *Letters of Credit- the Law and Practice of Compliance*

Adodo E *Letters of Credit- the Law and Practice of Compliance* (Oxford University Press United Kingdom 2014)

Amaefule *The Exceptions to the principle of Autonomy of Documentary Credits*

Amaefule C *The Exceptions to the principle of Autonomy of Documentary Credits* (LLD-thesis University of Birmingham 2011)

Bridge *The International Sale of goods*

Bridge M *International Sale of Goods* 2<sup>nd</sup> ed (Oxford University Press United Kingdom 2007)

Bollen 2007 *JIBLR*

Bollen R "International Payment Systems in Australian" 2007 *JIBLR* 373-386

Buckley and Nixon 2009 *JOBLFP*

Buckley R and Nixon J "The Role of Reputation in Banking" 2009 *JOBLFP* 37-50

Bridge *Benjamin's Sale of Goods*

Bridge M *Benjamin's Sale of Goods* 8<sup>th</sup> ed (Sweet & Maxwell London 2010)

Brindle *Law of Bank Payments*

Brindle *Law of Bank Payments* 4<sup>th</sup> ed (Sweet & Maxwell London 2010)

Bridge *The International Sale of Goods*

Bridge M *The International Sale of Goods* 3<sup>rd</sup> ed (Oxford University Press  
United Kingdom 2013)

Christie *The Law of Contract in South Africa*

Christie R *The Law of Contract in South Africa* 4<sup>th</sup> ed (Butterworths Durban  
2001)

Carr *International Trade Law*

Carr I *International Trade Law* 4<sup>th</sup> ed (Routledge-Cavendish London 2010)

Carr *International Trade Law*

Carr I *International Trade Law* 5<sup>th</sup> ed (Routledge Abingdon London 2014)

Dimatteo *International Contracting: Law and Practice*

Dimatteo L *International Contracting: Law and Practice* 3<sup>rd</sup> ed (Kluwer Law  
International London 2013)

Day *The Law of International Trade*

Day D *The law of International Trade* 2<sup>nd</sup> ed (Butterworths London 1993)

Du Bois "Contracts in General"

Du Bois "Contracts in General" in Graham B and Himonga C (eds) *Wille's  
Principles of South African Law* 9<sup>th</sup> ed (Juta & Co Cape Town 2007) 761-764

Dora and Neo 2004 *SJOLS*

Dora S and Neo S "A nullity Exception in Letters of Credit Transactions?" 2004  
*SJOLS* 46-7

Ellinger *Does an irrevocable Credit Constitute Payment*

Ellinger P *Does an irrevocable Credit Constitute Payment* (Oxford University Press London 1977)

Ellinger *et al The Law and Practice of Documentary Letters of Credit*

Ellinger P *et al The Law and Practice of Documentary Letters of Credit* (Oxford University Press London 2010)

Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees*

Enonchong N *The Independence Principle of Letters of Credit and Demand Guarantees* (Oxford University Press London 2011)

Enonchong 2006 *LMCLQ*

Enonchong N "The Autonomy Principle of Letters of Credit: The Illegality Exception?" 2006 *LMCLQ* 404-119

Fredericks and Neels 2003 *SA Merc LJ*

Fredericks E and Neels L "The Proper Law of a Documentary Letter of Credit" 2003 *SA Merc LJ* 63-74

Fellinger 1990 *JBFL*

Fellinger G "Letters of credit: the autonomy principle and the fraud exception" 1990 *JBFL* 4-23

Garcia and Luis 2009 *Mexican Law Review*

Garcia F and Luis R "The Autonomy Principle of Letters of Credit" 2009 *Mexican Law Review* 67-96

Goode *Commercial Law*

Goode R *Commercial Law* 4<sup>th</sup> ed (Lexis Nexis United Kingdom 2009)

Goode *Proprietary Rights and Insolvency in Sales Transactions*

Goode R *Proprietary Rights and Insolvency in Sales Transactions* 2<sup>nd</sup> ed  
(Sweet & Maxwell London 1989)

Goode *Proprietary Rights and Insolvency in Sales Transactions*

Goode R *Proprietary Rights and Insolvency in Sales Transactions* 3<sup>rd</sup> ed (Sweet  
& Maxwell London 2009)

