

Beneficiary Fraud and Demand Guarantees

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Abstract

It is settled in South African and English law that for the fraud exception to apply to demand guarantees or letters of credit the fraud must have been committed by the beneficiary (or his agent with the beneficiary's knowledge) and not by a third party. Even where the fraud relates to a forgery or materially fraudulent document, the fraud must have been committed by the beneficiary for the exception to apply. This is in contrast with American law, where the fraud relating to forgeries and materially fraudulent documents does not necessarily have to be committed by the beneficiary. This contribution considers the law in this regard in these three jurisdictions.

Keywords

Demand guarantee; letter of credit; fraud; forgery; materially fraudulent; third party fraud; interdict/injunction; independence principle.

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1 Introduction

In *Edward Owen Engineering Ltd v Barclays Bank International Ltd* Lord Denning MR said:¹

[A demand guarantee] has many similarities to a letter of credit, with which of course we are very familiar. It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and seller must be settled between themselves. The bank must honour the credit To this general principle there is an exception in the case of what is called established or obvious fraud to the knowledge of the bank.

Demand guarantees and letters of credits are all independent from the principal or underlying contracts (e.g., construction contract or sale agreement) and their operation will not be interfered with on grounds irrelevant to the guarantee/credit itself.² The independence principle is the foundation upon which these instruments are founded, but it is not absolute. The most prominent international exception to the principle of the independence of demand guarantees and letters of credit is fraud.³ "It is entirely consistent with the independence principle to say that a beneficiary who practices fraud on the applicant or the issuer is not entitled to payment

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¹ *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159 (CA) (hereafter *Edward Owen*) 169A-D.

² Bertrams *Bank Guarantees* 11.

³ For a discussion of other possible exceptions under the South African law, see Kelly-Louw "Limiting Exceptions" 197-218; Lupton and Kelly 2020 *CILSA* 1-37; Kelly-Louw 2009 *CILSA* 339; Sharrock *Law of Banking* 451-455; Kelly-Louw and Fayers 2021 *THRHR* 515; and Kelly-Louw "Validity of the Underlying Contract" 110-128. For examples of cases where alternative exceptions were either raised and/or entertained by courts, see *Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture* (1672/2013) 2014 ZAGPPHC 695 (2 September 2014); *Hollard Insurance Co Ltd v Jeany Industrial Holdings (Pty) Ltd* (2015/17231) 2016 ZAGPJHC 175 (24 June 2016); *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 1 SA 70 (SCA); *Mattress House (Proprietary) Ltd v Investec Property Fund Ltd* (2017/36270) [2017] ZAGPJHC 298 (13 October 2017) (hereafter *Mattress House*); *Transnet SOC Limited v Absa Insurance Company Ltd* (08853/2016) 2019 ZAGPJHC 476 (24 October 2019); *Casey v Firstrand Bank Ltd* 2014 2 SA 374 (SCA); *Joint Venture Between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd* 2021 2 SA 137 (SCA) (hereafter *Casey*); *Bombardier Africa Alliance Consortium v Lombard Insurance Company* 2021 1 SA 397 (GP).

under the [letter of] credit [or demand guarantee]."⁴ Generally, an issuer/guarantor (e.g., a bank or insurer) is not under an obligation to dishonour, even if fraud is present. The issuer/guarantor may honour payment, provided it does so in good faith.⁵ However, sometimes the issuer/guarantor may be hesitant to pay and to risk a court's decision after the fact that the payment was in bad faith.⁶ Such hesitancy is also fuelled by the fact that guarantors/issuers that honour a credit or guarantee when they have clear notice of fraud are not entitled to reimbursement.⁷ An issuer/guarantor is entitled to reimbursement of "payments properly made" under a letter of credit/demand guarantee.⁸

In view of the documentary nature of demand guarantees and letters of credit, a guarantor/issuer is not required to look beyond the documents. Where no fraud is apparent on the face of the documents, it does not amount to bad faith for an issuer/guarantor to pay the beneficiary, even if confronted by the applicant's claim that there is fraud.⁹ In such an instance, "the law may not impose on the issuer [or guarantor] the burden of deciding within a short time which of the two parties is telling the truth".¹⁰ The issuer/guarantor is not under a duty to inquire into "whether there is tainted presentation or whether the underlying contract was fraudulent or whether the documents are a forgery".¹¹ In the absence of dishonesty, for instance some collusion between the issuer/guarantor and the beneficiary, such a payment under the credit or demand guarantee will not be in bad faith.¹²

The decision is left to the issuers/guarantors of demand guarantees/letters of credit themselves to decide whether it should refuse payment on the grounds of forgery or fraud. The issuer/guarantor is compelled to pay where a compliant demand for payment is made in terms of a demand guarantee/letter of credit and there is little or weak evidence of fraud. An American court in *Old Colony Trust Co v Lawyers' Title & Trust Co*¹³ aptly said in the 1920s that if the issuer of a letter of credit "knows that a document although correct in form, is, in point of fact, false or illegal, he cannot be called upon to recognize such a document as complying with the terms of a letter of credit". So, if the falsification or forgery is evident from the face of the documents, the issuer/guarantor is allowed to refuse payment even

⁴ Dolan *Law of Letters of Credit* para 7.04(2).

⁵ Dolan *Law of Letters of Credit* paras 7.04(2) and 7.4(g).

⁶ Dolan *Law of Letters of Credit* para 7.04(4)(h).

⁷ Dolan *Law of Letters of Credit* para 7.04(4)(g).

⁸ Dolan *Law of Letters of Credit* para 7.05(1).

⁹ Dolan *Law of Letters of Credit* para 7.04(4)(g).

¹⁰ Dolan *Law of Letters of Credit* para 7.04(4)(g).

¹¹ Chuah *Law of International Trade* 592.

¹² Dolan *Law of Letters of Credit* para 7.04(4)(g).

¹³ *Old Colony Trust Co v Lawyers' Title & Trust Co* 297 Fed 152 (2nd Cir 1924) 158.

without a court interdict¹⁴ (or injunction as it is commonly known in England or the United States of America (the USA)). Where the fraud is discovered before any payment is made by the issuer/guarantor the issuer/guarantor has the right to refuse payment. Independent of this right and in addition to this, the applicant of the letter of credit/demand guarantee may also apply for an interdict to restrain enforcement of the credit/guarantee by the beneficiary, if he¹⁵ can prove clear fraud on the part of the beneficiary of which the issuer/guarantor has knowledge.¹⁶ It is one thing to allege fraud and a completely different thing to prove actual fraud.¹⁷ The onus is on the applicant to prove the fraud to either prevent the issuer/guarantor from making payment or the beneficiary from making a demand by way of an interdict (injunction).¹⁸

The fraud exception is also ingrained in South African law.¹⁹ The court in *Loomcraft Fabrics CC v Nedbank Ltd*²⁰ underscored that fraud on the part of the beneficiary would have to be clearly established and that the onus would have to be discharged by proof on a balance of probabilities, and that alleged fraud would "not lightly be inferred".²¹ Clear fraud established on a

¹⁴ Van Niekerk and Schulze *South African Law of International Trade* 292.

