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A critical assessment of the requirements for documentary compliance in the law of letters of credit.

By

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A minor dissertation submitted in partial

fulfilment of the requirements for the

degree of

Master of Laws (LLM)



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DECLARATION

I, Evelyn Chigerwe, hereby declare that this minor dissertation, submitted to the University of the Johannesburg, for the purposes of attaining the Master of Laws (LLM) degree is my own work. It has not been formally submitted for any other degree or examination at any other university for degree purposes.

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1. General Introduction

Letters of credit have over the times been used as a payment mechanism in instances where the buyer and seller are in different locations. Such letters of credit are vital to international trade, and are often described as its “lifeblood” or “backbone”.¹ Letters of credit are used in instances where the buyer and seller are in different locations. Under such circumstances the buyer has fear of receiving goods of an incorrect quantity or quality, or not receiving the goods at all. The seller on the other hand fears defaulting in payment, or that the buyer may refuse to accept the goods on a technicality.² Therefore in order to control this difficulty or distrust in international trade, payment by method of letters of credit was introduced to reduce the exporter’s risk of non-payment and the importer’s risk of non-delivery.³ Letters of credit are therefore formulated to protect the interests of both parties.

The use of letters of credit is justified and vastly favoured in international trade because they provide an effective guarantee of payment from a financially responsible third party.⁴ This is so because letters of credit involve an undertaking, usually given by the bank, that the bank will pay the beneficiary subject to presentation by the beneficiary of stipulated and complying documents.⁵ The bank’s undertaking to pay is generally considered as binding on the bank immediately after the beneficiary has received it.⁶ This, however, is a controversial topic in the legal literature due to the difficulty of explaining the bank’s liability on the basis of the traditional legal theory of contract.⁷

A letter of credit is in general honoured by the issuing bank upon the beneficiary’s or nominated bank’s presentation of documents which comply “strictly” on their face with the terms of the credit.⁸ This principle is often referred to as the “doctrine of strict compliance” and it entails that documents presented to a bank must strictly

¹ *RD Hardbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 146 155; Schulze “The UCP 600: A New Law Applicable to Documentary Letters of Credit” 2009 *SA Merc LJ* 228 228.

² Langerich *Documentary Credit in Practice* (2000) 30.

³ Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* (2011) 9.

⁴ Schulze (n1) 228-229; Brindle and Cox *Law of Bank Payments* (2004) 673.

⁵ ICC *Uniform Customs and Practice for Documentary Credits* ICC 2007 Publication NO 600 (generally referred to as the UCP 600 below) art 7; Bridge (general editor) *Benjamin’s Sale of Goods* (2014) 2012 at par 23-004; Horowitz *Letters of Credit and Demand Guarantees Defences to Payment* (2010) 2.

⁶ Horowitz (n5) 2.

⁷ Hugo “Documentary Credits: The Basis of Bank’s Obligation” 2000 *SALJ* 224 224-225.

⁸ UCP 600 art 14(a); Adodo *Letters of Credit The Law and Practice of Compliance* (2014) 151.

comply with the terms and conditions of the credit. The bank is not to look at the circumstances giving rise to the letter of credit. Even in circumstances where there is breach of the underlying transactions, the bank should not concern itself with such, but must only refer to the documents presented to it.⁹

Because letters of credit are vastly used in international trade the International Chamber of Commerce (ICC) introduced regulatory instruments to govern transactions involving letters of credit. Such instruments discussed in this dissertation are: the Uniform Custom Practices for Documentary Credits (UCP) 500 and 600 and the International Standard Banking Practice (ISBP). These instruments try to provide certainty and uniformity in the way banks deal with transactions involving letters of credit.

South African case law contains very little guidance on the interpretation of strict compliance. This strict compliance doctrine was acknowledged and applied in *Standard Bank of South Africa Ltd v OK Bazaars*¹⁰ wherein the court noted that “an issuing bank generally had no interest in the nature or terms of a letter of credit established on behalf of its customer: its interest was confined to ensure that the documents that were presented to it in exchange for payment conformed with its client's instructions. If the presented documents did not conform to the terms of the letter of credit, the issuing bank was not entitled to pay the beneficiary....”¹¹ Furthermore, in *Delfs v Kuehne & Nagel (Pty) Ltd*¹² payment was to be effected by means of a letter of credit and one of the requirements for the credit to be honoured was that the description of the goods contained in the delivery documents should correspond with what was set out in the letter of credit. Documentation presented to the bank was discrepant and consequently the issuing bank refused to honour the credit citing discrepancies in the documents.¹³ The court supported the issuing bank’s decision of declining to honour the credit due to discrepancies in documents. However, in both these cases the court did not elaborate on the standard that the banks should use to determine compliance in documents. English case law,

⁹ UCP 600 art 4 and art 14.

¹⁰ 2002 (3) SA 688 (SCA).

¹¹ *Standard Bank of South Africa Ltd v OK Bazaars* (n10) 697-698.

¹² 1990 (1) SA 822 (A).

¹³ *Delfs v Kuehne & Nagel (Pty) Ltd* (n12) 825.

however, appears to carry much weight in South Africa on the law of letters of credit and for this reason this dissertation will refer to a number of English cases.

The focus of this dissertation is the doctrine of strict compliance. The high rate of rejection in letters of credit together with multiple debatable court decisions relating to the doctrine of strict compliance indicate that the existing document-examination standard is a serious bottleneck in transactions involving letters of credit.¹⁴ It is the aim of this dissertation to examine the rigorousness of the doctrine of strict compliance. This dissertation will attempt to highlight and answer the question when documents presented to a bank should be regarded as compliant and to what extent can banks say documents presented are conforming. The literal compliance theory will be examined critically. This is followed by an analysis of the criticism levelled against literal compliance. Thereafter, the UCP provisions relating to compliance as well as the ISBP provisions will be analysed in an attempt to ascertain whether there is a set criterion or any precise guidelines that determine the strictness of the standard. This leads to a conclusion on the stance that South African Courts and banks should take when determining compliance.

