COPYRIGHT AND CITATION CONSIDERATIONS FOR THIS THESIS/ DISSERTATION

- Attribution — You must give appropriate credit, provide a link to the license, and indicate if changes were made. You may do so in any reasonable manner, but not in any way that suggests the licensor endorses you or your use.

- NonCommercial — You may not use the material for commercial purposes.

- ShareAlike — If you remix, transform, or build upon the material, you must distribute your contributions under the same license as the original.

How to cite this thesis

Surname, Initial(s). (2012). Title of the thesis or dissertation (Doctoral Thesis / Master's Dissertation). Johannesburg: University of Johannesburg. Available from: http://hdl.handle.net/102000/0002 (Accessed: 22 August 2017).

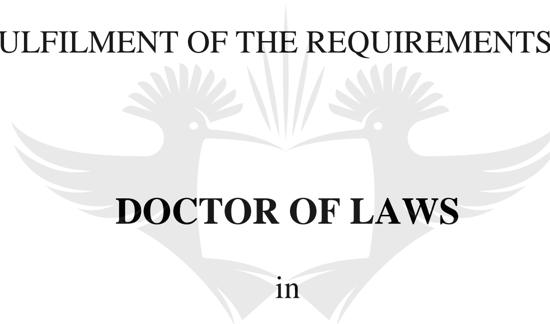
LETTERS OF CREDIT AND DEMAND GUARANTEES: A LEGAL STUDY ON THE IMPACT OF TARGETED FINANCIAL SANCTIONS FROM A SOUTH AFRICAN PERSPECTIVE

by

CAYLE SELWYN LUPTON

THESIS

SUBMITTED IN FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE



DOCTOR OF LAWS

in

MERCANTILE LAW

in the

FACULTY OF LAW

at the

UNIVERSITY OF JOHANNESBURG

SUPERVISOR: PROFESSOR C F HUGO

CO-SUPERVISOR: PROFESSOR H A STRYDOM

JULY 2022

DECLARATION

I hereby declare that this thesis is my own work. The content of the thesis reported herein was composed by and originated entirely from me.

I also declare that information derived from the published and unpublished work of others has been acknowledged in the text and references are given in the bibliography.

Cayle Selwyn Lupton
July 2022

ACKNOWLEDGEMENTS

I would like to acknowledge all who have contributed to the completion of this thesis. Firstly, I acknowledge my supervisors, Professors Charl Hugo and Hendrik Strydom, who, despite their extremely busy schedules, managed to review my work and provide me with valuable comments and insights. Professor Hugo, in particular, has contributed significantly to my intellectual development. He saw academic potential in me long before anybody else did. I am deeply indebted to him for the support, professional opportunities and words of wisdom and encouragement he has extended to me. I am also indebted to Professor Michelle Kelly-Louw, University of Cape Town, Faculty of Law. Not only has she supported and inspired me along the way, but she has also, without hesitation, entertained all professional and personal questions posed to her. Those who know me well know I have an endless supply of questions.

I would also like to acknowledge the generous financial assistance provided by the University of Johannesburg, Faculty of Law, in respect of my doctoral studies. Acknowledgment is also hereby extended specifically to the Centre for Banking Law, Faculty of Law, University of Johannesburg, for the financial and other assistance provided.

Moreover, I would like to express my sincere gratitude for the support of my family and friends. I am especially grateful to my wife, Meghan, and my daughter, Hailey, for the sacrifices made during the writing of this thesis. At times it was difficult, but you remained steadfast in your commitment to supporting me. This thesis is dedicated to the two of you. I would also like to thank my parents, Dale and Doreen, my brother and sister, Carl and Amy, my friend, Clifton, and my family in law, Lester, Delayne, Chadd and Leigh. From all of you I received much encouragement and renewed energy.

Finally, and most importantly, I thank and acknowledge my lord and saviour Jesus Christ, through whom I do all things. To Him be the glory and praise.

UNIVERSITY
OF
JOHANNESBURG

ABSTRACT

The purpose of this study is to provide a legal analysis of the impact of targeted financial sanctions on letters of credit and demand guarantees. The letter of credit is an important method of payment used in international trade. The demand guarantee plays a significant role as an instrument of security in commercial transactions. In their simplest form both instruments constitute an undertaking by a bank to pay a beneficiary against delivery of certain stipulated documents. Letters of credit and demand guarantees are known to be reliable and provide a considerable measure of certainty and predictability to the underlying transaction. Consequently, they have been described as the "lifeblood of international commerce".

Targeted financial sanctions entail assets freezing and prohibitions to prevent funds or other assets from being made available, directly or indirectly, for the benefit of designated individuals and entities. Endorsed by the United Nations and implemented by the vast majority of jurisdictions around the world, targeted financial sanctions are increasingly being used to combat financial crime, including money laundering, terrorism financing and weapon proliferation financing. Banks play a critical role in financial crime prevention and detection. Hence they have been identified as institutions that must comply with targeted financial sanctions.

The relationship between targeted financial sanctions and letters of credit and demand guarantees has generally not been well documented. It is hoped, therefore, that this study will make a meaningful contribution to the jurisprudence on letters of credit and demand guarantees.

In investigating the impact of targeted financial sanctions, the study can be categorised into three parts. Part one investigates a bank's compliance with *domestic* targeted financial sanctions. The chief findings of the study in this regard are that banks are under a legal obligation to comply with sanctions and, as a result, a bank that refuses to perform its contractual obligations under a letter of credit or demand guarantee may have a defence in law. In South African law the bank can raise the so-called defence of legal impossibility of performance to resist a claim for, or potential litigation in respect of, payment. Part two investigates a bank's compliance with *foreign* targeted financial sanctions. Because

UNIVERSITY
OF
JOHANNESBURG

compliance in this regard has no (legal) basis, the bank may conceivably be sued by the beneficiary for payment on the basis of breach of contract.

Part three investigates problematic documentary practices that banks have adopted or conceivably may adopt to manage their sanctions risk exposure. In this regard, attention is given to so-called sanctions clauses and other non-documentary conditions. The issue of unjustified amendments by the beneficiary for the purposes of sanctions evasion is also considered in part three. The general conclusion arrived at is that by interfering with payment, targeted financial sanctions render letters of credit and demand guarantees unreliable, thereby having the effect of reducing their value to international trade and commerce. The author proposes certain recommendations and initiatives aimed at mitigating the impact of targeted financial sanctions on credits and guarantees.

Key terms: letters of credit; demand guarantees; financial crime; sanctions evasion; targeted financial sanctions; compliance; banks; due diligence; payment; reimbursement; credits; guarantees.

LIST OF ABBREVIATIONS

ABLU	Annual Banking Law Update
ACAMS	Association of Anti-Money Laundering Specialists
All ER	All England Law Reports
All SA	All South African Law Reports
ATCSA	Anti-Terrorism, Crime and Security Act 2001
BAFT	Bankers Association for Finance and Trade
CA	Court of Appeal
CC	Constitutional Court
CLS	Continuous Linked Settlement
CTA	Counter Terrorism Act 2008
ESAAMLG	Eastern and Southern African Anti-Money Laundering Group
ECTEA	Economic Crime (Transparency and Enforcement) Act 2022
EU	European Union
FATF	Financial Action Task Force
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act 38 of 2001
FICAA	Financial Intelligence Centre Amendment Act 1 of 2017
FinCEN	Financial Crimes Enforcement Network
GAFILAT	Financial Action Task Force for Latin America
ICC	International Chamber of Commerce
IIBLP	Institute of International Banking Law and Practice
IEEPA	International Emergency Economic Powers Act of 1977
ISBP 745	International Standard Banking Practice, ICC Publication 681E, 2007

UNIVERSITY OF JOHANNESBURG

ISDGP 814	International Standard Demand Guarantee Practice for URDG, ICC Publication 814E, 2021
ISP98	International Standby Practices, ICC Publication, 590, 1998
HC	High Court
HL	House of Lords
Lloyd's Rep	Lloyd's List of Law Reports
MENAFATF	Middle East and North Africa Financial Action Task Force
NYS	New York Supplement
OFAC	Office of Foreign Assets Control
OFSI	Office of Financial Sanctions Implementation
POCA	Prevention of Organised Crime Act 121 of 1998
POCDATARA	Protection of Constitutional Democracy against Terrorist and Related Activities Act 33 of 2004
QB	Queen's Bench
RMCP	Risk Management and Compliance Programme
RTGS	Real-Time Gross Settlement
SALJ	South African Law Journal
SA Merc LJ	South African Mercantile Law Journal
SA	South African Law Reports
SAMLA	Sanctions and Anti-Money Laundering Act 2018
SCA	Supreme Court of Appeal
SDN	Specially Designated National
SWIFT	Society for Worldwide Interbank Financial Telecommunications
TAFU	Terrorist Asset-Freezing etc Act 2010
THRHR	Tydskrif vir Hedendaagse Romeins-Hollandse Reg / Journal of Contemporary Roman-Dutch Law
TEC	Treaty Establishing the European Community

UNIVERSITY
OF
JOHANNESBURG

TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TSAR	Tydskrif vir die Suid-Afrikaanse Reg / Journal of South African Law
TWEA	Trading with the Enemy Act of 1917
UCP 600	Uniform Customs and Practice for Documentary Credits, ICC Publication 600, 2007
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNSC	United Nations Security Council
URDG 758	Uniform Rules for Demand Guarantees, ICC Publication 758, 2010
USA PATRIOT ACT	Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (Title III: International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001
US	United States of America
WLD	Witwatersrand Local Division

UNIVERSITY OF JOHANNESBURG

TABLE OF CONTENTS

DECLARATION .... **ii**

ACKNOWLEDGEMENTS .... **iii**

ABSTRACT .... **iv-v**

LIST OF ABBREVIATIONS .... **vi-viii**

TABLE OF CONTENTS .... **ix-xv**

CHAPTER ONE: INTRODUCTION **1-7**

1.1 General introduction 1

1.2 Background and purpose of the study 1

1.3 Jurisdictions covered 3

1.4 Research methodology 4

1.5 Research scope and outline 5

CHAPTER TWO: INTRODUCTION TO LETTERS OF CREDIT AND DEMAND GUARANTEES **8-70**

2.1 General introductory remarks 8

2.2 Letters of credit 10

2.2.1 Introduction 10

2.2.2 Definition of a letter of credit 11

2.2.3 Operation of the letter of credit 13

2.2.3.1 The different parties involved 13

2.2.3.2 The discharge of the payment obligation 17

2.2.3.3 The specific payment undertaking of the issuing bank: sight payment, deferred payment, acceptance and negotiation 19

2.2.4 Other types of letters of credit 26

2.2.5 Alternative methods of payment in international sale transactions 28

2.2.5.1 Introduction 28

2.2.5.2 Payment in advance 28

2.2.5.3 Open account 29

2.2.5.4 Documentary collections 29

2.2.6 Conclusions 31

UNIVERSITY OF JOHANNESBURG

2.3 Demand guarantees ... 32
2.3.1 Introduction ... 32
2.3.2 Definition of a demand guarantee ... 33
2.3.3 Operation of the demand guarantee ... 35
2.3.4 The involvement of other parties ... 36
2.3.5 The use of standard-form guarantees ... 38
2.3.6 Different types of demand guarantees ... 39
2.3.6.1 Introduction ... 39
2.3.6.2 Performance guarantees ... 40
2.3.6.3 Payment guarantees ... 40
2.3.6.4 Advance payment guarantees ... 41
2.3.6.5 Retention guarantees ... 41
2.3.6.6 Maintenance (or warranty) guarantees ... 42
2.3.6.7 Tender guarantees ... 42
2.3.7 Alternative means of security ... 43
2.3.7.1 Introduction ... 43
2.3.7.2 Accessory guarantee ... 43
2.3.7.3 Indemnity ... 45
2.3.7.4 Insurance policy ... 46
2.3.8 Conclusions ... 47
2.4 Fundamental legal principles of letters of credit and demand guarantees ... 47
2.4.1 Comparison between letters of credit and demand guarantees ... 47
2.4.2 The independence principle ... 49
2.4.2.1 Introduction ... 49
2.4.2.2 Case law ... 50
2.4.3 The fraud exception ... 52
2.4.4 Other (potential) exceptions ... 55
2.4.4.1 Introductory remarks ... 55
2.4.4.2 Bad faith ... 55
2.4.4.3 Illegality ... 58
2.4.4.4 Conclusions ... 60
2.4.5 Documentary compliance ... 60
2.4.5.1 Introduction ... 60
2.4.5.2 International rules ... 61

