Title: The problems relating to interpretation of the strict compliance rule in letters of credits practice.

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Introduction

The letter of credit is a financial device developed to facilitate the flow of international trade and to assure certainty of payment by a banker. It is described as the life blood of international trade. Article 13 of the Uniform Customs and Practice for Documentary Credits (UCP 500 1993 Revision)[1] provides that the role of the bank is to examine the documents so as to ensure that the tendered documents do not contradict one another. This role is confirmed by the International Standard of Banking Practice (ISBP) for the examination of documents under documentary credits. The ISBP is envisaged to maintain uniformity of practice worldwide to the effect of saving time, speed up the flow of international trade, minimize cots and avoid unnecessary disputes. Opinions of the Banking Commission since 1975 till 2004 as shown in the unpublished opinions clearly illuminate the role of the banker in this respect. However, as a matter of fact a considerable number of credits are rejected on first presentation. The recent survey carried in the UK by SITPRO as contained in SITPRO's Letter of Credits Report dated 11th of April 2003 indicates that the rejection rate of first presentation against letters of credit lies in the range between 50-60% per cent. On first of April 2002 UCP 500 introduced an electronic supplement called (eUCP) which provides for electronic presentation of documents. The report covered the use of both paper credit and electronic letters of credits. Again, SITPRO report shows that they were offered the chance to examine the application of WebElecTra (the web based export documentation software system) in letters of credit transactions. The main reason underlying the problem is the question of interpretation of UCP Rules. The latitude of discrepancy is wide. It may

[1] Article 13 reads as follows:

a. *Banks 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 reflected in these Articles. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to in compliance withthe 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 for the presenter or pass them on without responsibility.*
b. *The issuing bank, the confirming bank if any, or a nominated bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take or refuse the documents and to inform the party from which it received the documents accordingly.*
c. *If a credit contains conditions without stating the document(s) to be presented in compliance therewith, banks will deem such conditions as not stated and will disregard them.*

include in addition to discrepancy in documents, errors and omissions, late presentation of documents. However, the magnitude of loss is high. SITPRO report estimates the loss incurred in UK in the year 2000, as a result of discrepant documents, at 113 Million sterling pounds.

The rule of strict compliance is conceptually structured on the rule of independence of the letter of credit from the underlying Contract. The banker is bound to effect payment on tender of conforming documents and also bound not to pay if presented with non-conforming documents. In effect, the rule, serves a double function. On the one hand, it imposes upon the beneficiary the obligation to tender regular conforming documents. On the other hand it imposes upon the bank the obligation of adhering to its mandate in not relaxing the beneficiary obligation.

The oft-quoted opinion of Lord Sumner in Equitable Trust Company of New York v Dawson Partners[2] is explanatory in this respect. His Lordship said "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." [3]

In the American case Labor v Lake Shore Banking Co.[4] Smith J, also stated that "a party who is entitled to draw against a letter of credit must strictly observe the terms and conditions under which the credit is to become available, and if he does not, and the bank refuses to honour his draft, he has no cause of action against the bank." [5] However, this principle has received divergent interpretations by both courts and commentators, as to whether strict compliance means exact verbalization as to the literal terms of the credit or it means exact tender as to the substance of the terms of the credit. As a result of failure to agree to one standard, exceptions have been carved out. These exceptions are placed under the name of the substantial compliance standard, or the reasonable bank approach in contrast to the strict or perfect tender standard. [6] Proponents of the rule of substantial compliance take the

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[2] [1927] 27 Lloyd's L.Rep 49

[3] Ibid at p. 53

[4] [1921] 196 App.Div.504 at p. 507.188 N.Y.Supp.162 at p.164; aff'd 231 N.Y 616, discussed by A.G .Davis " The Law relating to Commercial Letters of Credit"[London Sir Isaac Pitman & Sons Ltd., 1955 ed] at p.120

[5] ibid

[6] Cf. Boris Kozolchyk "Is present Letter of Credit up to this task?" Vol. 8-2 G.M.U Law Rev. 286 (1986)

view that literal application of the strict compliance rule favours formalism over reasonable commercial grounds and as such is apt to create injustice. On the other hand, proponents of the strict compliance rule argue that attackers of the rule fail to understand the factual realities from which the rule came into bein g. They opt for the view that it is a rule structured to ensure certainty of prompt payment, irrespective of commercial disputes. They regard the issuer's function to be a ministerial one.[7]

In the USA courts that subscribe to the substantial standard incline to achieve what they deem fair. They see no good reason to adhere to hyper-technicality required in documents tendered under a credit, when that offends their innate sense of justice. On the other hand, courts that subscribe to the strict compliance standard incline to regard the requirements of strict compliance as an aspect of freedom of contract, necessitated by commercial realities to further the objectives of predictability and certainty. It will be convenient to consider the issues relating to compliance under the headings:

I the Strict Compliance Standard.
(a) Cases in support of the standard.
(b) Equitable doctrines of Waiver and estoppel applied to Minimize abuse of the standard.
(c) The standard objectives.

II The substantial compliance standard.
(a) Cases in support of the standard.
(b) Justifications for the standard.

III The position in the Sudan and Saudi Arabia.

IV Suggested Solutions.

I. The Strict Compliance Standard

(a) Cases in support of the standard

In the Raynor v Hambro Bank, [8] the credit called for an invoice and a bill of lading covering a shipment of Coromandel Groundnuts. The

[7] Cf. Dana Converse Backus & Henry Hanfield "Custom and Letters of Credit" The Dixon, Irmaos case, 52 Columbia L.Rev.505 (1952)
[8] [1943] K.B, 37

beneficiary tendered an invoice for Coromandel Groundnuts and a bill of lading which described the goods as "machine-shelled groundnut kernels". On the margin of the bill were the marks "O.T.C., C.R.S. Aarhus." The banker refused to pay on the ground of non-compliance to the letter of credit terms. In an action for breach of contract against the defendant bank, evidence was adduced by persons who dealt in groundnuts in Mincing Lane, that description of the goods in the invoice and the bill of lading referred to the same commodity, as it was generally understood in the trade in London. Evidence also showed that the marks C.R.S. indicated in the bill of lading was short for Coromandel, as understood in the trade in London.

In the court of first instance Atkinson J., ruled that the defendant bank was not justified in declining to pay. On appeal the decision was reversed. MacKinnon L.J. said "to begin with, this case does not concern any transaction in Mincing Lane. It is a transaction with Denmark, and for aught I know, and for aught the evidence proved, the people in Denmark know nothing about the business usage of Mincing Lane. Moreover, quite apart from that special application of the relevant considerations, it is quite impossible to suggest that a banker is to be affected with knowledge of the custom and ordinary terms of every one of the thousands of trades for whose dealings he may issue letters of credit."[9]

In English, Scottish and Australian Bank v Bank of South Africa, [10] Bailhache J, was reported to have said "It is elementary to say that a person who ships in reliance on a letter of credit must do so in exact compliance with its terms. It is also elementary to say that a bank is not bound or indeed entitled to honour drafts presented to it under a letter of credit unless those drafts with accompanying documents are in strict accord with the credit as opened." [11] Again in Kydon Compania Naviera S.A. v National Bank Ltd.,[12] the facts relates to discrepancy in an invoice and a certificate [13] the plaintiff's counsel contended that discrepancies as to the figures of a gross and net

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[9] *Ibid*
[10] *[1922] 13Lioyd's L.Rep.21*
[11] *Ibid at p.24*
[12] *[1981] 1Lioyd's L. Rep 21*
[13] *A letter of credit was issued in favor of a seller of a ship, stipulating that payment shall be made on presentation of specified documents including an invoice. The tendered invoice contained a description of the vessel contrary to that which was indicated in the credit, though a tendered certificate tallied with the description of the credit. The court held that the bank was entitled to reject the documents.*

register of tonnage should be allowed as per Article 43[14] of UCP revision 1983 which allows a difference in the margin of 1O% per cent more or 1O% less than the amount or the quantity indicated, whenever the words "about", circa or similar expressions are used.