¹⁵ In this contribution words in the plural also mean in the singular and *vice versa*, and words in the feminine also mean in the masculine.

¹⁶ Hugo 2002 SALJ 105-106.

¹⁷ Dolan *Law of Letters of Credit* para 7.04(2).

¹⁸ See *Raubex Construction v Bryte Insurance Company* (337/2018) 2019 ZASCA 14 (20 March 2019) (hereafter *Raubex*) para 8.

¹⁹ For a discussion of fraud, see Kelly-Louw *Selective Legal Aspects* ch 5; Van Niekerk and Schulze *South African Law of International Trade* 291-298; Sharrock *Law of Banking* 422-430, 449-451; and Kelly-Louw "Limiting Exceptions" 197-218. See also *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 2 SA 86 (SCA) (hereafter *Lombard Insurance*); *Eskom Holdings v Hitachi Power Africa* (139/2013) 2013 ZASCA 101 (12 September 2013); *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W) (hereafter *Phillips*); *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A); *Basil Read (Pty) Ltd v Nedbank Ltd* 2012 6 SA 514 (GSJ) (hereafter *Basil Read*); *Petric Construction CC t/a AB Construction v Toasty Trading t/a Furstenburg Property Development* 2009 5 SA 550 (ECG) (hereafter *Petric Construction*); *Group Five Power International (Pty) Limited v Cenpower Generation Company Limited* (2008/41068) 2018 ZAGPJHC 663 (16 November 2018) (hereafter *Group Five Power v Cenpower*) para 88; *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng* 2015 5 SA 26 (GJ) (hereafter *Group Five Construction v MEC*); *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 2 SA 382 (SCA) (hereafter *Coface*); *Firststrand Bank Ltd v Brera Investments CC* 2013 5 SA 556 (SCA); *Casey*; and *Denel Soc Ltd v Absa Bank Ltd* 2013 3 All SA 81 (GSJ).

²⁰ *Loomcraft Fabrics CC v Nedbank Ltd* 1996 1 SA 812 (A) (hereafter *Loomcraft*).

²¹ *Loomcraft* 817E-H. See also *Casey*; *ZZ Enterprises v Standard Bank of South Africa Ltd* 1995 CLD 769 (W); and *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* [2014] 1 All SA 307 (SCA) (hereafter *Guardrisk*) para 18.

balance of probabilities,²² provides an exceptional circumstance for an issuer/guarantor to escape the liability to pay.²³ South African courts may interdict the issuer/guarantor from making a payment and/or the beneficiary from making a demand or receiving payment.²⁴ The standard of proof required for fraud is very high (that is, clearly established fraud), and fraud must not be inferred easily, and interdicts are granted only in exceptional circumstances. "[T]he history of the fraud defense clearly supports efforts to restrict the defense, lest the credit lose its unique virtues as a commercial device."²⁵

A settled issue in relation to the fraud exception under the South African law is that the fraud must have been committed by the beneficiary²⁶ and not by a third party. If the established fraud was committed by the beneficiary, the payment in terms of the demand guarantee/letter of credit may be interdicted. However, instances may also arise where the fraud is not necessarily committed by a beneficiary, but by a third party, without any knowledge of the beneficiary. In such instances, the question arises as to whether an interdict could or should be possible. Under the South African law and English law an interdict/injunction is only possible where the fraud was committed by the beneficiary, while the contrast would be possible under the American law irrespective of whether a fraud relating to a forgery and/or materially fraudulent document was committed by the beneficiary or a third party.

This contribution considers the law in this regard in these three jurisdictions. It specifically focusses on whether fraud relating to forgeries and materially fraudulent documents regarding demand guarantees committed by a third party would fall within the scope of the fraud exception. The focus is on demand guarantees, but as letters of credit are so similar to demand guarantees in nature, a discussion of the one would automatically necessitate a discussion of the other. Case law regarding demand

²² The normal civil standard of proof is required to successfully obtain an interdict, namely proof on a balance of probabilities (see *Guardrisk* para 18). Nonetheless, it has been contended that in relation to interdicts concerning letters of credit/demand guarantees based on fraud the degree of proof that is required is clearly stricter than that which applies ordinarily in civil cases (see Kelly-Louw *Selective Legal Aspects* para 5.6.3.). But exactly how much more convincing the evidence must be for granting an interdict is not settled (see Van Niekerk and Schulze *South African Law of International Trade* 294; Oelofse *Law of Documentary Letters* 480).

²³ *Loomcraft*, compare *Group Five Power v Cenpower* para 88; and *Mattress House* para 25.

²⁴ See *Union Carriage and Wagon Company Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W) (hereafter *Union Carriage*); *Phillips*; *Petric Construction*; *Basil Read* para 31; *Loomcraft*; *Group Five Construction v MEC*.

²⁵ *Dolan Law of Letters of Credit* para 7.04(3)(c).

²⁶ See, e.g., *Lombard Insurance* para 20; *KNS Construction (Pty) Ltd v Mutual & Federal Insurance Co* 2015 JDR 0082 (GJ); *Basil Read* paras 26, 28; *Coface*.

guarantees also serves as authority for letters of credit and *vice versa* due to their similar nature.²⁷

2 Third-party fraud

2.1 South African law

South African law distinguishes between fraud committed by the beneficiary on the documents (referred to as "fraud in the narrow sense"), and fraud committed by the beneficiary that does not relate to the documents, but relates to the conduct of the beneficiary in terms of the underlying contract (referred to as "fraud in the wide sense").²⁸ Sometimes a wrong deduction is made from the letter of credit cases relating to the fraud exception, that the courts are willing to apply the fraud exception only where the falsification or forgery concerns the documents presented in terms of the credit (namely, fraud in the narrow sense).²⁹ Such a deduction is wrong as the courts have not yet showed that they are unwilling to interdict a bank from paying in the case of fraud concerning the conduct by the beneficiary in terms of the underlying contract.³⁰ Case law,³¹ particularly in relation to demand guarantees,³² demonstrates that the South African courts are likely to also consider fraud in the wide sense and to look beyond just the forgery or falsification of the documents presented in terms of the letter of credit in considering whether there was any fraud on the part of the beneficiary.³³

In *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng*³⁴ the court accepted established clear fraud in the wide sense as an exception in relation to demand guarantees. The court in *All Teckline Contractors Incorporated v Mutual and Federal Insurance Company Limited*³⁵ also illustrates courts' willingness to include fraud in the wide sense as constituting a ground to resist payment of a demand guarantee.