2. General analysis of the doctrine of strict compliance

2.1 Introduction

One of the most important principles governing letters of credit is the doctrine of strict compliance. This doctrine entails that the documents presented to the bank under a letter of credit must comply strictly with the requirements stipulated in the letter of credit and should not in any way be discrepant or ambiguous.¹⁵ If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, then the issuing bank must honour the presentation.¹⁶ A presentation that does not conform to the requirements set in the letter of credit is not a complying

¹⁴ Krázovska *Impact of The Doctrine of Strict Compliance on a Letter of Credit Transaction* (2008 thesis DNK) 3 available at: http://pure.au.dk/portal-asb-student/files/2543/Krazovska_MasterThesis.pdf.

¹⁵ Adodo (n8) 151.

¹⁶ UCP 600 art 15; Uniform Commercial Code Art 5 109 (a).

presentation and will not be honoured.¹⁷ Therefore, the doctrine of strict compliance will disregard any documents that reflect any form of deviation from the stipulated requirements in a letter of credit. This means that a minor mistake can lead to a letter of credit being dishonoured. This strict-compliance doctrine is largely founded on the following dictum of Lord Sumner in the early case *Equitable Trust Company of New York v Dawson Partners Ltd*:

“It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorized to accept are in the matter of the accompanying documents strictly observed. There is no room for documents which are almost the same or which will do just as well. Business could not proceed securely on any other lines. The bank's branch abroad, which knows nothing officially of the detail of the transaction thus financed, cannot take upon itself to decide what will do well enough and what will not. If it does as it is told, it is safe; if it declines to do anything else, it is safe; if it departs from the conditions laid down, it acts at its own risk”.¹⁸

The doctrine implies that the bank is not obliged to, and will not look into the underlying transaction or the surrounding circumstances in order to determine the acceptability of the documents. The bank simply needs to decide whether or not to honour the credit solely based on examination of the documents presented and accept only those that strictly comply with the terms and conditions of the credit.¹⁹ It has been said that the bank must pay against complying documents even though the importer alleges that the exporter has committed a breach of the contract of sale.²⁰ The bank deals in documents and not with the goods to which the documents refer.²¹ Therefore the beneficiary must deliver complying documents as condition precedent to the availability of funds under a specific or particular letter of credit.²²

The purpose of the strict compliance rule is to protect the customer and provide certainty. Conformity of the documents is done on a *prima facie* basis and must be

¹⁷ UCP art 16; Affaki and Goode *Guide to ICC Uniform Rules for Demand Guarantee URDG 758* (2011) 333.

¹⁸ [1927] 2 Lloyd's Rep 49 52.

¹⁹ UCP art 14; Mugasha *The Law of Letters of Credit and Bank Guarantees* (2003) 23.

²⁰ *Philips & Another v Standard Bank of South Africa Ltd & Others* 1985 3 SA 301 (W) 301.

²¹ UCP 600 art 5.

²² Adodo (n8) 151.

determined in good faith.²³ This doctrine has been justified in letters of credit on two grounds. First, on principles of the law of agency (in England) – and on the principles of the law of mandate (in South Africa). In accordance with the South African approach the issuer must act within the mandate given by the applicant and obtain documents which comply strictly with the applicant's instructions.²⁴ Secondly, the doctrine ensures that the issuer obtains documents which are commercially marketable and can be used in case the goods are lost or destroyed.²⁵ Banks employ the doctrine of strict compliance when dealing with documentary credits to ensure certainty in the commercial transactions and security to the parties involved. Furthermore, a notable advantage of the doctrine of strict compliance is that it serves to reduce the risk on the banks by reducing the amount of information that they need to have concerning the principal transaction. They simply match the documents that are presented to the letter of credit.²⁶

This doctrine of strict compliance is strongly linked to the autonomy principle which is also a fundamental principle governing letters of credit. The autonomy principle is currently encapsulated in the UCP 600 as follows: “[a] credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary.”²⁷ Reinforcing this provision is article 5 calling for banks to deal only with documents and not with goods or services to which these documents may relate.²⁸ These clauses clearly highlight that the bank need not concern itself with the surrounding circumstances of the credit but must only consider the documents presented to it in order to determine whether a letter of credit amounts to a complying presentation in order to honour it.

²³ Chew “Strict Compliance in Letters of Credit, The Banker’s Protection or Bane?” 1990 *Singapore Academy Law Journal* 70 71.

²⁴ Mugasha (n19) 24.

²⁵ Mugasha (n19) 24.

²⁶ Ademola “Letters of Credit: Tower of Babel or Jacob’s Ladder? A Look at Whether Private Codifications of Commercial Usage Bring Us Any Closer to Harmonised International Commercial Law” 1933 *Centre for Energy, Petroleum & Mineral Law & Policy Annual Review (CAR)* 12. See following link:
<file:///E:/Ademola%20tower%20of%20babel.pdf>

²⁷ UCP 600 art 4.

²⁸ UCP 600 art 5.

2.2 Literal compliance

Some scholars of the strict compliance doctrine advocate for the literal-compliance interpretation.²⁹ For instance, Adodo supports a very strict and almost literal compliance point of view.³⁰ The literal compliance theory entails that the documents presented to a bank tendering a letter of credit must be *verbatim et literatim*, i.e. word for word and letter by letter as those required under the letter of credit. In other words, according to the literal compliance theory, all documents submitted under a letter of credit must be the mirror image of the requirements stipulated in the credit.³¹ This standard of compliance dictates that minor mistakes such as typographical errors are considered to be discrepancies which allow banks to reject the documents and subsequently not honour the credit.³²

Furthermore, literal compliance necessitates that the *de minimis non curat lex* principle is not applicable to letters of credit. Adodo thus states: “[p]ursuant to the rule, the *de minimis non curat lex* principle which ordinarily applies to documents tendered for payment of the purchase price under a sale of goods contract is inapplicable to documents presented under a letter of credit”.³³ Adodo further supports the literal compliance theory by pointing out that the enforcement of strict, literal compliance of documents with the terms and conditions of the credit ensures legal certainty and predictability.³⁴ Consistently, in the case *Moralice (London) Ltd v E D and F Man & Co*, it was held that the *de minimis non curat lex* principle did not apply to a letter of credit.³⁵ In this case, the letter of credit required that documents presented must show a consignment of 5000 bags of sugar. However, the documents presented showed a consignment of 4 997 bags of sugar and hence the bank rejected the documents and did not honour the letter of credit.³⁶ The court stated that the words in the bill of lading were clearly not the same as those required by the letter of credit and so the bank was entitled to refuse to honour the credit on

²⁹ See Adodo (n8) 154-155 and 156-160.