Goode 1980 *JBL*

Goode R "Reflections on Letters of Credit" 1980 *JBL* 291- 109

Grassi 1995 *Pace International Law Review*

Grassi P "Letters of Credit Transactions: The bank's position in Determining  
Documentary Compliance-A Comparative Evaluation under U.S., Swiss and  
German Law" 1995 *Pace International Law Review* 83-95

Garner *Black's Law Dictionary*

Garner B *Black's Law Dictionary* 9<sup>th</sup> ed (Thomson Reuters Dallas, Texas 2009)

Hooley 2002 *CLJ*

Hooley "Fraud and Letters of Credit: is there a nullity exception"? 2002 *CLJ*  
279-281

Hugo 1993 *SA MercLJ*

Hugo C "The Development of Documentary Letters of Credits as reflected in  
the Uniform Customs and Practice of Documentary Credits"1993 *SA Merc LJ*  
44-77

Hugo 1994 *SA MercLJ*

Hugo C "The Legal Nature of the Uniform Customs and Practice for  
Documentary Credits: Lex Mercatoria, Customs or Contracts? 1994 *SA Merc LJ*  
143-168

Hugo 2001 SA *Merc LJ*

Hugo C "Documentary Credits: Apparently Conforming Documents Equals Conforming Documents! The Bizarre Heritage of *United City Merchants (Investments) Ltd v Royal Bank of Canada*" 2001 SA *Merc LJ* 594-601

Hugo "Letters of Credit"

Hugo C "Letters of Credit: Reflections on Recent Developments" *Annual Banking Law Update* (1994 Indaba Hotel Witkoppen, Johannesburg) 8

Hugo "Documentary Credits and Independent Guarantees" 178

Hugo C "Documentary Credits and Independent Guarantees" *Annual Banking Law Update* (Indaba Hotel Witkoppen, Johannesburg) 178

Huntley, Blackie and Cathcart *Contract Cases and Materials*

Huntley J, Blakie J and Cathcart C *Contract Cases and Materials* 2<sup>nd</sup> ed (Sweet & Maxwell Edinburgh 2003)

Jack *Documentary Credits*

Jack R *Documentary credits: the law and practice of documentary credits including standby credits, and demand guarantees* 2<sup>nd</sup> ed (Butterworths London 1993)

Kerr *The Principles of the Law of Contract*

Kerr J *The Principles of the Law of Contract* 6<sup>th</sup> ed (Butterworths Durban 2002)

Kahn *Contract and Mercantile Law through Cases*

Kahn E *Contract and Mercantile Law through Cases* 2<sup>nd</sup> ed (Juta & Co Cape Town 1985)

Kelly-Louw *Selective Aspects of Bank demand Guarantees*

Kelly-Louw M *Selective Aspects of Bank Demand Guarantees* (LLD-thesis University of South Africa 2008)

Lu Lu *The Exceptions in Documentary Credits in English Law*

Lu Lu *The Exceptions in Documentary Credits in English Law* (LLD-thesis University of Plymouth 2011)

Oelofse *The Law of Documentary Letters of Credit in Comparative Perspective*

Oelofse *The Law of Documentary Letters of Credit in Comparative Perspective* (Inter legal Pretoria 1997)

Zweigert and Drobniq *Kozolchyk Letters of Credit*

Zweigert K and Drobniq U *Kozolchyk Letters of Credit* (International Encyclopaedia of Comparative Law 1973)

Megrah's and Cutteridge *Law of Banker's Commercial Credits*

Megrah's M and Cutteridge HC *Law of Banker's Commercial Credits* 8<sup>th</sup> ed (Europa Publications Limited London 2001)

Murray, Holloway and Hunt *Schmitthoff The Law and Practice of International Trade*

Murray C, Holloway D and Hunt D *Schmitthoff The Law and Practice of International Trade* 12<sup>th</sup> ed (Sweet & Maxwell London 2012)

Murray *et al Schmitthoff's Export Trade*

Murray *et al Schmitthoff's Export Trade* 11<sup>th</sup> ed (Sweet & Maxwell London 2007)

Malek, Guest and Jack *Documentary Credits*

Malek A, Quest D and Jack R *Documentary Credits* 4<sup>th</sup> ed (Bloomsbury Publishing PLC United Kingdom 2009)

Mueller *Letters of Credit with Focus on the UCP 600 and The Exceptions to The Principle of Autonomy*