UNIVERSITY OF JOHANNESBURG

2.4.5.3 Case law ... 63
2.4.5.4 Conclusions and analysis ... 68
2.5 Conclusion ... 69

CHAPTER THREE: OVERVIEW OF TARGETED FINANCIAL SANCTIONS WITH PARTICULAR FOCUS ON THE LEGAL AND REGULATORY FRAMEWORKS WITHIN WHICH THEY OPERATE ... 71-142
3.1 General introduction ... 71
3.2 United Nations ... 72
3.2.1 Background ... 72
3.2.2 Security Council and the development of targeted sanctions ... 73
3.2.3 Scope and application of targeted sanctions ... 76
3.2.4 Conclusions ... 81
3.3 European Union ... 81
3.3.1 General ... 81
3.3.2 Implementation of UN and unilateral EU sanctions ... 83
3.3.3 Directives ... 88
3.3.4 Position of the European Union on extraterritorial sanctions ... 91
3.3.5 Conclusions ... 92
3.4 United States of America ... 93
3.4.1 Historical background ... 93
3.4.2 The OFAC sanctions ... 93
3.4.2.1 Operation and extraterritorial effect ... 93
3.4.2.2 Trading with the Enemy Act and related regulations ... 96
3.4.2.3 International Emergency Economic Powers Act and related regulations ... 98
3.4.3 Compliance responsibilities ... 104
3.4.4 Conclusions ... 109
3.5 United Kingdom ... 109
3.5.1 General ... 109
3.5.2 Anti-Terrorism, Crime and Security Act ... 111
3.5.3 Counter Terrorism Act ... 113
3.5.4 Sanctions and Anti-Money Laundering Act ... 114
3.5.5 Economic Crime (Transparency and Enforcement) Act ... 118

UNIVERSITY OF JOHANNESBURG

3.5.6 The Protecting Against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations 120
3.5.7 Conclusions 121
3.6 South Africa 122
3.6.1 General 122
3.6.2 Protection of Constitutional Democracy against Terrorist and Related Activities Act 122
3.6.3 Financial Intelligence Centre Act 125
3.6.4 Financial Intelligence Centre Amendment Act 128
3.6.5 Conclusions 136
3.7 Comparative analysis and remarks 136
3.8 Conclusion 142

CHAPTER FOUR: KEY INTERNATIONAL ORGANISATIONS ON TARGETED FINANCIAL SANCTIONS 143-161
4.1 Introduction 143
4.2 Financial Action Task Force 143
4.3 International Chamber of Commerce 150
4.4 United Nations Commission on International Trade Law 152
4.5 Basel Committee on Banking Supervision 154
4.6 Institute of International Banking Law and Practice 156
4.7 Bankers Association for Finance and Trade 157
4.8 Wolfsberg Group 159
4.9 Conclusion 160

CHAPTER FIVE: IMPACT OF TARGETED FINANCIAL SANCTIONS ON LETTERS OF CREDIT AND DEMAND GUARANTEES 162-256
5.1 General introductory remarks 162
5.2 Compliance with domestic targeted financial sanctions 164
5.2.1 Introduction 164
5.2.2 Legal obligation to comply 164
5.2.3 Legal impossibility of performance 170
5.2.4 Criminal liability on the part of the bank 175
5.2.4.1 General 175

UNIVERSITY OF JOHANNESBURG

5.2.4.2 Processing a letter of credit or demand guarantee in the knowledge that performance was legally impossible 175
5.2.4.3 Processing a letter of credit or demand guarantee without the knowledge that performance was legally impossible 177
5.2.5 Interference with payment under letters of credit 179
5.2.5.1 South African private international law 179
5.2.5.2 Transactions involving only an issuing bank 183
5.2.5.3 Transactions involving confirming banks 183
5.2.5.4 Transactions involving nominated banks 184
5.2.5.5 Transactions involving transferring banks 185
5.2.5.6 Transactions involving reimbursing and claiming banks 186
5.2.5.7 Transactions involving collecting banks 188
5.2.5.8 Acceptance credit transactions 189
5.2.5.9 Back-to-back credit transactions 190
5.2.6 Interference with payment under demand guarantees 191
5.2.6.1 Transactions involving only a guarantor 191
5.2.6.2 Transactions involving counter-guarantors 192
5.2.7 Conclusions 193
5.3 Compliance with foreign targeted financial sanctions 193
5.3.1 Introduction 193
5.3.2 International sanctions 194
5.3.3 Impact of blocking statutes and other similar measures 196
5.3.4 Business and reputational considerations 197
5.3.5 Interference with payment under letters of credit 202
5.3.5.1 Excursus: payment in foreign currency 203
5.3.5.2 Transactions involving only an issuing bank 206
5.3.5.3 Transactions involving confirming banks 207
5.3.5.4 Transactions involving nominated banks 208
5.3.5.5 Transactions involving transferring banks 209
5.3.5.6 Transactions involving reimbursing and claiming banks 210
5.3.5.7 Transactions involving collecting banks 211
5.3.5.8 Acceptance credit transactions 212
5.3.5.9 Back-to-back credit transactions 213
5.3.6 Interference with payment under demand guarantees 214

UNIVERSITY OF JOHANNESBURG

5.3.6.1 Transactions involving only a guarantor 214
5.3.6.2 Transactions involving counter-guarantors 215
5.3.7 Summary and analysis 215
5.3.8 The beneficiary's legal recourse 218
5.3.8.1 Breach of contract 219
5.3.8.1.1 *Mora debitoris* 219
5.3.8.1.2 *Mora creditoris* 220
5.3.8.1.3 Positive malperformance 221
5.3.8.1.4 Repudiation 221
5.3.8.1.5 Prevention of performance 222
5.3.8.2 Contractual remedies 223
5.3.8.2.1 Introduction 223
5.3.8.2.2 Enforcement of performance 224
5.3.8.2.3 Cancellation of the contract 227
5.3.8.2.4 Damages 230
5.3.8.2.5 The beneficiary's election: enforce payment or cancel the contract? 233
5.3.9 Conclusions 234
5.4 Documentary issues 235
5.4.1 Introduction 235
5.4.2 Sanctions clauses 235
5.4.2.1 Types of sanctions clauses 237
5.4.2.2 Issues relating to the non-documentary nature of sanctions clauses .239
5.4.2.3 Contractual validity of the mandate given by the issuing bank to the nominated bank relating to a letter of credit containing a sanctions clause 242
5.4.2.3.1 Requirements of a valid contract 243
5.4.2.3.2 Application 249
5.4.2.3.3 Severability 250
5.4.2.3.4 Conclusions 252
5.4.3 Other non-documentary conditions 253
5.4.4 Unjustified amendments 253
5.4.5 Conclusions 254
5.5 General concluding remarks and analysis 255

UNIVERSITY OF JOHANNESBURG

CHAPTER SIX: RECOMMENDATIONS AND INITIATIVES TOWARDS MITIGATING THE IMPACT OF TARGETED FINANCIAL SANCTIONS ON LETTERS OF CREDIT AND DEMAND GUARANTEES 257-266

6.1 Introduction 257

6.2 Understanding the risks 260

6.3 Sanctions risk assessment 260

6.4 Sanctions clauses: their use and formulation 263

6.5 Inter-bank communication 264

6.6 General conclusion 265

BIBLIOGRAPHY 267-303

CHAPTER ONE: INTRODUCTION

1.1 General introduction

This chapter introduces the general theme of the study. It begins by providing essential background against which the purpose of the study is detailed. This is followed by an explanation on the jurisdictions covered, the research methodology employed, and the scope and outline of the research.

1.2 Background and purpose of the study

As an enforcement measure under article 41 of the United Nations Charter, targeted financial sanctions are routinely used in the maintenance and restoration of international peace and security.[1] The Financial Action Task Force describes "targeted financial sanctions" as "asset freezing and prohibitions to prevent funds or other assets from being made available, directly or indirectly, for the benefit of designated persons and entities".[2] These measures are therefore applied in relation to specific individuals and entities and not entire jurisdictions, regions or groups.[3] With leading international organisations such as the United Nations and the Financial Action Task Force advocating their use, the vast majority of jurisdictions around the world have enacted regulatory frameworks giving effect to targeted financial sanctions. These jurisdictions include the European Union, United States of America, United Kingdom and South Africa – the targeted financial sanctions regimes of which are particularly important for the purposes of this thesis. These frameworks translate into compliance obligations and expectations for, *inter alia*, banks and other financial institutions.[4] The practical implication is that banks must scrutinise and screen client relationships and transactions for indications of financial crime and especially sanctioned individuals and entities. Should the investigation reveal a sanctioned individual or entity, the bank will be required to impose targeted financial sanctions and as a result refuse to process or facilitate the transaction in question.

---

[1] More specifically for the purposes of this thesis, they are used to combat financial crime. The term "financial crime" refers to the use of financial institutions and their products and services to perpetrate crime. It encompasses several types of criminal activities, including bribery and corruption, money laundering, nuclear weapons proliferation financing and terrorist financing. See Byrne and Berger *Trade Based Financial Crime Compliance* (2017) 45.

[2] See the definition of "targeted financial sanctions" in FATF *Glossary of the FATF Recommendations*.

[3] Sanctions applied in relation to entire jurisdictions, regions or groups are known as comprehensive or broad-based sanctions. See in this regard par 3.2 below.

[4] Spruyt "A legal analysis of the duty on banks to comply with targeted financial sanctions" 2020 *TSAR* 1 24.

A distinction must be made between compliance with *domestic* targeted financial sanctions and compliance with *foreign* targeted financial sanctions.[5] While banks are under a legal obligation to comply with domestic sanctions, they are not legally obligated to comply with foreign sanctions. Compliance with foreign sanctions is instead motivated by strong business and reputational considerations. This conceptual difference in the nature of compliance with domestic and foreign sanctions means that problems associated with compliance and potential defences available to the bank, if any, may also be divergent.

Targeted financial sanctions are particularly relevant to international trade and commercial transactions, and in turn to letters of credit and demand guarantees. A letter of credit is an instrument of payment regularly used in international sales and a demand guarantee, an instrument of security regularly encountered in commercial transactions such as construction contracts. Essentially both instruments constitute an undertaking by a bank[6] to pay a beneficiary (for example, the seller in the case of a contract of sale or the contractor in the case of a construction contract) upon compliance with the conditions stipulated in the respective instrument. Such conditions are invariably documentary in nature. This means that, to be entitled to payment, the beneficiary must deliver certain stipulated documents. These instruments, moreover, share two fundamental principles. The first is that the documents must comply strictly with the requirements prescribed in the credit or guarantee. If the documents do not conform to the requirements, the bank is entitled to reject the demand for payment.[7] The second principle is that the bank's payment undertaking is independent of both the performance of the underlying contract (the international sale or construction contract) between the applicant and the beneficiary and the relationship between the applicant and the bank.[8] It follows that payment under letters of credit and demand guarantees is not dependent on factors outside of the documents and consequently is expected to be made expeditiously. Letters of credit and demand guarantees have been described as "the lifeblood of international commerce".[9]

The relationship between targeted financial sanctions and letters of credit and demand guarantees has generally not been well documented. Certain aspects of this relationship are

UNIVERSITY OF JOHANNESBURG

[5] See pars 5.2 and 5.3 below.

[6] referred to as the "issuing bank" in the case of letters of credit and the "guarantor" in the case of demand guarantees.

[7] This is known as the principle of documentary compliance. See par 2.4.3 below.

[8] This is known as the independence principle. See par 2.4.2 below.