³⁰ Adodo (n8) 154-155 and 156-160.

³¹ Hashim “Principle of Strict Compliance in Letters of Credit (LC): Towards A Proper Standard of Compliance” 2013 *Legal Network Series* 1 4.

³² Hashim (n31) 4.

³³ Adodo (n8) 155.

³⁴ Adodo (n8) 156.

³⁵ [1954] 2 Lloyd's Rep. 526.

³⁶ *Moralice* case (n35) 532. For a discussion of the case see Mipande *The Impact of Judicial Discretion on the Doctrine of Strict Compliance in the Law of Letters of Credit* (2013 Thesis Malawi) 15.

the grounds that the documents tendered did not comply precisely with the terms of the letter of credit.³⁷ Therefore, under the literal compliance interpretation, minor and trivial mistakes in documents presented under the letter of credit warrant rejection of the documents by the bank. Thier suggests that such a standard ensures that prior to honour “the beneficiary has performed the protective conditions prescribed by the customer, while insulating the issuer from disputes unrelated to its ministerial function”.³⁸

Furthermore, the literal compliance theory was clearly illustrated in the stance adopted by the bank in *Tosco Corporation v Federal Deposit Insurance Corporation*,³⁹ even though the court rejected the decision taken by the bank. In this case, the letter of credit required that the draft to be submitted to the issuing bank should clearly state that it was issued according to “Letter of Credit Number 105” in Clarkesville bank.⁴⁰ However, the draft that was presented to the issuing bank read that it was issued according to “letter of credit No. 105”.⁴¹ The issuing bank refused to honour the letter of credit because the beneficiary used the abbreviation “No.” instead of the full word “Number”.⁴² Even though the submitted draft contained a minor discrepancy, such discrepancy was not in any way material and did not affect the interpretation of the draft or any party.⁴³ The issuing bank considered literal compliance as the proper standard for documentary compliance.⁴⁴ Therefore, despite the triviality of the discrepancy, the presentation was rejected by the bank.

Furthermore, even in cases where the word used is interchangeable with the word required by a letter of credit, or where it is a well-known fact that the words refer to and mean the same thing, a bank following the literal compliance method may refuse to pay a letter of credit should one word or letter in the presented documents differ from the one required by the letter of credit. Another example in which the literal compliance theory was followed was in the case of *J. H. Rayner & Co. Ltd. v.*

³⁷ *Moralice Case* (n35) 533.

³⁸ Thier “Letters of Credit: A Solution to the Problem of Documentary Compliance” 1982 *Fordham Law Review* 848 856.

³⁹ 723 F 2d 1242 (1983).

⁴⁰ *Tosco case* (n39) 1247.

⁴¹ *Tosco case* (n39) 1247.

⁴² *Ibid.*

⁴³ *Ibid.*

⁴⁴ *Ibid.*

*Hambro's Bank Ltd*⁴⁵ wherein the defendant required that the plaintiff must present a bill of lading for "coromandel groundnuts".⁴⁶ However, the plaintiff presented a bill of lading containing the words "machine-shelled groundnut kernels".⁴⁷ The bank refused to pay against such presentation because the invoice did not match the letter of credit. The plaintiff argued that machine-shelled groundnut kernels are the same as coromandel groundnuts, and was a common synonym for the goods described in the letter of credit.⁴⁸ The issuing bank refused payment on this basis even though all parties, including the issuing bank, were aware that the terms were synonymous.⁴⁹ The court upheld the issuing bank's refusal of payment on the grounds that the bank could not be expected to be knowledgeable with every usage and custom of every trade in which the letters of credit are used (and as such knowledgeable of synonyms).⁵⁰

If one follows the literal compliance theory, then proper compliance implies that no documents presented under a letter of credit may contain any mistake. Even the slightest error will result in the issuing bank refusing to honour the letter of credit. Under the literal compliance theory, a hyphen in the wrong place can lead to different interpretations and accordingly can justify refusal by a bank to honour a credit. In an English case the court upheld the decision of the issuing bank to reject the documents presented because the letter of credit named the beneficiary as "Bulgrains Co Limited" instead of "Bulgrains & Co" Limited (i.e. including the ampersand).⁵¹ Hence, even a small punctuation error is intolerable because the bank cannot judge whether the discrepancy can lead to enormous damage since, in accordance with the UCP, banks only deal with the documents and not with the goods, services or performance to which they may relate.⁵² The bank is entitled to refuse payment if the documents do not comply with the stipulations of the credit. The bank's undertaking is conditional upon the proper documents being presented

⁴⁵ [1943] 1 KB 37.

⁴⁶ *J H Rayner case* (n45) 38.

⁴⁷ *Ibid.*

⁴⁸ *Ibid.*

⁴⁹ *J H Rayner case* (45) 41.

⁵⁰ *J H Rayner case* (45) 43.

⁵¹ *Bulgrains & Co Ltd vs Shinhan Bank* [2013] EHW 2498.

⁵² UCP 600 art 5.

by the beneficiary.⁵³ Hence documents containing even the slightest mistake will be rejected as they will be regarded as non-complying. Conversely, Goode notes that “if the documents deviate from the language of the letter of credit, the bank is entitled to withhold payment even if the deviation is purely terminological and has no materiality in fact”.⁵⁴

The literal compliance theory is premised on the conclusion that the issuing bank should not be in a position of determining whether a discrepancy contained in a document is significant.⁵⁵ Issuers are not in a position to know whether discrepancies matter to the commercial parties.⁵⁶ The issuer must simply decide whether to honour the credit or not based on what appears on the presented documents in comparison to what is required by the letter of credit. The examiner should only honour a credit where the documents presented are in literal compliance with the requirements of the credit.

