STRICT CONFORMITY OF DOCUMENTS UNDER A PERFORMANCE GUARANTEE. DOES A SIGNED COPY OF A DOCUMENT QUALIFY AS AN ORIGINAL?

Stefanutti & Bressan (Pty) Ltd v Nedbank Ltd (unreported judgment delivered on 30 July 2008) (case no 5311/2008) (D&CLD)

1 Introduction

Unlike in many overseas jurisdictions, there is a paucity of South African reported case law dealing with certain instruments of payment and guarantees for payment such as documentary letters of credit and performance guarantees, to mention but two examples of instruments prevalent in the field of payment and financing. (For an overview of the large body of reported case law in the UK on documentary letters of credit, to mention but one foreign jurisdiction, see Brindle and Cox *Law of Bank Payments* 3ed (2004) 651 *et seq*.)

For this reason any new case law dealing with either letters of credit or performance guarantees is to be welcomed as it would hopefully not only contribute to our understanding of this area of the law, but also provide an opportunity for comment and reflection. This holds especially true since the International Chamber of Commerce has recently (in July 2007) accepted and introduced a new version of the Uniform Customs and Practices for Documentary Credits (hereinafter "the UCP"): UCP 600. (For a broad introduction to the provisions of UCP 600, see *Commentary on UCP 600. Article-by-Article Analysis by the UCP 600 Drafting Group* (hereinafter "*Commentary*") (2007) *passim*; and Ellinger "The Uniform Customs and Practice for Documentary Credits (UCP): Their Development and the Current Revisions" 2007 *Lloyd's Maritime and Commercial Law Quarterly* 152 *et seq*; and for a South African perspective on UCP 600, see Schulze "The UCP 600: A New Law Applicable to Documentary Letters of Credit" 2009 21 *SA Merc LJ* (to be published).)

In passing: Apart from the main distinction between direct (three-party) and indirect (four-party) demand guarantees, they (*ie*, demand guarantees) may also be classified by reference to the phase or part of performance they are designed to secure, hence the following classification of the different types of demand guarantees: tender guarantee (tender bond); performance guarantee (performance bond); advance payment guarantee (repayment guarantee); retention guarantee; and maintenance guarantee (warranty guarantee). (For the role and function of each of these types of guarantee,

see Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* (unpublished LLD thesis University of South Africa 2009) 34 *et seq*.) In what follows below the author will use the concept of "guarantee", being a generic term, when referring to demand and/or performance guarantees in general.

The recent decision in *Stefanutti & Bressan (Pty) Ltd v Nedbank Ltd* (unreported judgment delivered on 30 July 2008 (case no 5311/2008) by the Durban & Coast Local Division of the High Court (now: KwaZulu-Natal High Court, Durban) is a rare and welcome addition to the rather modest collection of South African decisions dealing with performance guarantees.

2 *Stefanutti & Bressan (Pty) Ltd v Nedbank Ltd*

2 1 Facts

The applicant ("Stefanutti") undertook to design, supply and install a material handling system for the second respondent ("Hillside"). In terms of the contract between Stefannuti and Hillside, the former was required to provide a performance guarantee to the latter. Stefanutti applied with the first respondent ("Nedbank") to issue such a guarantee. The guarantee was later amended on two occasions (on 6 April 2006 and 28 March 2007, respectively) to increase the value of the performance guarantee to a total value of more than R5,2 million. The main guarantee, as well as the two subsequent letters of amendment to the guarantee, consisted of an original as well as two copies ("Bank Copy I" and "Bank Copy II"). The relevant clause in the guarantee provided that "payment shall be made by [Nedbank upon] written demand … accompanied by the *original* guarantee" (par 1-3) (parenthesis and emphasis added).

Both letters of amendment contained the following term: "*This letter* of amendment forms an integral part of the original letter of guarantee and must be attached thereto" (par 3.6) (emphasis added).

A dispute arose between Stefanutti and Hillside as to the performance by Stefanutti of its work in terms of the contract between them. Hillside indicated that it intended to call up the guarantee (par 3.2).

