

# The effect of sanctions and sanctions clauses in letters of credit on the independent nature of these instruments

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## **DEDICATION**

I dedicate this study to my parents, Gerrie en Stella Botes. I am eternally grateful for the continuous motivation and unwavering faith you have had in me throughout my life. Without your wisdom and support, I would never have joined the legal fraternity.

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## **ABSTRACT**

Two essential principles of letters of credit are autonomy and stringent compliance. Autonomy describes letters of credit as being distinct from and unrelated to the underlying agreement between the parties. The underlying purchase agreement between the parties does not apply to a letter of credit because it is a contract based on the delivery of papers. Therefore, banks are generally only allowed to refuse payment on the submission of fraudulent conforming documents that relate to letters of credit. According to the "strict compliance" principle, banks have the power to reject documents if they do not strictly abide by the terms noted on the letter of credit. Upon presentation of conforming documents, the credit must accordingly be paid.

Letters of credit are normally provided by commercial banks that have to protect their interests. Targeted financial sanctions interfere with the aforementioned free flow of money and certainty of payment, since banks may be prohibited from making or processing payments in transactions involving targeted individuals, companies or vessels. As such, targeted financial sanctions are severely detrimental to both international trade and to the interests of the banks.

Sanction clauses have emerged as a way for banks to protect their interests when issuing letters of credit and independent guarantees. In protecting their interest, the issuing bank normally makes use of an extremely broad sanction clause, for example:

XXX Bank complies with the international sanction laws and regulations issued by the United States of America, the European Union and the United Nations (as well as local laws and regulations applicable to the issuing branch) and in furtherance of those laws and regulations, XXXX Bank has adopted policies which in some cases go beyond the requirements of applicable laws and regulations. Therefore, XXX Bank undertakes no obligation to make any payment under, or otherwise to implement, this letter of credit (including but not limited to processing documents or advising the letter of credit), if there is involvement by any person (natural, corporate or governmental) listed in the USA, EU, UN or local sanction lists, or any

involvement by or nexus with Cuba, Sudan, Iran or Myanmar, or any of their governmental agencies.<sup>1</sup>

Sanction clauses are designed to protect banks in the event of payment being blocked by targeted financial sanctions. Wording such clauses broadly will have a significant and negative effect on the foundational principles of irrevocability and independence of letters of credit. This would undermine the essential principles of letters of credit. Sanctions are prohibitions instituted by an individual country or a group of countries, or the UN Security Council. Being a United Nations member prohibits Member States from conducting business with countries against whom sanctions have been instituted. Most countries have restrictive legislation that adds to this.

The most recent sanctions issued against Russia as a result of its invasion of Ukraine, had a detrimental effect on international trade in such a way that exports from sanctioning countries to Russia have declined by 60% and non-sanctioning countries by 40%.<sup>2</sup>

A further effect of sanctions against Russia is that certain banks have stopped issuing letters of credit relating to the trade of crude oil with Russia and any sanctions that are specifically focussed on the Russian energy sector could prevent payment in this regard.<sup>3</sup>

Against this background the research question asks how sanctions and sanction clauses affect the role and status of letters of credit in trade financing, with a special focus on their effect on the independence and the irrevocable nature of these instruments.

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<sup>1</sup> Dass, Chan and Zee 2020 <https://www.mondaq.com/export-controls-trade-investment-sanctions/949022/sanctions-clauses-and-trade-finance-recent-further-guidance-from-the-international-chamber-of-commerce->

<sup>2</sup> Chorzempa 2022 <https://www.pii.com/research/piie-charts/sanctions-against-russia-are-also-hurting-its-trade-nonsanctioning-countries>.

<sup>3</sup> Iordache and Todd 2022 <https://www.argusmedia.com/en/news/2305307-some-banks-not-giving-credit-letters-for-russian-oil>.

This study aims to answer the research question by considering the historic development of letters of credit into the known modern-day letter of credit. Thereafter, the study ventures into modern-day entities that provide for good governance and certainty in international trade relationships. Thereafter this study will venture into the incorporation and application of these entities in the South African legal sphere. This study further addresses the historical development of sanctions and how it is applied in modern-day engagements between various parties. This is followed by a consideration of the imposition of sanctions against South Africa and the effect thereof on international trade finance instruments. Then this study provides clarity on the view of the ICC relating to sanctions and answers the research question addressing it within the South African legal sphere.

**KEYWORDS:** Documentary credit; International payment instruments; International trade; Irrevocable; Letter(s) of credit; Sanction(s); Sanction clause(s)

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## **LIST OF ABBREVIATIONS**

ACFTA	African Continental Free Trade Agreement
BRICS	Brazil, Russia, India, China and South Africa
CISG	United Nations Convention on Contracts for the International Sale of Goods
EU	European Union
eUCP	Supplement to the Uniform Customs and Practice for Documentary Credits for Electronic Presentation
FAO	Food and Agriculture Organization
FIC	Financial Intelligence Centre Act 38 of 2001
GDP	Gross domestic product
ICC	International Chamber of Commerce
IMF	International Monetary Fund
INCOTERMS	International Contract Terms
ISBP	International Standard Banking Practice
SACU	Southern African Customs Union
SADC	Southern African Development Community
UCC	Uniform Commercial Code of the United States
UCP	Uniform Customs and Practices for Documentary Credits
UN	United Nations
UNCIO	United Nations Conference of International Organization
UNESCO	Educational, Scientific and Cultural Organization
UNHCR	United Nations High Commissioner for Refugees
UNICTRAL	United Nations Commission on International Trade
UNIDROIT	International Institute for the Unification of Private Law

UNRRA	United Nations Relief and Rehabilitation Administration
US	United States of America
USA	United States of America
WHO	World Health Organization
WTO	World Trade Organization
WWI	World War I
WWII	World War II

# **Chapter 1 Historical overview of the development of international trade finance instruments, specifically letters of credit**

## ***1.1 Introduction***

The inherently global character of trade transactions poses challenges and risks for the parties involved in these transactions. Secure payment and simultaneous delivery of goods are not possible as the parties involved in the transaction, are normally continents away from each other.

On the one hand the beneficiary has to be certain that he/she will receive payment for the goods and or services delivered, and on the other hand the buyers have to be certain that they will indeed receive the products and/or services they made payment for.<sup>4</sup> The development of letters of credit over the years was greatly influenced by the necessity for a safe payment method in the international arena.

The need to ensure secure payment contributed to the development and use of letters of credit between bankers and merchants. This essentially had the effect that letters of credit were a commercial device rather than a legal device.<sup>5</sup>

It is important to have an understanding of the history of letters of credit as this comprehension explains how the irrevocable character of letters of credit developed through the centuries and how this irrevocable nature has been incorporated into modern day letters of credit and the important role it plays.

## ***1.2 Definition of letters of credit***

Letters of credit as defined in the simplest terms possible, is a written assurance given by a bank (or other issuer) at the request of a client that the issuer will honour

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<sup>4</sup> Sharrock (ed) *The Law of Banking and Payments* 395. See the definition paragraph of letters of credit below for a more detailed description.

<sup>5</sup> Hugo *The Law Relating to Documentary Credits* 1.

draughts or other payment requests as long as the party drawing the draughts or making the payment demand abides by the terms stated in the letter of credit.<sup>6</sup>

The most popular and frequent payment method used in payment for goods in export trade is a letter of credit,<sup>7</sup> which British justices have referred to as "the lifeblood of global trade".<sup>8</sup>

Transactions involving letters of credit are about keeping records. In other words, when a bill of lading is used to represent products, it serves as a means of funding the transaction.<sup>9</sup>

According to Lord Wright, a letter of credit serves to rain money on papers to pass the time between when the paperwork is received and when it is paid for. This a typical practice in international trade.<sup>10</sup>

The ICC addresses the significance of preserving the security of letter of credit payments by integrating the irrevocability of letters of credit in the UPC in Article 2 and Article 3.

Article 2 (definition clause) refers to the definition of credit in relation to any contract, whether it be titled or described, and refers to as a letter of credit if it gives the issuing bank a final commitment to honour a compliance presentation.

Article 3 refers to credit being irrevocable, even if there is no indication to the contrary.<sup>11</sup>

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<sup>6</sup> Murray 1975 *The Business Lawyer* 1103.

<sup>7</sup> D'Arcy, Murray and Cleave "Schmitthoff's Export Trade" 166.

<sup>8</sup> *Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 145–155; *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1982] QB 208–222.

<sup>9</sup> D'Arcy, Murray and Cleave "Schmitthoff's Export Trade" 166–167.

<sup>10</sup> *TD Bailey, Son & Co v Ross T Smyth & Co Ltd* (1940) 56 TLR 825–828.

<sup>11</sup> Uniform Customs and Practices for Documentary Credit (2007).

### **1.3 Letter of credit from ancient times**

Although it is widely acknowledged that letters of credit, in their current form, was created in the nineteenth century,<sup>12</sup> various instruments preceded and aided in the development of letters of credit.

The first traces of instruments resembling letters of credit can be found dating back to 3000 BC in ancient Babylon and Egypt. During these times, something akin to a letter of credit ensured payment between parties with the use of a rudimentary form of trade instrument.<sup>13</sup> A Babylonian clay promissory note, now held in the University Museum of Philadelphia clearly indicates the repayment of principal and interest on a specific date.<sup>14</sup> Another clay tablet was found, dating back to 2100 BC, which indicates an amount payable to the bearer and a promise of payback in the form of a cash loan.<sup>15</sup>

In ancient Greece, the functions of banks were, *inter alia*, to prepare instruments resembling letters of credit in some respects on behalf of correspondents, to avoid the actual translocation of animals to pay bills.<sup>16</sup> Merchant-bankers used forms akin to letters of credit freely during the fourteenth century in Florence, Genoa and Venice, although their functions were somewhat different.<sup>17</sup>

The aim of the merchants through the law merchant<sup>18</sup> was to revive the non-existent economical and commercial activities after the fall of the Roman Empire.

The law merchant's rules provided for the enforceability of an instrument akin to a letter of credit by the beneficiary "notwithstanding that no consideration passed between the beneficiary and the issuer, and also notwithstanding that the contract

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<sup>12</sup> Hugo *The Law Relating to Documentary Credits* 54.

<sup>13</sup> ICC 2016 <https://iccwbo.org/media-wall/news-speeches/letters-of-credit-lcs-recognizing-the-value-of-simple-trade-instruments/>.

<sup>14</sup> Trimble 1948 *Harvard Law Review* 982.

<sup>15</sup> Trimble 1948 *Harvard Law Review* 982-983.

<sup>16</sup> Trimble 1948 *Harvard Law Review* 984.

<sup>17</sup> Trimble 1948 *Harvard Law Review* 985.