3.3 Criticism of literal compliance

The high rejection rates of documents containing only minor discrepancies threaten the continued use of documentary credits as method of payment in international trade.⁵⁷ Against this background critics of the literal compliance theory suggest that the doctrine of strict compliance should not be interpreted as requiring mirror image compliance.⁵⁸ Adherence to the literal, mirror image approach results in banks' checking of documents for compliance into an exceedingly rigorous proof-reading exercise.⁵⁹ Furthermore, critics of the literal compliance theory point out that the doctrine of strict compliance does not require blind literal compliance but should consider and evaluate the type of mistake or error in the documents. A discrepancy which should lead to the rejection of the documents will be one which affects the value or merchantability of the goods and may appear material. In *Benjamin's Sale*

⁵³ Hugo Documentary Credits: Apparently Conforming Documents Equals Conforming Documents! The Bizarre Heritage of *United City Merchants (Investments) Ltd v Royal Bank of Canada SA Merc L.J* 593 595.

⁵⁴ Goode *Commercial Law* (1995) 991.

⁵⁵ Dolan *The Law of Letters of Credit Commercial and Standby Credits* (1996) 6-10-6-11.

⁵⁶ *Ibid.*

⁵⁷ Hugo and Lambertyn “Documentary Credits and Independent Guarantees” *Annual Banking Law Update (ABLU)* (2007) 177 178.

⁵⁸ Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* (2008 thesis SA) 56.

⁵⁹ Adodo (n8) 156.

of Goods it is said: “[a] linguistic disparity that is apparent on the face of the document to be a typographical error does not render the presentation non-complying. Accordingly, an evident misspelling or other typing error that does not affect the meaning of a word or the sentence in which it occurs does not justify refusal.”⁶⁰ Therefore, critics of the literal compliance view seem to postulate that only discrepancies that may change the meaning in the documents or the intentions of the parties justify refusal of a letter of credit.

Furthermore where it can be shown or where it is quite evident that the discrepancy results from a patent error, it would be unrealistic and arbitrary to treat the entire tender as invalid by reason only of a mere technical slip or mistake.⁶¹ To regard every spelling error or patent mistake as a discrepancy which leads to dishonour of a credit would convert the commercial transaction into a proof-reading exercise.⁶² This approach notably contradicts the literal compliance theory as set out above. Where there is any inconsistency in documents, there is no obligation for the bank to pay on the strength of non-conforming documents as the required standard is that of strict conformity.⁶³

In the case of *Bulgrains and Company Ltd v Shinard Bank* it was stated that the only exception to the doctrine of strict compliance may be where the discrepancy is insignificant or trivial to such an extent that it cannot be regarded as material.⁶⁴ With specific reference to a name in the documents Jack puts it thus: “a document containing an error with a name..... should be rejected unless the nature of the error is such that it is unmistakably typographical and the document could not reasonably be referring to a person or organisation different from the ones specified in the credit. In assessing this, the bank should look only at the context in which the name appears in the document but not judge it against the facts of the underlying transaction.”⁶⁵ In accordance with this approach, therefore, discrepant documents presented under a letter of credit may be honoured if the discrepancies or irregularities are trivial to the extent that they do not change the meaning and context

⁶⁰ Bridge (general editor) *Benjamin's Sale of Goods* (2014) at 2074.

⁶¹ *Benjamin's Sale of Goods* (n60) 2074.

⁶² Adodo (n8) 156.

⁶³ Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* (2011) 296.

⁶⁴ *Bulgrains* case (n51) 2498.

⁶⁵ Jack *Documentary Credits* (2009) par 8.38.

of the credit. In determining whether this is the case, however, banks are not to have regard to the underlying transaction.

It would be fair to say that the English courts have accepted that certain discrepancies should not lead to the rejection of the documents, and so-viewed, do not support the literal compliance theory. Courts have considered the materiality of discrepancies.⁶⁶ In *Gian Singh & Co Ltd v. Banque De L'Indochine*, Lord Diplock put it thus: “[t]he relevance of minor variations depends on whether they are sufficiently material to disentitle the issuing bank from saying that in accepting the certificate it did as it was told.”⁶⁷ It is clear, however, that the bank cannot regard as trivial something that the applicant specifically required. In addition, in *Hing Yip Hing Fat Co Ltd v Daiwa Bank Ltd*, the court highlighted that, in the process of examining documents presented under a letter of credit, banks should not insist on a rigid and meticulous fulfilment of the precise wording in all cases.⁶⁸ It is submitted that South Africa is likely to follow a non-literal interpretation.⁶⁹ This is due to the fact that a letter of credit is a contract and hence the background and purpose must be considered.⁷⁰ This, however, holds the potential of violating the autonomy of letters of credit.

2.3 Conclusion

It is clear from the above that the doctrine of strict compliance contains a built-in tension. The name of the doctrine “strict compliance” suggests a very high level of compliance. On the other hand criticism of literal or mirror-image compliance by commentators and in the case law is convincing. It cannot be doubted seriously that there is such a thing as a discrepancy that is so insignificant that it can be ignored. The question as to how this tension is to be dealt with is difficult. In *Seaconsar Far East Ltd v Bank Markaza Jombhuri Islam Iran* the following was said: “I cannot regard as trivial something which, whatever may be the reason, the credit specifically requires. It would not, I think, help to attempt to define the sort of discrepancy which

⁶⁶ *Bulgrains* case (n51); Chew (n23) 74-75.

⁶⁷ (1974) 2 All ER 754.

⁶⁸ (1992) 2 HKLR 35.

⁶⁹ Oelofse *The law of Documentary Letters of Credit in Comparative Perspective* (1997) 267.

⁷⁰ *Ibid.*

can properly be regarded as trivial. But one might take for example, *Bankers Trust Co v State Bank of India*, [1991] 2 Lloyd's Rep 443 where one of the documents gave the buyers telex number as 931310 instead of 981310. The discrepancy in the present case is not of that order".⁷¹

It is suggested that two principles have emerged strongly in this regard and should guide banks in dealing with this difficult question:

- (a) In determining compliance banks should look only at the letter of credit itself and the documents presented under it. They should not seek guidance in the underlying contract.
- (b) The bank can never regard as trivial something that the applicant has required specifically.

