SOUTH GAUTENG HIGH COURT, JOHANNESBURG

CASE NO: 2011/07680

In the matter between:

CASEY, PAUL	First Applicant
KIMBERLEY ROLLER MILLS (PTY) LTD	Second Applicant
and	
FIRST NATIONAL BANK	Respondent

SUMMARY

SPILG, J:

Letters of Credit: *Nature of irrevocable standby letter of credit (documentary credit). It remains an autonomous instrument independent of the primary contract even where customer of foreign issuing bank effectively securing payment for incola debtor with scope for challenge being limited effectively to fraud.* Loomcraft Fabrics CC v Nedbank Ltd and Another 1996 (1) SA 812 (A) *applied.*

UCP 500: *Application of International Chamber of Commerce's (ICC) Uniform Customs and Practice for Documentary Credits. Articles 9(d) (i), (iv), Article 13 and Article 48 considered.*

Presciption *, Basis upon which prescription applies to Letters of Credit. In casu; the issuing bank had extend the Credit from time to time. If issuing bank not authorised to extend the Credit then customer's remedy lies against his bank for breach of mandate.*

Quaere: *Level of compliance with terms of Letter of Credit and the term "strict compliance" as applied in cases such as* Kredietbank Antwerp v Midland Bank Plc and Karaganda Ltd [1999] Lloyd's Rep. Bank 219 CA.

SOUTH GAUTENG HIGH COURT, JOHANNESBURG

CASE NO: 2011/07680

(1) REPORTABLE: YES / ~~NO~~
(2) OF INTEREST TO OTHER JUDGES: YES/~~NO~~
(3) REVISED.

18/4/2012

In the matter between:

CASEY, PAUL First Applicant

KIMBERLEY ROLLER MILLS (PTY) LTD Second Applicant

and

FIRST NATIONAL BANK Respondent

JUDGMENT

SPILG, J:

INTRODUCTION

1. In 1998 the Second Applicant, which will be referred to as Kimberley RM, obtained a one year term finance facility of R850 000 from the Respondent ("*FNB*"). The facility was provided against the receipt of both an unlimited suretyship by one of Kimberley RM's directors, a Mr Rauff, and also an "*Irrevocable Standby Letter of Credit*" for U$ 200 000 issued NationsBank NA (now *Bank of America*) in favour of FNB. Bank of America have been the bankers of Mr Casey who is the First Applicant. Mr Casey is a personal friend of Mr Rauff.

2. The term facility was increased and extended from time to time. On 12 August 2000 the facility, now increased to R980 000, was extended to 5 March 2001. Kimberley RM did not repay these advances. However in March 2005 it was granted a structured trade facility of R4.4 million for a period of one year repayable on 5 March 2006. A facility letter was signed by the company and the bank recording the terms, which included the provision of security as a condition precedent. On 29 June 2006 the facility was extended by way of a written addendum between the company and FNB to 15 March 2007. No further written extension was granted. It is evident that the Second Applicant's liability which existed at the end of March 2001 and which, during the intervening period prior to March 2005, had grown with interest charges, was effectively transferred out of the current or business account by agreement into a separate loan or advance account so as to treat it separately from the Second Applicant's ordinary trading account. This is by no means unusual in corporate client banking.

3. The Standby Letter of Credit (which will be referred to as an *"LC"*) had also been extended by way of an annual amendment issued by Bank of America. On 15 March 2010, in terms of a SWIFT *Amendment to a Documentary Credit* (noted as amendment no 14 to the LC originally issued on 2 June 1999) issued by Bank of America the new date of expiry was stipulated as 31 March 2011, it being noted in the narrative section that *"ALL OTHER TERMS AND CONDITIONS REMAIN UNCHANGED"*.

SWIFT is the acronym of the Society for Worldwide Interbank Financial Telecommunication.