<sup>18</sup> Alternatively referred to as the "*Lex Mercatoria*".

of the beneficiary (frequently a sale), which has given rise to the letter of credit, had been broken".<sup>19</sup>

#### **1.4 Twelfth to seventeenth century**

During the twelfth century, the church treasury facilitated periodic payments in Venice, Genoa and other areas in Europe. These payments were both negotiable and transferable. These periodic payments were necessary due to the danger of travelling with gold.

Long before the seventeenth century and throughout Europe (Milan, Bruges, Barcelona, Florence, Venice and Genoa), merchant-bankers were used to facilitate exchange. During this period, and until 1650, the bills of exchange from Northern-Italy were non-negotiable.<sup>20</sup>

#### **1.5 Letters of credit and the law merchant**

The law merchant was developed through the centuries with an international scope, first by custom and later law. The law merchant developed in such a way that it was referred to as the Middle Ages' private international law.<sup>21</sup>

It is evident that the instruments akin to letters of credit, governed by the law merchant, were first issued by wealthy merchants, later by churches that facilitated the transactions, then by private bankers, and ultimately by banks. The European civil law countries incorporated the law merchant into their legal systems with little difficulty. There was an initial reluctance by the common law to follow the law merchant explicitly. The mercantile principles were accepted by the beginning of the seventeenth century.

Originally, these instruments akin to modern-day letters of credit featured more in the mercantile sector than in the legal sector. They were bilateral arrangements

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<sup>19</sup> Trimble 1948 *Harvard Law Review* 986.

<sup>20</sup> Trimble 1948 *Harvard Law Review* 987-988.

<sup>21</sup> Holdsworth *A History of English Law* 526.

issued to persuade merchants to provide products or advance money to the affluent person's employees or agents, and wealthy or powerful people issued letters of promise of payment.<sup>22</sup> Merchants used instruments akin to letters of credit in a similar fashion and the proximity of the merchant network determined the reliability factor. Merchants and bankers also used these instruments akin to letters of credit for quite a while in the commercial sphere with an understanding of the business content and the business obligations that were created as a result of the issuing of a letter of credit. However, it is uncertain when legal rights and obligations developed into letters of credit.

The mercantile and legal sphere requires clarity with respect to the question: When do the rights and duties entrenched in a letter of credit become applicable? Is it by means of agreement upon issue of the letter of credit or later in the lifetime of the letter of credit; or is the letter of credit an offer that subsequently becomes an agreement; or does the letter of credit amount to representation that creates a legal right by estoppel when acted on?

The constant and regular use and the large amounts and high risks involved in the use of letters of credit necessitates investigation and certainty within the legal sphere.

Three centuries passed after the Norman Conquest for England's merchant law to develop, until it was finally enforced by the Admiralty Courts.<sup>23</sup>

In the *Pillans and Rose v Van Mierop and Hopkins*<sup>24</sup> matter, the Court provided a view on the challenges experienced by the common law judges where they had to justify the enforcement of letters of credit in accordance with the law merchant. The enforceable and irrevocable nature of letters of credit, in line with the law merchant, was upheld in this leading and watershed judgement.

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<sup>22</sup> Miller 1959 *U III LR* 162-163; Leon 1986 *Maryland Law Review* 433.

<sup>23</sup> Trimble 1948 *Harvard Law Review* 987.

<sup>24</sup> *Pillans and Rose v Van Mierop and Hopkins* 97 Eng Rep 1035 (KB 1765).

The facts of this case are as follows:

The Irish merchant (White) wanted the plaintiffs (Pillans and Rose) to accept a bill that he had drawn. The plaintiffs, however, required a credit that had been confirmed by a house in London. The merchant informed the plaintiffs that they will be reimbursed by him, through credit on the defendants. The plaintiffs honoured the draft, whereafter they engaged with the defendants to enquire if they will honour the plaintiffs' drafts (which were based on the credit provided by White to the amount of £800) upon which the defendants replied positively.

White became insolvent and on this basis the defendants declined the draw from the plaintiff on them on the basis that they may revoke White's credit before receipt confirmation.

The Court eventually ruled that the communication that took place between the plaintiff and the defendant constituted a letter of credit, and the defendants were ordered to pay the plaintiff.

The judges discussed

- (i) Principles of law governing the enforcement under Roman law of certain promises in writing and, under the common law, of promises 'for the debt of another';
- (ii) The fiction that the beneficiary or the payor had goods or credit in his hands, or would have them, belonging to White;
- (iii) The irrevocability of the defendants' undertaking on grounds in the nature of those for an estoppel; and
- (iv) An agreement to accept a bill of exchange as constituting an actual implied acceptance.

They all agreed that the promise contained in the defendants' testimony could be enforced in this business or commercial transaction without regard for the common law principles controlling the review.<sup>25</sup>

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<sup>25</sup> Trimble 1948 *Harvard Law Review* 990.

## ***1.6 After World War I***

The ICC was responsible for the development and optimisation of the modern form of letters of credit after WWI. This is discussed in detail in Chapter 2.

## ***1.7 Conclusion***

As indicated above, the importance of instruments akin to modern-day letters of credit has been central in international trade amongst merchants since the earliest times. During the development of letters of credit, its irrevocable nature has been ingrained as an inherent part that the characteristics of letters of credit consist of as it ensures certainty of payment.

Modern-day letters of credit have emerged and developed extensively in the aftermath of WW I. This is discussed further in Chapter 2 of this study. This development has continued over recent decades and their irrevocability has been reinforced by the courts.

However, letters of credit should be developed continuously to facilitate the international sale and movement of goods without losing the inherent characteristics of being irrevocable.

In summary, understanding the development and incorporation of the irrevocable characteristics of letters of credit gives clarity and better comprehension of the danger posed relating to anything that might impact on this irrevocable nature as well as why it is of extreme importance that this irrevocable nature must be protected in modern-day engagements utilizing letters of credit.

## **Chapter 2 The role of the International Chamber of Commerce and its responsibility to develop and promote consistent and uniform rules for trade finance instruments**

### ***2.1 Introduction***

The ICC is the largest private organization that impacts and regulates international trade through its various generally accepted and followed practices and therefore plays an important role to ensure uniformity within the international trade sphere.

For this reason, it is of the utmost importance to dedicate a chapter of this research study to provide insight into the history and development of the ICC.

### ***2.2 A history of the International Chamber of Commerce***

The aftermath of WW I left the economic world without any generally accepted rules to govern trade, finance, investment, and commercial relations between countries. The twelve founding members of the ICC, who went by the moniker "The Merchants of Peace", established the organisation at a meeting in Paris, France in 1919.<sup>26</sup> These merchants of peace acted based on the conviction that good trade relations contribute towards world peace, and those global rules and standards are best developed by the private sector and not by governments. Some milestones in its history are:<sup>27</sup>

1919 – Founding and establishment of the ICC.

1933 – The first set of the UCP is published by the ICC.

1936 – The first edition of the Incoterms rules is published by the ICC.

1944 – The ICC represents business at the Bretton Woods Conference where the proposal for establishing an international trade organisation (governing rules and regulations for international trade) was tabled.

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<sup>26</sup> ICC 1919 <https://iccwbo.org/about-us/who-we-are/history/>; Hugo 2017 *SALJ* 1.

<sup>27</sup> ICC 1919 <https://iccwbo.org/about-us/who-we-are/history/>.

1945 – The ICC forms part of the Conference of International Organizations (UNCIO) that drafted the UN Charter. The ICC was the only private sector organisation that was accredited to participate.

1977 – The ICC issues anti-corruption rules as the first business organisation to do this.

2015 – The ICC Academy is launched to focus on global trade-related education and co launches the Global Alliance for Trade Facilitation.

2016 – Observer status granted to the ICC at the UN General Assembly.

### ***2.3 Functions of the ICC***

As an international private organization, the ICC represents more than 45 million enterprises in more than 100 countries,<sup>28</sup> which focus on the drafting of standardized rules applicable to international trade.<sup>29</sup>

The mission of the ICC is to encourage ethical conduct and global regulatory strategy by promoting international commerce, and excellence as achieved through promoting global commerce and investment as a catalyst for inclusive development and prosperity and combining its worldwide influence with their special skills in advocacy, standard-setting activities, and international services to its members.<sup>30</sup>

The ICC place focus on the following, to reach its mission and to live out its values: namely the requirements of any stakeholder involved in international trade transactions, and it serves as a bridge between the private and the public sectors of the economy or the long history of formulating and developing rules for international commerce that business and international commerce role players voluntarily follow.

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<sup>28</sup> ICC 2022 <https://iccwbo.org/about-us/who-we-are/>.

<sup>29</sup> Hugo 2017 *SALJ* 5.

<sup>30</sup> ICC 2022 <https://iccwbo.org/about-us/who-we-are/our-mission/>.

One of the core values of the ICC is to enable business to ensure everyone has access to opportunity, wealth, and peace.<sup>31</sup> In 2018 the ICC identified six focus areas<sup>32</sup> to emphasize their focus and commitment towards world peace. It is important to note that these focus areas represent their initial founding ideals to their modern aims. These six focus areas further emphasize and contribute to the UN Global Goal 16, Peace and Justice.

These six focus areas are:<sup>33</sup>

1. Working as merchants of peace
2. Promoting Global goals for peace
3. Taking a stand against protectionism
4. Recognising business-worthy leaders
5. Resolving commercial disputes
6. Employing a global workforce<sup>34</sup>

## ***2.4 Structures of the International Chamber of Commerce***

Governance of the ICC is affected by the World Council, Executive Board, International Secretariat and the Finance Committee. These are further broken down into work groups of which Banking and Finance and the ICC Commercial Crime Services have relevance to this research paper.

## ***2.5 Rules developed by the ICC***

### *2.4.1 UCP for documentary credits*

#### 2.4.1.1 The UCP definition of documentary credit

In an international transaction, a documentary credit is created when the Buyer instructs the bank to issue a letter of credit to the Seller. The Bank agrees to pay

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<sup>31</sup> ICC 2022 <https://iccwbo.org/about-us/who-we-are/our-values/>.

<sup>32</sup> ICC 2018 <https://iccwbo.org/media-wall/news-speeches/6-ways-icc-championing-peace/>.

<sup>33</sup> ICC 2018 <https://iccwbo.org/media-wall/news-speeches/6-ways-icc-championing-peace/>.

<sup>34</sup> ICC 2018 <https://iccwbo.org/media-wall/news-speeches/6-ways-icc-championing-peace/>.

the Seller in accordance with the provisions of this letter of credit following receipt of the shipping documents listed therein.<sup>35</sup>

Hugo<sup>36</sup> refers to documentary credit as a type of payment that is frequently used in international trade. In essence, this means that, upon the receipt by the beneficiary of specific documents, for example a bill of lading, commercial deed, etc., from the bank acting on the client's behalf (in this case, a local buyer) (e.g. foreign seller), the independent promise will effect payment of the specific amount noted on the promise. The reason for its popularity is because it is acknowledged as a fairly safe form of payment.