[9] *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* 1977 (2) All ER 862 (QB) 870b (per Kerr J); *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976 (CA) 983; and *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812 (A) 816E and I.

insufficiently covered or are not covered at all in the works and materials of relevant international organisations.[10] A particularly important aspect in this regard relates to the situation where the documents presented under the letter of credit or demand guarantee contain a reference to a sanctioned individual or entity. The bank may refuse to make payment or process the transaction to comply with sanctions laws and regulations and expectations. This aspect, however, is more complex in practice and may give rise to difficult questions relating to the basis of the bank's refusal (especially in relation to compliance with foreign sanctions), the contractual obligations of the parties, breach of contract, the position of other banks involved and the recourse available to the beneficiary, to name a few. Most of the international guidance on this relationship is restricted to so-called sanctions clauses,[11] which are included in letters of credit and demand guarantees on the request of banks to limit their sanctions risk exposure. Scholarly writings on this relationship are also scarce. At least one academic contribution relating to the topic has emerged from South Africa.[12] Bearing in mind the important role played by credits and guarantees in international trade and commerce, it is argued, therefore, that a comprehensive investigation of the impact of targeted financial sanctions is necessary and will make a meaningful contribution to the literature on letters of credit and demand guarantees.

Against this background, the primary purpose of this study is to investigate fully the impact of targeted financial sanctions on letters of credit and demand guarantees. This is undertaken from a South African perspective. The study also aims to formulate general recommendations and initiatives to mitigate risks and problems identified in the investigation, suitable for use by bankers, international organisations, academics and any other interested parties.

UNIVERSITY OF JOHANNESBURG

1.3 Jurisdictions covered

The fact that this study is undertaken from a South African perspective does not necessarily mean that only the South African legal position is considered. The international law dimension

[10] On the international organisations relevant to targeted financial sanctions, see Chapter Four below.

[11] See, for example, International Chamber of Commerce https://iccwbo.org/publication/guidance-paper-on-the-use-of-sanctions-clauses-2014/ (accessed on 10 May 2022); and, by the same organisation, https://iccwbo.org/content/uploads/sites/3/2020/05/20200504-addendum-to-sanction-clauses-paper.pdf (accessed on 10 May 2022). See also Institute of International Banking Law and Practice "IIBLP Sanctions clause" in *2019 New York Events Conference Materials (Institute of International Banking Law and Practice)* (2019) 57 57.

[12] Hugo and Strydom "Sanctions, ships, international sales and security of payment" in Vrancken and Hugo (eds) *African Perspectives on Selected Marine, Maritime and International Trade Law Topics* (2020) 109–133.

of targeted financial sanctions and the global reach of these measures imply that the legal position of other jurisdictions must also be relevant to, and considered in, this study. This is especially the case regarding the research on compliance with foreign targeted financial sanctions which is explored with reference to the sanctions of the European Union, United Kingdom and United States of America.

Owing to the important role English law played and continues to play in relation to the development of the law relating to letters of credit and demand guarantees in South Africa,[13] English law is mostly referred to and discussed whenever South African letter-of-credit and demand-guarantee case law is examined.

It is clear therefore that the research presented in this study may not be beneficial only to a South African audience. South Africa's civil and common-law roots,[14] as well as the study's general consideration of the works and texts of leading international organisations such as the United Nations and the Financial Action Task Force, may also play a role in broadening the relevance and readership of this study.

1.4 Research methodology

This thesis applies a doctrinal approach.[15] Consequently, legal concepts and laws under consideration are not simply described, but also analysed and commented on appropriately. In this regard problems identified are examined by, for instance, exploring them in relation to the different types of letters of credit and demand guarantees and not only as it applies to these instruments in general. Problems identified are also considered with reference to international jurisprudence such as foreign case law, secondary literature and international works and materials.

A comparative study is undertaken in relation to the exploration of targeted financial sanctions. The jurisdictions considered in this regard are the European Union, United States of America, United Kingdom and South Africa. The sanctions regimes of the European Union, United States of America and United Kingdom are undoubtedly the most progressive and

[13] See Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* (2016) 248; and Hugo "Protecting the lifeblood of international commerce: a critical assessment of recent judgments of the South African supreme court of appeal relating to demand guarantees" 2014 *TSAR* 661 669.

[14] The South African legal system has been categorised as forming part of the "mixed legal family" due to its civil law and common law basis. See in this regard Du Plessis "Comparative law and the study of mixed legal systems" in Reimann and Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2019) 474 483.

[15] For a discussion of doctrinal legal research, see Hutchison and Ducan "Defining and describing what we do: doctrinal legal research" 2012 *Deakin Law Review* 83 *et seq*.

sophisticated in the world. It is for this reason that these jurisdictions were chosen for the comparative study. The sanctions regimes of these jurisdictions accordingly serve as an appropriate yardstick against which the South African sanctions regime can be assessed.

Furthermore, in evaluating concepts, principles and problems this thesis applies a number of tools and techniques, including the following:

(i) Reiterating and reexplaining aspects of the letter-of-credit and demand-guarantee transaction, as well as of sanctions laws and concomitant compliance requirements and expectations;

(ii) Drawing comparisons between case law and other sources of law to assess the relevance and importance of particular legal principles and practices, as well as their respective lines of reasoning; and

(iii) Cross-referencing, whenever appropriate, problems identified and the methods and ways in which they can be resolved or dealt with. This is intended to remind or inform the reader of the extent and significance of the research topic, and to highlight – and sometimes contrast – the nature and scope of these different problems.

Ultimately, it is hoped that these tools and techniques will assist in clarifying complex concepts, principles and problems identified in the research.

UNIVERSITY
OF
JOHANNESBURG

1.5 Research scope and outline

This thesis contains a total of six chapters. Chapter One introduces the general theme and scope of the study by providing background to, and detailing the purpose of, the study, and by setting out the jurisdictions covered, the research methodology employed and the research scope and outline.

Chapter Two entails an introduction to letters of credit and demand guarantees. In the first place, it explains the nature and role of the different types of letters of credit and demand guarantees encountered in practice. The different parties that may become involved in the transaction are also examined. To illustrate the superiority and versatility of letters of credit and demand guarantees, the chapter contrasts them with alternative means of payment and security. Secondly, the fundamental principles applicable to these instruments are examined: namely, the independence principle (including the established and emerging exceptions to this principle) and the principle of documentary compliance (including the doctrine of strict compliance).

Chapter Three is devoted to targeted financial sanctions. It presents an overview of the legal and regulatory frameworks within which these sanctions operate. To this end a comparative study of the targeted financial sanctions regimes of the European Union, United States of America, United Kingdom and South Africa is provided. But before doing so this chapter explores the development of targeted sanctions in relation to the United Nations and its activities in this regard.

Chapter Four evaluates the role and contribution of the most important international organisations as they relate to targeted financial sanctions. These are the Financial Action Task Force, International Chamber of Commerce, United Nations Commission on International Trade Law, Basel Committee on Banking Supervision, Institute of International Banking Law and Practice, Bankers Association for Finance and Trade, and the Wolfsberg Group. The role and contribution of the United Nations and European Union in relation to targeted financial sanctions are not discussed in this chapter since they receive sufficient attention in Chapter Three.

Chapter Five can be described as the focal point of the study. This chapter investigates the impact of targeted financial sanctions on letters of credit and demand guarantees. The chapter is essentially divided into three parts. The first part investigates the impact of the bank's compliance with (domestic) targeted financial sanctions, while the second investigates the impact of the bank's compliance with (foreign) targeted financial sanctions. The conceptual difference in the nature of compliance in each perspective motivated the separation between part one and part two. The third part investigates the problematic documentary practices that banks have subscribed to or conceivably may adopt to limit their sanctions risk exposure. The issue of unjustified amendments by the beneficiary for the purposes of sanctions evasion is also considered in the third part.

Chapter Six concludes the study with general recommendations and initiatives aimed at mitigating the impact of targeted financial sanctions on letters of credit and demand guarantees. Discussions in this regard relate to, *inter alia*, an understanding of the sanctions risks, the importance of a properly conducted sanctions risk assessment, use and formulation of sanctions clauses and inter-bank communication.

The specific focus of this study means that the scope of research has been limited in the following respects:

(i) Although sanctions may impact most if not all trade finance instruments, this study concentrates on independent payment and security instruments, and specifically letters

of credit and demand guarantees. Therefore, specific questions or issues relating, for example, to documentary collections, open account or accessory guarantees are mostly excluded in this thesis.

(ii) Questions relating to broad-based or comprehensive sanctions are generally excluded from the scope of the research.

(iii) The study does not deal with the impact of sanctions on international trade in general. Much literature already exists in this regard.[16] To have attempted such a work would not only have fallen beyond the scope of this study but would also have blurred its focus.

Case law, legislation and regulation, international and regulatory guidance as well as scholarly writing up to July 2022 have been considered for the purposes of writing this thesis.

[16] See, for example, Hufbauer and Elliot *US Economic Sanctions: Their Impact on Trade, Jobs and Wages* (April 1997) Working Paper Special; Caruso "The impact of international economic sanctions on trade: empirical evidence over the period 1960–2000" 2005 *Rivista Internazionale Di Scienze Sociali* 41–66; Hufbauer *et al Economic Sanctions Reconsidered* (2009) in general; Afesorgbor "The impact of economic sanctions on international trade: how do threatened sanctions compare with imposed sanctions?" 2019 *European Journal of Political Economy* 11–26; and Özdamar and Shahin "Consequences of economic sanctions: the state of the art and paths forward" 2021 *International Studies Review* 1–26.

CHAPTER TWO: INTRODUCTION TO LETTERS OF CREDIT AND DEMAND GUARANTEES

2.1 General introductory remarks

This chapter introduces letters of credit and demand guarantees by describing the two instruments, providing an overview of their operation and distinguishing them from alternative instruments serving similar functions. It also discusses the fundamental principles applicable to them.

At the outset, it is important to emphasise the legal frameworks which may govern letters of credit and demand guarantees. In most countries letters of credit and demand guarantees are regulated not by domestic laws, but by internationally established rules incorporated by the parties into their respective contracts. In letter-of-credit practice, the *Uniform Customs and Practice for Documentary Credits* (UCP 600),[1] drafted by the Banking Commission of the International Chamber of Commerce (ICC), is used widely by merchants and banking institutions throughout the world. The ICC extended the ambit of the UCP 600 by the *Supplement to UCP 600 for Electronic Presentation*, commonly known as the e-UCP,[2] which is designed to deal with the electronic presentation of documents. Also a companion to the UCP is the *International Standard Banking Practice* (ISBP 745),[3] which is aimed specifically at providing guidance on the examination of documents presented under letters of credit.[4] In the United States, however, legislation governing letters of credit has been introduced in the form of article 5 of the Uniform Commercial Code (UCC).[5] Owing to the strong position of China in world trade, attention should also be directed to the *Rules of the*

---

[1] Publication 600 (2007).

[2] On 1 July 2019 e-UCP version 2.0 came into operation. McKendrick *Goode on Commercial Law* (2017) 1015 states the following in relation to the e-UCP: "A system of electronic presentation offers a number of advantages, allowing the beneficiary conveniently to present documents directly to the issuing bank instead of to an advising or conforming bank, and providing an automated system for the checking of documents, which is otherwise a laborious manual process, thus saving labour and reducing the currently high percentage of discrepancies." For an article-by-article analysis of the e-UCP 2.0 see Meynell "Commentary on eUCP version 2.0 and eURC version 1.0" https://iccwbo.org/content/uploads/sites/3/2019/07/icc-commentary-on-eucp-2-0-and-eurc-1-0-article-by-article-analysis.pdf (accessed on 7 July 2020) 17–69.

[3] Publication 681E (2007).

[4] The introduction to the ISBP 745 reads as follows: "the international standard banking practices contained in the ISBP are consistent with UCP600, and with the Opinions and Decisions of the ICC Banking Commission and should be read in conjunction with the UCP600 and not in isolation".

[5] On this legislation see Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* (2008 thesis UNISA) 129 *et seq*.