²⁷ Malek and Quest *Jack* 247 para 9.5; Lupton 2019 *SA Merc LJ* 400.

²⁸ Van Niekerk and Schulze *South African Law of International Trade* 291; Lupton 2019 *SA Merc LJ* 403.

²⁹ See, e.g., Van Niekerk and Schulze *South African Law of International Trade* 295-296.

³⁰ For arguments supporting the allowance of a fraud exception in the wide sense, see Van Niekerk and Schulze *South African Law of International Trade* 292, 295-296; Kelly-Louw *Selective Legal Aspects* paras 5.6.2, 5.6.6; Sharrock *Law of Banking* 429.

³¹ See, e.g., *Union Carriage*.

³² See, in particular, *Group Five Construction v MEC*; *All Teckline Contractors Incorporated v Mutual and Federal Insurance Company Limited* (37706/15) 2017 ZAGPJHC 272 (18 September 2017) (hereafter *All Teckline*).

³³ Van Niekerk and Schulze *South African Law of International Trade* 292, 295-296.

³⁴ *Group Five Construction v MEC*.

³⁵ *All Teckline*.

The concept/scope of fraud differ in jurisdictions. Byrne is correct when he says:³⁶

The difficulty with the term 'fraud' is that to civil law lawyers it connotes criminal activity, and to common law lawyers it connotes issue of intent. Neither is accurate. Letter of credit fraud applies when there is material deviation in the documentation presented, either because it is forged or fraudulent, or because there is a material deviation from the underlying transaction intended to be effected by the beneficiary.

Due to the payment obligation of the guarantor/issuer of a demand guarantee and letter of credit being wholly independent of the underlying contract between the applicant and the beneficiary, the guarantor/issuer can escape liability under South African law only in the case of clearly established fraud on the part of the beneficiary.³⁷ In *Loomcraft Fabrics CC v Nedbank Ltd*,³⁸ the Appellate Division (as it then was), stressed that if a party wanted to succeed in respect of the fraud exception, it had to prove that the beneficiary presented documents to the issuer of a letter of credit knowing that they contained material misrepresentations of fact upon which the issuer would rely and which they knew were untrue. The court also pointed out that "[m]ere error, misunderstanding or oversight, however unreasonable" could not amount to fraud. The party must not merely show that the beneficiary's "contentions were incorrect"; the party must also show that the beneficiary "knew it to be incorrect and that the contention was advanced in bad faith".³⁹

Since *Loomcraft*, the Supreme Court of Appeal and other high courts have confirmed on several occasions that fraud committed by the beneficiary constitutes a valid exception. For instance, in *Lombard Insurance*⁴⁰ the Supreme Court of Appeal held as follows:⁴¹

The bank undertakes to pay provided only that the conditions specified in the credit are met. The only basis upon which the bank can escape liability is proof of *fraud on the part of the beneficiary*. This exception falls within a narrow compass and applies where the seller, for the purpose of drawing on the credit, fraudulently presents to the bank documents that *to the seller's knowledge* misrepresents the material facts... .

³⁶ Byrne *Introduction to Demand Guarantees* 98.

³⁷ *Basil Read* paras 26, 28.

³⁸ *Loomcraft* 815G-816G.

³⁹ *Loomcraft* 822G-823C. See also *Raubex* para 24; *Phenix Construction Technologies (Pty) Ltd v Hollard Insurance Company Limited* (10995/2015) 2017 ZAGPJHC 174 (4 May 2017) (hereafter *Phenix*) paras 37, 38.

⁴⁰ *Lombard Insurance*.

⁴¹ *Lombard Insurance* para 20 (emphasis added.)

Furthermore, in *Koumantarakis Group CC v Mystic River Investments 45 (Pty) Ltd*⁴² the court said:⁴³

[t]he liability of the bank to the beneficiary to honour the credit arises upon presentment to the bank of the document specified in the credit. The bank will escape liability only upon proof of fraud *on the part of the beneficiary*.⁴⁴

The Supreme Court of Appeal in *Guardrisk*⁴⁵ also validated that if fraud existed when a demand for payment under a demand guarantee was made, the guarantor/issuer would be excused from having to make payment in terms thereof. In dealing with the fraud exception, Theron JA specified the following:⁴⁶

It is trite that where a beneficiary who makes a call on a guarantee does so *with knowledge* that it is not entitled to payment, our courts will step in to protect the bank and decline enforcement of the guarantee in question. This fraud exception falls within a narrow compass and applies where:

'... the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that *to his (the seller's) knowledge* are untrue.'

Under the South African law, the beneficiary or his agent acting on his behalf must be party to the fraud for the fraud exception to find application. Questions that arise include whether or not the beneficiary has to have actual knowledge of his agent's having made the forgery or a materially false statement or whether knowledge is to be attributed to the beneficiary.⁴⁷ Similar to the position under the English law, the answers to these questions are uncertain. The South African law regarding the fraud exception is generally similar to the English law. English law especially played and continues to play an essential role in the development of the law relating to demand guarantees/letters of credit in South Africa.⁴⁸

⁴² *Koumantarakis Group CC v Mystic River Investments 45 (Pty) Ltd* 2007 6 SA 404 (D) (hereafter *Koumantarakis*).

⁴³ *Koumantarakis* para 51.

⁴⁴ See also *Raubex* para 8.

⁴⁵ *Guardrisk*.

⁴⁶ *Guardrisk* para 17 (emphasis added).

⁴⁷ In *Phenix* the agent of the beneficiary of a demand guarantee made a demand on its behalf. From the facts, it is unclear how the agent was able to act on the beneficiary's behalf and whether the beneficiary was aware of the fraudulent behaviour of his agent. Nonetheless, in the end the court found that the demand for payment made by the beneficiary's agent was fraudulent as the agent lacked an honest belief in the validity of its demand for full payment under the demand guarantee (*Phenix* para 53) and its conduct reflected a "fraudulent motive" (*Phenix* para 42). Accordingly, the issuer/guarantor was excused from paying any amount under the demand guarantee (for a discussion, see Lupton 2019 *SA Merc LJ* 404-408).

⁴⁸ For that reason, decisions of the English and other Commonwealth countries' courts can be persuasive in the South African law (see Hugo 2014 *TSAR* 669; Van Niekerk and Schulze *South African Law of International Trade* 248).