In Article 2 the UCP<sup>37</sup> defines credit as a contract that is irrevocable and creates a clear commitment on the part of the issuing bank to honour a complying presentation, regardless of its name or description.<sup>38</sup>

#### 2.4.1.2 History of the UCP

After the WW I period, letters of credit have become more popular and widely used, which aided in the modern-day development of letters of credit.<sup>39</sup> This period was also characterized by economic instability which led to the need to rely on security in the form of documentary credits.<sup>40</sup>

This period was characterised by the fact that each bank had different objectives and execution models of documentary credit issued and there was no standard form or regulations utilized in the governing of documentary credits.<sup>41</sup>

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<sup>35</sup> Ellinger 2007 *Lloyd's Maritime and Commercial Law Quarterly* 152; Hugo 2002 *SALJ* 101; Van Niekerk and Schulze *The South African Law of International Trade* 262; Sharrock (ed) *The Law of Banking and Payments* 395.

<sup>36</sup> Hugo 2000 *SALJ* 224.

<sup>37</sup> Uniform Customs and Practices for Documentary Credit (2007).

<sup>38</sup> Uniform Customs and Practices for Documentary Credit (2007).

<sup>39</sup> Paragraph 1.6 above.

<sup>40</sup> Hugo *The Law Relating to Documentary Credits* 79.

<sup>41</sup> Hugo *The Law Relating to Documentary Credits* 80.

During the 1930s, the ICC established the global rules for documentary credits, which are currently the most widely used and most successful privately drafted trade rules ever developed.<sup>42</sup>

In 1933 the initial version of the UCP was accepted and issued in Vienna,<sup>43</sup> which was called the UCP 82. This followed an American initiative to unify the past commercial letters of credit regulations approved and published by international banking organisations.<sup>44</sup> However, the UCP 82 was only introduced into the Belgian and French banking practices. The other countries accepted the UCP 82 but confirmed that it would only be implemented once certain amendments had been made, for example with respect to business use and the practice of sea, railway, and inland navigation carries and insurance. After amendment the UCP 82 became "an equitable basis for commercial documentary credit transactions, capable of general application in all countries".<sup>45</sup>

Subsequently, several updated versions have been developed and published in line with the demands and specifications of trade and business and to ensure that it reflects banking practices. They are: 1951 - UCP 151, 1962 - UCP 222, 1974 - UCP 290, 1983 - UCP 400, 1993 - UCP 500 and the latest version, UCP 600 in 2007 and the eUCP (based on and incorporating the UCP 600).

The UCP as not through all of its development had any enforceable legal character. Under the English law, the UCP is only applicable through article 1,<sup>46</sup> when a party inserts the UCP into a contract;<sup>47</sup> as the UCP has no enforceable legal<sup>48</sup> or customary character. It is thus critical to understand that the parties need to include the UCP in the letter of credit because it cannot be enforced on its own.

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<sup>42</sup> Hugo *The Law Relating to Documentary Credits* 80; Hugo 2000 *SALJ* 224; Schulze 2009 *SA Merc LJ* 228.

<sup>43</sup> Hugo *The Law Relating to Documentary Credits* 87.

<sup>44</sup> Uniform Customs and Practice for Commercial Documentary Credit (1938).

<sup>45</sup> Uniform Customs and Practice for Commercial Documentary Credit (1938); Wheble 1970 *Cornell Int'l LJ* 97-98.

<sup>46</sup> UCP 600, [2007] ICC Publication no. 600.

<sup>47</sup> D'Arcy, Murray and Cleave "Schmitthoff's Export Trade" 168.

<sup>48</sup> *Royal Bank of Scotland v Cassa di Risparmio delle Province Lombard* [1992] 1 Bank LR 251.

Article 1 of the UCP<sup>49</sup> speaks to how the UCP is applied and stipulates that the letter of credit need to specifically states that these regulations apply. Such letter of credit needs to specifically state that the Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600 ("UCP") will apply. Rules for letters of exchange ("credits") include, where applicable, standby letters of credit. Unless specifically changed and excluded by the credits, they are enforceable by all parties.<sup>50</sup>

The success of the UCP is further characterized by the voluntary and wide implementation by countries with extremely diverse judicial and economic systems.<sup>51</sup>

#### *2.4.2 Modern-day application of the UCP*

One of the highest risks of any international trade transaction is that of ensuring payment security. The parties engaged in the transaction typically have distinct banking procedures and municipal rules, which further complicates things.

The ICC has alleviated this challenge through the publication of the UCP, by creating generally accepted principles that standardized the banking practices between various countries.<sup>52</sup>

Most modern-day agreements incorporate the UCP into their terms which is consistent with national regulations and international banking standards to prevent conflicts and advance the orderly and effective conduct of international trade.<sup>53</sup>

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<sup>49</sup> Article 1, UCP 600, [2007] ICC Publication no. 600.

<sup>50</sup> Article 1, UCP 600, [2007] ICC Publication no. 600.

<sup>51</sup> Foreword, UCP 600, [2007] ICC Publication no. 600.

<sup>52</sup> Schulze 2009 *SA Merc LJ* 230.

<sup>53</sup> Schulze 2009 *SA Merc LJ* 230.

## **2.5 Additional development by the ICC relating to letters of credit**

The UCP is not the only work by the ICC that addresses letters of credit. The ICC also issued the following in addition to the UCP:<sup>54</sup>

1. Standard Forms.
2. International Standard Banking Practice.

The ISBP focuses on providing clarity and explanation with regard to the rules listed in the UCP and indicates how to interpret certain clauses of the UCP.

The UCP also refers to the ISBP in Article 2: Definitions as follows:

The word "compliant presentation" refers to a presentation that meets the credit requirements, the relevant rules, and global banking standards.<sup>55</sup>

3. Opinions relating to enquiries received by the Banking Commission.

These publications are compiled by experts and thus are not legally binding although they provide clarity about the interpretation and execution of the UCP.<sup>56</sup>

## **2.6 Conclusion**

The aftermath of WW I left the international economic world in tremendous turmoil, without any generally accepted economic engagement rules. This uncertainty aided in the development of a uniform international set of rules that secure payment using letters of credit. This vision of the founding members of the ICC is the single biggest influencer of the modern-day international economic engagement and payment security within the international trade sphere. The ICC has created and continues to refine the UCP, together with other explanatory publications, which regulate and provide clarity relating to letters of credit. The development of the eUCP clearly

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<sup>54</sup> Hugo 2017 *SALJ* 13.

<sup>55</sup> UCP 600, [2007] ICC Publication no. 600.

<sup>56</sup> Hugo 2017 *SALJ* 13.

indicates that the ICC places a high value on keeping current with technological developments utilized within the international trade sphere.

The UCP is one of the biggest success stories involving a private organization, as it is characterized by the voluntary implementation by countries with extremely diverse judicial and economic systems.

The establishment of the ICC and the general acceptance and incorporation of its publications and practices into both local legislation and custom by the role players within international trade transactions, therefore, makes it of the utmost importance towards this research study.

Effective research into the impact of sanctions on the irrevocable nature of letters of credit can therefore only be conducted once the reader understands the history and importance of who was responsible for the creation of the UCP; where the UCP originated from; why it was developed, as addressed in this chapter.

## **Chapter 3 The influence of the development, incorporation and implementation of ICC rules, specifically focussing on letters of credit, applicable to the South African legal and banking sphere**

### ***3.1 Introduction***

South Africa is a member of, to name but a few, the WTO, ACFTA, G20, SADC, SACU and BRICS and therefore an important role player within the international trade community.

With reference to Chapter 1 above, letters of credit are the most common way in which exporters pay for their goods<sup>57</sup> and taking into account that South Africa is an important role player in the international commerce community, it is important to investigate the incorporation of the ICC rules relating to letters of credit into South African legislation and the implementation of the ICC regulations within the South African legal and banking sphere.

In the 1993 case of *Ex Parte Sapan Trading (Pty) Ltd*,<sup>58</sup> Streicher J remarked with reference to documentary credits that "the topic has received very little attention" in South Africa despite a large body of foreign legal material.<sup>59</sup>

This situation has changed and since the *Ex Parte Sapan* verdict, documentary credits have been the main subject matter of various reported decisions (one of which was from the Court of Appeal),<sup>60</sup> a comprehensive textbook,<sup>61</sup> a doctoral

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<sup>57</sup> D'Arcy, Murray and Cleave "Schmitthoff's Export Trade" 166.

<sup>58</sup> *Ex Parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W) at 224E.

<sup>59</sup> Hugo 2000 SALJ 224.

<sup>60</sup> *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A); *Union Carriage and Wagon Company Ltd v Nedkor Bank* 1996 CLD 724 (W).

<sup>61</sup> Oelofse *The Law of Documentary Letters of Credit* 434.

thesis<sup>62</sup> and several articles published mainly in the South African Mercantile Law Journal.<sup>63</sup>

The above had the effect that letter of credit were incorporated and have become part of the curriculum of several law faculties (although mainly at the LLM level) and have been a regular item on the agenda of the popular Annual Banking Law Update.<sup>64</sup>

### ***3.2 Fundamental principles of letters of credit***

The law that expresses the independence of the letter of credit and the idea of strict compliance serves as the cornerstones of letters of credit.<sup>65</sup>

#### *3.2.1 The independence of the credit*

The underlying agreement between the parties and the letter of credit are separate from one another, which serves as the foundation for the independence principle. The only thing that matters to the bank that processes the credit is if the seller's given documents match those specified in the instructions.<sup>66</sup>

#### *3.2.2 The doctrine of strict compliance*

In 1927 the English courts stipulated that strict compliance define that when the bank follows the instructions listed, to the tee, it should be relatively safe. It further entails that no alternative document that is nearly as similar or functions the same will be accepted. In the event that the bank departs from this condition it will do so at its own peril.<sup>67</sup>

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<sup>62</sup> Hugo *The Law Relating to Documentary Credits* 1-356.

<sup>63</sup> Hugo *SA Merc LJ* 44; Hugo *SA Merc LJ* 143; Oelofse *SA Merc LJ* 56; Hugo *SA Merc LJ* 151; Oelofse 1996 *SA Merc LJ* 289; Geraghty 1999 *SA Merc LJ* 331.

<sup>64</sup> Hugo 2000 *SALJ* 224.

<sup>65</sup> D'Arcy, Murray and Cleave "Schmitthoff's Export Trade" 170.

<sup>66</sup> D'Arcy, Murray and Cleave "Schmitthoff's Export Trade" 170.

<sup>67</sup> Ramberg *International Commercial Transactions* 144.