Mr. Justice Parker rejected the plaintiff's contention. He said "I am equally unable to accept this contention. Unless otherwise specified in the credit, the beneficiary must follow the words of the credit, and this is so even where he uses an expression which, although different from the words of the credit, has, as between buyers and sellers, the same meaning as such words. It is important that this principle should be strictly adhered to. Departure from the principle would involve banks in just those sorts of uncertainties which it is essential for the proper operation of the credit system should be avoided."[15]

Most of the American courts take a similar position as the English courts with regard to the issue of the strict compliance standard. In Beyene v Irving Trust Co., [16] a letter of credit called for a bill of lading having the Arabic name Mohamed Soran as the notify party. Due to an oversight as to misspelling, the name was written "Mohamed Sokan". The second circuit of the Court of Appeal ruled that the bank was entitled to reject the bill of lading for this typographical error. The Court said "literal compliance is essential so as not to impose an obligation upon the bank that it did not undertake and so as not to jeopardize the banker's right to indemnity from its customer." [17]

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[14] Article 43 of UCP 1983 now stands for Article 39 UCP revision 1993. The tenor of both articles is the same. No change is entered. Article 39 of UCP revision 1993 reads in Para (a) as follows:

a. the words "about", " approximately" circa" or similar expressions used in connection with the amount of the credit or the quantity or the unit price stated in the credit are to be construed as allowing a difference not to exceed 10% more or 10% less than the amount or the quantity or the unit price of which they refer.
b. Unless a Credit stipulates that the quantity of the goods specified must not be exceeded or reduced, a tolerance of 5% more or less will be permissible, provided always that the amount of the drawings does not exceed the of the Credit, This tolerance does not apply when the Credit stipulates the quantity in terms of a stated number of packing units or individual items.
c. Unless a Credit which prohibits partial shipments stipulates otherwise, or unless sub-article (b) above is applicable, a tolerance of 5% less in the amount of the drawing will be permissible, provided that if the credit stipulates the quantity of the goods, such quantity of goods is shipped in full, and if the credit stipulates a unit price, such price is not reduced. This provision does not apply when expressions referred to in sub-article (a) above are used in the Credit.

[15] [1981] 1Lioyd's L.Rep.at 76

[16] 76 2F.2d 4, 20 cir.1985, discussed by Fairfax Leary & Michael R. Ipoliti " letters of credit have we fully recovered from their insolvency shocks" U.pa.J. Of Int'l Bus. L.Vol. 9.4, 595 (1937)

[17] ibid

Similarly, in Mid-Continental Supply Co. v Barclays Bank International Ltd., [18] the plaintiff company requested the defendant bank to issue a performance guarantee in favour of the Libyan Government with respect to unpaid custom duties. The terms of the credit conditioned payment as to presentation of the letter of credit itself, along with a certificate from the Libyan Government, showing that the applicant for the credit, upon demand, failed to make payment of the requisite custom duties. Upon demand by the Libyan Government, the account party sought a preliminary injunction, on the ground that the adduced certificate was insufficient. Judgment was entered for the defendant on the ground that breach of the underlying contract could not be alleged to obtain an injunctio n relief. Judge Wallach said "plaintiff must be deemed to have entered into the original transaction fully cognizant both of the attendant risks and potential rewards. To grant the drastic relief sought here would be merely to shift the burden of litigation in a foreign forum to Barclays (the issuer) which has assets subject to potential restraints throughout the world." [19]

A case which shows that documents must not contradict one another is Voest-Alpine Int'l Corp. v Chase Manhattan Bank, [20] where a letter of credit called for presentation of a certificate of inspection and a bill of lading indicating a date not later than 31st January. Although the tendered bill of lading showed shipment as the tenor of the credit called for, the inspection certificate was done on the 6th of February. The bank refused to honour the draft. The court ruled that the bank was justified in refusing to honour the draft. A similar decision to that of the Raynor v Hambro Bank was reached in Courtaulds North America inc. v North Carolina National Bank, [21] where the plaintiffs contracted with a seller to purchase yarn. An irrevocable letter of credit was established in favour of the seller calling for documents including a commercial invoice in triplicate showing "1OO Acrylic Yarn". Several shipments were accepted by the account party, although not in strict compliance. However, one shipment was accompanied by an invoice

[18] *No 7153 sup. ct. N.Y. 1984 (discussed by Stanley F. Farrar & Henry Landau "Letters of credit" Vol. 41, Buss. Law. 1435 (1986) at p.1436*

[19] *ibid*

[20] *N.A. 454 F. Supp 301 (S.D.N.Y. 1982), discussed by Michael Sandler and Barbara Di Ferrante "premier on trade finance. Export drafts, letters of credit & banker's acceptances" Vol. 11 N.C.J. Int'l L. & Com. Reg. 613 (1986).*

[21] *423 F.2d 638 (9th cir. 197O), discussed in "letters of credit current theories and usages. Comment Vol. 39 Louisiana L. Rev. (1979) p.582.*

showing "imported acrylic yarn" was refused by the bank. The seller sued for wrongful dishonour. Evidence was adduced in the court that in trade the phrase "imported acrylic yarn" was the same as 1OO% acrylic yarn. The court entered judgment for the defendant bank on the ground that documents tendered under the credit did not strictly conform to the credit terms. The court ruled that a banker need not be conversant with the different trades involved in letters of credit transactions.

(b) Equitable doctrines applied to minimize abuse of the standard

In practice some banks adhere to the requirement of formality in dealing with documentary discrepancies, even in very insignificant instances. In Brown v United States National Bank, [22] the defendant bank refused to accept a certificate just omitting the phrase "I hereby certify", however, the court ruled that payment should have been made. Issuing bankers sometimes raise tactical, technical objections to extricate their customers from a bad bargain, or when a customer notifies the issuer of his bankruptcy or, the banker comes to know that the account party is on the verge of insolvency. To do justice and guard against such an abuse of the strict compliance standard, courts in both the United States of America and England apply equitable doctrines such as waiver and estoppel.

The legal sense of the concept of waiver differs from that of estoppel as explained by Lord Denning M.R. in Panchaced Freres S.A. v Establishments General Grain Company, [23] where he said "when waiver is used in its legal sense, it only takes place when a man, with knowledge of a breach, does an unequivocal act which shows that he has elected to affirm the contract as still existing instead of disaffirming it as for instance in waiver of forfeiture." [24] As to estoppel his Lordship said "if a man who is entitled to reject goods on a certain ground, so conducts himself as to lead the other to believe that he is

[22] 220 Neb. 684, 371.N.W.2D 692, (1985) discussed by Fairfax Leary supra note at p.608
[23] [1970] 1 Lloyd's L.Rep.53
[24] Ibid at p. 57

not relying on that ground, then he can not afterwards set it up as a ground of rejection, when it would be unfair or unjust to allow him to do so." [25]

In Bank Melli Iran v Barclays Bank [26] the plaintiff, an Iranian bank, instructed the defendant bank to open a confirmed credit for U$4O, OOO, representing the value of 1OO new cheverolet trucks, in favor of an American seller. Payment was authorized against presentation of a delivery order, invoice, an insurance policy and U.S. Government undertaking, confirming that the trucks were new. The documents tendered showed non-conformity to the credit tenor. The invoice described the goods as "in new condition". The American Government undertaking described the goods as "1OO new, good, and chevrolet trucks from the United States of America". The delivery order described the goods as "new (hyphen) good". However, the defendant bank effected payment against the first set of documents and forwarded to the Iranian bank Photostat copies of the documents, informing them that they were holding the documents "in safe custody for your account, pending receipt of your further instructions". The plaintiffs received the documents, without expressing their rejection until two months after the defendant bank had paid against the documents. Mr. Justice McNair, ruled in favor of the defendants on the ground of ratification, that, though the documents were not in conformity with the tenor of the credit, nonetheless the subsequent course of action of the plaintiffs did not evince an intention to reject.

In Floating Dock Ltd. v The Hong Kong and Shanghai Banking Corporation, [27] the owners of a floating dock entered into an agreement to sell the dock to an American Company. In pursuance to that sale agreement, two documentary credits were established by the New York branch of the defendant bank, and advised to the plaintiffs by their London branch. The plaintiffs presented to the defendants the documents called for under the credit, but the latter refused to pay on the ground of non-compliance. Thereafter, the defendants through their London branch unconditionally agreed to accept and pay against the documents in the form in which they were presented. In reliance upon this agreement the plaintiffs instructed their representatives that the tugs should move towards the place of delivery. In an action for breach of contract, it was held that defendants were estopped

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[25] ibid
[26] [1951] 2 Lloyd's L.Rep. 367
[27] *[1986] 1ioyd's L.Rep. 65*
27a ibid at p.78

from refusing to honour the plaintiff's documents. Mr. Justice Evans said "treating the matter as one of estoppel, it remains necessary for the plaintiffs to establish that they relied upon the agreement or upon an implied representation arising there from, in the sense indicated, and that they suffered some detriment from so doing."(27a)

It seems to me that the plea of homologation under Scottish law might lead to the same result as that of estoppel. Both homologation and estoppel are invoked in situations whereby the other party acts in a manner, indicating approval of a particular state of affairs, with respect to a particular agreement, irrespective of whether the other party incurred detriment thereof or not. As aptly put by Bell "homologation is a generic term comprehending all confirmations by implied assent". [28] On the other hand, the plea of rei interventus embraces, inter alia, the gist of the concept of waiver, as the essence of the former, in the words of McBryde is that "one person has acted in such a way that the other party is barred from resiling from the contract". [29]To invoke waiver, knowledge of the other party must be shown. In rei interventus, the root of the personal bar rests on permission or encouragement or abstention of the other party. In the words of Professor David M. Walker "The main distinction between interventus and homologation is in respect of the person whose actings are alleged to have ratified the contract and excluded Locus poenitentiae. In rei interventus the plea is that the other party, by permitting the party taking the plea to act on the faith of the contract, has barred himself from resiling; in homologation the plea is that the other party, by himself acting on the faith of the contract, has barred himself from resiling." [30] Again the Scottish Law Commission has drawn a distinction between rei interventus and homologation that "The right to resile from a contract which has not been completed by the required type of writing may, however, be lost by rei interventus (where one party allows the other to act on the faith of the contract, as if it were complete, and alter his circumstances to his prejudice thereby) or homologation (where one party by his own actings indicates that he is regarding the contract as binding). [31]