2.2 English law

Under the English law the standard of proof required is "clear" or "obvious" fraud.⁴⁹ To be successful in invoking the fraud exception, it must also be shown that the fraud is known to the issuer/guarantor.⁵⁰ In addition, the evidence must also show that the only realistic inference to draw is that the demand is fraudulent.⁵¹ It is also required that the beneficiary must know of the fraud at the time of the presentation, because in the absence of such knowledge the beneficiary is not considered to be a party to the fraud.⁵² Thus, in terms of the English law an issuer/guarantor is absolved from paying under a letter of credit/demand guarantee where there is clear fraud of which the issuer/guarantor has knowledge and to which the beneficiary was a party.⁵³

The English law is very clear in that only clear fraud committed either by the beneficiary or his agent of which the beneficiary has knowledge will constitute an exception to the independence principle.⁵⁴ The leading case on the fraud rule in England, *United City Merchants (Investments) Ltd and Glass Fibres and Equipments Ltd v Royal Bank of Canada (Incorporated in Canada), Vitrorefuerzos SA and Banco Continental SA*,⁵⁵ made that abundantly clear. In this case, third parties (i.e., loading brokers), not acting for the beneficiaries (sellers) of a letter of credit and their assignee, had fraudulently entered an earlier date as the date of shipment on a notation stamped on the bill of lading. The confirming bank rejected the documents when they were presented for payment and the beneficiaries accordingly sued for wrongful dishonour.⁵⁶ The House of Lords confirmed that payment on a letter of credit had to be made, even where a beneficiary presented

⁴⁹ See *Edward Owen; R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] 1 QB 146 (CA); *Bolivinter Oil SA v Chase Manhattan Bank, Commercial Bank of Syria and General Company of Homes Refinery* [1984] 1 Lloyd's Rep 251 (CA). For a discussion of the standard of proof of fraud in the English law, see Malek and Quest *Jack* ch 9; Kelly-Louw *Selective Legal Aspects* para 5.4.3.

⁵⁰ See Kelly-Louw *Selective Legal Aspects* para 5.4.6.

⁵¹ *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554 (CA) 561. See also Kelly-Louw *Selective Legal Aspects* para 5.4.6.

⁵² Kelly-Louw *Selective Legal Aspects* para 5.4.6.

⁵³ Kelly-Louw *Selective Legal Aspects* para 5.4.6.

⁵⁴ Kelly-Louw *Selective Legal Aspects* para 5.4.1; Enonchong *Independence Principle* 95.

⁵⁵ *United City Merchants (Investments) Ltd and Glass Fibres and Equipments Ltd v Royal Bank of Canada (Incorporated in Canada), Vitrorefuerzos SA and Banco Continental SA* [1979] 1 Lloyd's Rep 267 (QB (Com Ct)); on appeal *sub nom* [1981] 1 Lloyd's Rep 604 (CA); and *reversd sub nom* [1983] AC 168 (HL).

⁵⁶ See *United City Merchants v Royal Bank of Canada* [1983] AC 168 (HL) 180-182.

fraudulent documents, provided the beneficiary was not a party to the fraud and the fraud was not apparent on the face of the documents.⁵⁷

Therefore, a court will grant an injunction (interdict) to the principal to prevent a call on a letter of credit/demand guarantee only where there is clear evidence of fraud available to the issuer/guarantor to which the beneficiary or his agent with the beneficiary's actual knowledge is a party.⁵⁸ The fraud exception does not include fraud by a third party of which the beneficiary has no knowledge.⁵⁹

Dishonesty on the part of the beneficiary under the English law is given much prominence, especially in cases involving forgeries and fraud.⁶⁰ English law considers fraud to involve dishonesty.⁶¹ If a "presenter makes a false representation without actual knowledge that it is false but with no honest belief in its truth" this could constitute a fraud in terms of the fraud exception.⁶² Therefore, if a beneficiary or a third party makes a materially false statement due to "an honest mistake and there was no intention to deceive" and he or the third party is "not aware of the false statement before presenting" the document it would be considered that no fraud was committed.⁶³ However, if the beneficiary has knowledge that a document is forged or materially fraudulent before presenting the document, he may be guilty of a fraud,⁶⁴ irrespective of whether he was party to the fraud. In *American Cyanamid Co v Ethicon Ltd*,⁶⁵ it was deemed that the bank should pay the beneficiary under the letter of credit despite the forged documents, as the beneficiary was not party to the forgery. In *Tukan Timber Ltd v Barclays Bank Plc*⁶⁶ it was also indorsed that a court could only interfere where the bank had notice of clear fraud committed by a beneficiary.⁶⁷

The court in *Montrod Ltd v Grundkötter Fleischvertriebs GmbH*⁶⁸ was concerned with the applicant's argument that the issuer should not pay against a document holding a forged signature. The court was convinced that the beneficiary was unaware of the forgery when he presented the

⁵⁷ *United City Merchants v Royal Bank of Canada* [1983] AC 168 (HL) 183.

⁵⁸ Chuah *Law of International Trade* para 11-073.

⁵⁹ Enonchong *Independence Principle* para 5.36.

⁶⁰ Chuah *Law of International Trade* 594.

⁶¹ Chuah *Law of International Trade* 594; Enonchong *Independence Principle* 101, 106.

⁶² Enonchong *Independence Principle* para 5.40.

⁶³ Enonchong *Independence Principle* para 5.31.

⁶⁴ Enonchong *Independence Principle* para 5.32.

⁶⁵ *American Cyanamid Co v Ethicon Ltd* [1975] AC 396 (HL).

⁶⁶ *Tukan Timber Ltd v Barclays Bank Plc* [1987] 1 Lloyd's Rep 171 (QB) (hereafter *Tukan Timber*).

⁶⁷ *Tukan Timber* 174.

⁶⁸ See *Montrod Ltd v Grundkötter Fleischvertriebs GmbH* [2001] 1 All ER (Comm) 368 (QB); [2002] 3 All ER 697 (CA) (hereafter *Montrod*); Kelly-Louw *Selective Legal Aspects* para 5.4.1.

document and found that the forgery or "nullity" exception to the independence principle was not available under the English law.⁶⁹ A document is a nullity "if it is forged or fraudulent in such a way as to destroy its essence".⁷⁰ So, even where a document presented to an issuer/guarantor could be a nullity due to its being a forgery or fraudulent, the issuer/guarantor is still under an obligation to pay, provided the beneficiary is not a party to that fraud.⁷¹

In terms of the English law issuers/guarantors are obliged to pay for documents that are nullities, provided the beneficiary (e.g., the seller and/or his agent(s)) have acted in good faith and the documents appear to conform.⁷² The issuer/guarantor is not under a duty to investigate the "genuineness of a signature which on its face purports to be the signature of the person named or described" in the letter of credit/demand guarantee.⁷³ It is a better rule that "a party innocent of any fraud should be entitled to reimbursement against documents which appear on their face to accord with the terms and conditions" of the credit/demand guarantee.⁷⁴ It is better because the rule will "assist the integrity of the system of documentary credits as a means of financing international transactions", while "any widening of the fraud exception will detract from it".⁷⁵

Furthermore, the issuer/guarantor should not be worried about the "'worth' of documents" as a "document can still be worthless even if it is not a nullity"; for instance, if it is discovered that the cargo perished before it was loaded.⁷⁶ This argument is based on the understanding that the applicant of a letter of credit/demand guarantee bears the ultimate risk "associated with documents which are apparently conformant but actually worthless".⁷⁷ The fraud must be committed by the beneficiary or at the very least, the beneficiary should not have any knowledge that a fraud or forgery had been committed by his agent.⁷⁸

⁶⁹ Dolan *Law of Letters of Credit* para 7.04(4)(b). Chuah points out that there is no definitive answer as to whether a nullity defence exists in the English law, and the *Montrod* judgment is persuasive that such a defence should not exist (Chuah *Law of International Trade* 593).