The letter of credit's connection to another transaction is irrelevant to the bank. Only when the documents appear to be legitimate at first glance but are actually fake and the bank is confident that the beneficiary (seller) is complicit in the crime, may it refuse to pay the credit.<sup>68</sup>

Beneficiaries may feel that strict compliance regulations are harsh, but their application makes letter of credit transactions predictable and certain.<sup>69</sup>

### **3.3 Application of letters of credit in the South African context**

Where a treaty has been agreed and has come into force, the member states are encompassed by the conditions and terms of such treaty. The UCP is, however, not a treaty as it was developed by the ICC and not the UN (with specific reference to Chapter 2 above), which therefore has the effect that it should be specifically incorporated to take effect.

To date, South Africa has not enacted legislation to address documentary credits specifically, nor has it incorporated the UCP into legislation.<sup>70</sup> Since specific legislation regulating letters of credit has not been promulgated in South Africa, the legal relationship of the parties involved in letters of credit is governed by the general principles of the law of contract.<sup>71</sup>

The contract law in South Africa is known as proper law<sup>72</sup> that will govern the formation of the contract and reality of the agreement. The law that governs a contract can, in theory, be chosen by the parties either explicitly or implicitly.<sup>73</sup> Limitations apply to this general principle, for example, the mandatory rules of the *lex fori*.<sup>74</sup>

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<sup>68</sup> *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168 (HL).

<sup>69</sup> Kang 2008 *Asian Business Lawyer* 95.

<sup>70</sup> Van Niekerk and Schulze *The South African Law of International Trade* 261.

<sup>71</sup> Van Niekerk and Schulze *The South African Law of International Trade* 261.

<sup>72</sup> Forsyth *Private International Law* 274.

<sup>73</sup> Fredericks and Neels 2003 *SA Merc LJ* 64.

<sup>74</sup> *Herbst v Suri* 1991 2 SA 75 (Z); *Henry v Branfield* 1996 1 SA 244 (D) at 249E-F.

Various parties are involved over the lifespan of a letter of credit. At least three different types of contracts are involved, namely:

The first is the fundamental sales agreement between the buyer and seller, which specifies that payment under the terms of the agreement must be made by letter of credit. The buyer (letter of credit applicant) and the bank giving the credit (issuing bank) enter into a second agreement, namely a mandate agreement. The third agreement is between the seller and the issuing bank (the beneficiary in the letter of credit sense).<sup>75</sup>

The commercial banks in South Africa have, through their banking organizations, accepted and incorporated the UCP as a general condition contained in their issuing of letters of credit to ensure application of the UCP on letters of credit. This is due to the fact that the UCP in itself does not possess any legal standing on its own as it is not an international treaty.

In the unlikely event that the parties fail to expressly incorporate the UCP into the agreements between them, the UCP shall only apply if it can be proven to form part of the *naturalia* of the agreement. The South Africa courts have been relying on international judgements to provide guidance in the establishment of *dicta* in the South African legal sphere.

In South African courts, fraud committed by beneficiaries is a recognized exception to the rule of independence. This is evident from the various judgements that cite and follow *United City Merchants (Investments) Ltd v Royal bank of Canada*.<sup>76</sup> Examples from the South African courts include *Union Carriage & Wagon Co Ltd v Nedcor Bank Ltd*,<sup>77</sup> *Loomcraft Fabrics CC v Nedbank Ltd*<sup>78</sup> and *Phillips v Standard Bank of South Africa Ltd*<sup>79, 80</sup>

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<sup>75</sup> Van Niekerk and Schulze *The South African Law of International Trade* 259.

<sup>76</sup> *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168 (HL).

<sup>77</sup> *Union Carriage & Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) at 731-732.

<sup>78</sup> *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A) at 816A.

<sup>79</sup> *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W) as 303D-I.

<sup>80</sup> Hugo 1993 *SA Merc LJ* 59.

The South African courts are likewise not reluctant to implement the UCP. In *Vereins-und Westbank AG v Veren Investments*,<sup>81</sup> the court specifically states that the letter of credit is governed by and in compliance with ICC Publication 400, Revised 1983: Uniform Customs and Practices of Documentary Credits.<sup>82</sup>

It is further important to take a look at the provisions of the Constitution.<sup>83</sup> Section 232 of the Constitution incorporates customary international law enforceable in the Republic unless it conflicts with the Constitution or an Act of Parliament.

In contrast to obligations derived from formally stated treaties and agreements, customary international law refers to obligations originating from long-standing international practice. Customary international law results from repeated, common practices by states that they uphold as a matter of duty.<sup>84</sup>

Through the incorporation of customary international law into the Constitution, one can regard that the Constitution have the aim to incorporate the ICC's rules and practices into the day-to-day engagement between parties.

### **3.4 Conclusion**

No legislation specifically addressing the application of letters of credit or the incorporation of the UCP has to date been enacted in South Africa. However, this is not to say that South Africa has failed to use letters of credit or give effect to the UCP.

Through the Banking Association South Africa, the commercial banks in South Africa have accepted the application of the UCP and the legal fraternity has accepted its incorporation through adherence to the general rules of contract.

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<sup>81</sup> *Vereins-und Westbank AG v Veren Investments* 2000 4 SA 238 (W).

<sup>82</sup> Hugo 2001 *SA Merc LJ* 594.

<sup>83</sup> *Constitution of the Republic of South Africa*, 1996.

<sup>84</sup> LII 2022 [https://www.law.cornell.edu/wex/customary\\_international\\_law](https://www.law.cornell.edu/wex/customary_international_law).

In the early days, the South African courts relied heavily on international judgements until such a time that the *dicta* in the South African legal sphere has been established for example *Vereins-und Westbank AG v Veren Investments*.<sup>85</sup>

Giving effect to and incorporating the UCP into the general day-to-day engagements and letters of credit, the South African banks clearly indicate the importance given to the ICC rules and trade practices in relation to trade transactions. This clearly indicates the weight that the South African banking sector attaches to the irrevocable nature of letters of credit.

The importance of international customary law is so highly regarded by the South African legislature that it was given effect through the incorporated if it into the Constitution of South Africa.<sup>86</sup>

It is important for this study to indicate that the South African legal and banking sphere regards the rules of the ICC, especially the UCP, as important as this is a fundamental element that governs letters of credit.

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<sup>85</sup> *Vereins-und Westbank AG v Veren Investments* 2000 4 SA 238 (W).

<sup>86</sup> Section 232 of the Constitution of the Republic of South Africa, 1996.

## **Chapter 4 Historical overview of the development, application, and impact of sanctions, inclusive of the different types of sanctions**

### ***4.1 Introduction***

Section 4.2 below defines sanctions as an official directive that restricts trade with a specific country and or person.

Chapter 4 ventures into the development, application and impact of sanctions as well as the different types of sanctions to create an understanding of the impact of sanctions on the irrevocable nature of letters of credit.

To establish this understanding, it is crucial to understand how and why sanctions were first created, the development of such into modern-day sanctions and the impact of sanctions on the party against whom sanctions were instituted.

### ***4.2 Definition of sanctions and embargoes***

There are two distinct concepts in the international sphere that relate to limitations or prohibitions, namely sanctions and embargoes. Despite the frequent confusion between these two ideas, they each have a distinct meaning.

The Oxford dictionary defines them as follows:

Sanction (noun) – an official order that limits trade, contact, etc., with a particular country, in order to make it do something, such as obeying international law.<sup>87</sup>

Embargo (noun) – an official order that bans trade with another country.<sup>88</sup>

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<sup>87</sup> Oxford Learner's Dictionaries 2022 [https://www.oxfordlearnersdictionaries.com/definition/english/sanction\\_1](https://www.oxfordlearnersdictionaries.com/definition/english/sanction_1).

<sup>88</sup> Oxford Learner's Dictionaries 2022 [https://www.oxfordlearnersdictionaries.com/definition/english/embargo\\_1](https://www.oxfordlearnersdictionaries.com/definition/english/embargo_1).

### ***4.3 Development of sanctions through the centuries***

#### *4.3.1 First traces of sanctions and embargoes*

The first evidence of embargoes dates back to 432 BC. The Athenian empire issued the Megarian Decree, which instituted economic embargoes on Megara.<sup>89</sup> The Decree was issued in reaction to the fact that the farmers of Megara farmed on holy land and the effect of the Decree was that the merchants of Megara were prohibited and excluded from the markets and harbours in the Athenian empire.

Between 232 and 225 BC the Gauls were subject to a trade embargo by the Romans, forbidding anybody (Romans and non-Romans) to trade in gold or silver with the Gauls.

#### *4.3.2 Sanctions and embargoes during the sixteenth century*

Trade embargoes and economic sanctions were used during the sixteenth-century religious wars in Europe to protect Christian minorities to ensure compliance with treaty obligations. In 1531 Zurich led Swiss protestant cantons in prohibiting the sale of salt, wine, flour and wine to the catholic cantons due to a breach by the catholic cantons of their obligations noted in the First Kappel Peace Treaty of 1529.<sup>90</sup>

#### *4.3.3 Pacific blockades in the nineteenth century*

Economic sanctions in the form of export controls were used in the late nineteenth century when there was a war. These economic sanctions, referred to as pacific blockades, played an important role during the nineteenth century. Normal blockades were distinguished from pacific blockades 1850 to differentiate between the peaceful pacific blockades and the blockades in a declared war situation. Pacific blockades aimed to deploy the navy of one nation or a coalition of nations to interrupt and obstruct trade at certain ports or along a coast where the countries

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<sup>89</sup> Lendering 2020 <https://www.livius.org/articles/concept/megarian-decree/>; Thucydides and Finley *History of the Peloponnesian War* 118–122.

<sup>90</sup> Alexander "The Origins and Use of Economic Sanctions" 8–9.

are not at war with each other. This later developed and became a way for countries with a much stronger military force to force countries or nations to pay their debt and resolve international disputes. It went as far as becoming "a measure of international police".<sup>91</sup>

In 1827 the first pacific blockade was reported during the Greek independence war. Greece fought Turkey for its independence. For purposes of blocking the Turkish and Egyptian armies, Russia, Britain and France sent their fleets to the Greek coast to prevent the Turkish and Egyptian forces from being reinforced and receiving supplies while they were fighting in Greece. Important to note here is that neither Russia, Britain nor France were at war with Turkey and although they entered into the pacific blockade without any instruction to engage in the battle, they retaliated when they came under fire from the Turkish forces.

What should have been a peaceful pacific blockade engagement, unfortunately resulted in the whole Turkish and Egyptian fleet being demolished and approximately 7000 men losing their lives during the Battle of Navarino.