The question which arose for decision was whether Hillside was entitled to payment under the guarantee where it presented the original guarantee, the original first letter of amendment, but only "Bank Copy II" of the second letter of amendment, signed in the original. It was common cause that "Bank Copy II" of the second letter of amendment was originally signed, but that it was nevertheless a copy of the original. The parties were in dispute whether Stefanutti ever delivered the original of the second letter of amendment to Hillside (par 6).

Stefanutti applied for an interdict to prevent Nedbank from paying under the guarantee because not all the original documents were in the possession of and presented by Hillside to Nedbank (par 1).

Hillside, in turn, argued that

(a) it was not necessary for it to present the signed version of the second amendment letter, marked "original". It was sufficient for it to submit the signed version marked "Bank Copy II". In this regard it argued that the letters of amendment did not specifically require that the *original* of these letters had to be submitted for payment under the guarantee, but merely that "*this letter* forms an integral part of … the guarantee";

(b) if it was indeed a requirement that payment of the guarantee was dependent upon the presentment to Nedbank of the original letter of amendment, that that condition had been fictionally fulfilled because Stefanutti had withheld the original from it (*ie*, Hillside); and

(c) because of the nature of a performance guarantee, Stefanutti had no *locus standi* to restrain Nedbank from making payment to Hillside (par 12).

2 2 The decision in Stefanutti & Bressan (Pty) Ltd v Nedbank Ltd

2 2 1 Whether "Bank Copy II" satisfied the requirement of an original document

In dealing with the first of the three legal questions put to him, Swain J held as follows: A bank is obliged to conform strictly to the terms of the guarantee (see *OK Bazaars (1929) Ltd v Standard Bank of SA Ltd* 2002 3 SA 688 (SCA) in par 25 (par 16 in the *Stefanutti* case)).

Although the original of the second amendment letter was never delivered by Stefanutti to Hillside, it could not be said that the former deliberately withheld the original document from the latter. A reasonable inference was drawn that Stefanutti believed that it had handed the original to Hillside, whereas it had only handed the document "Bank Copy II", but signed in the original (par 19).

The court held that the phrase "*this letter* … forms an integral part of the original … guarantee" had to be interpreted in the context of the evidence adduced on behalf of Nedbank, in which the importance of the three classes of documents was emphasized, namely "Original", "Bank Copy I" and "Bank Copy II" (par 19 and 22). From this it was clear that the "Bank Copy II" was to be used by Stefanutti solely for record purposes. "Bank Copy II", even when signed in the original, was nothing, more nor less, than a mere copy. The signatures on "Bank Copy II" did not elevate the copy to the status of an "original" or a "duplicate original" (par 24).

2 2 2 Whether the condition requiring presentment of original documents had been fictionally fulfilled

Because Hillside failed to raise the defence of "fictional fulfilment" (of delivery of the original letter of amendment) timeously (it was only raised after evidence had been led) the court rejected this argument. For the same reason it also rejected Hillside's alternative argument based upon an implied term between it and Stefanutti.

But even if it had raised it timeously, the court held that the fact that Hillside had conceded under cross-examination that it could not be said that Stefanutti withheld the original letter of amendment *deliberately*, struck at the whole basis for Hillside's claim to fictional fulfilment (par 35-39).

2 2 3 Whether Stefanutti had the necessary *locus standi* to apply for an interdict to prevent Nedbank from paying under the guarantee

In this regard Hillside relied on the following *dictum* in *Loomcraft Fabrics CC v Nedbank* (1996 1 SA 812 (SCA) 816C-D): "an interdict restraining a bank from paying in terms of a credit will accordingly not be granted at the instance of the buyer [here: Stefanutti] save in the most exceptional cases" (par 41)). However, the court in the *Loomcraft* case was not concerned with the question whether the bills in that case on their face conformed strictly to the requirements of the letter of credit, but whether a construction could be placed upon the bills, in terms of which the words "actually on board" could be ignored, with the result that the bills did not conform with the credit (par 44-47).