Supreme People's Court Concerning Several Issues in Hearing Letter of Credit Cases (Chinese LC Rules). By means of these rules the highest court in China provides guidance to Chinese courts in relation to letters of credit. The legal force of the Chinese LC Rules can be compared to that of a precedent in common-law jurisdictions.[6]

In demand-guarantee practice no single set of rules has attained anything close to the dominance achieved by the UCP in relation to letters of credit.[7] Attention is drawn to the following sets of rules that may govern a guarantee: the *Uniform Rules for Demand Guarantees* (URDG 758),[8] drafted by the Banking Commission of the ICC, which is supplemented by the recently published *International Standard Demand Guarantee Practice for URDG 758* (ISDGP 814);[9] the *International Standby Practices* (ISP98),[10] which originate from the United States and have been endorsed by the ICC; the *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* (UNCITRAL Convention), drafted by the United Nations Commission on International Trade Law (UNCITRAL);[11] and, in the case of standby letters of credit, even the UCP.[12] Attention must in this respect also be directed to the *Provisions of the Supreme People's Court of the People's Republic of China on Several Issues Concerning the Trial of Disputes over Independent Guarantees* (Chinese Independent Guarantee Rules) – which do for independent (demand) guarantees what the Chinese LC Rules do for letters of credit.[13]

UNIVERSITY OF JOHANNESBURG

[6] For background on these rules see "Editor's overview" in Byrne (ed) *LC Rules & Laws: Critical Texts for Independent Undertakings* (2018) 309–310.

[7] Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* (2011) 39 par 3.32.

[8] ICC publication 758 (2010). For a comprehensive guide of the URDG 758 see Affaki and Goode *Guide to ICC Uniform Rules for Demand Guarantees (URDG 758)* (2011).

[9] Publication 814E (2021).

[10] ICC publication 590 (1998). For an authoritative brief background by the main drafter see "Editor's overview" in Byrne (n 6) 29. For a more comprehensive background see Kelly-Louw (n 5) 114–119; and Marxen *Demand Guarantees in the Construction Industry: A Comparative Legal Study of their Use and Abuse from a South African, English and German Perspective* (2017 thesis UJ) 59–61.

[11] This convention was adopted by the General Assembly in 1995 and became effective on 1 January 2000 in those countries that adopted the convention, namely Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama and Tunisia. A good background is provided in Byrne (n 6) 211.

[12] Hugo "Letters of credit and demand guarantees: a tale of two sets of rules of the International Chamber of Commerce" 2017 *TSAR* 1 17. The standby letter of credit provides a security undertaking analogous to that of the demand guarantee. See par 2.3 below in this regard.

[13] These rules were adopted by the Judicial Committee of the Supreme People's Court in July 2016 and came into effect in the same year. For an English translation and background of these rules, see Byrne (n 6) 317 *et seq*. See further Hugo "Demand guarantees: insights from the People's Republic of China" in Hugo and Kelly-Louw (eds) *Jopie Jurist Mentor Supervisor and Friend* (2017) 129–132; and Hugo "Demand guarantees in the People's Republic of China and the Republic of South Africa" 2019 *BRICS LJ* 4 22–23.

It should be noted, however, that demand guarantees used domestically in South Africa generally do not incorporate any of these rules.[14] In such instances the guarantee must be interpreted with reference to the provisions of the instrument itself in terms of the South African law of contract.[15]

In the rulemaking process relating to letters of credit and demand guarantees the ICC and UNCITRAL have played, and continue to play, important roles. These are dealt with in Chapter Four.

The rules referred to above form an important part of this thesis.

2.2 Letters of credit

2.2.1 Introduction

The three parties to a basic international contract of sale are: the seller who provides the merchandise, the buyer who pays for them and accepts delivery, and the financier (usually a bank) of the buyer. In such a contract, the risks to which the parties are exposed primarily relate to non-performance of the contractual obligations. Although these risks also feature in domestic sales, they are "enhanced in international sales due to the fact that the party wishing to enforce the contract will often have to do so in a foreign jurisdiction (with the concomitant raising of costs and complexity)".[16]

International sellers typically encounter the risk of non-payment for merchandise shipped. To this end, the international buyer may be unable or unwilling to comply with its payment obligations under the contract. The seller would face considerable difficulty in enforcing payment in a foreign jurisdiction. Likewise, international buyers are exposed to the risk of shipment of sub-standard merchandise by the seller, or no shipment at all, for whatever reason. Should the buyer attempt to enforce the contract in a foreign jurisdiction, it may have to contend with additional costs and expenses in this respect. Apart from these risks, either party may also be faced with external risks which may prevent compliance with their respective contractual obligations. These include political interference, jurisdictional discourse and unfamiliar foreign legal systems, to mention but a few.[17]

---

[14] Hugo "Payment in and financing of international sale transactions" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 395 439.

[15] *Minister of Transport and Public Works, Western Cape v Zanbuild Construction (Pty) Ltd* 2011 5 SA 528 (SCA) pars 5, 13 and 19.

[16] Hugo (n 14) 394.

[17] Hugo *The Law Relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks* (1996 thesis Stellenbosch University) 2–3. See ICC *Guide*

In practice these risks give rise to a conflict of interest between the parties. Sellers, on the one hand, often do not wish to relinquish control over the goods prior to receiving payment, and buyers, on the other hand, prefer not to pay before taking control of the goods.[18] This conflict of interest necessitates the need for security of payment in international contracts of sale. Such security must, *inter alia*, be able to harmonise the conflicting interests of the parties.[19] In this regard, four methods of payment can be identified: letters of credit, payment in advance, open account and documentary collections. The study will focus on letters of credit with comparative evaluations regarding the other methods of payment.

2.2.2 Definition of a letter of credit

By the beginning of the nineteenth century the letter of credit, with all its essential features, slowly emerged as a means to effect payment and to finance transactions.[20] Since then, it has developed into the method of payment that achieves "the highest degree of equilibrium between the interests of the different parties".[21] Consequently, letters of credit have become an established feature of international commerce. This has prompted both the English and South African judiciary to characterise the letter of credit as the "lifeblood of commerce".[22]

Given its variation in use, however, defining a letter of credit is somewhat challenging. Letters of credit are thus best described in general terms. Article 2 of the UCP 600 comprehensively defines a letter of credit as "any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation". McKendrick,[23] on the other hand, offers the following more

UNIVERSITY OF JOHANNESBURG

to Export/Import: Global Business Standards & Strategies (2018) 14–16 which provides the following additional risks: transport risks, exchange rate fluctuations, unforeseen events (for example, strikes and natural disasters), investment risks and risks relating to cultural and language differences.

[18] Amaefule *The Exceptions to the Principle of Autonomy of Documentary Credits* (2011 thesis University of Birmingham) 11.

[19] Hugo (n 14) 403.

[20] The devastation of World War One had, *inter alia*, a profoundly negative impact on international trade – it destroyed much of the trust between merchants and between merchants and their customers. This presented an opportunity for the letter of credit to emerge as a popular payment instrument. See in this regard Hugo (n 12) 1–2. On the historical development of letters of credit see, *inter alia*, Hugo "The development of documentary letters of credit as reflected in the Uniform Customs and Practice of Documentary Credits" 1993 *SA Merc LJ* 44 *et seq*; and, though somewhat dated, Ellinger *Documentary Letters of Credit* (1970) 26 *et seq*.

[21] Hugo (n 14) 403.

[22] *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* 1977 (2) All ER 862 (QB) 870b. The phrase was subsequently cited with approval in the South African case *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812 (A) par 816E and I.

[23] (n 2) above.

straightforward definition: a "documentary credit is, in essence, a banker's assurance of payment against presentment of specified documents".

These definitions warrant a few general comments. The first is that for the seller to be entitled to payment, it must present the stipulated documents. The presentation of many different documents can be required by a letter of credit. Most common among these documents are the commercial invoice, the transport document (for example a marine bill of lading),[24] the insurance document, and any of a number of certificates such as a certificate of inspection, certificate of quality and certificate of origin. If the documents presented are not in conformance with the terms of the letter of credit, the seller will not be entitled to payment.[25] It follows that the letter of credit can be characterised as a *documentary* transaction.[26] Hence letters of credit are also known as documentary credits.[27] For the purposes of this study, the terms "letter of credit" and "documentary credit" are used interchangeably. Another and more important point is that the payment undertaking of the bank is independent of the underlying contract.[28] Finally, the "assurance" that McKendrick refers to, or the "honour" stipulated in the UCP, can materialise in various ways: to pay on delivery of conforming documents (sight payment); to pay some time after the delivery of conforming documents (deferred payment); to accept a term bill of exchange against delivery of conforming documents and to pay the bill (the banker's acceptance) when it matures;[29] or, lastly, to pay a bank that has purchased the documents from the seller – that is, to "negotiate" the conforming documents.[30] These are considered in more detail below.[31]

UNIVERSITY
OF
JOHANNESBURG

---

[24] The marine bill of lading would typically specify details such as the name and international maritime organisation (IMO) registration number of the vessel being used. For more detail regarding the background and role of the IMO registration number see More Than Shipping "Lloyd's and IMO numbers for shipping vessels" https://www.morethanshipping.com/lloyds-imo-number-vessels/ (accessed on 10 January 2020).

[25] also referred to as the doctrine of documentary compliance. See par 2.4.3 below for a discussion of this fundamental principle.

[26] art 5 of the UCP 600 puts it thus: "Banks deal with documents and not with goods, services or performance to which the documents may relate".

[27] McKendrick (n 2) 1011. Moreover, scholars and practitioners also refer to these instruments as "commercial letters of credit" and "bankers' irrevocable credits".

[28] This independence is another fundamental principle of letters of credit. See par 2.4.2 below.

[29] Note, however, the recent drive by the ICC to discourage the use of bills of exchange. See ICC Banking Commission *Guidance Paper – The Use of Drafts (Bills of Exchange) Under Documentary Credits* (January 2019).

[30] See art 2 of the UCP 600.

[31] See par 2.2.3.3 below.

2.2.3 Operation of the letter of credit

2.2.3.1 The different parties involved

In the case of payment by letter of credit, the buyer and seller will typically agree to this form of payment in the underlying contract of sale. The buyer, to give effect to the payment clause in the underlying contract, mandates a bank to issue such a letter of credit in favour of the seller. The bank issuing the letter of credit is generally referred to as the "issuing bank", the party for whose benefit the credit is issued is known as the "beneficiary", and the customer who mandates the bank to issue the credit is the "applicant".[32]

Although these may be regarded as the primary parties to the documentary-credit transaction,[33] they are not the only parties encountered in practice. Apart from the issuing bank, further banks may become involved in the operation of the letter of credit. The most important of these are the advising bank, nominated bank, negotiating bank, and confirming bank, each of which has a significant part to play in the trade transaction. In addition, a bank may also be involved as reimbursing bank, claiming bank, collecting bank, transferring bank or simply correspondent bank.

While the issuing bank can in principle communicate directly with the seller, this is seldom the case. Instead, it[34] will instruct another bank in the seller's country to do so. This bank is known as the *advising bank*.[35] The role of the advising bank is to advise the seller of the opening of the letter of credit and its terms, and it must satisfy itself as to the authenticity of the letter of credit.[36] In doing so, the advising bank is acting on the mandate of the issuing bank. Commentators refer to the advising bank as the agent of the issuing bank.[37] The advising bank, however, is not mandated to make a payment undertaking to the seller. It accordingly

---

[32] also referred to as the "account party".

[33] Oelofse *The Law of Documentary Letters of Credit in Comparative Perspective* (1997) 23.

[34] The pronoun "it" will mostly be used in this thesis. Not only is this done to avoid a gender-bias, but it is also in line with the observation that parties to letter-of-credit and demand-guarantee transactions are mostly banks, companies or other juristic entities.

[35] art 2 of the UCP 600 defines an advising bank as "the bank that advises the credit at the request of the issuing bank".

[36] art 9(b) of the UCP 600. At present it is customary for the authenticity of the letter of credit to be automatically apparent. This is attributed to the use of SWIFT communications. The acronym stands for "Society for Worldwide Interbank Financial Telecommunications", which is based in Belgium. See Carter and Farha "Overview and operation of the evolving US financial sanctions, including the example of Iran" *Proceedings of the Annual Meeting (American Society of International Law)* 107 (2013) 315 316 who explain that it provides a "common language … for financial institutions around the world and is thus vital to the settlement of international payments."