Twenty-one pacific blockades were deployed between 1827 and WW I. The targeted countries of these pacific blockades were almost all small and underdeveloped countries in Europe, Asia and South America. The list of pacific blockades is as follows: Turkey, 1827; Portugal, 1831; Holland, 1832–1833; Colombia, 1834; Panama, 1837; Mexico, 1838; Argentina, 1838–1840; San Salvador, 1842; Nicaragua, 1842 & 1844; Argentina, 1845–1850; Greece, 1850; Sicily, 1860–1861; Brazil, 1862–1863; Bolivia, 1879; China, 1884–1885; Greece, 1886; Zanzibar, 1888–1889; Siam, 1893; Greece, 1886; Zanzibar, 1888–1889; Siam, 1893; Greece, 1897; Venezuela, 1902–1903. The countries that instituted the pacific blockades were Britain, 12 times; France, 11 times; Italy, 3 times; Germany, 3 times; Russia 2 times; Austria, 2 times; and Chile, 1 time. It is clear from this list that powerful states used this as a cost-effective weapon against smaller underdeveloped countries. These

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<sup>91</sup> Davis and Engerman 2003 *Journal of Economic Perspectives* 187–197.

powerful states mostly acted on their own, since only seven of the 21 blockades were combined blockades.<sup>92</sup>

#### *4.3.4 League of Nations*

After the founding of the League of Nations in 1919 and ratification by 42 nations, it officially came into being on 10 January 1920 after the Paris Peace Conference, which ended WW I. The legitimacy of pacific blockades and more generally sanctions was addressed by the member states in a much more formal manner and was incorporated into the Covenant.

Section 16 of the League's Covenant addressed sanctions in Article 16. It states in subsection 1 that any Member of the League who uses force against another Member of the League in violation of their obligations under Articles 12, 13, or 15 is deemed to have committed an act of war. In order to prevent public, commercial, or private sexual activity, it severed all financial and commercial ties, outlaws' interaction between its own citizens and citizens of the offending country, and outlaws all financial transactions between citizens of the offending country and citizens of other countries, notwithstanding membership to the League. On 5 October 1921, the Assembly accepted the amendment proposals that, with the exception of what is indicated, have been confirmed.

Any Member of the League who violated its obligations under Articles 12, 13, or 15 by going to war essentially declared war against all the other Members of the League. Member States agreed to bring those who were believed to have committed the act into quick submission. Whether or not they were members of the League, all trade and financial ties had to be severed, and all transactions between citizens of that country's territories and citizens of the offending country had to be prohibited. Additionally, the Member States had to forbid any financial, commercial,

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<sup>92</sup> Davis and Engerman 2003 *Journal of Economic Perspectives* 187–197.

or personal transactions between its citizens and citizens of any other country, even if those citizens considered themselves to be members of the League.

The General Assembly passed the above amendments on 27 September 1924, which replaced those made on 5 October 1921. These amendments stated that severing all commercial or financial ties between own citizens and citizens of the offending country, prohibiting any interaction between persons residing in his territory and persons residing in the territory of the offending country, and all commits immediately to the prevention of financial relations between such persons.

In the event where there was a breach of the agreement, the Council had the final say. When the Council evaluated this subject, the votes of the League Members who were said to have turned to war and the Members to whom such action was intended were not taken into account.

The dates on which it recommended the use of economic pressure under this Article were communicated by the Council to all Member States of the League.

However, in the case of some Member States, the Council could determine that delaying the implementation of these measures for a predetermined period of time would help accomplish the aforementioned goals or that delaying implementation would be necessary. This decision could be carried out if they wanted to cater for losses and lessen the trouble, caused to their members.

In certain situations, it was up to the Council to suggest to the Governments involved that the Member States of the League had to collectively contribute to the forces used to protect the covenants of the League through effective military, naval, or air power.

In these situations, the Council were responsible for advising the individual governments on how much military or naval force the League Member States had to collectively provide to the forces employed to defend the League.

The Member States of the League were also required to support one another financially and economically when taking actions in accordance with this Article and work together when the League took actions to lessen losses and inconveniences brought on by the aforementioned actions. In addition, they had to support one another in resisting exceptional measures and take the appropriate steps to thwart any alliance members who were cooperating to defend the alliance.

Through a Council vote supported by the representatives of all other League Members, any League Member who disobeyed the league agreement could be deemed no longer a member of the League.

The Soviet Union requested Finland to give up a number of critical positions on Finnish soil as well as any terrain that was supposedly under foreign possession and represented a threat to Leningrad's security in November 1939. Finland suggested looking into allegations related to the non-aggression agreement that the two nations signed on 21 January 1932, and which was valid until 31 December 1945. On 30 November, the Soviet Union unilaterally repudiated the treaty and launched an invasion of Finland. In accordance with Article 15 of the Convention, the Finnish government petitioned the League of Nations and requested that Parliament look into the situation. On 11 December, Congress convened, but the Soviets declined to go.

The Assembly declared on 14 December that the Soviet Union did not only fail to comply with its unique political arrangement with Finland, but also violated Article 12 of the League of Nations Agreement and the Paris Agreement via the aggression it perpetrated against Finland. The Soviet Union further failed to comply with one of the most essential accords of the League of Nations for the protection of national peace and security by declining to be present when the Article 15 dispute was being discussed.

In light of this, the Assembly suggested that "the Council should provide its judgement on this topic" and "what should be the outcome of this scenario" and decided that the Union of Soviet Socialist Republics "had been placed outside the

Union of Soviet Socialist States by its act" in accordance with Article 16, Paragraph 4 of the Agreement. The Union of Soviet Socialist Republics was thus expelled from the League of Nations. China, Greece and Yugoslavia abstained, while Iran and Peru were not present, but the resolution was unanimously approved.<sup>93</sup>

The League of Nations instituted sanctions in four instances during its existence. In 1921 it instituted sanctions against Yugoslavia, in 1925 against Greece, from 1932 to 1953 against Paraguay and Bolivia, and from 1935 to 1956 against Italy. Other European nations' resistance to the constraints imposed by the sanctions against Italy caused them to fail.

The League of Nations was dissolved on 8 April 1946 when the United Nations was established.<sup>94</sup>

#### *4.3.5 United Nations*

The League of Nations era came to an end when the majority of the world's superpowers quit the organisation and went back to their old defence arrangements and power blocs, but the League's efforts were not in vain.

The effort begun by the League was continued by the UN. The World Health Organization (WHO) was created from the health organisation. The Food and Agriculture Organization (FAO) evolved from the Food Commission. The Educational, Scientific, and Cultural Organization (UNESCO) was established in the place of the Intellectual Cooperation Committee. The Trusteeship Council has taken the position of the Standing Credentials Commission. The United Nations Relief and Rehabilitation Agency (UNRRA) and the United Nations High Commissioner for Refugees (UNHCR) provided funding for the activities of the Nansen Office.<sup>95</sup>

Chapter VII of the United Nations Charter provides for the Security Council to maintain and restore international peace and security. In accordance with articles

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<sup>93</sup> Fuller (ed) 1919 [https://history.state.gov/historicaldocuments/frus1919Parisv13/pg\\_88-91](https://history.state.gov/historicaldocuments/frus1919Parisv13/pg_88-91).

<sup>94</sup> UN (OG) 2022 <https://www.ungeneva.org/en/library-archives/league-of-nations/transition>.

<sup>95</sup> UN (OG) 2022 <https://www.ungeneva.org/en/library-archives/league-of-nations/organs>.

2(4), 39, 41, 42 and 43 of the UN Charter, sanctions can be used with or without the use of armed troops to ensure enforcement.<sup>96</sup>

The Security Council imposed sanctions five times between 1946 and 1990. These sanctions were directed at Iraq, North Korea, South Africa, Portugal and Rhodesia.

Between 1960 and 1990 individual countries imposed sanctions unilaterally. The United States of America (USA) was the front-runner in imposing sanctions. From the 1990s, the tendency changed from unilaterally imposed sanctions to intergovernmental coalitions imposing sanctions, with the United Kingdom (UK) playing a more active role in imposing sanctions.

#### ***4.4 Types of sanctions***

Sanctions have various forms depending on the outcome the imposer aims to achieve with the sanctions. Unilateral sanctions are those sanctions a single country institutes against another country. Multilateral sanctions come into being when a group of countries support instituting sanctions against a country. Export sanctions are sanctions that block goods from flowing into a country. Import sanctions are sanctions that block goods from leaving the country.

As listed above, sanctions can be instituted against a country as a whole or they can target specific industries, for example economic sanctions, military sanctions, diplomatic sanctions, sports sanctions, trade sanctions, political sanctions, sanctions on individuals, or sanctions protecting the environment.

#### ***4.5 The purpose and effect of sanctions***

In the early twentieth century, sanctions were imposed to disrupt military actions. However, the purpose of imposing sanctions has evolved and changed from efforts to disrupt military actions to a broader set of international goals, including preventing conflicts, advancing the realisation of liberty and democracy, preserving

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<sup>96</sup> UN OLA 2022 <https://legal.un.org/repertory/art41.shtml>.

the environment, enhancing human and labour rights, preventing the spread of nuclear weapons, releasing prisoners of war, and regaining occupied territories.<sup>97</sup>

Modern-day sanctions on goods in transit impacts the movement, harbouring, and refuelling of ships. The effect of this is that ships may be prohibited from accessing harbours and obtaining fuel for further sailing. The effect of this is that the shipment may not reach its end destination and therefore not deliver its cargo. Non-delivery will have the effect that the necessary papers required to pay on the presentation of the letters of credit will not be provided and therefore there will be no obligation on the parties involved in a trade relationship to effect payment.

A sanctioned person or company is typically prevented from accessing assets or property under its control or from acquiring financial services in relation to those monies or properties as a result of financial sanctions.<sup>98</sup>

#### **4.6 Conclusion**

Sanctions have developed through the centuries and have become an integral part of the interaction between various countries among themselves and of each country with the United Nations. This chapter made it clear that the major goal of sanctions and embargoes is to change the behaviour of governments, people, or organisations in the target country.<sup>99</sup> The United Nations, through the Security Council (Chapter VII)<sup>100</sup> has the power to recommend and or institute sanctions against countries.

Sanctions has such a devastating effect on all affected parties and if applied without any guidance, definitely affect the irrevocable nature of letters of credit.

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<sup>97</sup> Davis and Engerman 2003 *Journal of Economic Perspectives* 187–197.

<sup>98</sup> Hugo and Spruyt 2018 *TSAR* 249-250.

<sup>99</sup> Melyantsev 2016 <https://blog.tradewin.net/sanctions-and-embargoes>.

<sup>100</sup> UN OLA 2022 <https://www.un.org/en/about-us/un-charter/chapter-7>.

## **Chapter 5 Sanctions instituted against South Africa and their effect on the South African role players in international trade finance instruments**

### ***5.1 The history and effect of the sanctions the international community instituted against South Africa***

South Africa formed part of the original 51 members of the UN and has been a member ever since the organization's foundation in 1945.

From 1948 to 1993 South Africa adopted and adhered to apartheid policies. These policies enforced government-sanctioned racial segregation on the non-white majority. It involved economic and political discrimination against the non-white majority.

International calls to end apartheid gained dramatic support after the massacre at Sharpeville in 1960 where 69 unarmed black people were killed and 180 were injured.