4. It should be noted that one of the conditions contained in the letter granting the 2005 facility to Kimberley RM of R4.4 million was the provision of an: "*Acceptable Irrevocable Standby Letter of Credit in favour of FNB from Bank of America guaranteeing payment to us should you not meet your obligations in respect of the agreed facility with us*".

   The SWIFT *Amendment* (identified as amendment no 09*)* dated 24 March 2005 expired on 31 March 2006. However no subsequent SWIFT *Amendments* were attached to the papers until the *Amendment* dated 15 March 2010 (amendment no 14).

5. Despite certain anomalies which have already been mentioned, Mr Casey confirms in his founding affidavit that the LC was *"periodically increased so that, at date hereof, it was to the value of U$420 000".* Moreover in the replying affidavit, it is said that *"the fact that the First Applicant* (Mr Casey) *might or might not have authorised an extension of the expiry date in 2000 is of absolutely no relevance".* This was said in response to FNB's averment that it never requested the Bank of America to amend the expiry date of the LC and could show, from certain documents disclosed in response to a Rule 35(13) application for production, that Mr Casey had in fact authorised the Bank of America to extend the maturity of the LC to beyond 2000 and at some stage Mr Rauff had added in manuscript to a copy of the 2005 facility letter mentioned earlier that "*I will have Mr Casey attend to the required increase on his return to Vancouver – see my email of today 05 Sept 2005."*

6. Accordingly at face value the First Applicant's case is not that Bank of America had extended the expiry of the LC without his authority. I will return to this when considering the general inviolability of LCs and against whom relief may be claimed if issued or paid out other than in terms of the

authority obtained (whether to issue or subsequently to amend) by the issuing bank from its own customer.

7. It will be recalled that the liability of Kimberley RM under the 2005 agreement had become due owing and payable when FNB did not extend its facility beyond 31 March 2007. The effect is that the debt owed by Kimberley RM would become prescribed on 1 April 2010 absent legal demand or interruption under the provisions of the Prescription Act 69 of 1968.

8. Sometime after July 2010 without prejudice negotiations took place between the Second Applicant and FNB. During October 2010 FNB apparently advised that it would present the LC for payment. This prompted the Applicants' attorneys on 26 October 2010 to require an undertaking from FNB that it would not present the LC because "*.... the claim against our client has become prescribed and, consequently, also any claim against the Surety*". This was followed up the following day with the threat of interdictory proceedings if an undertaking was not forthcoming. On the 28th October the Applicants' attorneys apparently contended that it would be unlawful for FNB to present the LC. This was rejected by FNB.

9. On 29 October 2010 the Applicants' attorneys advised that an urgent application would be brought later that day. The response was that the LC had already been called up. It is evident that without responding to the earlier communications FNB during the evening of 28 October presented the LC for payment to Bank of America. The SWIFT reads:

"KIMBERLEY Roller Mills (PTY) LTD has not met his/its obligations to firstrand bank limited, in respect of the facilities granted by FIRSTRAND BANK LIMITED.,

THEREFORE USD 420 000.00 IS NOW DUE AND PAYABLE UNDER BANK OF AMERICA IRREVOCABLE STANDBY LETTER OF CREDIT NUMBER 972458.

KINDLY CREDIT THE FOLLOWING ACCOUNT IMMEDIATELY...."

10. The LC was subsequently paid out by Bank of America to FNB.

THE ISSUES

11. There are two issues regarding the merits. Principally the one, already foreshadowed in the extract from the Applicants' emails of late October, is that an LC constitutes security ancillary to the principal debt and when FNB presented the LC to Bank of America it falsely asserted that the debt was due when it knew that the debt had prescribed and that the amount claimed contravened the *in duplum* rule. Following from the last point, the other issue is that the amount claimed against Kimberley RM is more than double the principal debt and accordingly FNB cannot recover more than that amount by reason of the *in duplum* rule. See *Ethekweni Municipality v Verulam Medicentre (Pty) Ltd* [2006] 3 AllSA 325 (SCA).