Mueller *Letters of Credit with Focus on The UCP 600 and the Exceptions to the Principle of Autonomy with Emphasis on the Fraud Rule under the Laws of the USA, UK, and RSA* (LLM-dissertation University of Western Cape 2013)

Sanborn *Origin of the Early English Maritime and Commercial Law*

Sanborn F *Origins of the early English Maritime and Commercial Law* (Professional Books Limited London 1930)

Sharrock *Business Transactions Law*

Sharrock S *Business Transactions Law* 7<sup>th</sup> (Juta & Co Cape Town Ltd 2007)

Trietel *The Law of Contract*

Trietel G *The Law of Contract* 6<sup>th</sup> ed (Sweet & Maxwell London 1983)

Trietel *An Outline of The Law of Contract*

Trietel G *An Outline of The Law of Contract* 5<sup>th</sup> ed (Butterworths London 1995)

Trietel *The Law of Contract*

Trietel G *The Law of Contract* 10<sup>th</sup> ed (Sweet & Maxwell London 1999)

Todd 2008 *LMCLQ*

Todd P "Non-genuine Shipping Documents and Nullities" 2008 *LMCLQ* 547-559

Van der Merwe *et al Contract General Principles*

Van Der Merwe *et al* (eds) *Contract General Principles* 2<sup>nd</sup> ed (Juta & Co Cape Town 2003)

Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics*

Van Niekerk J and Schulze W *The South African Law of International Trade: Selected Topics* 3<sup>rd</sup> ed (SAGA Legal Publications Pretoria 2011)

Wolff *The Law of Cross-Border Business Transactions*

Wolff L *The Law of Cross Border Business Transactions* (Wolters Kluwer Law & Business Netherlands 2013)

Wong and Chin 2004 *LMCLQ*

Wong Y and Chin L "Autonomy- A nullity exception at last?" 14-26

Xiang 2001 *UNSWLJ*

Xiang G "The Identity of the Fraudulent Party under the Fraud Rule in the Law of Letters of Credit" 2001 *UNSWLJ*119-137

Xiang *The Fraud Rule in the Law of Letters of Credit: A Comparative Study*

Xiang G *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* (Kluwer Law International Hong Kong 2002)

### **Case law**

*American accord* 1979 Lloyd's Rep

*Bank of Credit & Commerce Hong Kong Ltd (in Liquidation) v Sonali Bank* 1995 1 Lloyd's Rep

*Bankers Trust Co v State Bank of India* 1991 2 Lloyd's Rep

*Banque de l'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd* 1983 1 QB 711 (CA)

*Banco Santander SA v Bayfern Ltd & Others* 1999 CLC

*Beam Technology (Mfg) Pte Ltd v Standard Chartered Bank* 2003 1 SLR 597

*Bolivinter Oil SA v Chase Manhattan Bank* 1984 1 Lloyd's Rep

*Christopher Staughton in Credit Agricole Indosuez v Muslim Commercial Bank* 2000 1  
Lloyd's Rep

*Contronic Distributors Pty Ltd v Bank of New South Wales* 1984 3 NSWLR

*Credit Agricole Indosuez v Muslim Commercial Bank Ltd* 2002 1 All ER (Com)

*Diamond Cutting Works Federation v Triefus & Co Ltd* 1956 1 Lloyd's Rep

*Dormell Properties 282 CC v Renasa Insurance Co Ltd & Others* NNO 2011 1 SA 70  
(SCA)

*Dynamics Corporation of America v Citizens and Southern National Bank* 356 F Supp  
991 (ND Ga 1973)

*Establishments Chinbaux SARL v Harbourmaster Ltd* 1955 1 Lloyd's Rep

*Equitable Trust Company of New York v Dawson Partners Ltd* 1926 27 Ll L Rep 49  
(HL)

*Edward Owen Engineering Ltd v Barclays Bank International Westminster Bank Ltd  
and others* 1978 1 Lloyd's Rep

*Egyptian International Foreign Trade Co v Soplex Wholesale Supplies* 1984 1 Lloyd's  
Rep

*Ex parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W)

*Forbes, Campbell & Co* 1992 9 LIL Rep

*Garcia v Page & CO Ltd* 1936 55 LIL. Rep

*Gian Singh & Co Ltd v Banque del Indochine* 1974 2 Lloyd's Rep 1 (PC)