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[28] *Cf* Bell, Commentaries, Vol. 1 at p63, see also Law V Thompson [1978] S.C, 343 Per Lord Maxwell at p345, see also Secretary of State V Ravenstone Sec. Ltd 1976 S.C, 171,a s per Lord President at p.190

[29] Cf. William W. McBryde," the law of contract in Scotland" [W.Green and Stone, 1987 ed] at p.647, see also Secretary of State V Ravenstone Securities Ltd S.C, 171

[30] Cf. David M. Walker " the law of contract" [London Butterworth's, 1979]

[31] Cf. Scottish Law Commission, Consultative Memorandum No. 66 entitled " Constitution and Proof of Voluntary Obligations and authentication of writings" July 1985 at p.9

In Exchange Mutual Insurance Co. v Commerce Union Bank[32] an American case, the beneficiary under the credit submitted the documents called for under the credit. The defendant bank kept the documents without notifying the beneficiary of any defect till the credit expired. The court on the ground of estoppel held that the bank had to pay notwithstanding the discrepancy in the documents. In Overseas Trading Corp. v Irving Trust Co[33]., the plaintiffs accepted the tendered documents and reimbursed the bank. Shortly afterwards, they discovered that the documents were not in compliance to the tenor of the letter of credit. In an action for breach of contract, the issuing banker contended that acceptance of the documents by the plaintiffs constituted a waiver as to the alleged defects. The court declined to accept this contention, on the ground that to succeed on a waiver defense, the banker must show that the plaintiffs had manifested an act showing knowledge of the defects.

Again, in North America Foreign Trading Co. Ltd. v General Electronics, Ltd.[34] the account party asked the issuing banker to release to him the merchandize before arrival of all the requisite documents, against an indemnity, as to any consequential loss attendant to an early release. Afterwards, the beneficiary tendered defective documents, which the issuing banker accepted and effected payment thereof. In an action for breach of contract, the court ruled that an indemnity does not imply waiver as to documentary defects.

Though both jurisdictions agree on the concepts underlying equitable doctrines, nevertheless different approaches between them as to this issue should be highlighted. On the one hand, English cases show that a banker can reject a document for specific defects and ask the beneficiary to rectify it, without being debarred from raising further objections, at the time of the second rectified tender as to the initial document or other required documents. On the other hand, American cases show that the banker is bound by the objections he raises at the time of the initial tender to the effect that later objections would not be entertained, that is to say a banker can not raise objections after the fact. Furthermore, the issuing banker should notify

[32] 686 SW 2D 913 (Tenn.CT.App. (1989) discussed by Stanley F. Farrar & Henry Landau supra note 18 at p.1439

[33] *82 N.Y.S 2d 72 sup ct. [1948] discussed by John. F.Dolan " the law of letters of credit [Warren Corham & Lamont, Boston, New York] at 6-35*

[34] *67 AD.2d 890, 413 N.Y 528 700 [1979] discussed by Dolan op cit at 6-35*

the beneficiary with the point of non-conformity at the time of the examination of documents, otherwise the issuer would be estopped from raising any defense at the trial.

The line of thought espoused by the English courts can be explained better by quoting Roche J., in Westminster Bank v Banco Nationale Di Credito,[35] where the learned judge said "It is too well settled in principle and abundantly covered by authority that if a person is entitled to reject documents and he rejects them on the wrong ground or without taking all the ground he could take, it is nonetheless open to such person; if he is questioned about the matter, and his action is impugned, to rely upon all the grounds that he might have taken".[36]

Similarly, in Panchaud Freres S.A. v Establishment General,[37] Lord Denning, M.R. said "It is well settled that if a buyer rejects and gives one ground for it, he is not confined to that ground. If he afterwards finds out another ground on which he was entitled to reject, then in the ordinary way he can rely on that ground also."[38]

The position was also clearly put by Mr. Justice Parker in the case of Kydon Compania Naviera S.A. v National Westminster Bank Ltd. & others,[39] where the learned judge said "Suppose (1) there are five documents and the bank rejects for three specified defects in document 1; (2) that the beneficiary rectifies the three defects and presents again. It is clear that the bank is not by this alone estopped from raising other defects either in the initial document or the next document, it can reject again, and again it will not be stopped. It is for the beneficiary to see that the documents are all in order, and he has no cause for complaint if the bank rejects as soon as they find one or more defects, or if they reject again on finding further defects, and so on."[40]

The American position can be explained by quoting Woolley J., in Second National Bank of Allegheny v Lash Corporation,[41] where he said "-- but when it (the bank) named one ground for its refusal and remained silent with respect to three, the reasonable intendment of its conduct was to lull the drawer of the drafts to inaction and cause it to let pass what time and

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[35] *[1928] 31Lioyd's L.Rep. 306*
[36] *Id at p.311*
[37] *[1970] 1 Lloyd's L.Rep.53*
[38] *Ibid at p. 56*
[39] *[1981] 1Lioyd's L.Rep. 68*
[40] *Ibid at 79*
[41] *299 F.371 at p.373 discussed by Ellinger " Documentary Letters of Credits [Singapore 1970] at p.288*

opportunity it had to correct the infirmities of the bills of lading, and then, if sued, to reap for itself a benefit from the utterly helpless position into which it had induced its adversary to drift." [42] Similarly, in Bank of America v Whitney-Central National Bank,[43] the banker on the basis of non-compliance declined to accept the tendered documents. In an action for wrongful dishonor, the banker raised a further objection as to the signature on the documents. The court held that a further objection can not be raised at the trial, that "if failure to object to signature to documents would not in any case constitute a waiver, it seems clear it does where, as here, the refusal [to take the documents] is based upon another ground which related not to the manner of execution, but to the documents themselves."[44] Again in Barclays Bank D.C.O. v Mercantile National Bank, [45] the fifth circuit ruled that "the issuer cannot lull the customer into believing that there was no problem with documentation when there was still time for the customer to have attempted to cure the technical defect and then turn around to assert the lack thereof as a defense to the suit on the draft." [46]

The position taken by the English courts seems better than that of the American courts; by being flexible as to the chances it gives to a banker to raise objections at both stages of documentary checking and trial. Moreover, it alerts the attention of the beneficiary to see to it, that the documents must be in the order called for under the credit. In so doing, it ensures both fairness and objectivity of the strict standard without being itself strict. On the other hand, the American position tends to invoke mechanical rules to ensure predictability of consequences. In so doing, it inclines to cure formalism by the same tool of formalism.

(c) The objectives of the strict standard

Proponents of the strict compliance standard contend that the said standard serves the objectives of certainty and reliability of the banker's credit; that against sureness of payment to the beneficiary, the account party is also made sure to receive documents in conformity to the tenor of the credit. In the words of Maurice Megrah, "The implicit obligations of the banker is to pay

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[42] *Ibid*
[43] *291 F. 291 [.922]1923] discussed by Ellinger op cit at p.288*
[44] *ibid*
[45] *481 F 2d 1224 5th Cir [1974] Cert. dismissed 414 U.S.1139[1974] discussed in comment Fordham L. Rev. Vol. 50, 848 [1982]*
[46] *ibid*

against "genuine conforming documents; otherwise credits will be a sham and open to all sorts of chicanery"[47]. It may be added that if payment were contingent upon the interpretation of the underlying contract, the beneficiary will find little inducement to utilize the device.

It appears to me that the rationale behind the doctrine of substantial compliance does not warrant its application in letters of credit law. The basic justification for the substantial performance doctrine in Contract Law is to preclude the promisee from forfeiting the right of the promisor, when the latter performs a substantial portion of his part of the bargain. However, the banker, under a letter of credit cannot reap unjust enrichment for just declining to honour a draft as the banker normally charges a small fee. Furthermore, the doctrine of substantial compliance is not tenable as a justification in a letter of credit transaction, where it expressly stipulates, as a condition precedent, tender of particular documents.