The application of these general principles in practice can be difficult. Against this background the international banking community has attempted to come to the assistance of banks by means of the provisions of the UCP and the ISBP, which are considered below.

3. Regulatory instruments of the ICC

3.1 Introduction

Because letters credit form an important part of commercial transactions, the ICC has developed rules to regulate transactions involving letters of credit namely the *Uniform Customs Practice for Documentary Credits (UCP)* and the *International Standard Banking Practice (ISBP)*, among others.⁷² The UCP contains various provisions relevant to compliance of documents. There have been various revisions of the UCP, and the UCP 600 of 2007 is the most recent. This version is generally

⁷¹ [1993] 1 Lloyd's rep 236 (CA) 240.

⁷² For a detailed discussion on the development of the UCP see Hugo "The Development of Documentary Letters of Credit as reflected in the Uniform Customs and Practice of Documentary Credits" 1993 *SA Merc LJ* 44; Hugo "The 1993 Revision of the Uniform Customs and Practices for Documentary Credits" 1996 *SA Merc LJ* 151; Hugo "The Legal Nature of the Uniform Customs and Practice for Documentary Credits: Lex Mercatoria, Custom, or Contracts" 1996 *SA Merc LJ* 143; Schulze (n1) 228.

regarded as being clearer, more concise and better arranged than its predecessors.⁷³

The UCP is a set of standard contract terms compiled by the International Chamber of Commerce subject to which the vast majority of documentary credits are issued.⁷⁴ Almost all letters of credit issued today incorporate the UCP which facilitates uniform bank treatment of documents throughout the trading world.⁷⁵ However, it needs to be emphasised from the outset that the UCP has no force of law in itself, but only binds the parties concerned in so far as they have incorporated it contractually.⁷⁶ In South African law the UCP may perhaps have become trade usage and this implies that the parties have to expressly exclude it from their contract or it will possibly be implied *ex lege* into the contracts by a court.⁷⁷ Hugo notes that, “[t]he UCP is contractually incorporated both in the relationship between the applicant for the credit and the issuing bank (in the application form), as well as in the relationship between the issuing bank and the beneficiary (in the credit itself).”⁷⁸

Bank practices may differ in some respects from country to country.⁷⁹ Because of this, the ICC also introduced the *International Standard Banking Practice* to facilitate and regulate trade transactions dealing with letters of credit. This was an attempt to codify what the ICC regarded as the “international standard banking practice”. Furthermore, this was aimed at preventing the conformity or not of documents being determined purely by local usages.⁸⁰ The first draft of the ISBP was first published by the ICC in 2003 and the most recent one in 2007 following publication of the UCP 600. However, the ISBP does not replicate the actual nature of international standard banking practice as trade usages and bank customs vary from one country to another.

⁷³Schulze (n1) 232.

⁷⁴Hugo (n53) 596.

⁷⁵Baker and Dolan *Users' Handbook for Documentary Credits under UCP 600* (2008) 10.

⁷⁶UCP 600 art 1; Schulze (n1) 228 232.

⁷⁷Schulze “The South African Banking Adjudicator – A Brief Overview” (2000) 12 *SA Merc LJ* 38 50-2.

⁷⁸Hugo (n53) 593.

⁷⁹Oelofse (n69) 272.

⁸⁰Oelofse (n69) 272-273.

3.2 Provisions of the UCP 500

In some instances, the UCP 500 brought more light in relation to how the doctrine of strict compliance was to be interpreted and in some cases it created confusion among banks and scholars in this regard. Article 13 of the UCP 500 dealt with compliance of documents in letters of credits. It reads as follows:

“[b]anks must examine all documents stipulated in the credit with reasonable care, to ascertain whether or not they appear on their face to be in compliance with the terms and conditions of the credit. Compliance of the stipulated documents on their face with the terms and conditions of the credit shall be determined by international standard banking practice as determined in these articles. Documents which appear on their face to be inconsistent with one another, will be considered as not appearing on their face with the terms and conditions of the credit. Documents not stipulated in the credit will not be examined by banks. If they receive such documents they shall return them to the presenter or pass them on without responsibility.”

This article raises five clear points. The first relates to the examination of the documents “on their face”. The words “on their face” do not simply denote the literal front contrasted with the back of a document, but rather refers to all the information contained in a document.⁸¹ In other words, the decision whether the documents presented are complying is purely based on what appears from the *prima facie* appearance and content of the documents and not on the banker’s own understanding of the wording.⁸² This wording indicates that banks do not have to consider extraneous material when determining whether documents presented are conforming. However, it is worth pointing out that nowhere in the UCP 500 does it say documents presented must comply “strictly”. Instead the drafters simply used the words “appear on their face” – a term of little assistance in seeking an answer to the level of compliance required.

⁸¹ International Chamber of Commerce (ICC) *Documentary Credits UCP 500 and 400 Compared An Article-by-Article Detailed Analysis of the New UCP 500 Compared with the UCP 400* (1993) 39; Van Niekerk and Schulze (n63) 292.

⁸² ICC (n81) 39.

The second point raised in the article is that compliance is to be determined with reference to “international standard banking practice”. This provision seems to introduce an objective standard which banks must use to determine compliance in documents.⁸³ Furthermore reference to an objective standard was aimed at creating uniformity in the way that banks determine conformity of documents. However bank practices in the world are different and against this background it is difficult to speak of an international banking practice.⁸⁴ The question that needs to be answered is what this international standard banking practice which the UCP 500 was referring to actually is. In this regard, it is worth pointing out that the ICC published the first International Standard Banking Practice (ISBP) in 2003. This was a codification of what the ICC regarded as international standard banking practice. However, this publication was long after the UCP 500 came into operation in 1994. Therefore, the drafters of the UCP 500 could not have been referring to the ISBP. International banking practices may be found in practices performed by document checkers.⁸⁵ In addition the ICC suggest that international standard banking practice is embedded in the UCP, hence the qualification “as reflected in these articles”.⁸⁶ If one follows this qualification, expert evidence of what amounts to international standard banking practice can only be referred to by reference to the UCP.⁸⁷

The third point raised in the article relates to inconsistent documents. Documents which are inconsistent with one another will be considered as not conforming.⁸⁸ The inconsistency rule applies when two or more documents are inconsistent with each other but when considered individually the documents comply with the requirements of the credit. The provision requires that documents presented must be read together in determining compliance.⁸⁹ Each document must conform to the required standard and all documents presented must collectively be consistent with one another. The

⁸³ Oelofse (n69) 272.