The Sharpeville incident resulted in economic and military embargoes against South Africa. In November 1962, the UN passed Resolution 1761. This Resolution condemned the racist apartheid policies implemented by South Africa and it called on all the UN members to stop all economic and military relationships with South Africa.<sup>101</sup> However, it was a voluntary embargo.

Point 4<sup>102</sup> of the Resolution is especially important as it calls upon Member States to adopt the following actions, either singly or together, to change these policies in conformity with the Charter to sever or refuse to establish diplomatic ties with the South African government; to block harbour ports to all vessels displaying the South African flag; to pass legislation barring entry of national vessels into South African ports; to ban all South African products and stop from exporting any items, including

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<sup>101</sup> UN OLA 2022 [https://legal.un.org/repertory/art14/english/rep\\_supp3\\_vol1\\_art14.pdf](https://legal.un.org/repertory/art14/english/rep_supp3_vol1_art14.pdf).

<sup>102</sup> UN OLA 2022 [https://legal.un.org/repertory/art14/english/rep\\_supp3\\_vol1\\_art14.pdf](https://legal.un.org/repertory/art14/english/rep_supp3_vol1_art14.pdf).

weaponry and ammunition, to South Africa and to refuse any South African government-owned aircraft access to landing and flying facilities.

Although only a few of South Africa's top trading partners have called for complete military and economic embargoes, in 1973 the UN labelled apartheid as "a crime against humanity". A resolution called for a compulsory arms embargo against South Africa in 1977.

In 1986, South Africa's most important trading partners applied economic sanctions, and it appeared that the time had arrived to topple the apartheid administration through economic pressure.<sup>103</sup>

The economy of South African and sanctions were the subjects of a report by the Overseas Development Institute in 1986. The economy of South African and the effects of such global economic policies on hopes for future development were the main topics.<sup>104</sup>

The following are the internal repercussions of punishments that are covered in this paper:<sup>105</sup>

It is obvious that limiting South Africa's ability to attract foreign investment, finance, technology, and capacity, as well as limiting foreign trade, would have a lot of detrimental effects at home. Employment has declined, costs increased, and it has caused a lack of basic materials. Economic growth has generally slowed down, and investment and foreign exchange income has dropped. Some actions had a more dramatic and immediate effect than others for example the successful cutting off of the oil supply. The South African economy was severely harmed by the blockade of South African ports, the cessation of all access to international financing, and—

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<sup>103</sup> Hefti and Staehelin-Witt *Schweizerischer Nationalfonds* 1.

<sup>104</sup> ODI London 1986 <http://cdn-odi-production.s3-website-eu-west-1.amazonaws.com/media/documents/6704.pdf>.

<sup>105</sup> ODI London 1986 <http://cdn-odi-production.s3-website-eu-west-1.amazonaws.com/media/documents/6704.pdf>.

possibly most significantly—the coordinated central bank moves that result in a sharp decline in the price of gold.

In addition to these kinds of measures, the broader the variety of measures imposed (notably by South Africa's key economic partners), the larger and more immediate the resultant negative economic impact, particularly if alternative sources and marketplaces cannot be rapidly located.

International trade restrictions and embargoes were imposed by governments that dealt with South Africa more frequently, and many of its trading partners was actively exploring new ones. South Africa continued to be predominantly a commodity exporter and an importer of equipment, transport equipment, and finished goods despite its relative development. When this was evaluated, the possible effects of rising trade sanctions, significant considerations included the direction of the market and opportunities for moving suppliers and end markets.<sup>106</sup>

The sanctions imposed also had a significant impact on the South African financial sector.<sup>107</sup> The area of financial sanctions had the most significant effect on the South African economy. A harsher shock to the economy of South Africa than the possibility of trade sanctions came from the government, numerous semigovernmental entities, and the private sector seeing a significant rise in external debt during the last part of the 1970s and early 1980s. The IMF and overseas commercial banks, with the majority of the funds coming from the latter, were the key sources of capital inflows. These banks provided short-term loans instead of long-term lending because of the unpredictability that surrounded South Africa. Things were getting better. The short-term portion of total foreign debt increased from 29% to 41% between 1980 and 1984. There was a net influx of R6.9 billion to the government, municipal governments, and para-national institutions in the years 1980 to 1985 alone. South Africa's overall external debt by September 1985

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<sup>106</sup> ODI London 1986 <http://cdn-odi-production.s3-website-eu-west-1.amazonaws.com/media/documents/6704.pdf>.

<sup>107</sup> ODI London 1986 <http://cdn-odi-production.s3-website-eu-west-1.amazonaws.com/media/documents/6704.pdf>.

had reached \$24 billion, with around \$8 billion of that amount due to British institutions.

A sizable foreign bank decided to stop renewing short-term loans and stop making new loans to South Africa in the middle of 1985, with the help of a small number of Americans. The action was taken in relation to South Africa's debt equity ratio being under 15%, an improvement in the balance of payments position in 1983–84, and a decrease in the country's foreign bank debt from when it peaked in 1983 at \$18.8 billion. It was not initially launched for financial gain. The importance of South Africa as a significant source of money for potential future growth risen. The South African government reacted by announcing a suspension of debt servicing and a payment freeze on the \$14 billion (or 58%) of remaining balance of foreign debt. Later that year, in March, there was agreement to resume the payments that had been suspended as long as he paid off the \$500 million debt that was due at that time.

Although the South African financial meltdown was far from being over, it has significantly harmed the economy of the nation. As a result, severe foreign exchange controls were first reinstated, which caused the rand's value to plunge sharply and raise the trade surplus required to settle prior obligations. Due to South Africa's declining credit rating, it was unlikely that international banks would extend the country's significant amounts of credit soon. However, future loans are expected to have large premiums and relatively short maturities, adding to South Africa's already challenging external funding challenges. Some Swiss and West Germany banks were inclined to maintain lending to South Africa. Furthermore, it was still unclear what role Japanese banks and trade companies—many of which were based in South Africa.

A combination of political pressures, financial uncertainty, diminishing earnings, and financial worries made more major banks reluctant to conduct trade with South Africa. An explicit policy banning new financing to South African private or public borrowers was implemented by 26 major US banks by the middle of 1986, up from

just three barely two years earlier. Additionally, major UK banks including Hill Samuel and Standard Chartered have curtailed their direct exposure to South Africa.

One of the most significant developments, however, was the statement made by Barclays, the largest foreign bank in South Africa, that it would completely leave the country. Since properties were sold on a reciprocal basis to a hypothetical South African client, there is little chance that the sale will have a materially detrimental direct effect on the African economy (the transaction would only lead to an outflow of about £6 million). The indirect effects, however, might be considerably more significant. Due to Barclay's decision, additional UK-based financial and non-financial creditors as well as other financial institutions that still wanted to lend to the nation was forced to withdraw.

With these demands, South Africa were in a very difficult situation. It elected, as recommended by the South African embassy in London, to forego its commitments on foreign debt and cease all payments if it believes the chances of gaining access to significant sums of private foreign financing were very poor. Such steps would increase the possibility that all future international bank financing will halt while also relieving some of the nation's most severe currency exchange debts and reducing short-term economic limitations. That in itself had a lengthy deflationary impact on the economy, possibly increasing the likelihood that the West will increase sanctions.

There have been various investigations on the effect of sanctions on South Africa. One such investigation was conducted by Richard Porter of the Department of Economics of the University of Michigan in 1979.<sup>108</sup>

Porter reached the following conclusions:

The kind of sanctions envisaged, the degree to which they are implemented and executed, and whether they are regarded as short-term or long-term will all have a significant impact on how the impact is estimated.

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<sup>108</sup> Porter 1979 Journal of Conflict Resolution 579–612.

Although the long-term study of the report is limited, it is obvious that sanctions could harm South Africa's rate of economic growth. South Africa would increase at a traditional rate of 4% (yearly actual growth) to 5.5% during the past quarter century, but should entry to new foreign innovation and imported capital equipment is cut off (rather than merely capital flows), it were not the scenario at all.

The degree to which South Africa's imports drop will determine how the sanctions would affect the country in the short run. As a result, financial or investment penalties would certainly have a major impact on South African production alone, especially once the anticipated South African retaliation had stopped capital inflows.

Directly limiting South Africa's import capability could have negative short- and long-term ramifications for the nation. The efficiency of the embargo will determine how much of an impact it has. There would not be any economic harm even if South Africa's imports decreased by less than a fifth. Imports made up around 0.5 % of GDP for every percentage point decrease. As soon as imports decreased by more than a quarter, the impact increases. When the import fall is cut in half, the correlation of GDP drops to import decline rises by a ratio of around 1.4. There would be significant unemployment and shifts for all workers if imports were reduced by more than half.

It is clear from the above that the sanctions imposed on South Africa by the UN and its Members had a direct influence on the international trade relationships between South Africa and its international counterparts. The closure of ports to South African vessels meant that no South African product could transport goods via ship to another country, nor may any South African aircraft be awarded landing and passage facilities.

The payment of any imported and exported goods is central to all international trade. This is normally done with letters of credit. Chapter 1 examined the rich history of letters of credit and the integral role it plays in the international trade sphere.

Limited trade occurred during the time of the imposed sanctions on South Africa. This affected the provisioning and use of letters of credit due to South Africa's economic vulnerability in the international market.

The fact that some of the major role players in the international banking sector withdrew either completely or partly from South Africa had the effect that South Africa was downgraded by the international financial sector.

## ***5.2 South African legislation and sanctions***

Due to President P.W. Botha's heart attack at the beginning of 1989, there was a change in political dominance. He was forced to resign as National Party chairman as a result. F.W. de Klerk, a former education minister, was chosen as his replacement. On February 2, 1990, de Klerk gave a speech outlining the political transition and recognising the necessity for swift, comprehensive policy reforms. This was one year after taking office.<sup>109</sup>

South Africa was re-admitted as a member of the UN in 1994 following the end of apartheid policies. Being a recognized Member of the UN, the South African government had to put into practice the resolutions published by the UN and its Councils (for example the Security Council). This was done by way of various pieces of legislation by the South African government.

In terms of sanctions, three instances of South African legislation that complies with Security Council resolutions are:

- 1) *Financial Intelligence Centre Act (FIC)*;<sup>110</sup>
- 2) *Financial Intelligence Centre Amendment Act*;<sup>111</sup> and

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<sup>109</sup> Hefti and Staehelin-Witt *Schweizerischer Nationalfonds* 4–5.

<sup>110</sup> Financial Intelligence Centre Act 38 of 2001.

<sup>111</sup> Financial Intelligence Centre Amendment Act 1 of 2017.

3) *Protection of Constitutional Democracy against Terrorist and Related Activities Act*.<sup>112</sup>

The FIC Act<sup>113</sup> was implemented to curb the financing of terrorism, money laundering, and other similar acts.