In the *Stefanutti* case the document marked "Bank Copy II" patently did not conform to the requirements of the guarantee. As a result, Nedbank was neither obliged, nor entitled to pay Hillside without Stefanutti's consent. Nedbank had to ensure that it conformed strictly to the instructions which it received (par 51).

Stefanutti was accordingly entitled to an interdict to restrain Nedbank from paying under the guarantee.

3 Strict Conformity and Original Documents under UCP 600

By way of a general background it should be stated that there are two fundamental doctrines which underlie the operation of letters of credit, and for purposes of the present discussion, also performance guarantees. The first is that letters of credit and performance guarantees are independent and autonomous from the underlying contract. This is also referred to as the "doctrine of autonomy". Closely linked to the doctrine of autonomy is the second doctrine which entails that banks deal in documents only ("doctrine of documents"). (For a more detailed discussion of these two doctrines, see

Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* 2ed (2006) 306 *et seq*.)

In passing it needs to be mentioned that over the years a limited number of exceptions have been recognized on these two rules, notably where there was fraud involved on the part of the beneficiary or the presenter of the documents. As the UCP does not specifically deal with these exceptions, they do not merit our further attention here. (On the fraud exception in the sphere of documentary letters of credit, see Oelofse *The Law of Documentary Letters of Credit in Comparative Pespective* (1997) 470 *et seq*; and Van Niekerk and Schulze 313 *et seq*; and on the fraud exception in the sphere of demand guarantees, see Kelly-Louw 209 *et seq*.)

The *Stefanutti* case turned on the application of the second of these two doctrines. For the sake of brevity this doctrine will be referred to as the "doctrine of documents". The doctrine of documents, in turn, consists of two parts. First, it entails that the letter of credit deals purely with documents. Secondly, the requirement of strict compliance demands that the documents that are tendered by the beneficiary must conform strictly to the terms and conditions of the letter of credit. Closely linked to the second part of the doctrine of documents, is the question what is regarded as an original document. (More about original documents *vis-à-vis* copies thereof later.)

Let's now turn to the second part of the doctrine of documents, namely that the documents which are presented by the beneficiary must conform strictly to the documents as required in the letter of credit. The principle of strict conformity has been acknowledged and applied in South African law (see *Delfs v Kuehne & Nagel (Pty) Ltd* 1990 1 SA 822 (A)).

By way of a general introduction it can be said that the bank has a duty to examine the documents to determine whether they conform to the requirements set out in the letter of credit or guarantee. Once the beneficiary has submitted to the bank a set of documents that conform to the requirements stipulated in the letter of credit or guarantee, the bank has no further option than to effect payment to the beneficiary. This second part of the document doctrine is fundamental to the use of letters of credit of performance guarantees in international trade. It also places a burden on the applicant, before requesting a bank to issue a letter of credit or guarantee, first to obtain some knowledge about the business integrity of the beneficiary. Failure to do so could result in a financial loss to the applicant (see Van Niekerk and Schulze 309).

There is no obligation on the bank to pay on the strength of nonconforming documents. The required standard is that of strict conformity. The principle of strict conformity constitutes the second part of the doctrine that the bank deals purely with documents. Of the principle of strict conformity it has been said that there is no room in the law of letters of credit or guarantees for documents that are "almost the same" as those described in the letter of credit or guarantee, or for documents that will do just as well. Even if the deviation from the requirements stated in the letter of credit or guarantee is very small, the bank may and, in fact, must refuse payment. If

it, nevertheless, pays on nonconforming documents without the consent of the applicant, it does not fulfil its mandate toward the applicant. As a result it may not be able to recover the amount paid to the beneficiary from the applicant (Van Niekerk and Schulze 309-310).

The basic duty of a bank involved in a letter of credit or guarantee thus is to ensure that the documents comply with the requirements as listed in the letter of credit or guarantee.