⁸⁴ Ibid.

⁸⁵ International Chamber of Commerce *Commentary on the UCP 600 Article by Article Analysis by the UCP 600 Drafting Group* (2007) 64.

⁸⁶ ICC (n81) 39.

⁸⁷ Oelofse (n69) 273.

⁸⁸ UCP 500 Art 13(a).

⁸⁹ Oelofse (n69) 276.

provision has the effect that a defect in one document cannot be rectified by reference to the content of another document presented.⁹⁰

The fourth point raised in the article refers to the presentation of documents that were not required under the credit. Article 13(a) provides that any such document will not be examined and must be returned to the presenter. It can be argued that the article in this respect rejects the literal compliance theory since, in terms of this theory, the presentation of a document not called for necessarily means that the presented documents cannot be the mirror image of the documents stipulated in the credit. Therefore, in cases where additional documents are presented to a bank, the application of literal compliance would mean that such presentation amounts to noncompliance. However, art 13(a) avoids this consequence by providing that such extra documents must be returned and not considered in order to determine compliance. Presentation of such extra documents accordingly does not render the credit noncompliant – even if the extra document is clearly inconsistent with another required document. The fourth point therefore overrides the third point. The implication of this position is that banks must realise that they are concerned only with documents required in the credit and have no duty to examine any additional documents presented by the beneficiary.⁹¹

Finally article 13(a) also makes the point that the bank's duty is to examine the documents with "reasonable care". Reasonable care refers to the care that is applied by a particular bank experienced to deal with documentary credit transactions.⁹² Only when documents appear upon reasonable and careful examination to comply with the terms and conditions of the credit will they be accepted by the examining bank.⁹³ If the documents presented comply with this standard then such presentation must be regarded as complying even if the examiner gripped with extra eagerness not required by the UCP discovers discrepancies.⁹⁴ Discrepancies cannot depend on the degree of inquisitiveness of the bank.⁹⁵ If the bank examines the documents

⁹⁰ Ibid.

⁹¹ UCP 500 Art 13; ICC (n81) 40.

⁹² Jack (n65) 173.

⁹³ Hapgood *Paget's Law of Banking* (2007) 926.

⁹⁴ *Benjamin's Sale of Goods* (n60) at par 23-102.

⁹⁵ Ibid.

presented with reasonable care and they comply on their face then the bank would have discharged its duty as against its customer and is entitled to reimbursement.⁹⁶

Article 13 (a) must further be read in conjunction with article 15 which, according to Oelofse, is the provision most directly concerned with the principle of strict compliance.⁹⁷ Article 15 provides that, “[b]anks assume no responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s).....”⁹⁸. This, according to Oelofse, means that banks deal only with documents⁹⁹ and, more particularly, only at face value.¹⁰⁰ The case *United City Merchants (Investments) Ltd v Royal Bank of Canada*¹⁰¹ is especially relevant in this context. In this case Lord Diplock held that the bank should honour the credit based on apparently conforming documents even if the documents were not in fact conforming, due to a fraudulent alteration made by a third party on the bill of lading.¹⁰² Whether this is correct has been a subject of debate among scholars. Goode is of the view that a bank should not be compelled to pay against documents that it knows are non-conforming since they are forged.¹⁰³ Further to this, Hugo notes the bank should not pay on “apparently conforming documents” or “documents that conform on their face”, but, in accordance with article 9 against “the stipulated documents”.¹⁰⁴ Since the credit did not stipulate for the presentation of a fraudulently altered document, the bank cannot be expected to pay.¹⁰⁵

Provision for non-documentary conditions is encapsulated in Article 13(c). Non-documentary conditions do not stipulate the documents that must be presented in compliance with a letter of credit.¹⁰⁶ The problem with such conditions is that they will require the bank to look at the underlying transaction in an attempt to determine whether the condition has been met.¹⁰⁷ This then goes against the independence

⁹⁶ Hugo (n53) 596.

⁹⁷ Oelofse (n69) 276.

⁹⁸ UCP 500 art 15.

⁹⁹ UCP 500 article 13(a). Also see Oelofse (n69) 278.

¹⁰⁰ Oelofse (n69) 278.

¹⁰¹ [1983] AC 168 (HL).

¹⁰² Ibid.

¹⁰³ Goode *Commercial Law* (1995) 1008.

¹⁰⁴ Hugo (n53) 600.

¹⁰⁵ Hugo (n53) 595.

¹⁰⁶ Hugo *The Law Relating to Documentary Credits From a South African Perspective with Special Reference to The Legal Position of the Issuing and Confirming Bank* (1996 Thesis SA) 128; Hugo 1996 SA Merc LJ (n72) 158.

¹⁰⁷ Hugo (106) 129.

principle requiring banks not to look at the underlying transaction to determine compliance. Therefore, banks must disregard conditions in letters of credit that do not stipulate the documents to be presented to determine compliance and must regard such conditions as not stated.¹⁰⁸

Another important article in this regard is article 37(c). The greater part of article 37 (c) states that description of goods in a commercial invoice must correspond with the description in the credit. However, in all other documents, the goods may be described in general terms and must not be inconsistent with the description of the goods in the credit. This clearly deviates from the strict standard.¹⁰⁹ The UCP 500 seems to require a stricter standard of compliance for invoices as compared to other documents in a letter of credit. In documents presented other than in invoices, the standard of compliance is relaxed and need not be the mirror image of the requirements of the credit. Strict compliance is only required in invoices according to this provision. The justification of such provision may be found in the fact that invoices provide the description of goods that the seller will deliver to the buyer and as such banks are not knowledgeable about the goods which the parties deal with. Article 37(c) has now been replaced with article 14(d) in the UCP 600 which is discussed below.