⁷⁰ Malek and Quest *Jack* 256 para 9.21 and the authority cited.

⁷¹ See *Montrod*.

⁷² See *Montrod*; Kelly-Louw *Selective Legal Aspects* para 5.4.1. See also *Gian Singh & Co Ltd v Banque de L'Indochine* [1974] 1 WLR 1234 where it was held that the bank was not liable for paying upon the tender of a forged document.

⁷³ Chuah *Law of International Trade* 592.

⁷⁴ Malek and Quest *Jack* 258 para 9.23.

⁷⁵ Malek and Quest *Jack* 258 para 9.23.

⁷⁶ Malek and Quest *Jack* 258 para 9.23.

⁷⁷ Malek and Quest *Jack* 258 para 9.23.

⁷⁸ Chuah agrees that whatever the fraud relates to, e.g., document-wise or in the underlying contract, the fraud must have been perpetrated by the beneficiary or his agent (Chuah *Law of International Trade* 593).

Under English law, it is unclear whether the beneficiary in regard to the context of the fraud exception will be liable for the fraud of his agent or whether the "agent's knowledge is to be imputed to the beneficiary".⁷⁹ Enonchong argues that if the "beneficiary's agent passes on a misrepresentation to the beneficiary who then presents it in good faith" to the guarantor/issuer it is likely that "the beneficiary will not be liable for the fraud of the agent if the beneficiary is himself an intended victim of the agent's fraud".⁸⁰

It is vital that the beneficiary should not have knowledge of the fraud at the time of making a demand.⁸¹ *Group Josi Re v Walbrook Insurance Co Ltd*⁸² stated that the *United City Merchants* decision showed that it did not matter that at the time of trial the beneficiary knew that the documents presented under the letter of credit were not truthful in a material respect. It was the time of presentation that was critical.⁸³ Undoubtedly, the beneficiary must not know of the fraud at the time of the presentation if he is to be shielded. If the beneficiary is unaware of the fraud or forgery at the time of presentation, he clearly cannot be party to the fraud, and it would be irrelevant if he learns about the fraud afterwards.⁸⁴

2.3 American law

The USA law regarding the identity of the fraudulent party that may invoke the fraud rule, particularly as it relates to forgeries and fraudulent documents, is slightly different to the English and South African law respectively.⁸⁵

The fraud rule under the USA law is exemplified in their Revised *Uniform Commercial Code* (UCC)⁸⁶ (last revised in 1995) article 5 section 5-109 (UCC 5-109).⁸⁷ UCC 5-109 stipulates that the required standard of fraud to invoke the fraud rule, is for the fraud involved to be "material".⁸⁸ Thus "material fraud" is the standard that is required.⁸⁹ Generally the scope and

⁷⁹ Enonchong *Independence Principle* para 5.35.

⁸⁰ Enonchong *Independence Principle* para 5.35 and the authority cited.

⁸¹ See Kelly-Louw *Selective Legal Aspects* para 5.4.4.

⁸² *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 Lloyd's Rep 345 (CA) (hereafter *Group Josi*).

⁸³ *Group Josi* 360.

⁸⁴ See Kelly-Louw *Selective Legal Aspects* para 5.4.4.

⁸⁵ See Kelly-Louw *Selective Legal Aspects* fn 157 in para 5.4.1, fn 323 in para 5.5.2.1, fn 401 in para 5.5.2.2.

⁸⁶ *Uniform Commercial Code of the United States* (hereafter UCC).

⁸⁷ *Uniform Commercial Code of the United States* (1995) art 5 s 5-109 (hereafter UCC 5-109). For a discussion of the fraud rule under UCC 5-109 and its predecessor, the prior UCC, the 1962 version, a 5 s 5-114(2) (hereafter "Prior UCC 5-114(2)"), see Dolan *Law of Letters of Credit* para 7.04.

⁸⁸ Official Comment 1 to s 5-109.

⁸⁹ Gao *Fraud Rule* 84.

meaning of materiality is left for the courts to decide. However, the Official Comment⁹⁰ stipulates that material fraud by the beneficiary occurs only when he has "no colorable right to expect honor and where there is no basis in fact to support such a right to honor".⁹¹

UCC 5-109 provides as follows:

- (a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would *facilitate a material fraud by the beneficiary on the issuer or applicant*:
 - (1) the issuer shall honor the presentation, if honor is demanded by
 - (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and
 - (2) the issuer, acting in good faith, may honor or dishonor the presentation in any other case.
- (b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would *facilitate a material fraud by the beneficiary* on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honouring a presentation or grant similar relief against the issuer or other persons only if the court finds that:
 - (1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;
 - (2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;
 - (3) all of the conditions to entitle a person to the relief under the law of this State have been met; and
 - (4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does

⁹⁰ Official Comment 1 to s 5-109.

⁹¹ See Hugo *Law Relating to Documentary Credits* 291-292; Dolan *Law of Letters of Credit* para 7.04(3) 7-70; Kelly-Louw *Selective Legal Aspects* para 5.5.2.2. Official Comment 1 to UCC 5-109 specifies that material fraud "requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction".

not qualify for protection under subsection (a)(1). (My emphasis.)⁹²

The general rule against which the fraud and forgery exceptions must be measured states⁹³ that "[e]xcept as otherwise provided in Section 5-109, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (e) appears on its face strictly to comply with the terms and conditions of the letter of credit".⁹⁴

UCC 5-109(a), caters for three fraud categories namely: (1) where a required document has been forged; (2) where a required document is materially fraudulent; and (3) where honour of the presentation "would facilitate a material fraud by the beneficiary on the issuer or applicant".⁹⁵ The section handles forgery and material fraud similarly.⁹⁶ Although the line between a forged document and a document that is materially fraudulent is somewhat blurred, Byrne says that there is a meaningful difference between them. He explains it as follows:⁹⁷