UCP 500 required "banks" to examine the documents "with reasonable care" (see sub-art 13(a)).

Article 14 UCP 600 now combines sub-arts 13(a) and 14(b) UCP 500. From a banking practice's point of view, art 14 UCP 600 – under the title "Standard for Examination of Documents" – probably contains some of the most important new initiatives and changes contained in UCP 600. The majority of letter-of-credit rejections are because of non-conforming documents. Inconsistent examining standards by banks account for a large number of rejections. Article 14 UCP 600 consists of 12 sub-articles.

The author will restrict himself and merely refer to one of these sub-articles here, namely sub-art 14(d) of UCP 600. (For a more detailed discussion of these 12 sub-articles, see Schulze (to be published).)

Sub-article 14(d) UCP 600 provides that data in a document need not be identical to, but must not conflict with data in that document or any other stipulated document or the credit. Sub-article 14(d) is the equivalent of the second sentence of art 21 UCP 500 and the last sentence of the first paragraph of sub-art 13(a) UCP 500. Because the data in the signed copy of the document in the *Stefanutti* case was identical with the data required in the guarantee, a detailed discussion of the provisions contained in sub-art 14(d) would be superfluous here.

Article 17 UCP 600 specifically addresses the issue which was at stake in the *Stefanutti* case, namely the validity of original documents *vis-à-vis* copies thereof. The facts which led to the application for an interdict preventing Nedbank from honouring the guarantee in the *Stefanutti* case occurred before July 2007 and were therefore subject to UCP 500 and not UCP 600.

In passing, I need to point out that the facts which led to the application for an interdict preventing Nedbank from honouring the guarantee in the *Stefanutti* case occurred before July 2007, that is, at the time when UCP 500 was still in force and before UCP 600 came into operation. However, the typed version of the court's hitherto unreported judgment does not contain any indication that the guarantee (or its two subsequent amendments) was specifically made subject to the provisions of UCP 500. (A discussion of the vexed question as to the legal nature of the UCP, and more specifically the question as to the binding nature of the UCP, where it has not been expressly incorporated in a letter of credit or guarantee, falls outside the scope of the present article. For a discussion of this question, see Van Niekerk and Schulze 275-276.)

It is trite law that UCP 600 applies to both letters of credit and demand

guarantees (see Kelly-Louw 132-133).

In reaching its decision the court did not find it necessary to refer to the provisions from UCP 500 which dealt with original documents *vis-à-vis* copies of the same. The decision of the court was simply based on an interpretation of the requirement of an "original document" as stipulated in the guarantee, on the one hand, and the reliance which the court placed on earlier case law, most notably the decisions in *OK Bazaars v Standard Bank of SA* (*supra*); and *Loomcraft Fabrics CC v Nedbank* (*supra*), on the other hand.

Let's assume for the moment that the guarantee in the *Stefanutti* case was indeed governed by UCP 500. Sub-article 20(b) of UCP 500 provided that "[u]nless otherwise stipulated in the Credit, banks will also accept as an original document(s), a document(s) produced or appearing to have been produced:

> "i by repographic, automated or computerized systems;
> ii as carbon copies; provided that it is marked as original and, where necessary, appears to be signed. A document may be signed by handwriting, by facsimile signature, by perforated signature, by stamp, by symbol, or by any other mechanical or electronic method or authentication."

The provisions contained in sub-art 20(b) of UCP 500 raised a number of queries. Several overseas' court cases, too, raised the issue of what constitutes an original document. These queries and issues resulted in the ICC Banking Commission in July 1999 issuing a Decision on "The Determination of an 'Original' document in the context of [sub-art 20(b) of UCP 500]" (see *Commentary* 75).

This Decision on sub-art 20(b) of UCP 500 was used as the basis for the revision and reformulation of the provisions which are now contained in sub-arts 17(b) and (c) UCP 600.

Sub-article 17(a) UCP 600 now requires that at least one original of each document stipulated in the credit must be presented.