Resolutions of the UN Security Council are expressly addressed in sections 26A(1) and 28A of FIC in that it is a notification of Persons and Entities in accordance with Chapter VII of the United Nations Charter, the United Nations Security Council adopted a resolution that identifies individuals or entities that Member States of the United Nations must respond to by financial sanctions. The Minister must publish the decisions adopted in the Official Gazette and through other suitable media of dissemination, according to the methods outlined in the resolution and accountable entity that owns or controls property owned or controlled by: (a) a legal entity that has committed, attempted to commit, or facilitated a particular crime within the interpretation of the *Constitutional Democracy Protection from Terrorist and Related Activities Act 2004*; a few organisations listed in the President's notification issued in accordance with section 25 of the 2004 *Constitutional Democracy Protection from Terrorism and Related Activities Act*; Additionally, (b) any individual, whether natural or legal, named in a United Nations Security Council resolution as contemplated by section 26A(1) Notice; must notify the Centre of such fact and the required details within the set timeline.<sup>114</sup>

Section 26 of the *Financial Intelligence Centre Amendment Act*<sup>115</sup> provide for the inclusion of international financial sanctions "under the supervisory purview of the (financial intelligence) centre".<sup>116</sup>

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<sup>112</sup> Protection of Constitutional Democracy against Terrorist and Related Activities Act 33 of 2004.

<sup>113</sup> Financial Intelligence Centre Act 38 of 2001.

<sup>114</sup> Protection of Constitutional Democracy against Terrorist and Related Activities Act 33 of 2004.

<sup>115</sup> Financial Intelligence Centre Amendment Act 1 of 2017.

<sup>116</sup> Hugo and Spruyt 2018 *TSAR* 250.

Additional to the FIC the *Protection of Constitutional Democracy against Terrorist and Related Activities Act*<sup>117</sup> provides in its foreword for adherence to UN resolutions in that it stipulates that actions had to be taken to prevent and combat terrorism and related activities; provide for terrorist offences and other crimes related to or linked to terrorism; provide for treaty violations; influence international regulations addressing terrorism and associated activities; provide frameworks for conformance with resolutions of the United Nations Security Council obliging Member States to prevent and combat the financing of terrorists and associated activities with regard to terrorism and related activities.<sup>118</sup>

Chapter 5 goes further and gives effect to UN resolutions.<sup>119</sup>

### **5.3 Conclusion**

South Africa has felt the brunt of sanctions and part of the effect of these sanctions was the non-delivery of goods previously governed by international trade agreements.

South Africa has given effect to international regulations regarding sanctions by enacting this into local legislation. This entails that all South Africans are to adhere to sanctions being instituted either by South Africa itself or any international organization that South Africa is a member of.

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<sup>117</sup> *Protection of Constitutional Democracy against Terrorist and Related Activities Act* 33 of 2004.

<sup>118</sup> *Protection of Constitutional Democracy against Terrorist and Related Activities Act* 33 of 2004.

<sup>119</sup> *Protection of Constitutional Democracy against Terrorist and Related Activities Act* 33 of 2004.

## **Chapter 6 The International Chamber of Commerce view on sanctions**

### ***6.1 International Chamber of Commerce on sanctions***

Banking institutions need to ensure adherence to legislation by incorporating "sanction clauses" in letters of credit. However, the addition of these clauses is problematic as it places a condition on a letter of credit. This negates and amends the independent and irrevocable nature of a letter of credit.

Sanctions may make it more difficult for a bank to carry out its ICC-required obligations. Alternative sanctions policies may be levied on international banks depending on the countries where they conduct business. Due to the potential for contradictory regulatory standards, some banks may be willing to create internal procedures to reduce the associated legal risks. Certain banks utilize sanctions clauses to limit these legal concerns.<sup>120</sup>

The ICC's concern about the impact of the use of sanctions clauses on the irrevocable and independent nature of letters of credit has necessitated a guidance paper, called "The Guidance Paper on the use of Sanction Clauses in Trade Finance-related Instruments subject to ICC rules, including Documentary and Standby Letters of Credit, Documentary Collections and Demand Guarantees."<sup>121</sup>

This guidance paper in its introduction refers to the political nature of sanctions, placing it outside the scope of application of the ICC in that to accomplish political and economic objectives, sanctions are enforced by the United Nations, the EU Council, or specific nations. You can forbid trade with particular nations, individuals, or products. Sanctions are necessary, but that is a political matter outside the purview of the ICC. Courts, national agencies, or administrative bodies may decide whether a sanction is enforceable. This is not a problem solvable by the ICC or other financial legislation. The consequences for trade finance instruments that address

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<sup>120</sup> ICC 2014 [https://www.icc-switzerland.ch/images/8.Guidance-Paper-on-The-Use-Of-Sanctions-Clauses\\_2014.pdf](https://www.icc-switzerland.ch/images/8.Guidance-Paper-on-The-Use-Of-Sanctions-Clauses_2014.pdf)

<sup>121</sup> ICC 2022 <https://iccwbo.org/content/uploads/sites/3/2014/08/guidance-paper-on-the-use-of-sanctions-clauses-in-trade-finance-related-instruments-subject-to-ICC-Rules.pdf>.

sanctions or how sanctions should have been interpreted are not discussed in the ICC Rules. The laws of the operating country, the country of formation or certification or site of payment, and other laws controlling the transaction are among the sanctions and restrictions to which a bank engaged in commerce finance-related instruments is subject. The terms and conditions of such security may be superseded by sanctions and regulations that are judged to be relevant to that security because they are commonly regarded as binding and may take precedence over ICC rules that apply to that security.<sup>122</sup>

The ICC guidance document that addressed sanction clauses in relation to: Banks may insert so-called "sanctions clauses" in their contracts to inform their counterparty, including correspondent banks or beneficiaries, about the potential effects of sanctions on their obligations stemming from trade-related transactions.

These provisions differ greatly in scope and lack any established standards. Where it states: [bank] has a legal duty to abide by the sanction laws and regulations mandatory to [bank].

Unless such exclusion or boycott is mandated by those countries' laws, several nations forbid the use of "exclude" or "boycott" norms or wording in a transaction based on discrimination. If trade finance papers or orders to provide verification, advice, or other services linked to such documents contain sanctions provisions in these jurisdictions, the recipient will reject the papers or instructions and will not follow them.

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<sup>122</sup> ICC 2022 <https://iccwbo.org/content/uploads/sites/3/2014/08/guidance-paper-on-the-use-of-sanctions-clauses-in-trade-finance-related-instruments-subject-to-ICC-Rules.pdf>.

provisions in these jurisdictions, the recipient will reject the documents or instructions and will not follow them.

Given the position of the confirming bank, designated remittance bank, guarantor, or recipient, this can provide major issues. If a bank is given the discretion to accept or refuse payments based on internal sanctions procedures, the bank can even wonder if it has actually entered into a legally enforceable agreement. Of course, the relevant laws must be followed in resolving this matter. The proposal to modify UCP 600's reimbursement rules to comply with sanctions against designated banks is especially concerning. A guarantor who has followed the guidelines and counter guarantees obtained from the counter-guarantee in accordance with URDG 758 is faced with the same issues.

Any internal penalties policies relating to sanctions, that the issuing bank may be imposing, are unknown to the nominated bank, which makes it challenging if the lending or counter-guarantee contains sanctions clauses connected to the bank's internal policy requirements. The nominated bank is entitled to a refund if it paid for a compliance presentation but the policies in question assert a wider scope than the sanctions and restrictions that must be applied to the originating bank. Consequently, a designated bank's risk analysis may take into account the probability of a non-refund in addition to the risk to the issuing bank and the nation, because of internal or external sanctions-related policies. Increased expenses, delays, and possibly legal issues may result.

The guidance document also provides sanctions clauses as examples –

Presentation of document(s) that are not in compliance with the applicable anti-boycott, anti-money laundering, anti-terrorism, anti-drug trafficking and economic sanctions laws and regulations is not acceptable. Applicable laws vary depending on the transaction and may include United Nations, United States and/or local laws.<sup>123</sup>

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<sup>123</sup> ICC 2022 <https://iccwbo.org/content/uploads/sites/3/2014/08/guidance-paper-on-the-use-of-sanctions-clauses-in-trade-finance-related-instruments-subject-to-ICC-Rules.pdf>.

The ICC provides the following recommendations in the guidance document:<sup>124</sup>

Banks are urged not to provide trade finance products with sanction clauses designed to impose limitations that go beyond or clash with appropriate statutory or regulatory requirements. Additionally, if other banks engaged in the transaction incorporate such terms, legal practitioners are encouraged to be conscious of the dangers associated with them.

The legal practitioner is irrevocably autonomous of the credit, debt instrument or debt obligation, assurance of payment in trade finance transactions, letters of credit or debt instruments are subject to ICC Regulations. Failure to adhere to this autonomy can compromise the letter of credit's integrity and reputation.

Despite this guidance paper issued by the ICC, banks have continued to utilize and apply sanction clauses to letters of credit that impact the irrevocable nature of letters of credit in a negative way. The ICC however regard the protection of this inherent characteristic of letters of credit as important in that it issued an Addendum to the 2014 Guidance Paper<sup>125</sup> in 2020.<sup>126</sup>

The ICC still recommend that sanctions clauses be left out from letters of credit. Below are another sample clause to be incorporated into letters of credit should there be a real need to mitigate sanctions, with propose wording as:

[notwithstanding anything to the contrary in the applicable ICC Rules on in this undertaking,] We disclaim liability for delay, non-return of documents, non-payment, or other action or inaction compelled by restrictive measures, counter-measures or sanctions laws or regulations mandatorily applicable to us or to [our correspondent banks in] the relevant transaction.<sup>127</sup>

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<sup>124</sup> ICC 2022 <https://iccwbo.org/content/uploads/sites/3/2014/08/guidance-paper-on-the-use-of-sanctions-clauses-in-trade-finance-related-instruments-subject-to-ICC-Rules.pdf>.

<sup>125</sup> ICC 2022 <https://iccwbo.org/content/uploads/sites/3/2014/08/guidance-paper-on-the-use-of-sanctions-clauses-in-trade-finance-related-instruments-subject-to-ICC-Rules.pdf>.

<sup>126</sup> ICC 2020 <https://iccwbo.org/content/uploads/sites/3/2020/05/20200504-addendum-to-sanction-clauses-paper.pdf>.

<sup>127</sup> ICC 2020 <https://iccwbo.org/content/uploads/sites/3/2020/05/20200504-addendum-to-sanction-clauses-paper.pdf>

## **6.2 Conclusion**

Being the largest recognized private organisation and representing more than 45 million businesses in more than 100 countries,<sup>128</sup> the ICC understands the importance of ensuring that letters of credit retain their well-developed and accepted characteristics of independence and strict compliance to ensure international trade. The main focus of the ICC is to create a global approach to international commerce, ethical corporate behaviour, and regulation by combining their global power with unique experience in advocacy, standard-setting activities, and global service.<sup>129</sup>

To ensure that the ICC gives effect to its obligation to promote "responsible business conduct",<sup>130</sup> it recognizes the existence and importance of sanctions and the fact that its members should adhere to local legislation relating to sanctions. The ICC further notes the devastating effects that sanctions have once they are instituted.