[37] See Ellinger and Neo *The Law and Practice of Documentary Letters of Credit* (2010) 177.

serves as a mere "messenger"[38] of the issuing bank. The instructions of the issuing bank will normally be received by the advising bank by means of SWIFT communication.[39]

Just as the issuing bank does not communicate the credit directly to the beneficiary, it also does not expect the beneficiary to tender documents and receive payment directly from it. It may for this reason decide to nominate a bank in the seller's country to pay on its behalf. For ease of transaction, the advising bank and the *nominated bank* are often, but not necessarily, the same bank. The UCP 600 defines a nominated bank as "the bank with which the credit is available or any bank in the case of a credit available with any bank".[40] In practice the nominated bank will take delivery of the stipulated documents from the seller, and, if the documents are in conformance with the terms of the credit, will pay the seller or accept its draft.[41] This means that the payment obligation of the nominated bank is executed in accordance with its contract of mandate with the issuing bank, and not a contract with the seller.[42] Hence, when it pays, it discharges only the issuing bank's obligation to pay. In other words, it does not acquire the documents in its own right but rather on behalf of the issuing bank.

There may, however, be an instance where the nominated bank, or any bank, may acquire the documents in its own right. The definition of a nominated bank in the UCP 600 quoted above is relevant in this regard. It provides that a nominated bank can be "any bank in the case of a credit available with any bank". In this context the bank becomes involved in the transaction by virtue of it having "negotiated" the credit and not by virtue of a contract of mandate. Article 2 of the UCP 600 defines the term "negotiation" as follows:

> "**Negotiation** means the purchase by the nominated bank of drafts and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank".

Thus, in the case of the letter of credit being available with any bank, by purchasing the documents from the seller, a bank (any bank) becomes a so-called *negotiating bank* – a term encountered in previous editions of the UCP,[43] but not in the UCP 600. Therefore, in the UCP

---

[38] Hugo (n 14) 405.

[39] See (n 36) above.

[40] art 2.

[41] Oelofse (n 33) 24–26.

[42] The nominated bank is in no way contractually bound to pay the beneficiary.

[43] See art 19 of the *Uniform Customs and Practice for Documentary Credits*: Publication 500, (1993) (UCP 500).

600 "the term 'nominated bank' can refer to a bank acting in one of two significantly different legal contexts".[44]

In certain instances, the seller may require that the letter of credit be confirmed by a bank in its own country or in another reputable country. This is especially the case when either the issuing bank or the country in which the issuing bank is located is perceived as risky by the seller. In such instances another bank, the *confirming bank*, will become involved. Article 2 of the UCP 600 defines a confirming bank as a "bank that adds its confirmation to a credit upon the issuing bank's authorization or request". Confirmations provided on the authorisation or request of the issuing bank are referred to as "proper confirmations". Because the confirming bank adds its own autonomous undertaking to that of the issuing bank, the beneficiary of a confirmed letter of credit has an autonomous claim against both the issuing bank and the confirming bank.[45] Provided the seller tenders conforming documents it can therefore enforce payment against either of these banks. In practice, the confirming bank often, but not necessarily, plays the role of both advising and nominated bank, thus displacing them.

Proper confirmations must be distinguished from so-called "silent confirmations". In terms of a silent confirmation, it is the seller, not the issuing bank, which authorises or requests the confirmation. Silent confirmations fall outside the scope of the UCP 600 and essentially render the "confirming" bank a mere advising bank of the issuing bank.[46]

The UCP 600 also provides for a *reimbursing bank.* Article 13(a) reads as follows:

> "If a credit states that reimbursement is to be obtained by a nominated bank ('claiming bank') claiming on another party ('reimbursing bank'), the credit must state if the reimbursement is subject to the ICC rules for bank-to-bank reimbursements in effect on the date of issuance of the credit."

UNIVERSITY
OF
JOHANNESBURG

The nominated or confirming bank (in this context, the *claiming bank*) will, accordingly, claim reimbursement from the *reimbursing bank* and not from the issuing bank. The reimbursing bank therefore merely performs an indirect reimbursement function. The documents are not presented to the reimbursing bank but are delivered directly to the issuing bank.[47]

In addition to the above scenarios, a bank may also become involved in the letter-of-credit transaction as collecting bank, transferring bank and correspondent bank. In the case of

[44] Hugo (n 14) 406.

[45] The term "confirmation" is defined in art 2 of the UCP 600 as "a definite undertaking of the confirming bank, in addition to that of the issuing bank, to honour or negotiate a complying presentation".

[46] Hugo (n 14) 406.

[47] Chuah *Law of International Trade: Cross-Border Commercial Transactions* (2013) 614–615 par 11–104.

a collecting bank, a bank may, on request of the seller, be authorised to present the documents and receive payment on behalf of the seller. This bank, the collecting bank, acts as the seller's agent and accordingly possesses the rights of the seller in so far as presenting the documents and receiving payment are concerned. Consequently, any defence available against the seller is available against the collecting bank.[48]

Transferring banks are dealt with in more detail below in relation to transferable credits.[49] In short, transferable credits are used in cases where the seller is a middleman – that is, the seller itself is purchasing the goods from a supplier or manufacturer in order to resell them.[50] The idea of a transferable credit is to enable the seller to pay its supplier by using a letter of credit issued in its favour. The credit itself is not transferred; rather, it confers upon the seller the right to request the nominated bank, now renamed the *transferring bank*, to make the whole or part of the credit available to a second beneficiary (the manufacturer or supplier). This entails the advising by the transferring bank of a new credit of the same issuing bank to a second beneficiary. The transferring bank will then, against conforming documents, pay the supplier its price, pay the beneficiary its profit (that is, the difference between the second beneficiary's invoice and the price stipulated in the original credit) and recover the full purchase price from the issuing bank.

In this regard, back-to-back credits merit consideration. These credits, akin to transferable credits, involve the use of two consecutive credit facilities. In a back-to-back credit the seller, relying on the letter of credit procured by the buyer in favour of the seller, requests its bank to issue a distinct credit to the seller's supplier. In this way, the first credit is used as collateral for the seller's own obligations towards its supplier.[51] The documents required in terms of the back-to-back credit must be capable of being presented on behalf of the seller in accordance with the first credit.[52] Back-to-back credits receive more attention below.

Finally, in instances where the nominated currency is not the currency of the jurisdiction in which the issuing bank is located, the issuing bank may instruct its foreign correspondent to

[48] Mugasha *The Law of Letters of Credit and Bank Guarantees* (2003) 205.

[49] See par 2.2.4 below.

[50] Mugasha (n 48) 220.

[51] Mugasha (n 48) 217.

[52] thus, the specifications must be identical, and the documents must relate to the same goods.

open the credit by sending a requesting/instructing statement to the correspondent bank.[53] This correspondent bank relationship may be governed by a formal agreement. Alternatively, the two banks may hold so-called "nostro" or "vostro" accounts, which are mirror correspondent accounts held by two banks in different jurisdictions to facilitate foreign currency transactions.[54] These accounts are often encountered in international letters of credit nominated in US dollars. Reimbursement occurs on the proper performance of the issuing bank's instructions (that is, payment is made on behalf of the issuing bank).

2.2.3.2 The discharge of the payment obligation

As mentioned above, the primary parties to the letter of credit are the applicant (buyer), beneficiary (seller) and issuing bank. The advising bank and nominated bank are also, more often than not, encountered in practice. In order to best understand the parties' interaction in practice, it is necessary to assess the basic process leading up to the discharge of the payment obligation under the credit.

First of all, the contract of sale sets out the expectations of the parties. This means that it will stipulate that payment is to be arranged by means of a letter of credit.

The next step is for the buyer to approach a bank of its choice (the issuing bank) for issuance of the letter of credit. This step requires of the buyer to complete a standard application form for the issuing of the letter of credit.[55] The main particulars of the credit are specified in this form. These include the following: the identity of the parties to the letter-of-credit transaction, its expiry date, the specific documents to be presented by the beneficiary, and the specific payment undertaking of the issuing bank. As regards the documents, the buyer must be precise in its description, since the bank is essentially instructed to pay against these.[56] Depending on the creditworthiness of the buyer,[57] the bank may require security before approving the application.[58]

UNIVERSITY OF JOHANNESBURG

---

[53] See "International updates" (April 2019) *Documentary Credit World* 8 where reference is made to a "nostro statement"; and Padinhere "What Covid-19 is showing us about the future of trade" (June 2020) *Documentary Credit World* 39 where reference is made to "nostro details".

[54] Mugasha (n 48) 214.

[55] Adodo *Letters of Credit: The Law and Practice of Compliance* (2014) 29 par 2.03 *et seq*; and Bridge *Benjamin's Sale of Goods* (2014) 2012 par 23–004.

[56] *Midland Bank Ltd v Seymour* [1955] 2 Lloyd's Rep (QB) 147 153.

[57] Hugo (n 17) 9.

[58] This request by the bank is typically referred to as an "internal credit approval".

Once the bank has approved the application and decided to issue the letter of credit, this fact will be communicated via SWIFT to the advising bank, which will, in turn, communicate to (or advise) the seller that the credit has been issued, and indicate what the terms of the credit are.[59] This can be regarded as the third step in the process.

The fourth step is for the seller to apply its mind to the terms and conditions of the credit.[60] If the seller is of the view that the credit does not meet the specifications of the contract of sale, it must reject the letter of credit and notify the advising bank of its rejection immediately. This step is crucial for the seller. Should it fail to reject a non-conforming letter of credit, it may be regarded as having varied the contract of sale or having waived the right to insist upon compliance with it.[61]

Should everything go as planned and payment is required to be made, the seller must submit the stipulated documents to the nominated bank. If the nominated bank is satisfied with the documents presented, it will pay, incur a deferred payment undertaking, accept a draft or negotiate the credit pursuant to its terms. The buyer's payment obligation will typically be discharged only once the nominated bank has actually paid – and not by the incurring of a deferred payment obligation or the acceptance of a draft.[62]

The final step in the process is for the nominated and issuing banks to be reimbursed under their respective contracts of mandate. This entails that the nominated bank must forward the documents to the issuing bank (who will reimburse the nominated bank), after which the issuing bank will present them to the buyer (who will reimburse the issuing bank) – provided of course the documents are conforming. Once this has occurred, the process of the letter of credit is concluded.

UNIVERSITY OF JOHANNESBURG

[59] Although the issuing bank can in principle communicate directly with the seller, this seldom happens. See par 2.2.3.1 above in this respect. The terms will include that the credit is subject to the UCP.

[60] Hugo (n 14) 408.

[61] For a detailed analysis on this step see Oelofse (n 33) 68–70.

[62] In *W J Alan & Co Ltd v El Nasr Export and Import Co* [1972] 2 QB 189 (CA) 209C–211C the question that arose was whether the issuing of the credit on request of the beneficiary (and not, as is typically the case, the applicant) constitutes a discharge of the buyer's obligation (i.e., absolute payment) or merely suspends the obligation (i.e., conditional payment). The court held that this question must be determined with reference to the underlying contract. The implication is that the buyer and seller are free to agree that the buyer will be discharged by issuing the credit. Such provisions are, however, rarely encountered in practice. For commentary on the issue of absolute and conditional payment see Oelofse (n 33) 83–94; and Botosh "Evaluation of the conditional–absolute payment issue in letters of credit: identifying which position provides maximum party autonomy, certainty, flexibility, fairness and good faith" 2016 *International Journal of Economics and Law* 9–14.

2.2.3.3 The specific payment undertaking of the issuing bank: sight payment, deferred payment, acceptance and negotiation

As mentioned above,[63] and in the terminology employed by the UCP 600, the issuing bank is required to "honour" the payment undertaking upon presentation of complying documents. Honour is defined in the UCP 600 as follows:

> "Honour means:
> a. to pay at sight if the credit is available by sight payment.
> b. to incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment.
> c. to accept a bill of exchange ('draft') drawn by the beneficiary and pay at maturity if the credit is available by acceptance."[64]

It is clear from this definition that the manner in which the payment obligation is honoured is entirely dependent upon the specific undertaking of the issuing bank.[65] Its undertaking may take one of four forms: to pay on sight, to pay on a deferred basis, to pay on acceptance of a term bill of exchange or when payment is arranged by means of negotiation.