A forged document is one that is not authentic. A forged document, for example, could be an inspection certificate signed by the beneficiary posing as the inspector. Forged documents constitute letter of credit fraud. However, a fraudulent document is one that contains fraudulent information. The document could nonetheless be authentic. Not all fraudulent documents constitute letter of credit fraud. This is true because fraud is qualified by "material". Therefore, only material fraud is letter of credit fraud.⁹⁸

UCC 5-109 evidently also specifies that the fraud exception will apply not only in a case where a required document has been forged or is materially fraudulent, but also where there is fraud in the underlying transaction (i.e., "honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant").⁹⁹ The exception is phrased broadly and it clearly also includes fraud in the underlying transaction (thus "fraud in the wide" sense).¹⁰⁰ In dealing with fraud in the transaction, Dolan stresses "only the

⁹² UCC 5-109(a), like its predecessor, i.e., Prior UCC 5-114(2), also makes certain third parties immune from the fraud rule. UCC 5-109(a)(1) stipulates four instances where the issuer is nevertheless obliged to honour the presentation as against certain third parties, for instance parties who have given value in good faith. For more on this, see Gao 2002 *LMCLQ* 10.

⁹³ See UCC 5-108(a).

⁹⁴ See Kelly-Louw *Selective Legal Aspects* para 5.5.4.4.

⁹⁵ See Kelly-Louw *Selective Legal Aspects* para 5.5.2.2.

⁹⁶ Byrne *Introduction to Demand Guarantees* 99.

⁹⁷ Byrne *Introduction to Demand Guarantees* 99.

⁹⁸ Although "material fraud" is the standard of fraud under the fraud exception, UCC 5-109 does not define "material fraud". For more on what this would entail, see *Sztejn v J Henry Schroder Banking Corporation*³¹ NYS 2d 631 (1941); Byrne *Introduction to Demand Guarantees* 99; Kelly-Louw *Selective Legal Aspects* para 5.5.4.

⁹⁹ See Kelly-Louw *Selective Legal Aspects* para 5.5.3.

¹⁰⁰ See Kelly-Louw *Selective Legal Aspects* paras 5.5.3, 5.5.2.2. Prior UCC 5-114(2) provided: "[u]nless otherwise agreed when documents appear on their face to

unscrupulous beneficiary who intentionally practices fraud should be enjoined".¹⁰¹ So, where there is "no fraud in the document and no fraud practised by the beneficiary on the issuer [or applicant] an injunction is not proper" as "[f]raud by a third party does not justify stopping payment".¹⁰²

A question that sometimes causes uncertainty under American law is if the fraud must be committed by the beneficiary for the rule to apply when it relates to forgeries and materially fraudulent documents. Some argue that because UCC 5-109 specifically refers to the term "beneficiary" in stating that the fraud rule will be invoked if "a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud *by the beneficiary*" (emphasis added), they are of the opinion that this means that the section requires either forgery or material fraud *by the beneficiary*.¹⁰³ So, where fraud is perpetrated by someone else, an injunction is not possible.¹⁰⁴ However, Barnes strongly disagrees that the forgery or fraudulent document must have been committed by the beneficiary. He states that the UCC 5-109 fraud rule applies "if ... a required document is forged or materially fraudulent, or...".¹⁰⁵ He then motivates his view and adds:

Stop there. The syntax and punctuation of subsection (a) are sufficient to separate the two tests. The separation in the next subsection (b) confirms the separation in (a), as does official comment 1 to 5-109: 'This recodification makes clear that fraud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant.

comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7-507) or of a certified security (Section 8-108) or is forged or fraudulent or there is fraud in the transaction...". It thus included fraud where the required documents were forged or fraudulent or where there was "fraud in the transaction". The expression "fraud in the transaction" caused uncertainty and conflicting views. It was not clear whether the "transaction" referred to the relationship between the beneficiary and the issuer or to the underlying contract between the beneficiary and the applicant or to both. Some argued narrowly that the phrase should be limited by interpreting it to mean fraud in the letter of credit transaction and not fraud in the underlying transaction, while others took a less strict view and accepted that fraud in the underlying transaction could be sufficient (for more on this uncertainty, see Kelly-Louw *Selective Legal Aspects* paras 5.5.2.1, 5.5.2.2, 5.5.3). However, this uncertainty no longer exists as UCC 5-109 is drafted broadly enough to also include fraud in the underlying transaction (see Dolan *Law of Letters of Credit* paras 7.04(3), 7.04(3)(b); Kelly-Louw *Selective Legal Aspects* para 5.5.3).

¹⁰¹ Dolan *Law of Letters of Credit* para 7.04(2).

¹⁰² Dolan *Law of Letters of Credit* para 7.04(4)(c). See also *Accord Continental Grain Co v Meridien Int'l Bank Ltd* 894 F Supp 654 (SDNY 1995).

¹⁰³ See Kelly-Louw *Selective Legal Aspects* fn 401 in para 5.5.2.2.

¹⁰⁴ See Wunnicke, Wunnicke and Turner *Standby and Commercial Letters of Credit* 163.

¹⁰⁵ Unpublished notes by James G Barnes on 19 March 2022. Barnes is senior counsel with Baker & McKenzie LLP in the firm's Chicago, Illinois, office. The comments are made in his personal capacity and do not reflect his firm's views.

Gao holds a similar view. He highlights that under UCC 5-109 the fraud exception applies in two instances: (1) "a required document" presented is forged or materially fraudulent; or (2) "honor of the presentation" for payment would facilitate fraud by the beneficiary. Though the perpetrator will be the beneficiary in the latter case, he emphasizes that this will not automatically be so in the former case. He stresses that a forged or fraudulent document may be produced by somebody other than the beneficiary (e.g., by the insurer of the goods or the carrier or an engineer or architect in the case of a demand guarantee). Accordingly, UCC 5-109 has, in his view, therefore not completely ruled out the application of the fraud exception if fraud is perpetrated by someone other than the beneficiary. According to Gao, UCC 5-109 is essentially concerned with the nature of the documents tendered, rather than the identity of the fraudulent party.¹⁰⁶

Klein also supports Gao's opinion and adds:¹⁰⁷

If the beneficiary knowingly or unknowingly submits a forged or materially fraudulent document, the result is that the applicant is defrauded and should have a right to object to payment on that ground. The policy of UCC 5-109 is to give the applicant protection where otherwise he would be subject to material fraud by the beneficiary or the draw occurs as a result of [a] forged or materially fraudulent document. Besides the logic of Gao's position based on the alternate two (independent) bases for dishonor or injunction language of UCC 5-109 (where the first basis does not require a showing that the document was forged 'by the beneficiary'), the commentary and some of the cases talk about the right to enjoin a draw where there is "no colorable basis" for it. Putting aside the case of *TC Skyward v. Deutsche Bank*, the "no colorable basis" test does not on its face require a showing of scienter or intentional fraud. As a matter of grammar in the context of the alternate conditions used in UCC 5-109 for dishonor or injunction, the phrase 'by the beneficiary' doesn't modify the phrase where a document is forged or materially fraudulent.