With these two main considerations, the ICC has effectively drafted the guidance paper for its members to ensure adherence to local legislation and to keep the essential characteristics of letters of credit intact.

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<sup>128</sup> ICC 2022 <https://iccwbo.org/about-us/who-we-are/>.

<sup>129</sup> ICC 2022 <https://iccwbo.oorg/about-us/who-are-we/our-mission/>.

<sup>130</sup> ICC 2022 <https://iccwbo.oorg/about-us/who-are-we/our-mission/>.

## **Chapter 7 Conclusions and recommendations**

### ***7.1 Introduction***

This study aimed to investigate how sanctions and sanction provisions affect the irrevocability of letters of credit. International transactions generally use letters of credit as their foundation to secure payment. They create certainty of payment between the parties and subsequently benefit international trade between countries based on their irrevocable and independent nature.

The effect of sanctions is determined by the effectiveness and the extent to which such sanctions are implemented, imposed and enforced. Sanctions have a strong political nature and are instituted by individual countries and/or the UN's Security Council by means of a Resolution.

The first chapter provided insight into and clarity about the historical development of letters of credit to emphasize the development of the well-entrenched principles of independence and irrevocability as inherent characteristics of letters of credit.

Chapter 1 traced letters of credit from ancient times to the period after WW I, revealing the integral part that letters of credit played from the earliest days. It also focused on the crucial role of these letters of credit throughout history.<sup>131</sup>

The second chapter centred on the establishment, history, function and rules of the ICC and the important role of the ICC in the international trade environment. It provides insight into the importance of the ICC as a private body. A large number of companies and countries are members of the ICC.<sup>132</sup> The ICC's primary objective is to advance global trade and investment as engines of inclusive growth and prosperity.

To advance a global perspective on international commerce, ethical corporate behaviour, and regulation, a combination of worldwide influence with distinctive

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<sup>131</sup> Trimble 1948 *Harvard Law Review* 989.

<sup>132</sup> ICC 2022 <https://iccwbo.org/about-us/who-we-are/>.

experience in lobbying, standard-setting activities, and global service.<sup>133</sup> This chapter also dealt with the various rules developed by the ICC, including Incoterms and the UCP.

Chapter 3 addressed the influence and the incorporation of the ICC rules and their application in South African legislation and case law.

As early as 1993, South African courts have referred to the reality that documentary credits have received very little attention. This was specifically mentioned in *Ex Parte Sapan Trading (Pty) Ltd*.<sup>134</sup> The chapter covered the two guiding concepts of letters of credit, namely the independence and the stringent compliance theory. Letters of credit and the UCP are subject to and should adhere to South Africa's general principles of contract law.<sup>135</sup>

South African courts depend on and incorporate the principles of letters of credit through the use of international judgements, for example *United City Merchants (Investments) Ltd v Royal Bank of Canada*,<sup>136</sup> in cases such as *Union Carriage & Wagon Co Ltd v Nedcor Bank Ltd*,<sup>137</sup> *Loomcraft Fabrics CC v Nedbank Ltd*<sup>138</sup> and *Phillips v Standard Bank of South Africa Ltd*.<sup>139</sup> In *Vereins-und Westbank AG v Veren Investments*<sup>140</sup> the court specifically stated:

This credit is subject to the Uniform Customs and Practice for Documentary Credits 1983 Revision ICC Publication 400 and is hereby operative.<sup>141</sup>

The fourth chapter provided insight into the historical development and application of sanctions. Sanctions have been applied throughout history from as early as 432 BC. Initially, sanctions were instituted in a war situation. It later developed into

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<sup>133</sup> ICC 2022 <https://iccwbo.org/about-us/who-we-are/our-mission/>.

<sup>134</sup> *Ex Parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W).

<sup>135</sup> Van Niekerk and Schulze *The South African Law of International Trade* 261-262.

<sup>136</sup> *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168 (HL).

<sup>137</sup> *Union Carriage & Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) at 731-732.

<sup>138</sup> *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A) at 816A.

<sup>139</sup> *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W) as 303D-I.

<sup>140</sup> *Vereins-und Westbank AG v Veren Investments* 2000 4 SA 238 (W).

<sup>141</sup> Hugo 2001 *SA Merc LJ* 594.

something that is used in a peace situation without the threat of possible war lingering.

The chapter further investigated the establishment of the League of Nations and its focus on a more structured implementation of sanctions than the process followed for the pacific blockades. The League of Nations in article 16<sup>142</sup> (and explanatory notes) of the League's Covenant, addressed sanctions and set out rules for its members.

The League of Nations dissolved with the establishment of the United Nations in 1946. Chapter VII<sup>143</sup> of the United Nations Charter<sup>144</sup> provides for the Security Council to maintain and restore international peace and security. The study specifically referenced articles 2(4), 39, 41, 42 and 43 of the UN Charter,<sup>145</sup> which provide for sanctions to ensure enforcement without the use of armed forces.

The chapter explains the various types of sanctions and their purposes. In conclusion, Chapter 4 ended with the main purpose of sanctions and embargoes to as influence the behaviours of the target country's governments, individuals or groups to improve the situation in that country.

Chapter 5 investigated the reason why sanctions were instituted against South Africa<sup>146</sup> and discusses the effect these sanctions had on South Africa, its economy, and its international trade relationships.<sup>147</sup>

Chapter 5 also focused on the incorporation of the resolutions passed by the United Nations and its Security Council with specific reference to sanctions in the South African legislation.

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<sup>142</sup> Fuller (ed) 1919 [https://history.state.gov/historicaldocuments/frus1919Parisv13/pg\\_88-91](https://history.state.gov/historicaldocuments/frus1919Parisv13/pg_88-91).

<sup>143</sup> UN OLA 2022 <https://www.un.org/en/about-us/un-charter/chapter-7>.

<sup>144</sup> UN OLA 2022 <https://www.un.org/en/charter-united-nations/>.

<sup>145</sup> UN OLA 2022 <https://www.un.org/en/charter-united-nations/>.

<sup>146</sup> UN OLA 2022 [https://legal.un.org/repertory/art14/english/rep\\_supp3\\_vol1\\_art14.pdf](https://legal.un.org/repertory/art14/english/rep_supp3_vol1_art14.pdf).

<sup>147</sup> ODI London 1986 <http://cdn-odi-production.s3-website-eu-west-1.amazonaws.com/media/documents/6704.pdf>.

Two examples of legislation that adhere to the resolutions passed by the Security Council that refer to sanctions are:

- 1) The *Financial Intelligence Centre Act* (FIC);<sup>148</sup> and
- 2) *Protection of Constitutional Democracy against Terrorist and Related Activities Act*.<sup>149</sup>

Chapter 6 investigated the view of the ICC on sanctions and the manner in which they ensure that letters of credit retain its well established and developed characteristics of independence and irrevocability while adhering to local legislation.

It also discussed the guidance document issued by the ICC in this regard.<sup>150</sup>

## **7.2 Final conclusions and recommendations**

Letters of credit have a long history of use among traders in international business transactions. Letters of credit have through the centuries developed their inherent characteristics of independence and irrevocability. Traders and businesses placed and still place an extremely high priority on the independence and irrevocability of letters of credit as these characteristics ensure the flow of business and payments in the international sphere of transactions. These inherent characteristics of letters of credit have withstood the proverbial test of time and should therefore be protected.

One of the greatest challenges for those involved in global commerce transactions is the risk involved in the transaction. This includes the risk of non-delivery and or inferior goods, part-payment, or non-payment of the contract price. The irrevocable and independent nature of letters of credit mitigate these risks involved in the

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<sup>148</sup> Financial Intelligence Centre Act 38 of 2001.

<sup>149</sup> Protection of Constitutional Democracy against Terrorist and Related Activities Act 33 of 2004.

<sup>150</sup> ICC 2022 <https://iccwbo.org/content/uploads/sites/3/2014/08/guidance-paper-on-the-use-of-sanctions-clauses-in-trade-finance-related-instruments-subject-to-ICC-Rules.pdf>.

international trade transaction and create certainty of payment. They are also free from the conditions underlying agreement.

The objective of the independence and irrevocable nature of letters of credit is to provide protection and certainty for business transactions. Any addition or condition to letters of credit that add a special, suspensive, prohibiting, or conditional clause may affect this independent and irrevocable nature of the letter of credit. Therefore, any such special, suspensive, prohibiting, or conditional clauses added to letters of credit should be avoided as it destroys the certainty inherently created by letters of credit.

Sanctions have developed through the years into an instrument used by either the UN, EU, USA or other individual countries and implemented against another country that does not comply with the generally accepted rules or transgress these mutually accepted rules and are enforced by the issuance of sanctions against any person and or country that transgress these acceptable rules by either an individual country or the security council of the UN.

Sanction issues remain a commercially sensitive topic for all parties involved in international business transactions. Banks do sanction risk assessments in the form of a prior screening of all deals to mitigate the risk involved. Sanction clauses have been added by banks in an attempt to mitigate the risk involved in the institution of sanctions.

Having joined the UN, South Africa is bound by the resolutions and/or decisions of the UN. To give domestic effect to these resolutions issued by the UN, South Africa should incorporate UN resolutions and decisions into South African legislation. South Africa has to date enacted various pieces legislation to ensure adherence to the UN resolutions and via publication in the *Gazette*.

Adherence to South African legislation is non-negotiable. A basic principle of the South African contract law is that a contract may not be enforced or effected if it triggers an illegality under any South African legislation. These principles provide

the clarity and comfort that legal subjects do not have to provide for this adherence to legislation in agreements between them. Protection of and adherence to sanctions are therefore catered for in these principles.

As a final conclusion and to answer the research question: "How do sanctions and sanction clauses affect the role and stature of letters of credit and guarantees in trade financing, with special reference to their impact on the independence of these instruments?"

It is clear that based on the protection provided to banks through local legislation, the examples provided by the ICC in section 3 of the Guidance Paper<sup>151</sup> and the Addendum in 2020<sup>152</sup> offer sufficient protection for banks. More importantly, it will not detract from the irrevocable nature of letters of credit as the utilization of the Guidance Paper and Addendum will still ensure and secure payment of the letter of credit. There will thus not be any requirement for commercial banks to add more comprehensive and/or vague or general clauses to letters of credit when issuing letters of credit.

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<sup>151</sup> ICC 2022 <https://iccwbo.org/content/uploads/sites/3/2014/08/guidance-paper-on-the-use-of-sanctions-clauses-in-trade-finance-related-instruments-subject-to-ICC-Rules.pdf>.

<sup>152</sup> ICC 2020 <https://iccwbo.org/content/uploads/sites/3/2020/05/20200504-addendum-to-sanction-clausespaper.pdf>.

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