Placed in this context, the substantial standard runs contrary to the basic objective of certainty secured by the strict standard, that the role of the banker is to determine whether the documents conform on their face to the credit tenor or not. If bankers were to apply the substantial standard, they need to conduct an inquiry outside the documentary ambit. This entails a time consuming effort and increases costs. In effect, the banker needs not only trained bankers in the custom and usage of the banking industry, but also needs lawyers to investigate the intricate legal issues involved in the process of determining whether a certain performance is to be deemed substantial or not. In fact, documentary checkers in all banks are not lawyers or experts in the arts of different trades. Moreover, a banker is obliged to consummate the process of checking within a reasonable time.[48] Due to these considerations Professor Dolan a leading authority in letters of credit law attacked the substantial standard by saying "The substantial standard is no standard at all. It is an invitation to controversy. It promotes disputes. It is anathema to the effective functioning of the marvelous commercial device. It transforms the

[47] *Maurice Megrah " Risk aspects of the irrevocable documentary credit" Arizona L. Rev. Vol. 24, 255[1982]*

[48] *Article 13 (b) of the UCP revision 1993 provides that, " The issuing bank, the Confirming bank, if any, or a nominated bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the date of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.*

quick, efficient, inexpensive letter of credit into the lumbering expensive performance bond." [49]

It also appears to me that the substantial standard opens a loophole to uncontrolled discretion, that instead of having one standard ensuring a predictable consequence, individually structured solutions will take place, as clearly put by Henry Harfield that "Ad hoc policy-oriented decisions that impose individually-tailored solutions undercut the stability and certainty that are generally important in commercial transactions, and essential in letter of credit transactions." [50] It may be added that a beneficiary under the substantial standard will have little incentive to seek to comply if he knows that documents short of the tenor of the letter of credit can do as well.

II. The substantial compliance standard

(a) Cases in support of the standard

In Dixon, Irmaos & CIA v Chase National Bank, [51] pursuant to a sale contract of cotton between a Belgian buyer and a Brazilian seller, the Bank de Bruxelles, a Belgian bank, established in favor of the seller an irrevocable letter of credit which was advised to the beneficiary by Chase National Bank of New York. The letter of credit called for particular documents, including a full set of bills of lading covering the said cotton. The beneficiary received from the carrier a bill of lading in duplicate. Thereupon, he forwarded one counterpart of it along with his draft and other required documents to Guaranty Trust Company of New York, for presentation and collection. Guaranty Trust Company tendered the beneficiary documents accompanied with an indemnity against loss which might arise as a consequence of tender of only one counterpart. The defendant bank, Chase, refused to honour the draft drawn under the indemnity. Hence, the action. The beneficiary contended that it was the custom of New York bankers to accept indemnities if less than the requisite full set of bills of lading were tendered. The defendant bank did not deny the existence of the custom, but contended that the custom left discretion to the bank to decline to accept the indemnity. The Court of Appeal for the second circuit ruled that, in the presence of such a

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[49] *John .F.Dolan " strict compliance with letters of credit:: striking a fair balance" Vol.102 Banking Law Journal.18 [1985]*

[50] *Henry Harfield " Code, customs and conscience in letters of credit law" 3 U.C.C.L.J at pp. 9-10*

[51] *144 F2d 759 [2d cir.1944] Cert. denied, 324 U.S. 850 [1944], discussed by by Backus and Harfield note 7 at 505*

custom, a bank is obligated to pay, if an indemnity, in lieu of a missing document is adduced.

Another similar case is Association de Azucareos de Guatemala v United States National Bank of Oregon, [52] where an American buyer contracted to purchase sugar from the plaintiffs. At the request of the buyer an irrevocable letter of credit was established in favor of the plaintiffs. The tenor of the credit called for payment of 96% of the invoice value on the showing that the percentage of the sugar polarization - sugar purity - was of 96 degrees. On arrival of the sugar the polarization was found to be 95.176356 degrees. The customer requested the banker to inform the plaintiffs of the fact of the low polarization and suggested payment of 75% of the invoice value. The bank conveyed the message but in a different manner, by informing the plaintiffs that the sugar was 'below the credit terms'. To this the plaintiffs agreed, believing that the degree of polarization is below 94 degrees. When the plaintiffs knew of the exact deficiency, they sued for the difference. The court ruled in favour of the plaintiffs, on the ground that the bank should have made the requisite inquiry as to the practice of the sugar industry.

It is submitted that a banker under a letter of credit transaction is not bound to look beyond the four corners of the credit to establish a state of affairs. Article 14 (b) of the UCP revision 1993 clearly states that " upon receipt of documents, the issuing bank and/or the confirming bank, if any, or a Nominated bank acting on their behalf, must determine on the basis of the documents alone whether or not they appear on their face to in compliance with the terms and conditions of the credit. If the documents appear on their face not to be in compliance with the terms and conditions of the credit, such banks may refuse to take up the documents." However, in both the above-discussed cases extrinsic factors were accepted by the courts to reach results they deem fair.

The two cases show a relaxation of the rule of strict compliance in favour of substantial compliance. They were in contrast to the decision taken in the Raynor & Co. v Hambros Bank.[53] Where the court held that the banker is not supposed to be affected with knowledge of the custom and customary terms of the thousands of trades involved in letters of credit transactions. A criticism was leveled against the Dixon opinion that "The Dixon, Irmaos

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[52] 423 F.2d 638 (9th cir. 1970) discussed in a comment Vol. 39 Louisiana L.J. supra 21, at 582

[53] [1943] 1 K.B 37

opinion means that custom will be permitted to substitute a wholly new term for an unambiguous term in the contract. And here lies the mischief of Dixon, Irmaos, for in this view of the case, resort to custom is perverted into frustration of freedom of contract."[54] However, Professor John Honnold argued that the conflict between the Raynor and the Dixon decisions is less than evident that "in Raynor the question was whether a banker's action under a letter of credit should be controlled by the custom in a produce market, with which, as the court observed, a banker could hardly be expected to be familiar, in Dixon the issue was whether bankers should be bound in the handling of documentary letters of credit by their own custom. The difference is decisive." [55] But it is clearly evident that the Association de Azucares de Guatemala case shows a clear deviation from the strict compliance rule. A banker is not required to make an enquiry with regard to the trade practice relating to the letter of credit transaction.

In Banco Espanol de Credito v State Street Bank & Trust Co.,[56] the credit stipulated tender of an inspection certificate indicating that "the goods are in conformity with the order." The beneficiary tendered a certificate stating that on an examination of a ten per cent sample the "whole was found conforming to the conditions stipulated on the order stock sheets." The court was asked to decide whether order meant original order or it included the subsequent "order stock sheets". Viewed on the basis of strict compliance rule, the tendered certificate was not conforming to the credit tenor. However, the court ruled that the bank was not justified in dishonoring the beneficiary drafts, on the ground that reference in the certificate to a sample is what an inspector is contemplated to undertake. Mr. Justice Coffin in the Court of Appeal, First Circuit said "We take as a starting point the substantial body of case law which establishes and supports the general rule that documents submitted incident to a letter of credit are to be strictly construed. This is because international financial transactions rest upon the accuracy of documents rather than on the condition of the goods they represent. But we note some leaven in the loaf of strict construction. Not only does haec verba

[54] *CF. Backs & Harfield supra note 7 at 598*

[55] *John Honnold " Letters of credit, custom, missing documents and the Dixon case: A reply to Backus and Harfield" Vol. 53 Columbia Law Review (1953) at p 507*

[56] *385 F2d 230, 233 [Ist Cir.1967] the text of the case was reported in Ralph H. Folsom, Michael Wallace Gordon, John .A. Spanogle " International Business Transactions"[West Publishing Co., St Paul, Minn., pp.195-202 1986 ed*

not control absolutely, but some courts now cast their eyes on a wider scene than a single document."[57]

Another case in which the substantial standard rule was applied is Flagship Cruises Ltd. v New England Merchants National Bank of Boston,[58] where the credit stipulated tender of a draft accompanied by a statement indicating that the draft was related to a particular agreement. The beneficiary presented a draft and a statement that the letter of credit related to that particular agreement. The court ruled in favor of the beneficiary on the ground that the tender complied with the requirement of the letter of credit in every material respect. The Court of Appeal, First Circuit said "We see this very simply as a case of the greater including the smaller. That is, if a draft must reveal its nexus in a specific agreement, this requirement would be satisfied if the entire letter of credit, on which the draft depends, relates to the specific agreement. We do not see this kind of interpretation as relaxing the strict construction approach in letters of credit but rather as equating a literal requirement for its functional equal." [59]

Again, the issue of substantial performance arose in Croker Commercial Services inc. v Countryside Bank,[60] where a credit called for a certificate indicating that a company called "Everyone's Effort, inc." had failed to pay invoices issued by the plaintiffs, the beneficiary. Instead of the required certificate, the beneficiary tendered a certificate in the tenor that everyone's Effort, inc., failed to pay invoices issued by third parties and factored by the plaintiffs. The court was asked to decide whether there was a difference between an invoice indicating factoring by Croker and invoices issued by Croker. The court ruled that the difference is insignificant.

On principle, however, in English law, the maxim de minimis non curat lex, or the rule of insignificance does not apply as between the banker and the beneficiary under a credit. In Moralice (London) Ltd. v E.D. & F. Man[61] Mr. Justice McNair said "I think it is probably true to say that when a CIF contract provides that payment shall be by means of presentation of documents against an irrevocable credit, that necessarily involves, not only, in the

[57] *ibid*
[58] *369 F.2d 699 Ist cir [1978]*
[59] *Ibid at p703*
[60] *538 F.Supp.1360, 1362 N.D.111 [1981]*
[61] *[1952] 2 Lloyd's L.Rep 526*

contract between the confirming bank and the seller, but that the documents must be such as will strictly comply with the terms of the credit.'[62]

The American position endows banks with discretion as to determination of compliancy to an extent which goes beyond mere de minimis discrepancy. In American Airlines inc. v FDIC,[63] the draft presented with the requisite documents did not indicate the correct number of the credit. Moreover, it did not indicate a drawee. The court held that the banker is not entitled to decline payment as the submitted documents, though not conforming to the credit terms, but could not mislead the issuing bank.