Sight payment

Sight payment credits[66] are credits which entitle the seller to payment upon presentation of conforming documents to the nominated bank.[67] The nominated bank merely authenticates that the documents are in fact in accordance with the terms stated in the letter of credit. If this is the case, the nominated bank is required to pay the seller. If not, the nominated bank will be entitled to refuse payment. Should the seller seek recourse in this regard, it can enforce payment against the issuing bank and not the nominated bank.[68] Sight payment credits sometimes make use of bills of exchange. In such instances, the seller will be required to draw a sight draft on the issuing bank and to indorse it to the nominated bank. The nominated bank will pay the sight value of the credit to the seller against delivery of conforming documents, and then present the bill as the holder thereof (the indorsee in possession) to the issuing bank. By paying the nominated bank in accordance with the bill of exchange the issuing bank discharges its

UNIVERSITY OF JOHANNESBURG

---

[63] See par 2.2.2 above.

[64] art 2. This definition should be read together with art 7(a)(v), which provides for honour by negotiation.

[65] Adodo (n 55) 17 par 1.32.

[66] also referred to as a "cash credit". See in this regard Oelofse (n 33) 58.

[67] Mugasha (n 48) 33.

[68] See art 7(a)(ii) of the UCP 600 which provides the following: "Provided that the stipulated documents are presented to the nominated bank … and that they constitute a complying presentation, the issuing bank must honour if the credit is available by: … ii. sight payment with a nominated bank and that nominated bank does not pay."

reimbursement obligation towards the nominated bank.[69] The nominated bank, of course, also delivers the documents, together with the bill of exchange, to the issuing bank. The nominated bank's right to be reimbursed is dependent upon the documents being in conformity with the letter of credit.[70] The use of a bill of exchange in this situation, however, is not really functional except that it establishes a paper trail of the payment from the issuing bank through the nominated bank to the seller.[71]

Acceptance credits

In the case of an acceptance credit the seller will present an unaccepted term bill of exchange drawn on the nominated bank together with the documents.[72] Provided the documents presented are complying, the nominated bank will accept the bill and pay it when it matures.[73] If acceptance of the bill is refused, the seller can enforce payment against the issuing bank.[74]

Having accepted the bill the nominated bank will pass on the documents to the issuing bank, which will either provide the nominated bank with the necessary funds to meet the bill of exchange or will reimburse the nominated bank once it has paid.[75] The seller, as holder of an accepted bill of exchange (banker's acceptance), has two options: in the first place, it can keep the bill until it matures and then present it for payment to the nominated bank. The second option for the seller is to discount (sell) the bill by indorsing it at a discounted amount to a third party, before maturity. The discounter buys it at discount by virtue of the fact that it will be able to claim payment against the nominated bank (acceptor) only on maturity of the bill. Thus, the bill is sold "at less than its face value".[76] This transaction, moreover, can be with or without recourse to the seller. In the case of recourse financing, should the discounter not receive payment from the nominated bank, the seller will have to return the money it received from the discounter in exchange for a re-cession to it of the claim against the buyer. In the case of non-

UNIVERSITY OF JOHANNESBURG

[69] Mugasha (n 48) 33.

[70] art 7(c) of the UCP 600 puts it thus: "The issuing bank undertakes to reimburse a nominated bank that has honoured … a complying presentation and forwarded the documents to the issuing bank".

[71] See Hugo (n 17) 41 who describes its use as an "unnecessary complication".

[72] The description "term bill of exchange" implies that the bill will mature on a future date.

[73] For example, 90 days after the date of shipment.

[74] See art 7(a)(iv) of the UCP 600.

[75] Hugo (n 14) 411.

[76] Hugo "Discounting practices and documentary credits" 2002 *SALJ* 101 102.

recourse financing, however, the discounter effectively bears the risk, and will have no claim against the seller should the nominated bank refuse to make payment.

Using acceptance credits is advantageous to the buyer since it enables the extension of credit to the buyer. The issuing bank will not need to pay before maturity of the bill of exchange and may be willing to extend this advantage to the buyer (in other words pass on the documents to the buyer without being paid immediately). This could enable the buyer to finance its purchase from proceeds generated from selling the same goods.

As the discounting transaction occurs by virtue of negotiation of the bill of exchange, the discounter may satisfy the requirements of a holder in due course, in which case it will acquire the bill free of equities.[77] Consequently, if the seller (the payee of the bill of exchange) is unable for whatever reason to enforce payment of the bill against the nominated bank, the discounter (as indorsee) will be able to do so.[78]

Deferred payment credits

Just as in the case of acceptance credits, a deferred payment credit is one under which the bank undertakes to pay on a maturity date. But in the case of deferred payment credits, this is achieved without the use of a bill of exchange.[79] In the case of a deferred payment credit, the bank's payment undertaking is mostly expressed with reference to the date on the transport document,[80] for example "90 days after the date of shipment". If the documents tendered are conforming, the nominated bank will accept the obligation to pay the seller on the future date (payment is thus deferred). But if the nominated bank refuses to accept the deferred payment obligation on presentation of conforming documents, payment can be enforced against the issuing bank.[81]

Akin to the position under acceptance credits, deferred payment credits offer credit to the buyer. An added advantage for the buyer is that it receives the goods and can determine

---

[77] See s 27(1) of the Bills of Exchange Act 34 of 1964.

[78] Hugo (n 76) 107.

[79] Von der Goltz *Deferred Payment Credits as Special Types* of *Documentary Credits* (1998 dissertation Stellenbosch University) 14–15. See further Adodo (n 55) 18 par 1.35 who states that due to the fact that a bill of exchange is not used, stamp duty (charges), which is commonly imposed on bills of exchange in some countries, is avoided.

[80] Hugo (n 14) 412.

[81] Art 7(a)(iii) of the UCP 600 provides as follows: "Provided that the stipulated documents are presented to the nominated bank … and that they constitute a complying presentation, the issuing bank must honour if the credit is available by: …iii. Deferred payment with a nominated bank and that nominated bank does not incur its deferred payment undertaking or, having incurred its deferred payment undertaking, does not pay at maturity".

whether they comply with the contract of sale before paying. When payment is deferred in this manner the seller does not, as mentioned above, receive a bill of exchange once he presents the required documents to the nominated bank. Instead, he receives an "unconditional undertaking"[82] to be paid on the maturity date pursuant to the deferred payment undertaking. This unconditional undertaking can also be discounted with or without recourse.[83] However, discounting the right to payment under deferred payment credits differs from the discounting of a bill of exchange under acceptance credits. Hugo captures the distinction as follows:

> "[W]hilst the purchaser of a bill of exchange [under an acceptance credit] can by virtue of acquiring it as holder in due course acquire it free of equities, the purchaser of the right to payment under a deferred payment credit acquires this right as cessionary and therefore subject to the nemo plus juris rule".[84]

In relation to discounting and deferred payment credits, this means that a nominated bank that, for example, pays a fraudulent seller prematurely is essentially making an advance to the seller in exchange for cession of its rights against the issuing bank. So viewed, the nominated bank would not be entitled to claim reimbursement from the issuing bank in terms of its contract of mandate. In the period before the UCP 600 came into operation, legal issues relating to the discounting of deferred payment credits arose in various jurisdictions.[85] In 2002, one commentator concluded "cases from different countries in continental Europe, as well as recent English and South African case law, have indicated that [discounting deferred payment credits] may be a very risky practice".[86]

On 1 January 1994, the 1993 revision of the UCP (UCP 500) came into operation.[87] Article 14(a) dealt with reimbursement in relation to a nominated bank as follows:

> "When the Issuing Bank authorizes another bank to pay, [or] incur a deferred payment undertaking... against documents which appear on their face to be in compliance with the terms and conditions of the credit, the Issuing Bank . . . [is] bound . . . to reimburse the Nominated Bank which has paid, [or] incurred a deferred payment undertaking . . . ."

[82] Hugo (n 14) 412.

[83] See the discussion above relating to recourse and non-recourse financing above under the heading "Acceptance credits".

[84] Hugo (n 14) 412. The nemo plus juris rule essentially holds that no person may transfer more rights than they hold.

[85] Such issues emerged, *inter alia*, in *Banco Santander SA v Bayfern Ltd* [1999] CLC 1321 (England); and *Vereins- und Westbank AG v Veren Investments* 2000 (4) SA 238 (W) (South Africa).

[86] Hugo (n 76) 109.

[87] UCP 500. For a concise summary of the substantive changes to the 1983 revision by the UCP 500 see Oelofse "Developments in the law of documentary letters of credit" 1996 *SA Merc LJ* 56 56–57.

In cases where a bank was acting as both the confirming and nominated bank, article 10(d) would govern its right to reimbursement

> "by nominating another bank . . . or by authorizing another bank to add its confirmation, the Issuing Bank authorizes such bank to pay . . . against documents which appear on their face to be in compliance with the terms and conditions of the Credit and undertakes to reimburse such bank . . . ."

From the above it is clear that the UCP 500 did not address the premature payment of a discounted deferred credit. For this reason, Langley J in *Banco Santander SA v Bayfern Ltd*[88] held that Banco Santander, the confirming bank that had paid prematurely in a discounting transaction, was not entitled to reimbursement. He referred to article 14(a), which establishes that

> "the issuing bank cannot complain about the documents presented under the credit once they have been taken up so as to dispute the confirming and/or nominated bank's right to incur the deferred payment obligation. But that obligation remains to pay at maturity with the right to be reimbursed if you do so."[89]

Moreover, he stated that the question as to which article (14 or 10) governed reimbursement was irrelevant since deferred payment credits envisage payment to be made at maturity. The reimbursement obligation was therefore to be executed on payment being made at maturity. The presence of established fraud, as in this case, simply implied that the confirming bank was not under an obligation to pay or that the issuing bank was under an obligation to reimburse. The beneficiary would in any event have had no rights under the letter of credit on maturity, and therefore nothing to assign to the discounter.[90]

This approach was endorsed by Stegmann J in the South African case of *Vereins- und Westbank AG v Veren Investments.*[91] Because the nominated bank paid prematurely, Stegmann J found that payment was not made in accordance with its contract of mandate.[92] Thus, the nominated bank was not successful in enforcing reimbursement against the issuing bank.

In 2007 the UCP 600 came into operation. Contrary to the position under the UCP 500, this revision addressed the issue of reimbursement in the case of the discounting of deferred

[88] *Banco Santander SA v Bayfern Ltd* (n 85) above.

[89] par 25g–h.

[90] The second basis of Banco Santander's case related to established practice rather than to a legal issue. Essentially its second argument was that it had the implied authority of the issuing bank to discount the credit. It acquired this authority, so it argued, on the basis of international banking practice. For a comprehensive discussion on this case see Malek and Quest *Jack: Documentary Credits* (2009) 270 par 9.43–9.47.

[91] *Vereins- und Westbank AG* (n 85) 256 par 49.

[92] par 64.

payment credits. This issue, in fact, was a "major catalyst for the revision of the UCP".[93] Article 12(b) reads as follows:

> "By nominating a bank to accept a draft or incur a deferred payment undertaking, an issuing bank authorizes that nominated bank to *prepay or purchase a … deferred payment undertaking incurred by that nominated bank."*[94]

Accordingly, a nominated bank is now regarded as acting within its mandate when it pays the beneficiary prematurely in a discounting transaction. The issuing bank's reimbursement obligations, moreover, are now entrenched. Article 7(c) reads as follows:

> "An issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the issuing bank. *Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity ….*"[95]

Therefore, under the UCP 600 the position of a nominated bank that prepays is now more secure. The implication is that where letters of credit are subject to the UCP 600, the *Banco Santander* and *Vereins- und Westbank* cases no longer constitute good law in this respect.[96]

While it is appreciated that the UCP 600 reflects general international consensus, it is important to emphasise that it is binding only upon incorporation into letters of credit.[97] If not incorporated the aforementioned cases remain good law. But since the UCP invariably governs commercial letters of credit today, it is probably fair to conclude, as Hugo does, that the aforementioned provisions of the UCP600 are an accurate "reflect[ion] [of] the current law" on discounting in this manner by a nominated or confirming bank. However, if another bank, not involved in the letter-of-credit transaction, were to discount the deferred payment rights of the beneficiary, this bank will not be able to avail itself of the protection offered by the UCP 600.[98]

---

[93] Hugo and Lambertyn "Documentary credits and independent guarantees" in *Annual Banking Law Update* (2007) 183–184.