It is thus evident that for the USA fraud rule to apply to forgeries and materially fraudulent documents (fraud in the narrow sense), the fraud need not necessarily have been committed by the beneficiary. Such a standpoint is contrary to the English and South African positions, discussed earlier, where this type of fraud must have been committed by the beneficiary. Under both the South African and English law fraud in the narrow sense must have been committed by the beneficiary, so if a third party forged a document that the beneficiary is unaware of, the beneficiary will be protected (unless of course the issuer knows about the forgery or fraudulent document). As already stated, the English law does not cater for a nullity exception so if a forgery on the document makes the document a nullity it will constitute a fraud only if it was committed by the beneficiary. "Absent

¹⁰⁶ See Gao *Fraud Rule* 116-117.

¹⁰⁷ Unpublished notes by Carter H Klein on 19 March 2022. Mr Klein is a partner at Jenner & Block (Chicago). The comments made are in Klein's personal capacity and do not represent the view of his firm.

clear beneficiary fraud, the English courts are inclined to see the issuer pay."¹⁰⁸ The fraud rule under the USA law in contrast caters for instances where the fraud relating to the document makes the document a nullity irrespective of whether the nullity was created by the beneficiary or not.¹⁰⁹

Under the English law and South African law honest belief on the part of the beneficiary is likely to be enough to exclude the fraud rule.¹¹⁰ The "central aspect of knowledge of the beneficiary to its material entitlement" has gained ground in both South African and English demand guarantee/letter of credit law to establish whether a demand is fraudulent.¹¹¹ Accordingly, the "behaviour of the beneficiary" is also considered.¹¹² However, under the American law for courts to intervene on the ground of fraud it is not necessary for the applicant of a credit/demand guarantee to demonstrate that the beneficiary acted deceitfully or with malicious intent.¹¹³ Furthermore, as neither UCC 5-109 nor its Official Comment insinuates that the beneficiary's intention to defraud should be proved, it appears that "material fraud"¹¹⁴ under UCC 5-109 considers more "the severity of the effect of the fraud on the transaction rather than the state of mind of the beneficiary".¹¹⁵

3 Closing comments

In *United City Merchants*¹¹⁶ the House of Lords refused to justify dishonour even though a document was admittedly false. The main reason for that

¹⁰⁸ Dolan *Law of Letters of Credit* para 7.04(4)(b) 7-94.

¹⁰⁹ Dolan *Law of Letters of Credit* para 7.04(4)(b) 7-94.

¹¹⁰ See Kelly-Louw *Selective Legal Aspects* paras 5.5.3, 5.4.2. In *Guardrisk* the South African Supreme Court of Appeal said (para 7): "It is trite that where a beneficiary who makes a call on a guarantee does so with knowledge that it is not entitled to payment, our courts will step in to protect the bank and decline enforcement of the guarantee in question." For a discussion that shows that the South African courts have moved towards a position that the concept of fraud in demand guarantees is similar to that held in English law (i.e., the absence of an "honest belief") see Marxen *Demand Guarantees* para 5.2.5; Lupton 2019 *SA Merc LJ* 403, 408, 414. In *Raubex* para 24 the Supreme Court of Appeal also said a "party has to go further and show that the representor advanced the contentions in bad faith, knowing them to be incorrect".

¹¹¹ Lupton 2019 *SA Merc LJ* 404.

¹¹² Lupton 2019 *SA Merc LJ* 404.

¹¹³ See Kelly-Louw *Selective Legal Aspects* para 5.5.3; *Rockwell International Systems Inc v Citibank NA and Bank Tejarat* 719 F 2d 583 (USCA 2nd Cir 1983) 589. See also *Dynamics Corporation of America v The Citizens and Southern National Bank* 356 F Supp 991 (ND Ga 1973); *Harris Corporation v National Iranian Radio and Television* 691 F 2d 1344 (11th Cir 1982); Gao *Fraud Rule* 97; Enonchong 2007 *LMCLQ* 86.

¹¹⁴ See Kelly-Louw *Selective Legal Aspects* para 5.5.3 and the discussion of "material fraud" as a standard of fraud under s 5-109 para 5.5.4.4.

¹¹⁵ See Buckley 1995 *JBFLP* 97. See also Gao *Fraud Rule* 85; Kelly-Louw *Selective Legal Aspects* para 5.5.3.

¹¹⁶ *United City Merchants v Royal Bank of Canada* [1983] AC 168 (HL).

was because it was not the beneficiary that had falsified documents, but a third party that had falsified the bills of lading by backdating them. The evidence presented showed that the beneficiary was unaware that the bills were false when he had presented them. In the House of Lords' opinion such a fraud on the part of the broker could not prevent the innocent beneficiary from obtaining payment under the credit. This judgment also serves as authority for the South African position on this matter, due to the importance/influence and close ties of the English law to the development of the South African law dealing with letters of credit/demand guarantees. However, the South African Supreme Court of Appeal and other high courts also independently echoed on several occasions that only beneficiary fraud will suffice, as mentioned above.

The *United City Merchants* case, however, is in conflict with USA UCC 5-109, where it does not matter whether the forgery or materially fraudulent document was made by the beneficiary or not.¹¹⁷ The American law in this regard is clearly based on the principle that "[i]t is also consistent with the spirit of the strict compliance rule to say that a beneficiary who presents fraudulent or false documents has not complied with the credit [demand guarantee]".¹¹⁸

For the fraud exception to apply to demand guarantees/letters of credit under the English and South African law respectively, the fraud must have been committed by the beneficiary (or his agent with the beneficiary's knowledge). If the beneficiary is not a party to the fraud, the exception will not find application. It will not suffice if it was committed by a third party or the beneficiary's agent without the beneficiary's knowledge. Even if the fraud relates to a forgery or materially fraudulent document, the fraud must have been committed by the beneficiary for the exception to apply. Neither of the jurisdictions acknowledges a nullity exception.

A more perplexed situation arises under the South African and English law where a fraud or forgery is committed by a third party without the knowledge of the beneficiary, but where he becomes aware of the fraud or forgery before or at the time of presentation. Guidance may be found in *Montrod*,¹¹⁹ where Judge Raymond Jack QC found that it was not dishonest for the beneficiary to request payment against documents which it had presented honestly even if by the time of payment it was known that a document was not truthful in a material respect.¹²⁰ In my view it is correct that such behaviour will not automatically amount to a fraud by the beneficiary, but it will ultimately depend on the merits/facts of the case whether the beneficiary

¹¹⁷ Dolan *Law of Letters of Credit* para 7.04(3)(c).