(b) Justifications for the standard

Proponents of the substantial standard argue that the standard is apt to promote equity to the beneficiary. In a de minimis discrepancy the banker must abstain from raising insignificant discrepancies as a basis of rejection to tendered documents. The standard prevents the account party from trying to extricate himself from a bad bargain on the ground of a hyper technical argument. They contend that rejection of a banker in cases of trivial discrepancies is an exercise of commercial bad faith. The banker must act equidistantly in his examination of tendered documents.

In practice it appears that some banks endeavor to abuse the strict compliance rule. In First National Bank of Atlanta v Wynne,[64] the letter of credit called for a statement to be signed by the beneficiary indicating that the account party has recorded a default. It also called that the draft must indicate a credit number. The beneficiary presented the certificate as required. As to the draft it did not bear the number of the credit, however, the whole body of the credit was attached to the draft. The Court of Appeal ruled that such a tender did not show a material defect. Again, in U.S. Industries inc. v Second New Haven Bank, [65] the letter of credit called for a draft along with a statement that "the drawing represents payment of goods for which payment has been demanded and not received." The beneficiary presented a draft and instead of the required statement, the invoice was appended to the draft. The court held that, although there was a discrepancy but it was not a major one as to mislead the bank.

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[62] *Ibid 533*
[63] *610 F.Supp, 199[d.kn 1985] discussed by Stanley F.Farrar & Henry Harfield supra note 18 at p1436*
[64] 149 *Ga APP. 811, 256 S.E 2d 383 [1979]*
[65] *462 F. Supp.662 [D.Conn. 1978 [discussed by Boris Kozolchyk supra note 6 at pp. 340-341`*

Hence, supporters of the substantial standard argue that what matters is not archetypal conformity of a document, but its merchantability. Adherence to strict compliance would ultimately undermine the letter of credit device. In the words of Professor Boris Kozolchyk "to think that merchants who enter into a letter of credit transaction reasonably expect that the failure to supply an easily suppliable letter, word, statement or formality is what determines their loss of veritable fortunes is to assume that they regard bank payment at best, as a form of lottery, and at worst, of clever larceny. If this is the result to which strict compliance must lead, letters of credit are not likely to live much longer." [66]

The basic thrust of the substantial standard is to prevent a banker from abusing the strict compliance standard. However, this danger of abuse would not be curtailed by giving the banker a wide discretion. It is arguable that, if a banker, on the ground of reasonableness is given such a discretion, then certainty of a letter of credit as a financial device will be lost. Whether there is an abuse or not must be left to the courts. Finally, allowing a banker a wide discretion on the basis of the substantial standard is likely to create a double standard. Thus, under the substantial standard, the banker will be liable to the beneficiary unless reasonable examination was conducted. On the other hand, a banker who fails to observe his mandate as to strict compliance vis a vis the account party will be unable to claim reimbursement from the account party.

III. the position in the Sudan and Kingdom of Saudi Arabia

Bankers in the Sudan invariably subject letters of credit issued by them to the Uniform Customs and Practice (UCP). The practice is to adhere strictly to the tenor of the credit. Documents required under the credit are normally those required under the CIF or F.O.B. terms, or any other similar term. The banking practice in the Sudan recognizes the strict obligation of the buyer to effect payment against documents. The right of the seller to claim payment on tender of documents shall not be prejudiced by the state of the goods being defective or unfit for the purpose or inconsistent with the express terms of the contract. However, in the Sudan most problems of documentary compliance arise from inaccuracies as to tendered certificates of quality or origin or inspection. The banker normally contacts the account party to see whether he

[66] *Op cit at p345*

could waive the discrepancies as to the required certificate. In most cases, the account party would refuse to make a waiver and alternatively ask for rectification of the certificate. This writer was once asked to deliver an opinion in a case involving a defective certificate of origin with respect to a consignment of cement to a Sudanese Government agency. The account party asked the issuing banker to notify the beneficiary to rectify the defect. A chain of correspondence passed between the issuing banker and the beneficiary. As a result of this correspondence, a delay of almost three months occurred to the effect that charges of storing the goods in a warehouse reached a considerable amount. In the end the certificate was rectified. As the beneficiary failed to tender the requisite document called for under the credit, he was asked to shoulder the loss incurred in storing the goods. The opinion shows an application of the strict compliance rule.

In the Sudan, Exchange Control regulations pose some difficulties. For example the issuing banker due to government interference might delay in reimbursing the advising banker. To militate against such a situation rich merchants used to keep accounts with foreign banks. Moreover, issuing bankers would not establish a credit unless the applicant for the credit adduces a good collateral security or have an account in foreign currency with the issuing banker. However, there is at present a noticeable improvement in this respect, following oil discovery in the Sudan, which to some extent substantially reduced lack of hard currency.

It is relevant to note that the practice in the banking industry in the Sudan is influenced by the English practice. The Sudan Bill Of Exchange Act of 1917 was modeled after its English counterpart. This is due to the fact that the modern Sudanese judicial system was influenced by the common law system during the Anglo-Egyptian Condominium rule of 1898. As no codified law was available at that time to cover areas of commercial law such as contract, Sale of Goods, agency etc., the British introduced section 9 (nine) in the Civil Justice Ordinance which stated that in matters not provided for by legislation "the court shall act according to justice, equity and good conscience." Under this pretext the common law was received in the Sudan, though changes have been made to satisfy conditions unique to the country[67].

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[67] *Cf. professor M. I. Cahill " The legal system of the Sudan" Vol. 20 Internati onal and Comparative Law Quarterly 624 [1971] at p 637, see also Professor Zaki Mustafa, " The Common law in the Sudan, an account of the justice, equity and good conscience provision " see also by the same author " opting out of the common law. Recent development in the legal system*

Accordingly Sudanese lawyers turned in cases which demand guidance to English commentators, and even English decisions. The approach of the British was explained in 1925 by Owen J., in Ahamed Hassan Abdel Monieum v Heirs of Ibrahim Khalil [68] where he said "The courts in the Sudan are entitled to adopt or reject the English Common Law, as modified by statute or not, according to whether it is in consonance with the principles of justice, equity and good conscience, having regard to the conditions in this country." [69]

Similarly, in Saudi Arabia banks invariably subject letters of credit to the (UCP). The strict compliance is viewed as an incident of freedom of contract under Islamic Shari' a. The basic rule is that whenever a contract stipulates clear terms, the contract must be performed, in good faith, according to its terms, even if performance is excessively onerous. Judicial interpretation can not deviate from clear expressed terms, unless performance, as a result of general circumstances was rendered impossible. Observance of strict compliance is structured on the concepts of justice and faithfulness. Faithfulness (in Arabic Amana) signifies respect of a person's covenants in connection with others rights.

It is interesting to note in passing that in the United States the doctrine of good faith is suggested to resolve a number of legal situations, inter alia, abuse of the power to determine compliance in documentary credits, slacking off by an issuing banker to notify discrepancies, willful rendering of only substantial performance, and evasion of the spirit of the deal. Article 2O5 of the Restatement (second) of Contract 1981 states that "every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." Professor Robert Summers, commenting on the section said "The section symbolizes a Commitment to the most fundamental objectives a legal system can have - justice and justice according to law. Thus, it is of a piece with explicit requirements of "contractual morality" such as the unconscionability doctrine and various general equitable principles. The increasing recognition of such requirement is one of the hallmarks of the law of our time." [70]

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of the Sudan." Journal of African Law [1973] p 133, see generally Thompson, C F "The sources of the law in new nations of Africa. A case study of the Republic of the Sudan. Wisc.l. Rev. 1146 [1966]

[68] I S.LR.P 302

[69] Ibid at p308

[70] Robert Summers "The general duty of good faith. Recognition and conceptualization " Cornell Law Review Vol 67, 811[1982] at p811

However, the issue facing commentators and courts is to provide a conceptualization, in terms of a general positive definition as to the expression good faith, and the criteria to be used in determining a particular conduct as bad faith. The Restatement's comment says "Do not ask what good faith is, ask what courts have found to be instances of bad faith and reason by analogy from them to do justice and protect the reasonable expectation of the parties." [71] One commentator described breach of contract as an aspect of bad faith as follows:- "more important, a breach of contract by failing to perform in good faith can be described as a use of discretion in performance to recapture opportunities foregone on entering the contract. To determine whether a contract was breached, from the cost perspective we ask whether the promisor in fact paid the reasonably expected cost of performance." [72]