[94] my emphasis.

[95] my emphasis.

[96] Hugo (n 14) 413.

[97] See par 2.1 above.

[98] Hugo (n 14) 413.

Credits available by negotiation

Article 2 of the UCP 600 defines negotiation as

> "… the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank."

Accordingly, in the case of a credit available by negotiation, the seller will present the specified documents to a bank stipulated in the credit, or in the case of a so-called "open negotiable credit"[99] to any bank. The bank is then authorised to "negotiate" the credit. "Negotiate" in this context means to purchase a bill of exchange drawn on some other bank[100] (if applicable) or to purchase the documents under a credit, typically for a price less than the face value of the letter of credit, at a discount. As such it is a discounting transaction.

When dealing with negotiation, a distinction should be made between a "negotiation credit" and a "straight credit".[101] In the case of a straight credit the undertaking of the issuing bank is addressed to the seller alone. Here the negotiating bank can seek payment from the issuing bank only by virtue of a cession of the seller's rights. Therefore, the negotiation transaction in this regard amounts to the "purchasing … of the documents … [and] of the seller's rights to claim payment from the issuing bank".[102] In a negotiation credit, on the other hand, the issuing bank's undertaking is given not only to the seller but also to the bank willing or authorised to negotiate the documents. Here the negotiating bank acquires its right to payment from the credit itself. This means that a formal cession of rights by the seller is not required.[103]

UNIVERSITY OF JOHANNESBURG

The discounting can be with or without recourse to the seller. If the bank does not wish to purchase the documents, the seller can enforce payment against the issuing bank.[104] The bank will forward the documents to the issuing bank and will be paid the amount stated in the

---

[99] McKendrick (n 2) 1027. The UCP 600 has opted to use the wider concept "nominated bank". In contrast, the UCP 500 referred to specifically defined concepts such as a "freely negotiable credit" as opposed to a "closed negotiable credit". Adodo (n 55) 20 par 1.41 employs terminology similar to that of the UCP 500: "unrestricted" and "restricted" negotiation credits.

[100] usually the issuing bank.

[101] Enonchong (n 7) 19 par 2.36–2.38; and Mugasha (n 48) 35.

[102] Hugo (n 14) 414.

[103] Oelofse (n 33) 58–59; and Hugo (n 14) 414.

[104] Art 7(a)(v) of the UCP 600 becomes relevant. It reads as follows: "Provided that the stipulated documents are presented to the nominated bank or the issuing bank and that they constitute a complying presentation, the issuing bank must honour if the credit is available by: … v. negotiation with a nominated bank and that nominated bank does not negotiate".

credit. As negotiating bank, its right to reimbursement arises from the issuing bank's undertaking in the credit.[105]

2.2.4 Other types of letters of credit

The essential point that emerges from the discussion above is that letters of credit may be used to create a variety of different payment obligations. This attests to its versatility. This versatility can be demonstrated further by two other types of letters of credit, namely transferable and back-to-back credits.

Transferable credits

Article 38(b) of the UCP 600 refers to a "transferable credit". This credit is used to serve the interests of a middleman in a string contract, such as "a seller that does not produce or manufacture the goods itself but acquires them elsewhere".[106] To qualify as a transferable credit, the credit must expressly indicate that it is transferable.[107] In the case of this credit the (original) beneficiary acquires the right to request the nominated bank (in this context termed the "transferring bank") to make the credit available in whole or in part to another beneficiary or beneficiaries. This means that the transferring bank advises a new (and independent) credit of the same issuing bank to the second beneficiary.[108] A transferring bank is defined in the UCP 600 as "a nominated bank that transfers the credit or, in a credit that is available with any bank, a bank that is specifically authorized by the issuing bank to transfer and that transfers the credit".[109] Thus, if a credit is available with any bank it is regarded as a non-transferable credit unless the issuing bank specifically authorises a bank to transfer.

The documents presented under the transferred credit must meet the requirements of the original credit.[110] Once the second beneficiary presents the documents, including its own invoice, under the transferred credit it receives part of the amount as payment from the transferring bank. The transferring bank will then pay the balance over to the original

---

[105] See art 7(c) of the UCP 600 which states that the "issuing bank undertakes to reimburse a nominated bank that has … negotiated a complying presentation and forwarded the documents to the issuing bank."

[106] Hugo (n 14) 430.

[107] art 38(a) of the UCP 600.

[108] Bridge (n 55) 2183 par 23–292 and 2190 par 23–309.

[109] art 2.

[110] See Enonchong (n 7) 21 par 2.41 who at n 85 states that the invoice is to be treated as an exception, since the amount of the second beneficiary's invoice will often be less than the original beneficiary's invoice. This is because the original beneficiary will try to conceal the identity of his own suppliers from his buyer.

beneficiary and will replace the second beneficiary's invoice with that of the original beneficiary (seller) before forwarding the documents to the issuing bank. The implication is that the buyer will be aware that the seller was being supplied by a third party (there is no other explanation for using a transferable credit), but the identity of the supplier and the seller's profit can be concealed. In this regard, the bank is contractually obliged to keep the identity of the supplier and the seller's profits confidential. If it fails to do so the seller will have a contractual claim for damages against the bank relating to any resultant loss of profits.[111]

In accordance with article 38(a) of the UCP 600, a bank is under no obligation to transfer a credit except to the extent that it accepts to do so at the request of the beneficiary. This entails that the bank is entitled to accept or reject a transfer request. If it accepts, it will stipulate the terms on which it agrees to do so. If it rejects, although it is preferred that banks do not reject to transfer,[112] the beneficiary may approach the issuing bank and request it to transfer the credit.

Back-to-back credits

The "back-to-back credit" serves a similar purpose to a transferable credit. In this case the beneficiary approaches its bank for the issuance of a credit in favour of its supplier, using the original credit, issued by another bank, as security.[113] On the security of the original credit the beneficiary's bank then issues a new, independent credit relying for security on the fact that its customer is the beneficiary of another letter of credit. Hence the two credits (the original and the backing credit) are "back-to-back". Back-to-back credits can therefore be regarded as an alternative to transferable credits. While the backing credit is independent of the original credit, the terms of the former are typically analogous to that of the latter. This is because the seller must ensure that the documents received from the supplier satisfy the requirements of the original credit. The supplier, who becomes the beneficiary of the back-to-back credit, must present the documents under the backing credit to the seller's bank and receive payment. Before doing so, however, the seller's bank will substitute the seller's invoice with that of the supplier. Similarly, the seller, or beneficiary under the original credit, will use the documents to make its own presentation under the original credit. Given the independent nature of the two credits,

UNIVERSITY OF JOHANNESBURG

---

[111] *Jackson v Royal Bank of Scotland* (2005) *Lloyd's Rep* 366 (HL).

[112] Hugo (n 14) 431 suggests "that banks should not lightly refuse to transfer as this would have a stifling effect on a useful trade instrument". In support of this point he relies on *Bank Negara Indonesia 1946 v Larisa (Singapore) Pte Ltd* [1988] 1 AC 583 (PC), wherein the bank's refusal had "disastrous consequences".

[113] Enonchong (n 7) 21 par 2.42.

the bank issuing the backing credit will have to pay if conforming documents are tendered irrespective of whether its customer (the supplier) is able to obtain payment under the backing credit.

The back-to-back credit is an entirely new and independent credit issued by a different bank. Hence, when it is used, it is possible to conceal not only the identity of the supplier from the buyer, but also the very fact that it is being supplied. The bank issuing the back-to-back credit, however, is exposed to the risk that after it has paid the supplier, its customer may not be able to tender conforming documents and therefore that the backing credit will not be paid.[114]

2.2.5 Alternative methods of payment in international sale transactions

2.2.5.1 Introduction

The letter of credit's ability to harmonise conflicting interests, its comparative advantages and its versatility can be displayed by comparing it with other payment instruments encountered in international trade. Other methods of payment are considered immediately below.

2.2.5.2 Payment in advance

Payment in advance simply means that the buyer pays the seller before receiving anything. In other words, payment is made before the goods are shipped. This is obviously most advantageous for the seller because, in principle, it bears no risk at all.[115] The buyer, on the other hand, bears the risks inherent to the sale transaction. These risks include that it has no assurance that the seller will perform according to the contract,[116] despite the fact that it has paid.[117] Consequently the buyer's interests are not taken into account. Therefore, buyers ought not to agree to this method of payment unless "there is a good measure of trust between the contracting parties" and the seller has provided a guarantee for its performance.[118] This method of payment is indicative of a seller in a strong bargaining position.

---

[114] See in this regard *Mannesman Handel AG v Kaunlaren Shipping Corporation* [1993] 1 *Lloyd's Rep* 89; for commentary see McKendrick (n 2) 1077–1078; and Malek and Quest (n 90) 31–32 par 2.2.8.

[115] Hugo (n 14) 395.

[116] The buyer has no assurance that the seller will, for example, ship the goods at the time, place and in the order contracted for.

[117] Hugo (n 14) 395.

[118] Mugasha (n 48) 5. See also Van Niekerk and Schulze *The South African Law of International Trade: Selected Topics* (2011) 249. In relation to the seller guaranteeing performance see par 2.3 below.

2.2.5.3 Open account

In the case of payment by open account the seller ships the goods to the buyer against payment of its invoice on a future date agreed upon by the parties.[119] The seller accordingly relinquishes control of the goods before receiving payment and effectively bears all the risk.[120] Therefore, payment by open account can essentially be viewed as the opposite of payment in advance. The buyer will normally have the advantage of inspecting the goods before making payment and may even be able to finance its purchase from the proceeds of a subsequent sale of the very same goods.[121] The principal disadvantages of the seller are the release of title to the goods to the buyer without assurance of payment,[122] and that the seller is out of pocket until the buyer pays. It follows that this method of payment should be agreed to by the seller only if it is satisfied that both the buyer and its country are reliable or where the buyer's obligation to pay is secured by a guarantee.[123] This form of payment is commonly used between parent companies and their subsidiaries.

2.2.5.4 Documentary collections

The fundamental premise upon which documentary collections exist is that the seller will retain control of the documents until payment is received. Two types of collections can be identified, namely, "documents against payment" (D/P collections) and "documents against acceptance" (D/A collections). These collection arrangements are almost always governed by the International Chamber of Commerce's *Uniform Rules for Collections* (URC "522")[124] which must be contractually incorporated by the parties.

Although the parties may in principle communicate directly with one another, banks are usually employed in this regard.[125] The collection procedure can be described as follows: the seller collates the documents (usually the commercial invoice, transport document such as

[119] Van Niekerk and Schulze (n 118) 254.

[120] Hugo (n 17) 4.

[121] Hugo (n 14) 396.

[122] Hugo (n 14) 396. See further ICC *Guide to Export/Import* (n 17) 125.

[123] ICC *Guide to Export/Import* (n 17) 125. Hugo (n 14) 396 adds that regard must also be had to the import regulations of the buyer's country. In the domestic context, the seller need only satisfy itself as to the reliability of the buyer. On the use of a guarantee to secure the buyer's obligations, see par 2.3 below.

[124] Publication 522, (1995). On 1 July 2019 the International Chamber of Commerce issued the electronic *Uniform Rules for Collections* (e-URC 1.0). These rules were issued to advance the digitalisation of documentary collections. For a comprehensive evaluation of the e-URC 1.0 see Meynell (n 2) 70–101.

[125] McKendrick (n 2) 1010.

a bill of lading, insurance document, any required certificates, and, in the case of D/A collections, a bill of exchange drawn by the seller on the buyer in favour of the seller). These documents are presented to the seller's bank (the remitting bank)[126] with instructions to collect payment from the buyer or, in the case of D/A collections, have the bill of exchange accepted by the buyer. The remitting bank then passes the documents to its correspondent in the buyer's country (the collecting bank). The collecting bank will deliver the documents to the buyer but will release them only against payment (hence "documents against payment") or acceptance of the bill of exchange (hence "documents against acceptance").[127]

Akin to the position concerning letters of credit, the banks involved in the documentary collection arrangement deal only with documents and not goods.[128] However, a distinction between the two methods of payment must be noted in this respect. In the case of documentary collections the remitting and collecting banks' role is that of collecting agents. They merely present and release the documents to the buyer upon fulfilment of the collection instructions. In a letter-of-credit transaction, however, the seller reinforces its position by exacting an undertaking to pay from a bank. Thus, the issuing bank commits itself to pay the seller against the presentation of conforming documents. It follows that under a letter of credit the (issuing) bank has a more substantive role[129] than do the remitting and collecting banks in the documentary collection arrangement.