12. There is also a dispute about whether FNB effectively frustrated the Applicants from launching an urgent application prior to payment. In my view there is nothing in the present application that turns on this, not even in regard to costs.

13. The Applicants however seek costs against in relation to an abortive Rule 35(12) and (14) application brought by FNB against them for the production of documents. Although the Applicants contend that they responded fully, they claim that the applications were irregular and vexatious.

NATURE OF LETTERS OF CREDIT

14. An irrevocable standby letter of credit, also referred to as an irrevocable documentary credit, provides an effective form of securitisation for international transactions or obligations. It facilitates cross border trade and is most prevalent in securing payment for goods shipped between exporters and importers. In its most basic form the LC arises when an issuing bank, acting at the request of a customer (usually the person liable to pay for the goods) or on its own behalf, assumes an obligation upon the presentation of the stipulated documents (such as a bill of lading and independently verified certificates of origin, quality, quantity or other certificate of compliance requirements), and provided the terms and conditions of the LC are complied with, to pay an amount into the beneficiary's account irrespective of any dispute between the parties to the transaction involving the sale of the merchandise itself. See generally Article 2 of UCP500 the relevance of which is explained in para 19.

15. The inherent advantage of an instrument of this nature has led to its utilisation in other areas of commerce. In the present case it is utilised to secure payment of monies held oversees by a person not party to the original purchase and sale transaction.

16. In *Loomcraft Fabrics CC v Nedbank Ltd and Another* 1996 (1) SA 812 (A) at 816 D - F the court adopted the following passage from *R D Harbottle (Mercantile) Ltd and Another v National Westminster Bank Ltd and Others* [1977] 2 All ER 862 (QB) at 870*b-d* :

> *'It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the lifeblood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts. The courts are not F concerned with their difficulties to enforce such claims; these are risks which the merchants take. In this case the plaintiffs took the*

risk of the unconditional wording of the guarantees. The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged.' (emphasis added)

In *United City Merchants (investments) Ltd and others v Royal Bank of Canada and Others* [1982] 2 All ER 720, a case applied in *Loomcraft*, Lord Diplock said at 725d and f;

"if on their face the documents presented to the confirming bank by the seller conform with the requirements of the credit as notified to him by the confirming bank, that bank is under a contractual obligation to the seller to honour the credit ..... The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give the seller an assured right to be paid before he parts with control of the goods that does not permit of any dispute with the buyer as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment of payment"

17. In *Loomcraft* the then Appellate Division dealt, at 816G - 817G, with the disastrous consequences to international trade if the purpose of LCs was undermined and referred to the well established exception which would not permit payment if the beneficiary is party to a fraud in relation to the documents presented to the bank in support of the right to payment under the LC. See also *Phillips and Another v Standard Bank of South Africa Ltd and Others* 1985 (3) SA 301 (WLD) at 304C and *Ex parte Sapan Trading (Pty) Ltd* 1995 (1) SA 218 (WLD) at 224H.

18. Mr Casey has sought to bring himself within the ambit of this exception by contending that a fraud was committed on him when the bank certified that the amount was due, owing and payable by Kimberley RM when, so it is contended, the debt had prescribed and when the amount was in contravention of the *in duplum* rule.

19. The practice regarding irrevocable credits is subject to a body of rules formulated by the International Chamber of Commerce (ICC) known as the *Uniform Customs and Practice for Documentary Credits*, or UCP. The 1993 UCP Revision is known as UCP 500. The current revision of 2007 is

known as UCP 600. The LC before me, in its terms, is said to be subject to the 1993 revision. The parties appear to accept that UCP 600 did not automatically supplant it. I do not believe that anything turns on this.

20. It is established law that a standby letter of credit is independent of the primary contract. Ordinarily that would be the agreement between the purchaser and seller. The effect is that the buyer cannot go behind the document and attempt to stop or suspend payment because of complaints concerning the quality of the goods or other alleged breaches of contract by the seller except where the ultimate beneficiary was fraudulent. See the cases cited in paras [16] and [17] with regard to the autonomous nature of LCs.