In Saudi Arabia the strict compliance rule is upheld on the ground of good faith performance, but on a totally different conceptualization. Indeed, good faith has a practical consequence in everyday business, as it ensures predictability of performance as to contract terms. One hudith (saying) of the prophet states "Al-Amana Ghina", which translated in English says "faithfulness is wealth". A Covenant of a Muslim is deemed to be a Covenant of Allah as Allah is its witness. Whoever abides with his Covenant has followed the path prescribed by God, and whoever contravenes his Covenant disobeys the order of God. In Qur'an the relevant verse says 'Fulfill the Covenant of Allah when ye undertake or enter into a Covenant, and do not violate oath after their confirmation, and your having set Allah as guarantor over you; assuredly knoweth what ye do. Be not like her who unraveled her thread into untwisted strands after it was strong, regarding your oath as merely intrigue amongst you." [73]

Another hudith of the prophet says "For everyone who has committed a breach of faith there shall be a flag (of disgrace) on the day of judgment. It will be hoisted. Its height will be in proportion to the enormity of his breach of faith. No breacher of faith is more unjust than an amir (prince) who breaks his Covenant." [74] Muwaffaq al Din Ibn Qudama, a leading authority of the

[71] *See comment on section 205 of the Restatement (second) of contracts [1997]*
[72] *Steyen J.Burton "more on good faith performance. A reply to professor Summers "69 Iowa L.Rev. 497 [1984] at p 505*
[73] *Qur'an 16.93, 94.*
[74] *Ibn Taimiya, Majmu'at Fatawa [1908-1911] at p. 33, quoted by Habachy " property, rights and contract in Muslim law" Vol 62 Columbia L. Rev. 450 [1962] at 463*

Hanbali School of legal thought said "Our legal scholars have said that a breach of faith on the part of an Imam is more serious and heinous than a breach of faith of anyone else, because of its evil consequences. For if the Imams break faith and get a name for doing so, the enemy will not trust them in a Covenant or truce and this will cause the Muslim leaders to be discredited." [75]

The thesis advanced in this analysis is to show that strict compliance under Islamic law, as applied in Saudi Arabia, is taken as an aspect of freedom of contract. Observing the credit mandate in good faith has a religious basis, rather than a secular conceptualization, tailored to fit in the practical realities of commerce. On the other hand raising hyper technical, insignificant, minor issues, from the part of the account party, with the intention of evading a deal would be deemed a bad faith exercise.

Bankers in Saudi Arabia prefer to settle disputes arising out of inter-bank relationships and those with customers through negotiation or conciliation rather than turn to courts or arbitrators. The basic reason is that bankers believe that litigation is harmful to their image. Disputed issues are normally of a technical nature which requires expertise, in the area of banking industry. They also believe that negotiations take a relatively short time and allow a free exchange of information with less publicity. Even during the process of arbitration settlement is encouraged in accord with Article 16 of the Saudi Arbitration regulations of 1983 which reads "The decision of the arbitrators shall be taken by a majority vote and if they are authorized to reach a compromise solution (in Arabic Sulh) their decision shall be by unanimity." On the other hand, in difficult situations, arbitration is preferred to the prolonged formal process of litigation. This is due to the absence of internationally accepted rules, governing the exercise of jurisdiction by National Courts. Added to this, is the shortage in judges experienced in the technicalities attendant to international commercial transactions. Finally, bankers in letters of credit transactions incline to secure a solution within the confines of the UCP. Thus, in many situations, the parties prefer to structure an "ad hoc" arbitration, administered and conducted in the manner they choose, retaining a lawyer to act as a neutral adviser, who normally reaches an acceptable solution to both parties.

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[75] *Qurtubi Vol. Ahkam al –Qur'an, quoted by Anderson and Coulson " The Muslim ruler and contractual relations" 33 N.Y.U.L.Rev.917[1958*]

In international contracts involving a Saudi party, it is not uncommon to find a proviso stipulating that in case of dispute, resolution shall be made via international arbitration in accordance to a non-Saudi law. Arbitration, in Saudi Arabia, is playing an important role as a mechanism to resolve commercial disputes. In recent years, particular attention was given by the Government to Arbitration. In 1986 New Arbitration Regulations were promulgated. [76] These regulations replaced the Commercial Court Rules on Arbitration. [77] The Chamber of Commerce and Industry has also arbitration regulations. [78] The Saudi Government has recently ratified the International Centre for the Settlement of Investment Disputes Convention [79] (ICSID) though not yet ratified the UN Convention on the recognition and Enforcement of Arbitral Awards.[80]

Commercial disputes arising from negotiable instruments - termed in Saudi Arabia as commercial papers, and letters of credit, are heard by the Commission for Settlement of Commercial Disputes (CSCD) which sits in Riyadh, Jeddah and Dammam. It works in the form of panels of three: two Shari' a judges and one legal adviser, a representative of the Ministry of Commerce.[81] Due to increasing volume of case load before the (CSCD) banking law disputes are at present decided before two specialized Committees which are offshoots of the (CSCD). One is called the Commercial Paper Committee which deals with disputes relating to negotiable instruments. The other is called the Legal Committee which was formed in 1987. It deals with disputes involving banks and their customers.

Arbitration could be utilized to resolve a specific existing dispute, or to affect an already stipulated arbitration clause. However, before embarking into arbitration, the parties must file with the (CSCD), in the case of commercial disputes, an arbitration document or instrument, termed in Arabic (Wathiquat Al-Tahkim).[82] This document must be signed, including particulars as to the parties and the subject matter of the dispute.

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[76] *Royal Decree No. M/46*

[77] *Royal Decree M/32 OF 1-15 1350 A.H [1931 A.D] amended by Royal Decree M/51 OF 1389.A.H. [1969] and Royal Decree M/8 OF 1393 A.H [1973]*

[78] *M/16, 1400*

[79] *Convention on the Settlement of Investment disputes, Oct.14, 1966, 17U.S.T.1970.T.IA.S.No. 6090 1575 U.N.T.S.159*

[80] *The other main judicial body is called the Board of Grievances (in Arabic Diwan al-Mazalim). T he Board deals with disputes between the Government and foreign private parties, normally companies engaged in big projects. Besides these two main specialized judicial boards, Shari'ah courts are available in different parts of the country.*

[81] *Article 1 of Saudi Arbitration Regulations.*

[82] *Id Article 5*

Notifications and notices made during and after the process of arbitration must be made through the (CSCD). The reason is to check the proper functioning of the arbitration mechanism. Article 8 of the Regulations states as follows: The Clerk of the Authority originally competent to hear the dispute shall be in charge of all the notifications and notices provided for in the regulation. All awards issued by the arbitrators shall be filed within five days with the (CSCD). Objections to the award must be filed within fifteen days from the date of notification of the result of the award; otherwise the award shall be final[83] The CSCD review will normally focus on whether the award contravenes in any material respect an Islamic Shari' a rule.

The Arbitration Rules address the problem of delay by stipulating that the arbitrators shall render a decision within the time specified in the Arbitration instrument, unless it is agreed to extend it. If no time is fixed, the arbitrators shall render their decision within ninety days from the date of approval of the arbitration instrument. [84]

Letters of credit disputes are resolved in accordance with the UCP rules which do not raise any conflict whatsoever, with any doctrinal or primary Shari' a source. In effect predictable results are secured. It is the practice that a contract which does not include an express choice of law as to the Saudi law, shall be construed and governed by the place of performance of the contract. Therefore, in letters of credit transactions, the position of the beneficiary vis a vis the issuing banker and the account party, would be predictable and secured.

IV. Suggested Solutions

Discrepancy situations are of common occurrence in letters of credit transactions. The Midland Bank with the co-operation of the Simplification of International Trade Procedure Board (SITPRO)[85] conducted a research as to the rate of discrepancy in letters of credit transactions. The study concluded that for the year 1986, the rate of discrepancy was 51.4 per cent. [86] The recent survey carried in the U.K by SITPRO dated April 11 2003 shows that the rejection rate of first presentation against letters of credits was in the range of 50-60% per cent. The nub of the problem is that the law relating to

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[83] *Id Article 18*
[84] *Id Article 9*
[85] *SITPRO is an independent organization sponsored by The British Overseas Board (BOTB)*
[86] *CFf. Clive M. Shmitthof " Discrepancy of documents in letters of credit transactions " in J.B {1987] AT P 94*

documentary compliance is an intricate, multifarious area to warrant a solution that would eradicate the problems involved, as rightly observed by Professor Schmitthof that "The truth of the matter is that courts decline to be tied to a particular academic principle when dealing with the discrepancy of documents. This branch of the law is too multiform to admit generalization. When a problem of discrepancy of documents arises, the facts of the case are decisive. The search for a general principle underlying all these cases would be fruitless." [87]

Beneficiaries under letters of credit are normally experienced merchants. There is no good reason to absolve them from tendering the requisite documents called for under a credit. The basic solution lies in adhering to the rule of strict compliance; and implementation of equity considerations, whenever the situation demands as such. However, a number of practical solutions conducive to minimize the actually encountered difficulties should be highlighted. The beneficiary might overcome the difficulty of non-conforming documents by asking the account party to secure an amendment during the credit term. The beneficiary might consider it an elaborate precaution to negotiate incorporation of a proviso in the underlying contract, to the effect that the account party shall on reasonable request by the beneficiary agree to have an amendment being made. Although it is trite law that an amendment in a letter of credit needs approval of the issuing banker, it is not likely that a banker can decline to endorse the interest of his customer.