*GKN Contractors Ltd v Lloyds Bank PLC* 1985 30 BLR

*Hadley v Baxendale* 1854 9 Exch

*Hughue v Asset Management plc* 1995 3 All ER

*Inraco Ltd Notis Shipping Corporation-The Bhoja Trader* 1981 2 Lloyd's Rep 256 (CA)

*KNS Construction (Pty) Ltd v Mutual & Federal Insurance Co* 2015 JDR0082

*Kwei Tek Chao v British Traders and Shippers* 1954 2 QB

*Lombard Insurance Co Ltd v City of Cape Town* 2008 2 SA 423 (SCA)

*Loomcraft Fabrics CC v Nedbank Ltd and another* 1996 1 SA 812 (A)

*Mahonia Ltd v J P Morgan Chase* 2003 2 Lloyd's Rep

*Mees Pierson NV v Bay Pacific Pte. Ltd* 2000 4 SLR

*Montrod Ltd v Grundkotter Fleishvertriebs GmbH* 2002 1 ER 257

*New Braunfels National Bank v Odiorne* 780 2d 313 (1989)

*OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd* 2002 3 SA 688 (SCA)

*Pavia & Co. S.P.A. v. Thurmann-Nielsen* 1952 2 QB 84 (CA)

*Philips & Another v Standard Bank of South Africa Ltd & Others* 1985 (3) SA 301 (W)

*Phoenix General Insurance Co of Greese S.A Halvanon General Insurance Co.* 1988

*Power Curber International Ltd v National Bank of Kuwait SAK* 1981 3 ALL ER

*RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* 1978 QB

*Scatec Solar SA Ltd Itochu Corporation v Terrafix Sued Africa Pty Ltd HBC Bank PLC.*  
(Unreported) case Number 449/2014 of 5 March 2014

*Seaconsar Far East Ltd v Bank Markazi Jomhuri Islami Iran* 1993 1 Lloyd's Rep 236

*Shamsher Jute Mills Ltd. v Sethia (London) Ltd* 1987 1 Lloyd's

*Soproma S.p.A. v Marine & Animal By-Products Corporation* 1966 1 Lloyd's Rep

*Standard Chartered Bank v Pakistan National Shipping Corporation (No 2)* 1998 1  
Lloyd's Rep

*Standard Chartered Bank v Pakistan National Shipping Corp (No 2)* 2001 1 ALL  
(Comm)

*Sztejn v J Henry Schroder Banking Corporation* 31 N.Y.S 2d

*Trust SPRL v Danubian Trading Co Ltd* 1952 1 Lloyd's Rep

*Tukan Timber Ltd v Barclays Bank Ltd* 1987 1 Lloyd's Rep 171 (QB)

*Union Carriage & Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W)

*United City Merchants (Investments) Ltd v Royal Bank of Canada* 1979 1 Lloyd's Rep

*United City Merchants v Royal Bank of Canada* 1983 AC 168 (HL)

*United City Merchants (Investment) Limited v Royal Bank of Canada* 1982 2 All E.R

*United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank* 1985 2  
Lloyd's Rep

*Vitrorefuerzos S.A. and Banco Continental S.A.* 1979 1 Lloyd's Rep

*Vereins und Westbank AG v Veren Investments and Others* 2000 4 SA (W)

*W J Alan & Co Ltd v El Nasr Export and Import Co* 1972 2 QB

### ***International instruments***

*Uniform Customs and Practice for Documentary Credits* 600 (2007)

*Uniform Customs and Practice for Documentary Credits* 500 (1993)

*United Nations Convention on Independent Guarantees and Standby Letters of Credit*  
(1996)

### ***Internet sources***

Desmit 2015 <http://blog.lawdepot.com>

Desmit K 2015 *Letters of Credit as a Payment Instrument.*

<http://blog.lawdepot.com> accessed 5 August 2016

Eker 2010 <http://www.letter of credit documents.html>

Eker O 2010 *Letters of Credit Documents in an International Trade Transaction.* <http://www.letter of credit documents.html> accessed 6 August 2016

Islam 2008 <http://dspace.daffodilvarsity.edu>

Islam M 2008 *Statistics on Letters of credit fraud.*

<http://dspace.daffodilvarsity.edu> accessed 18 September 2016