21. The corollary is that the party providing the funds will seek protection by requiring, through agreement, an objective determination of compliance, in the form of documents, which must be produced before payment can be effected under the LC. These documentary requirements are inserted in the LC as the conditions to be met before the beneficiary will be entitled to payment on it.

22. Ordinarily the banks act as facilitators for the transfer of funds. The issuing bank will grant an irrevocable LC for the transfer of funds which it has secured at its customer's expense (usually the importer) on the production of documents that are identified in the LC upon verification by the confirming bank (usually the bank of the beneficiary importer) of compliance with the terms of the LC.

23. The interaction between these three parties is evident in relation to amendments to an LC. In this regard *Halsbury's Laws of England* 4th ed (Re-issue) vol. 3 (1) para 244 on the subject of banking is edifying; an "... *irrevocable credit can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank, if any, and the*

beneficiary; and partial acceptance of amendments contained in one and the same advice of amendment is not allowed and consequently will not be given any effect."

See also Article 9(d) (i) and (iv) read with Article 48 of UCP 500 in respect of which *Halsbury* at para 244 ftn 3 says the following: "*Although this provision makes no reference to the party applying for the credit, the issuing bank will ordinarily put itself at risk if it consents to an amendment without the prior consent of the applicant*"

24. The nature and legitimacy of LCs as a commercial instrument requires there to be strict compliance with its terms. To this end *Halsbury* at 248 notes:

> "*The documents must conform strictly with the terms of the credit; and there is no room for documents which are almost the same or which will do just as well as those specified.*"

See the case law cited at footnote 1 and para 249. See also *Paget's Law of Banking* at para 35.20. *Paget* at para 35.25 notes that in terms of Article 9(d)(i) an irrevocable LC cannot be amended or cancelled without the agreement of the issuing bank, the confirming bank (if any) and the beneficiary, although under Article 9(d)(ii) the issuing bank is bound immediately upon the issue of the LC, whereas the confirming bank may choose not to amend.

25. In this context it is significant that in *Position Paper No. 1*, the ICC's Commission on Banking Techniques Practice deprecated the practice of certain issuing and advising banks to incorporate a provision that an amendment becomes automatically effective unless formally rejected by the beneficiary within a specified time or by a specified date.

26. I do not wish to suggest that by strict compliance I mean rigid or exact literal compliance with the wording of the LC. That is not an issue before me and I do not wish to go beyond the confines of the case. Article 13 of

UCP 500, which is concerned with the standard of scrutiny required by a banker of an LC or similar documentary credit instrument, provides in sub-Article (a) that all documents stipulated in such instrument must be examined " *...to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit ..... determined by international standard banking practice as reflected in these Articles .* (emphasis added). See also Articles 14(a) –(c).

Suffice it that the English courts distinguish between "*strict*" compliance and "*exact literal compliance'* but do not consider "*substantial compliance"* as sufficient. See *Banque de L'Indochine et de Suez S.A. v J.H. Rayner (Mincing Lane) Ltd* [1983] QB 711 CA at 721D-722B and *Kredietbank Antwerp v Midland Bank Plc and Karaganda Ltd* [1999] Lloyd's Rep. Bank 219 CA at 223 para 12 (see generally from p222 para 7 to p223 para 11)

27. Mr Casey contends that the debt has prescribed although it is common cause that the issuing bank extended the LC from time to time. If the issuing bank did not have authority to extend the period then that cannot affect the recipient's rights. It is for Mr Casey to approach his banker as the issuer of the LC to claim a refund on the ground that the bank failed to act in terms of its mandate, an ordinary claim based on the banker/customer relationship.