In this light, one can say that the UCP 500 did attempt to bring clarity in relation to the examination and determination of conformity. Furthermore, it did try and introduce uniformity in the manner in which compliance is to be determined. However the UCP 500 did not give clear-cut guidelines that need to be followed in the determination of compliance. The question of when will documents be regarded as compliant under the UCP 500 was therefore not comprehensively cut out and made clear.

3.4 Provisions of the UCP 600

The UCP 600 has adopted a number of changes and has clarified some aspects that were regarded as having been vague or difficult to interpret in the UCP 500. Article

¹⁰⁸ Article 13(c) UCP 500.

¹⁰⁹ Hugo 1996 *SA Merc LJ* (n72)153.

14 dealing with the examination of presented documents under a letter of credit is the logical point of departure. This provision serves as the starting point in the examination of documents. Article 14(a) of the UCP 600 provides:

“A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.”

Four points emerge from this article. The first is that the test for compliance is the same whether the documents are being examined by the nominated bank, confirming bank or issuing bank. According to Van Niekerk and Schulze: “this examination rule does not apply to ‘banks’ (generically) but to a nominated bank acting on its nomination, a confirming bank (if any) and to the issuing bank”.¹¹⁰ They go on to point out that every bank is a nominated bank in a freely negotiable credit, therefore the standard applies to all banks.¹¹¹ The standard used does not vary depending on whether it is a beneficiary-bank relationship or applicant-bank relationship. Such provision tends to foster uniformity as all the mentioned banks in this provision will be required to use the same standard. This is unlike the bifurcated standard which was once applied in America where banks used either strict compliance or substantial compliance depending on whether the bank is dealing with the beneficiary or the applicant of the credit.¹¹²

The second point is that the bank in determining compliance must only have regard to documents tendered by the beneficiary. This strengthens the principle of autonomy that banks are not concerned with the underlying contracts or agreements that gave rise to the letter of credit.¹¹³ Furthermore, the provision fosters the documentary nature of credits.¹¹⁴ The provision marks out the extent of consideration to be given to documents presented by the bank’s document checker to establish conformity.¹¹⁵ The bank’s examiner must only consider the documents presented. In this regard article 14(a) must be read together with article 5, ie banks deals with only

¹¹⁰ Van Niekerk and Schulze (n63) 292.

¹¹¹ Ibid

¹¹² Oelofse (n69) 301.

¹¹³ UCP 600 Article 5; Murray Carole *Export Trade: The Law and Practice of International Trade* (2007) 195.

¹¹⁴ *Benjamin’s Sale of Goods* (n60) par 23-076.

¹¹⁵ *Benjamin’s Sale of Goods* (n60) par 23-102.

with documents and not with goods or services to which these documents relate. Payment must only be conditional on documentary compliance as the function of a bank is purely ministerial and not an investigative one.¹¹⁶

The third point is that, similar to the position under the UCP 500, the documents are to be examined “on their face”.¹¹⁷ The determination of conformity is done on a *prima facie* basis.¹¹⁸ As noted under the discussion of this provision under the UCP 500, this provision refers to all the data embodied in a document and not simply the front versus the back of a document.¹¹⁹ Examination is limited to consideration of the entire contents of documents presented and once again this reinforces the documentary nature of the credit.¹²⁰ However, this provision still does not shed light on whether an apparently conforming but fraudulently altered or forged document can be regarded as compliant (the *United City Merchants* problem referred to above).¹²¹

The fourth point that emerges from this article is that the purpose of the examination of the documents is to determine whether they constitute a “complying presentation”, a term defined in article 2 as follows: “[c]omplying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules (UCP) and international standard banking practice.”¹²² As was the position under the UCP 500 the determination whether the documents are complying is done by reference to the UCP, terms and conditions of the letter of credit and international standard banking practice. Banks only need to measure compliance on these given standards and must not consider extraneous information. It is nevertheless probably fair to say that the UCP 600 has presented better

¹¹⁶ *Benjamin's Sale of Goods* (n60) par 23-086; Adodo (n8) 133.

¹¹⁷ ICC (n85) stated that: “Whilst the phrase ‘on their face’ continues to remain in this article, it has been removed from all other articles of UCP 600. The phrase as it is used in relation to the examination of documents was seen to be a well-established concept understood by those in the legal profession and experienced documentary credit practitioners. The concept of ‘on their face’ does not refer to a simple front versus the back of a document, but extends to the review of data within a document in order to determine that a presentation complies with international standard banking practice and the principles contained in UCP..... Banks are not obliged to go beyond the face of a document to establish whether or not a document complies with a requirement in the UCP.”

¹¹⁸ Sarna *Letters of Credit the Law and Current Practice* (1986) 74.

¹¹⁹ Van Niekerk and Schulze (n63) 292.

¹²⁰ *Benjamin's Sale of Goods* (n60) 2071.

¹²¹ Cross reference to the discussion of this matter.

¹²² UCP 600 art 2.

guidance on how to determine compliance of documents (inter alia by specifying the bases upon which it must be determined).¹²³

It is of interest to note that the requirement in the UCP 500 that banks were to examine documents with “reasonable care” has been omitted in the UCP 600. Reasonable care simply means the care that would be exercised in the particular circumstances by a bank capable of handling documentary credit transactions.¹²⁴ It is said the current UCP 600 specifically omitted the words “with reasonable care” in order to impose a stricter liability on banks in their examination of documents.¹²⁵ The current duty required by the UCP 600 is not the mere duty to examine documents with reasonable care but to determine on the basis of the documents alone whether they appear on their face to constitute a complying presentation.¹²⁶ The change to remove the “reasonable care” requirement was prompted by certain changes made from the time when the UCP 500 was published, for example the publication of the ISBP which is now applied to the examination of most documents presented under documentary credit.¹²⁷

Amongst the more precise requirements article 14(d) is perhaps the most important. It provides that: “[d]ata in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated documents or the credit.”¹²⁸ This new provision goes somewhat further than article 37(c) of the UCP 500. It can be interpreted as a slight moderation of the standard of compliance (a softening of the rigours of strict compliance). The documents presented to a bank need not be verbatim to the documents stipulated in a credit. What is now required is that the contents of these documents generally be the same. No mirror-image compliance is required.¹²⁹ In addition the phrase “when read in context” means that a number of factors must be taken into account when determining compliance. These

¹²³ Schulze (n1) 242.