It further provides guidelines as to what will be regarded as an "original". It states that "a bank shall treat as an original any document bearing an apparently original signature, mark, stamp or label of the issuer of the document unless the document itself indicates that it is not an original" (see sub-art 17(b)). This will be the case where a document is stamped "copy". A further document will be treated as an original if it:

- appears to be written, typed, perforated or stamped by the document issuer's hand;
- appears to be on the document's issuer's original stationery; or
- states that it is original "unless the statement appears not to apply to the document presented" (*eg*, where a covering letter describes the attached documents as originals, but a notation on one of them indicates that it is, nevertheless, a copy: see Ellinger 169).

Two further guidelines as to the concept of "originality" have been added to sub-art 17. Firstly, if a letter of credit (or guarantee) requires presentation of copies of documents, presentation of either originals or copies are permitted (sub-art 17(d)). Secondly, a requirement for the presentation of multiple documents is satisfied by the presentation of at least one original and the remaining number in copies. As modern technology allows for easy reproduction, it has been remarked that is surprising that the presentation of a "copy" or "copies" is not satisfied by the tender of the original (sub-art 17(d)). The Drafting Group in its *Commentary* on UCP 600 explains that if the intention is to require copies of documents only, the documentary credit must be precise in its requirement for copies (76).

Applied to the facts of the *Stefanutti* case it would mean that in terms of sub-art 20(b) UCP 500, the document marked "Bank Copy II", although it contained an original signature, remained a copy of the original. Because the guarantee required that the *original* document had to be submitted by the beneficiary to Nedbank, it (*ie*, Nedbank) was entitled to reject payment because, in the wording of sub-art 20(b) "the credit [here: guarantee] stipulated otherwise" (*ie*, it required that an original document had to be submitted).

Were the *Steffanutti* case to be adjudicated on under UCP 600, the author believes that the outcome would have been the same, but for different reasons. In terms of sub-art 17(b) UCP 600 a bank must treat as an original "any document bearing an apparently original signature, mark, stamp … unless *the document itself indicates that it is not an original*" (emphasis added). Because the document in question in the *Stefanutti* case bore the heading "Bank Copy II", itself indicated that it was not an original and would thus not have been accepted as such, had the case been adjudicated on under UCP 600.

4 Conclusion

The decision in the *Stefanutti* case merits a number of comments.

Firstly, the author believes that the decision in the *Stefanutti* case was decided correctly. In the event of the non-application of the provisions of UCP (*eg*, where the parties had expressly excluded the UCP from the guarantee) the court correctly upheld the common-law doctrine of strict conformity of documents. Had the guarantee been made subject to UCP 500 (either expressly or impliedly) the decision of the court would still have been correct because the guarantee required an original document to be submitted (see again sub-art 20(b) UCP 500). Were the *Steffanutti* case to be adjudicated in terms of UCP 600, the decision of the court would again have been correct, because the document itself indicated that it was a copy and not an original (see again sub-art 17(b) UCP 600).

Secondly, the *Stefanutti* case does not dilute the principle that a bank guarantee is an independent and separate undertaking by the bank to pay the beneficiary (here: "Hillside"). In the *Stefanutti* case the applicant successfully interdicted the issuing bank (Nedbank) from paying under the

guarantee because the documents which were presented by the beneficiary (Hillside) to obtain payment under the guarantee did not strictly conform to the terms and conditions of the guarantee.

Thirdly, the relevance of the *Stefanutti* case for banks and other issuers of guarantees is that the non-compliance by a beneficiary of a condition or requirement of presenting "original documents" will not be regarded by the court as a mere trivial irregularity. If the guarantee requires original documents to be produced to obtain payment under it (*ie*, the guarantee) a copy, even if originally signed, will not suffice.

Finally, banks and their employees should therefore scrutinize the terms and conditions of letters of credit and performance guarantees carefully to ensure that the contents and status (*ie*, original *vis-à-vis* copies of) documents strictly conform with the conditions and requirements under the credit or guarantee.

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