¹¹⁸ Dolan *Law of Letters of Credit* para 7.04(2).

¹¹⁹ See *Montrod*; Kelly-Louw *Selective Legal Aspects* para 5.4.1.

¹²⁰ See also Chuah *Law of International Trade* 593.

then also commits a fraud by proceeding with a demand, despite learning that a fraud or forgery was committed by a third party. Under the American law, the knowledge of the beneficiary at the time of presentation will be irrelevant.

It is clear from the above that neither the English courts nor the South African courts will recognise a fraud defense unless it is the beneficiary that practices the fraud.¹²¹ Dolan points out that the English position "puts greater risk of fraud and all risk of unknown forgery on the applicant" and makes "the English credits stronger, less susceptible to injunctions against payment".¹²² This is definitely true and also applies to the South African law. Not only is it more difficult generally under the English and South African law to obtain an injunction/interdict for fraud than under the American law,¹²³ the fraud exception under the first two jurisdictions is also more limited in its application, in that it is restricted to beneficiary fraud only. Barnes¹²⁴ indicates that when UCC 5-109 was drafted the intention was to:

maximise the usefulness and attractiveness of letters of credit to all concerned, which meant protecting applicants against beneficiary arguments that they were not trying to exploit the independence principle and were ignorant of what their freight forwarders were doing, while protecting beneficiaries with workable materiality requirements.

Although the English and South African law correspondingly are more stringent than the American law, by limiting forgeries or materially fraudulent documents to the beneficiary, they offer a better approach. It is not convincing that an innocent beneficiary should carry the risk of fraud if the forgery or fraudulent document was made by another party independently from and without knowledge of it by the beneficiary. It is essentially settled in practice that applicants of demand guarantees carry the risks of fraudulent and abusive calls on demand guarantees. Unlike consumer-related transactions, where there is a dire need for protection of the consumer and a more equal distribution of rights, commercial transactions are generally unequal relationships with one party inevitably holding more power, particularly bargaining power, than the other. In the USA's process of balancing the scales and providing for a more equal situation/fairness for all parties involved in a letter of credit transaction (by implication also demand guarantees) they have, in my view, tilted the scales too much in favour of the applicant of the credit and made the scope of fraud in relation to forgeries or materially fraudulent documents too broad. The USA allows *carte blanche* for fraud relating to forgeries and material fraud on the

¹²¹ Dolan *Law of Letters of Credit* para 7.04(4)(b) 7-93.

¹²² Dolan *Law of Letters of Credit* para 7.04(4)(b) 7-94.

¹²³ For detailed discussions of the difficulties of obtaining interdicts/injunctions under the English, American and South African law, see Kelly-Louw *Selective Legal Aspects* ch 5.

¹²⁴ Unpublished notes by James G Barnes on 21 March 2022; see also fn 105 above.

documents, but strangely limits fraud in the transaction to fraud committed by the beneficiary.

There are only two ways in which the sanctity and commercial usefulness of demand guarantees/letters of credit can truly be protected and maintained: firstly, seriously limiting the permissible list of exceptions to the independence principle; secondly, also limiting the actual application of an accepted exception. Solely limiting the list of exceptions will serve little purpose, if the limited list of exceptions is applied so broadly that if one looks closely at any particular one, it also includes other unintended exceptions. A demand guarantee is foremost a security instrument and its purpose is therefore "to serve as a risk mitigation tool to the beneficiary".¹²⁵ Undeniably, a demand guarantee may "work unfairly to the persons involved in transactions underlying it" but it "is part of the nature of the beast and follows from its autonomous nature".¹²⁶ The risk of unfair or abusive calls is inherent in demand guarantees and just by their very "nature and application" "heavy risks" are imposed on the applicants of these instruments.¹²⁷ So, if there is a need for a more equal division of rights/fairness or a more balanced instrument, it might serve the parties better rather to make use of alternative security instruments (e.g., suretyships).

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¹²⁵ Andrle 2021 *Documentary Credit World* 16-17; also see Kelly-Louw "Validity of the Underlying Contract" 127-128.

¹²⁶ *Standard Bank Namibia LTD v Karibib Construction Services* (Appeal Judgment) (case number SA 29/2017) [2019] NASC 593 (09 October 2019) para 22.

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Joint Venture Between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v South African National Roads Agency Soc Ltd 2021 2 SA 137 (SCA)

Koumantarakis Group CC v Mystic River Investments 45 (Pty) Ltd 2007 6 SA 404 (D)

KNS Construction (Pty) Ltd v Mutual & Federal Insurance Co 2015 JDR 0082 (GJ)

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Mattress House (Proprietary) Ltd v Investec Property Fund Ltd (2017/36270) [2017] ZAGPJHC 298 (13 October 2017)

Montrod Ltd v Grundkötter Fleischvertriebs GmbH [2001] 1 All ER (Comm) 368 (QBD); [2002] 3 All ER 697 (CA)

Old Colony Trust Co v Lawyers' Title & Trust Co 297 Fed 152 (2nd Cir 1924)

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Sulzer Pumps (South Africa) (Proprietary) Limited v Covec-MC Joint Venture (1672/2013) 2014 ZAGPPHC 695 (2 September 2014)

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Union Carriage and Wagon Company Ltd v Nedcor Bank Ltd 1996 CLR 724 (W)

United City Merchants (Investments) Ltd and Glass Fibres and Equipments Ltd v Royal Bank of Canada (Incorporated in Canada), Vitrorefuerzos SA and Banco Continental SA [1979] 1 Lloyd's Rep 267 (QB (Com Ct)); on appeal *sub nom* [1981] 1 Lloyd's Rep 604 (CA); and *revsd sub nom* [1983] AC 168 (HL)

United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd [1985] 2 Lloyd's Rep 554 (CA)

ZZ Enterprises v Standard Bank of South Africa Ltd 1995 CLD 769 (W)

Legislation

Uniform Commercial Code of the United States (1962)

Uniform Commercial Code of the United States (1995)

List of Abbreviations

CILSA	Comparative and International Law Journal of Southern Africa
JBFLP	Journal of Banking and Finance Law and Practice
LMCLQ	Lloyd's Maritime and Commercial Law Quarterly
MEC	Member of the Executive Council
SALJ	South African Law Journal
SA Merc LJ	South African Mercantile Law Journal
THRHR	Tydskrif vir die Hedendaagse Romeins-Hollandse Reg / Journal of Contemporary Roman-Dutch Law

TSAR	Tydskrif vir die Suid-Afrikaanse Reg / Journal of South African Law
UCC	Uniform Commercial Code of the United States
USA	United States of America