Though the doctrine of waiver cannot be successfully invoked against a banker, in a transaction basically made for the interest of his customer, nevertheless, on the basis of the account party express waiver, the banker can secure his position as to reimbursement. This could arise in the case of tender of documents after the expiry date. A stale tender would normally be refused by the issuing banker, even if a discrepancy is a de minimis one. Thus, to solve such a problem, the issuing banker must notify the applicant for the credit to see if he is prepared to waive a particular defect. In practice some applicants for credits refuse to waive a defect, even, in minor discrepancies, whenever they were in financial difficulties approaching insolvency, or whenever due to unforeseeable market forces, the price of the commodity subject of the underlying transaction falls. A resolution to such a practical difficulty could not be couched in any meaningful concrete terms;

[87] *Ibid at p. 110*

however, the beneficiary may elect to guard against such a contingency in the underlying contract. In effect, many letter of credit problems are due to the hard realities of the market place, besides the normal human frailties which, at any rate, could not be eradicated. However, a well drafted letter of credit can cater for such difficulties particularly in the case of minor insignificant discrepancies.

The equitable doctrine of estoppel can be raised by the beneficiary, whenever appropriate, as a protection against the abuse of the strict compliance standard. The doctrine could be applied in the event that the banker delays in examining the document within the prescribed time span allowed to the detriment of the beneficiary. In such an instance, the banker must be estopped from raising later objections. Article 13 of UCP revision 1993 in connection with discrepant documents and notice provides for such an incident. As provided in paragraph 13(a) the banker is bound to ascertain documentary compliance in light of the established international standards of banking practice. The reasonable time afforded to a banker shall not exceed seven banking days following the date of receipt of the documents. Within this prescribed period, the banker must decide whether to take up or refuse the documents. The banker is bound within this period to inform the party from whom it received the documents.

The stipulated time span applies to both the issuing and confirming banks. It is pertinent to indicate that the issuing bank and / or the confirming bank shall not be relieved from their obligation to examine the documents, even if the remitting bank draws their attention to discrepancy in the documents or if it has advised the said banks that it has effected payment under reserve or an indemnity. However, such a reserve or an indemnity relates only to the arrangement between the remitting bank and the party towards whom or from whom or on whose behalf the indemnity was got.

In the event of a discrepancy in the documents called for under the credit, the issuing or confirming bank or any nominated bank acting on their behalf must utilize the most expeditious means of communication to notify the bank from which the documents were received or the beneficiary if the documents were received directly from him. The notice must state in a plain manner the discrepancies with reference to which the issuing bank declines to accept the documents. Perhaps it is of paramount importance that the issuing bank is obliged to point out whether it is holding the documents at the disposal of or

is returning them to, the presentor (remitting bank or the beneficiary, as the case may be). In the event the issuing bank or the confirming bank fail to effect notification in the manner prescribed above, it shall be precluded from claiming discrepancy in the documents.

In connection with reimbursement the issuing bank shall have the right to go back to the remitting bank and call for refund of any reimbursement which may have been made to that bank. The issuing bank shall not be allowed to claim that the documents are not in strict compliance with the terms and conditions of the credit if that bank fails to abide by the provisions as clearly prescribed under article 14 or fails to hold the documents at the disposal of, or return them to, the presenter. In the event the issuing bank authorizes another to pay, accept drafts or negotiate against complying documents or incur a deferred payment, the issuing or confirming banks are bound to reimburse the nominated bank which has effected the mandate and are bound to take up the documents

In a recent case, Harlow and Jones Ltd. v American Express Bank Ltd. and Creditanstalt Bankverein (Third party) [88] a letter of credit was issued by the defendants in favor of the plaintiffs, steel traders, for the account of an Indian company. The credit stipulated that it was valid up to January 15, 1987 for negotiation. On February 2, 1987, the plaintiffs sent the documents to their bankers, Creditanstalt, of London, which notified the defendants of particular discrepancies in the documents *viz*, the credit was expired and the documents were later presented. The defendants requested Creditanstalt to send the documents "on collection basis" which they did on February 17, after having approval of the plaintiffs. On collection basis is a common term used by banks indicating that documents presented after expiry date implies an extension of the credit and that the issuing banking on consultation with his customer is to decide whether or not the documents are acceptable to him under the terms of the credit.

The defendants kept the documents till maturity of the bills drawn under the credit which were afterwards dishonored by their customer. In an action against the defendants, the court speaking through Mr. Justice Gatehouse said "It seems to me that the letter of February 17 must be taken to have meant what it said: that the defendants were obliged either to reject the documents or to accept them in accordance with its terms. They acted

[88] *[1990] 2Q.B, 343*

contrary to their instructions, and they are in my judgment, accordingly liable."[89]

More recently in Bankers Trust Co. v State Bank of India [90] the plaintiffs, issuing bankers, received from the defendants, advising bankers, the documents called for under a credit on September 21, 1988. The checking process lasted until September 26th, which revealed discrepancies in the documents. Thereafter, the issuing bankers notified the applicants for the credit who themselves inspected the documents and returned them on September 29th with a comprehensive list of discrepancies. Again, the plaintiffs instituted a number of rechecks of the documents which continued until September 30th. Then late in the evening the same day, the plaintiffs sent to the defendants, who had already negotiated the drafts drawn under the credit, a telex showing their rejection of the documents, stating that the documents will be at the disposal of the defendants only after payment.

The Court was asked to consider whether the time taken by the plaintiffs in the examination of the documents over the period September 21 to September 30 exceeded a reasonable time under article 16(e) of the UCP 1983 revision? Was it permissible under the said article for the plaintiffs to consult the applicants for the credit and/or release the documents to them, in the manner actually adopted by the plaintiffs or at all? The Court ruled that the extension of the time for examination of the documents by allowing the applicants for the credit to examine them themselves involved going beyond the reasonable time appropriate for such examination. Mr. Justice Hirst said "taking the matter as a whole, and for all the above reasons, I hold that the answer to the question "reasonable time for what?" under article 16 is the process which the Issuing bank is required to carry out under articles 15 and 16c, namely the issuing banks examination of the documents, and their determination on the basis of the documents alone whether to take them up or to refuse them" [91]

It appears, then, from this decision that consultation with the applicant for the credit should be for the purpose to see whether he wishes to waive or not any discrepancies identified by the banker, provided that such consultation shall be within the reasonable time needed by the issuing banker himself to carry out the task of examination of documents. Mr. B.S. Wheble,

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[89] *Ibid at p348*
[90] *[1991] 1 Q.B., 587*
[91] *Ibid at p.600*

Chairman of the ICC Banking Commission, called as an expert witness in this case testified that it is appropriate for an issuing banker, where he discovers discrepancies, to consult the applicant for the credit to see if he is prepared to waive the identified discrepancies, even if this, in appropriate cases, necessitates release of the documents to him. On the other hand he said "it would not be appropriate to release the documents to the applicant in order to enable him to comb through the documents in order to find further discrepancies, that task being essentially the role of the bank." [92] However, Mr. Wheble testified that the process of consultation conducted by the plaintiffs came within the reasonable time prescribed under article 16(c).

The decision is a stern warning to issuing bankers that having decided to decline to accept the documents, a prompt notice should be given to the presenting banker clearly indicating that the documents will be held at the disposal of or returning them to the latter.[93] Several considerations argue in favor of the court's decision. First, the decision gives business efficacy to the letter of credit device on the ground that permitting the applicant for the credit to examine the documents is a standard dangerously susceptible to biased applications. It also contradicts the rule of independence of the credit from the underlying transaction and might give the applicant for the credit a chance to extricate himself from a non-profitable transaction. Second, certainty and reliability of the banker's credit will be enhanced if such an issue is regarded as a point of principle rather than a point of fact which entails an inquiry outside the ambit of the issuing banker's role. The issuing banker is obliged to decide on the basis of the documents alone whether to take up such documents or to refuse them. The issuing banker's mandate is confined to matters only appearing on the face of the documents.