¹²⁴ Jack (n65) 173.

¹²⁵ Rodrigo “UCP 500 to 600: A forward Movement” 2011 *e Law Journal Murdoch University Electronic Journal of Law* 8.

¹²⁶ UCP 600 art 14; Van Niekerk and Schulze (n63) 292.

¹²⁷ ICC (n85) 62.

¹²⁸ UCP 600 art 14 (d).

¹²⁹ ICC (n85) 64; also see Schulze (n1) 243.

include: the requirements of the credit; the structure and purpose of the documents; and the international standard banking practice.¹³⁰ As noted, this is a clear deviation from the strict-compliance rule requiring banks not to look at the purpose of the documents. If properly read and understood and it emerges that the words in the documents presented are not identical but carry the same meaning and they correspond then the bank should not reject such documents.¹³¹

3.5 ISBP PROVISIONS

The ICC also introduced the ISBP to assist banks in determining whether a presentation of documents is conforming and to try to establish uniformity in international trade transactions in this regard. The ISBP 2007 revision is the most recent following the publication of the UCP 600. The ISBP cannot be said to reflect actual international standard banking practice since bank practices are different in different jurisdictions.¹³² Therefore, there is no clearly formulated “international standard banking practice” by which banks can measure conformity in documents and justify their decisions. In fact, as Kelly-Louw points out, “the drafters of the ISBP recognised that the law in certain countries may compel a practice different from that stated in the ISBP”.¹³³ The ISBP’s effect is destined to depend on its acceptance as a declaration or an authoritative statement of international practice developed by banks and referred to in article 13(a) of the UCP 500.¹³⁴

Regarding the relationship between the UCP and the ISBP it is noteworthy to point out, as Ellinger and Neo do, that the ISBP does not seek in any way to amend the UCP.¹³⁵ The ISBP, instead, attempts to explain how the practices articulated in the UCP are to be applied by documentary-credit practitioners.¹³⁶ The ISBP, therefore, does not seek to supersede the UCP but rather to compliment it. Although this was said with reference to the previous draft of the ISBP in conjunction with the UCP 500,

¹³⁰ICC (n85) 64.

¹³¹ Murray (n115) 198.

¹³² Oelofse (n69) 272.

¹³³ Kelly-Louw (n58) 62.

¹³⁴ Kelly-Louw (n58) 62.

¹³⁵ Ellinger and Neo *The law and practice of Documentary Letters of Credit* (2010) 32.

¹³⁶ *Ibid* 32.

it is suggested that the principle would still apply to the current ISBP and the UCP 600.

Should the ISBP indeed have the status of “standard international banking practice” or, in some other manner (for example by contractual incorporation) govern the relationship between the parties in a documentary credit transaction, some provisions will contribute towards more certainty relating to the question whether the documents can be regarded as compliant. Paragraph 25 of the ISBP, for example, provides as follows:

“[a] misspelling or typing error that does not affect the meaning of a word or the sentence in which it occurs, does not make a document discrepant. For example, a description of the merchandise as “mashine” instead of “machine”, “fountan pen” instead of “fountain pen” or “modle” instead of “model” would not make the document discrepant. However, a description as “model 123” instead of “model 321” would not be regarded as a typing error and would constitute a discrepancy.”¹³⁷

There is no room for literal compliance (or the mirror image) against this background. The provision clearly shows that banks need not act like robots when trying to determine compliance of documents presented under letters of credit. Typographical and spelling errors, and other obviously trivial differences between the documents and the credit do not to render the presentation non-compliant under the ISBP.¹³⁸ It would probably be fair to say, in general terms, that the ISBP favours fairly strict compliance, but allows trivial discrepancies and obvious typographical and spelling errors.

Moreover, paragraph 128 of the ISBP requires that the description of goods in charter-party bills of lading do not conflict with that stated in the credit but may simply be shown in general terms.¹³⁹ The requirement is not that the data content be identical but should not conflict with the contents of other documents presented under the credit. This is entirely consistent with article 14(d) of the UCP 600.¹⁴⁰ Such provisions have put the strict-compliance rule under pressure as documents which

¹³⁷ ISBP 2007 revision par 25.

¹³⁸ Kelly-Louw (n58) 61& 65.

¹³⁹ ISBP 2007 revision paragraph 128.

¹⁴⁰ Kelly-Louw (n58) 64.

are generally conforming can be tendered and honoured following the UCP 600 and the ISBP.

3.6 Conclusion

The regulatory instruments introduced by the ICC have brought some clarity to the examination of documents. There are guidelines for examining compliance which banks adhere to. However, because the application of these instruments to letter-of-credit transactions is dependent on the parties incorporating them into their contracts, banks may be faced with a difficult situation where parties do not wish to have the UCP or ISBP govern their contracts. Under such circumstances it becomes difficult to measure compliance of documents. However, the UCP and the ISBP generally do not require mirror-image compliance and as such the determination of conformity is no longer as exacting a task as was required under literal compliance. The regulatory instruments have therefore lightened the burden for banks by not requiring them to require literal conformity in documents.

4. Final Conclusion

The rigour required for documents to be conforming is now somewhat relaxed compared to that required under literal compliance. In addition guidelines have been set to determine compliance. However, some of these guidelines that banks use to determine conformity need to be clarified, eg what exactly is meant by international standard banking practice. Against this background one can suggest that South African banks should incline to a strict but slightly relaxed standard of determination of compliance. This is achieved by the incorporation of the UCP into letter-of-credit transactions with the consequence that the majority of these transactions are governed by a uniform standard of compliance.

The requirement that documents presented must be the mirror image of the stipulated requirements in a letter of credit was burdensome on banks and as such resulted in multiple credits being rejected as banks had to look at every letter and punctuation for compliance. Introduction of the UCP and the UCP 500 in particular saw change in the manner that banks determine compliance. Reference to an

objective standard of compliance was made in a bid to introduce uniformity and certainty when determining conformity. However, the UCP 500 did not outline comprehensively how compliance is to be determined save for saying documents must “comply on their face”. The UCP 600 reformulated some provisions of the UCP 500 and brought more clarity in certain respects as discussed above.

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