28. Commercial and banking law relating to LCs emphasises the need for strict adherence to the terms of the LC by the confirming banker where one is appointed. In the present case the confirming banker and the beneficiary are one and the same. In terms of the LC, FNB as confirming banker was obliged to authenticate that:

> " *KIMBERLEY Roller Mills (PTY) LTD. has not met his/its obligations to first NATIONAL BANK OF SOUTHERN AFRICA LTD, in respect of the facilities granted by FIRST NATIONAL BANK OF SOUTHERN AFRICA LTD.THEREFORE USD (INSERT AMOUNT) IS NOW DUE AND PAYABLE UNDER NATIONSBANK, N.A. IRREVOCABLE STANDBY LETTER OF CREDIT NUMBER 972458."*

29. On a plain reading, the LC is triggered if Kimberley RM does not meet its obligations to FNB (the successor in title to First National Bank of Southern Africa Ltd). On an ordinary interpretation of the document the catalyst for payment is not that the amount is due and payable since under the LC that is simply the *consequence* flowing from Kimberley RM not meeting its obligations. If the term had required FNB to authenticate that an amount was "*CURRENTLY DUE OWING AND PAYABLE* " then there might be scope to argue that the intervention of prescription would not allow for authentication.

30. In the present case it is common cause that Kimberley RM had not met its obligations. The interpretation I have adopted is also in conformity with the conduct of Mr Casey who had to consciously instruct his bankers to extend the LC each year, and did so.

31. The next point raised by Mr Casey regarding prescription seeks to rely on the autonomous nature of the LC. Once again if the requirement for payment was that a specified amount was due, owing and payable then it is not the self-standing nature of the LC which is decisive but rather whether the requirement of the LC had been satisfied. However once FNB authenticates that Kimberley RM has not met its obligations then it does not matter when the obligation was incurred, as long as the LC remains extant. As mentioned earlier the papers reveal that Mr Casey dutifully went to his bankers and instructed them to extend the expiry date of the LC.

32. As a self standing obligation the LC is dependent only on its own terms for continued validity. I have found that these terms require no more than that Kimberley RM did not meet its obligations to FNB and that the LC, which by its nature is of short duration (or extended for short durations at a time) remains extant. If there was no intention to be bound in 2009 for these outstanding obligations then there was no need for Mr Rouff to try and settle them or for Mr Casey to have continued extending the LC year on year. The extension of the LC appears to have been the reason for FNB

continuing with negotiations for the repayment and not calling up the amount immediately.

33. The Applicants also suggested that the debt had prescribed in 2001 on the basis that the advance facility was a separate transaction that had been incurred in 1998. I do not agree. It is evident that the 2005 advance was a consolidation of liability hitherto incurred by the company, particularly as the company confirms that no money was actually advanced pursuant to the 2005 agreement.

34. I turn to the application of the *in duplum* rule. The amount of U$ 420 000 is the equivalent of just under R2.9 million provided the exchange rate does not exceed 7:1 against the Rand. Considering that the original debt was reconstituted by voluntary agreement as a new capital advance, it does not appear that there is any scope for applying the rule.

COSTS

35. In my view the desirability of bringing the Rule 35 (14) application is evident. In particular FNB required sight of documents, such as the instructions from Mr Casey to his bankers regarding the extension of the LCs. It is however correct that FNB should have in its possession all the documentation regarding their dealings with the Applicants and no explanation is tendered as to why it asked for these additional documents. The application produced the desired result of establishing that Mr Casey had continued to instruct his bankers to extend the LCs; this could not have been achieved without the application.

36. However the Respondent did not require just under half of the documents requested. Accordingly it should not be entitled to tax more than half the costs of the Rule 35(14) application.

ORDER

37. I accordingly order that:

a. The application is dismissed;

b. The Applicants are to pay the Respondent's costs save for half the costs of the Rule 35 application.

SPILG J

DATE OF HEARING:	11 March 2011
EX PARTE JUDGMENT:	8 August 2011
FOR APPLICANTS:	Adv AJ Bester SC
	Van Zyl le Roux Attorneys
FOR RESPONDENTS:	Adv I Miltz
	Edward Nathan Sonnenbergs