The issuing banker who delays in determining whether to take up the documents or to refuse them, but thereafter accepts them is bound to reimburse the remitting banker in full, including financial charges such as interest, from the date when the issuing banker ought to have accepted or rejected the documents? The remitting banker, upon receipt of the documents from the beneficiary, is bound to act within a reasonable time in accordance with the provisions of paragraph (c) and (d) of article 13 and if failed to act as aforesaid is he liable to the beneficiary for breach of contract.? It is

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[92] *Ibid at p. 593*

[93] *Cf Rabobank Nederland V. The Sumitoms Bank Ltd. (The Royan) [1987] 1 Q.B, 345, On appeal [1988] 2 Li. L. Rep. 250*

submitted that if the issuing banker elected to refuse the documents and gave notice to that effect without delay to the remitting banker, he is entitled to claim under article 14(d) from the latter refund of any reimbursement which may have been made to the remitting banker. On the other hand, if the remitting banker on the ground of being authorized by the issuing banker effected payment or incurred a deferred payment undertaking or accepted or negotiated drafts drawn against documents in *ex facie* conformity to the credit terms, the issuing banker as the party who gave such authority is obliged, as a matter of fairness, to reimburse the remitting banker in full, including financial charges incurred by the latter, from the date when the issuing banker ought to have accepted or rejected the documents. In the same line of argument, as the issuing banker's delay represents a breach of his undertaking to the remitting banker, the former should be estopped from claiming that the tendered documents were discrepant.

In support of this view Mr. Justice Gatehouse in Rabobank Nederland v The Sumitomo Bank Ltd. (The Royan) [94] said "Where discrepant documents are in the end accepted it must be the position that the discrepancies are waived and the position is just as if there had been no discrepancies in the first place, and payment must therefore be made by the issuing bank to the confirming bank so as to reimburse it for the payment that it has made." [95]

A remitting banker who has already confirmed the issuing banker's irrevocable credit undertakes to make payment to the beneficiary on tender of the requisite documents called for under the credit.[96] The UCP revision 1993 provides guide as to a specific time within which payment must be made which Article 13 (a) read in conjunction with article 14 (d). the determination of a specific time span for documents' examination addressed a lacuna in UCP revision 1983 where the time span for documents' examination was determined by the phrase," reasonable time" which had spawned much controversy. In an explanation to the concept of "reasonable time" contained in paragraph (c) of article 16, Bernard Wheble, Chairman of the ICC Banking Commission, said "Considerable thought was given to the possibility of replacing "reasonable time" by a specific period of time. Replies to a detailed

[94] *[i987] 1Q.B. 345*
[95] *Ibid 353*
[96] *Article 9 of the UCP revision 1993 clearly provides in Para (a) that an irrevocable credit constitutes a definite undertaking of the issuing ban, provided that the stipulated documents are presented to the nominated bank or to the issuing bank and that the terms and conditions of the credit are complied with.*

questionnaire showed approximately equal support for the *status quo* and for a change. The suggestion for the specified period of time ranged from "36 hours" to "30 days" and from calendar days to banking days. It was therefore felt impossible to recommend any change."[97] Accordingly, the policy of the article is considered to be better served by keeping the *status quo* despite misgivings voiced by some bankers.

It may be argued that that with a view to promoting certainty and uniformity a seven-day limit for examination of documents by either the remitting or the advising banker represents a reasonable time within which examination must be made, absent agreement or particular circumstances requiring a different time for response such as those identified under article 17 of the UCP.[98] As a practical matter, however, commercial or business standards should be applied, besides the duty of good faith and good dealing. In Bankers Trust v State Bank of India [99] an expert witness from Barclays testified that "the basis of the whole Barclays' system is that a time limit of three days is imposed and operated as constituting a reasonable time." [100]

On the whole, therefore, a uniform system as to examination of documents will avoid arbitrary distinctions between letters of credit transactions and will promote judicial efficiency and uniformity of decisions in this area of the law. In the final analysis, this chapter argues that where a banker unreasonably delays in the process of examination of documents, he should be held liable in damages to the non-defaulting party to the extent that the non-defaulting party should be placed so far as money can do it, in the same position he would have been in but for the breach by the defaulting party. [101]

Good faith is a standard implied in contractual obligations. If the issuing banker failed to notify the beneficiary of non-conforming documents within a reasonable time, it must be precluded from raising any discrepancy point, at a later stage. It also denotes good faith and fairness if a banker

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[97] *Cf .UCP 1974/1983 Revisions compared and explained [published in April 1984 by ICC Publishing S.A] at p.33*

[98] *Article 17 deals with force majeure situations such as Acts of God, riots, civil commotions, insurrections wars or any other causes beyond the control of banks.*

[99] *[1991] 1Q.B. , 587*

[100] *Ibid at p.594*

[101] *Cf. Farnsworth, "legal remedies for breach of contract" 70 Columbia L.REV. (1970) AT P.1145, see also Robert L.Brrmingham," Damage measures and economic rationality: The Geometry of Contract Law" 94 Duke L.J 49 [1969] see also Lewis A. Kornhauser "An Introduction to the economic analysis of contract remedies" 57 UN. Of Col..L.Rev. [1986] at p683*

declined to reject a document carrying words which he knows to convey the same meaning.

The beneficiary must negotiate the underlying contract to determine clearly what documents he had to tender. He can also negotiate to incorporate a proviso in the underlying contract entitling him to suspend performance, in case the account party fails to procure the credit in accordance to the terms of the underlying contract. Concomitant to this, the beneficiary must negotiate an expiry date which allows him a sufficient time span to tender his documents, prior to the credit expiry date. Some credits authorize payment to the beneficiary at a place not his normal place of residence or business. In such a situation a beneficiary must negotiate for a credit authorizing payment at his local bank. The practicality of the point is that it enables the beneficiary to rectify documents (if any) at the earliest possible opportunity.

Documents called for under credits are not standardized. It would probably lessen discrepancy difficulties if these documents were to be standardized on a global basis.

Conclusion

The strict compliance standard in letters of credit transactions obligates the beneficiary before drawing under the credit to tender regular conforming documents. On the other hand, the banker's mandate is to examine the documents to see that the beneficiary has strictly observed the terms and conditions of the credit.

The standard is established in banking practice, as embodied in both versions 1993 of the UCP, however the problem relates to interpretation of the standard. The issue is, whether strict compliance means literal interpretation of the credit terms, or does it mean an exact tender as to the substance of the terms of the credit, irrespective of minor discrepancies.

Proponents of the strict compliance standard believe that the standard serves the objectives of certainty and reliability of the bankers' credit. Advocates of the substantial standard contend that the standard is fair and just. A banker should not dishonor the beneficiary's drafts on the grounds of a de minimum discrepancy or a hyper technical situation.

English courts uphold the strict compliance standard. The beneficiary must tender the requisite documents in accordance to the literal terms of the credit. However, they apply equitable doctrines such as waiver and estoppel,

whenever appropriate, against the bankers' abuse of the strict compliance standard.

In the Sudan, bankers adhere to the strict standard as provided for under the UCP. In Kingdom of Saudi Arabia observance of the strict compliance standard is viewed as an incident of freedom of contract. Strict compliance is structured on Islamic Shari' a concepts of justice and faithfulness. Both concepts explain respect of a person's covenants in connection with others rights.

In the U.S.A. the two interpretations of the rule are applied. Some courts subscribe to the strict standard, whilst others subscribe to the substantial standard. American courts also apply equitable doctrines but their approach is different from that of the English courts. Under the English law, the banker can reject a document for specific defects, without being estopped to raise later objections to that document or other required documents. Under the American law, the banker is bound by the objections he raises at the time of first tender. He is estopped from raising later objections. Moreover, the banker must notify the beneficiary as to any discrepancy in the documents at the time of examination of the documents, otherwise he would be estopped from raising any objection as to that discrepancy at the trial stage.

It may be argued that the strict compliance standard is of practical importance to an efficient functioning of letters of credit. The standard facilitates prompt examination of the tendered documents. It also alerts the attention of beneficiaries of credits to exercise utmost diligence in tendering the required documents from their part. The standard provides certainty, predictability, reliability and simplicity.

The alternative substantial compliance standard necessitates application of discretion. It places on the banker the responsibility of exercising due diligence in determining whether substantial compliance has been met or not. As documentary checkers are not lawyers, the substantial compliance standard would not be workable in practice.

Silence of the UCP as to equitable remedies allows the courts to apply these doctrines whenever appropriate. However, a broad approach is apt to undermine the independence of the letter of credit device. The practical and legal arguments tend to uphold the strict compliance standard provided that the issuing banker takes an impartial position.

It may be suggested that in case of discrepant documents the issuing banker may consult with the applicant for the credit to see if he is prepared to waive the discrepancies or not, provided that such consultation shall be within the reasonable time needed by the issuing banker himself to carry out the task of examination of documents. It also suggests that with a view to promoting certainty and uniformity a presumption could and should be devised as to the time span which constitutes a reasonable time within which such examination must be made. A uniform system as to examination of documents enhances business efficacy; avoids arbitrary distinctions between letters of credit transactions and promotes judicial efficiency and uniformity of decisions in this area of the law. This chapter makes the point that where an issuing banker unreasonably delays in the process of examination of documents, he is obliged to reimburse the remitting banker in full including financial charges incurred by the latter from the time when the issuing banker ought to have accepted or rejected the documents. Again, it may be argued that where a remitting banker unreasonably delays in the process of examination and remitting the documents, he should be held liable in damages to the non-defaulting party who should be placed, insofar as money can do it, in the same position as if timely performance has been made.