Although reflecting a compromise offering advantages to both parties, documentary collections are still weighted in favour of the buyer. The seller, in the case of D/P collections, remains in control of the documents (and therefore of the goods) until payment or an acceptance is received. He has no assurance, however, that the buyer will take up the documents and pay (or accept the bill of exchange and pay it on maturity).[130] This would place the seller in the precarious position of having to dispose of the goods in a foreign port,[131] and attempt to enforce payment against the buyer in a foreign jurisdiction.[132]

In the case of D/A collections, moreover, the acceptance of the bill allows the buyer a period of credit. Where the bill of exchange is accepted, the seller, as payee in possession and

UNIVERSITY OF JOHANNESBURG

[126] art 3(a)(2) of the URC 522.

[127] Hugo (n 14) 399.

[128] Bridge (n 55) 257 par 6.19.

[129] This substantive function is independent of the underlying contract of sale. See in this regard par 2.4.2 below.

[130] See Chuah (n 47) 556–557 par 11–010; and Adodo (n 55) 6–7 par 1.04.

[131] Hugo (n 17) 5.

[132] Van Niekerk and Schulze (n 118) 251–252.

consequently holder,[133] has two options. It may either wait until the bill matures and then present it to the buyer (who as acceptor is primarily liable on the bill) for payment, or it can discount the bill.[134] Discounting will enable the seller to receive its money before maturity of the bill. This means that the seller will negotiate the bill by indorsing and delivering the bill to another (normally a financial institution), which will then present the bill for payment on maturity. Should the buyer dishonour the bill by non-payment, the holder can enforce payment against the buyer as acceptor,[135] as well as against the seller as drawer and indorser,[136] since both are jointly and severally liable. As such, this type of discounting transaction is with recourse against the seller. The discountability of the bill of exchange will therefore depend upon the financial standing of the buyer and/or seller. If neither have a good financial standing, it is unlikely that the seller will be able to discount the bill, unless it has been avalised.[137] To facilitate the discounting of the bill, the contract of sale, when payment is arranged on a DA collection basis, will often require that the buyer's bank avalise the bill in addition to the buyer accepting it.[138]

2.2.6 Conclusions

Letters of credit are a common feature in international sale transactions. Their documentary and independent[139] nature enable them to harmonise the conflicting interests of the parties concerned. This renders them superior to payment in advance and payment by open account. Furthermore, the payment undertaking from the bank provides much needed certainty and therefore sets them apart from documentary collections in which the banks involved merely act as collecting agents. Letters of credit also offer more advantages to the parties and are more versatile than other payment methods. Payment in international trade accordingly is best secured by these instruments.[140]

---

[133] See the definition of "holder" in s 1 of the Bills of Exchange Act (n 77).

[134] See Adodo (n 55) 7 par 1.04.

[135] See s 52 read in conjunction with s 55 of the Bills of Exchange Act (n 77).

[136] See s 53(1) and (2) read with s 55 of the Bills of Exchange Act (n 77).

[137] Chuah (n 47) 636 par 11–135. On the aval from a South African perspective see Malan, Pretorius and Du Toit *Malan on Bills of Exchange, Cheques and Promissory Notes in South African Law* (2009) par 152–154; and, though somewhat dated, Malan "Forfaiting and the aval" 1993 *TSAR* 200 *et seq*.

[138] Wolff *Law of Cross-Border Business Transactions Principles, Concepts, Skills* (2013) 166.

[139] See par 2.4.2 below.

[140] Hugo (n 17) 6 (footnotes omitted).

2.3 Demand guarantees

2.3.1 Introduction

As opposed to a payment undertaking (as in the case of letters of credit), parties to commercial transactions may require a security undertaking. Various types of security undertakings are available. The most prominent are demand guarantees, accessory guarantees, contracts of indemnity, and insurance policies.[141] The focus in this thesis falls on demand guarantees.[142]

As demand guarantees are regularly used in international commercial transactions, they have been described as a "standard feature"[143] of international commerce. Indeed, large cross-border transactions are almost always backed by a demand guarantee or standby letter of credit.[144] Demand guarantees are also, however, encountered domestically. In South Africa they are prolific in construction projects.[145] This is ascribed to the fact that "[l]arge construction projects provide considerable scope for disputes of various kinds to arise, both in the course of executing the works and after the works have been completed".[146] These disputes can give rise to difficult (legal and non-legal) questions and ultimately protracted litigation or arbitration procedures.[147] This has led Marxen to conclude that "construction can be complex and potentially risky".[148] Over the last decade or so demand guarantees have featured prominently

[141] Accessory guarantees, contracts of indemnity, and insurance policies are discussed at paragraph 2.3.7 below.

[142] These guarantees are also, *inter alia*, referred to as independent undertakings, independent guarantees, bank guarantees, and default undertakings. See Kelly-Louw (n 5) 1 in this respect. Furthermore, they are equated with standby letters of credits. Although standby letters of credit serve the same security function as demand guarantees, they have a different historical development than demand guarantees. See in this regard Kelly-Louw (n 5) 100–103. See further Hugo "Bank guarantees" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 437 438 who states that the term "independent guarantee" is a better and more accurate reflection of this instrument. This is due to their independent nature which is discussed at par 2.4.2 below. However, the term "demand guarantee" is well entrenched in South African law and is, for this reason, the term favoured in this study.

[143] Wilmont-Smith *Construction Contracts Law and Practice* (2010) 194 par 9.21.

[144] Standby letters of credit are popular in transactions involving parties from the United States of America. On this point see Adodo (n 55) par 1.16.

[145] They may, however, be used in other contexts. See *Union Carriage and Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W); *Casey v Firstrand Bank Ltd* 2014 (2) SA 374 (SCA); and *Mahonia Ltd v JP Morgan Chase Bank* [2003] 2 *Lloyd's Rep* 911 (QB).

[146] *Radon Projects (Pty) Ltd v N V Properties (Pty) Ltd* 2013 (6) SA 345 (SCA) par 1.

[147] Bailey *Construction Law Volume III* (2011) 1419 par 23.02 states that complex construction projects can lead to "some of the most factually detailed and legally complicated disputes one may encounter in commercial law".

[148] Marxen (n 10) 9. See further Barru "How to guarantee contractor performance on international construction projects: comparing surety bonds with bank guarantees and standby letters of credit" 2005 *The George Washington International Law Review* 51 who warns that "major construction projects are complex and high risk endeavours".

in South African case law. These judgments have been important in the development of the law of demand guarantees in South Africa.

2.3.2 Definition of a demand guarantee

A demand guarantee can be described as an instrument in which the guarantor, usually a bank or insurance company,[149] undertakes to pay a stipulated sum of money to the beneficiary upon the submission of a conforming demand.[150] In the demand the beneficiary would typically allege breach of the underlying contract by the applicant or that the applicant has been liquidated. Provided the demand is in conformance with the requirements of the guarantee, it "provides conclusive evidence that payment is due".[151] In the past, demand guarantees were often payable on first demand without any additional documents. This practice, however, has changed in recent times and today demand guarantees increasingly require a more precise demand often bolstered by further documents such as a notice of cancellation or liquidation order.[152] The demand guarantee, therefore, like a letter of credit, can be regarded as *documentary* in nature. Since the demand guarantee, moreover, is intended to provide the beneficiary with swift and easy access to the funds, it is commonly characterised as tantamount to cash in hand.[153]

The URDG 758[154] provides a similar definition. Article 2 provides that a demand guarantee is "any signed undertaking, however named or described, providing for payment on

[149] In South Africa, the vast majority of demand-guarantee cases involve an insurance company acting as guarantor rather than a bank. See, *inter alia*, *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* 2010 2 SA 86 (SCA); *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* 2012 (2) SA 537 (SCA); *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited* 2015 (ZAGPJHC) 264 (20 Oct 2015); *University of the Western Cape v ABSA Insurance Company* 2015 (ZAGPJHC) 303 (28 Oct 2015); *Mutual and Federal Insurance Co Ltd v KNS Construction (Pty) Ltd* 208/2015 [2016] (ZASCA) 87 (31 May 2016); *Mattress House (Pty) Ltd t/a Mia Bella Interiors v Investec Property Fund Ltd* 2017/36270 [2017] *ZAGPHC* 298 (13 October 2017); *Lombard Insurance Co Ltd v Schoeman* (2018 (1) SA 240 (GJ)); *Schoeman v Lombard Insurance Co Ltd* 2019 (1299/2017) (ZASCA) 66 (29 May 2019); and *Investec Bank Ltd v Lombard Insurance Co Ltd* 69330/2018 (ZAGPPHC) 251 (26 June 2019).

[150] Bertrams *Bank Guarantees in International Trade* (2013) 8 par 1–5 and 46 par 4–2 *et seq*; and Enonchong (n 7) 29–30 par 3.01.

[151] *State Bank of India v Denel SOC Limited* [2015] 2 All SA 152 (SCA) par 9 (per Fourie AJA).

[152] Kelly-Louw (n 5) 17 par 2.1. Other documents that have also been encountered in this regard include a judgment or arbitral award confirming the breach of contract, the original copy of the demand guarantee itself, and a written notice demanding payment of the specified amount.

[153] *Intraco Ltd v Notis Shipping Corporation (The 'Bhoja Trader')* [1981] 2 *Lloyd's Rep* 256 (CA) 257; and *Group Five Power International (Pty) Ltd v Cenpower Generation Company Ltd* 2018 unreported case no 41068/2008 (ZAGPJHC) 663 (16 November 2018) par 91. See further Kelly-Louw "The documentary nature of demand guarantees and the doctrine of strict compliance" part 1 2009 *SA Merc LJ* 306 307 who terms the demand guarantee a "substitute for cash".

[154] (n 8) above.

presentation of a complying demand". It is important that demand guarantees are formulated using unambiguous, accurate and fitting language to avoid potential misinterpretation. Especially problematic in this regard is that it may be interpreted as an accessory guarantee.[155] In *Minister of Transport and Public Works, Western Cape v Zanbuild Construction (Pty) Ltd*,[156] Brand JA differentiated between accessory and demand guarantees as follows:

> "The essential difference between the two … is that a claim under a[n] [accessory guarantee] is required at least to allege and – depending on the terms of the [guarantee] – sometimes also to establish liability on the part of the contractor for the same amount. A [demand guarantee] … on the other hand, requires no allegation of liability on the part of the contractor under the construction contracts. All that is required for payment is a demand by the claimant, stated to be on the basis of the event specified in the [demand guarantee]."[157]

Although both instruments provide a security undertaking wherein the guarantor binds itself to pay the beneficiary in the circumstances contemplated in the guarantee, the liability of the guarantor under an accessory guarantee is determined with reference to the debtor's default in law of its obligations towards the creditor (beneficiary).[158] This means that the guarantor, in the case of an accessory guarantee, may raise any defence to the beneficiary's claim that would have been available to the debtor whose performance is secured by the guarantee. In the case of a demand guarantee, on the other hand, the guarantor's payment undertaking is independent of the underlying contract, thus entitling the beneficiary to payment upon the mere submission of a conforming demand.[159] This is a far-reaching and fundamental difference: accessory guarantees provide significantly less security and liquidity to the beneficiary than demand guarantees.[160] Accessory guarantees are discussed in more detail below.[161]

UNIVERSITY
OF
JOHANNESBURG

[155] Kelly-Louw "Construction of demand guarantees gone awry" 2013 *SA Merc LJ* 404 404; and *Mutual and Federal Insurance Co Ltd v KNS Construction (Pty) Ltd* (n 149).

[156] (n 15) above.

[157] par 13. See, however, Hugo (n 142) 442 n 26 who states that this dictum must be approached with caution. He argues that "if the guarantee requires an allegation of liability under the construction contract, this in itself does not mean that the guarantee cannot be a demand guarantee. If the guarantee requires proof of liability under the construction contract, however, the guarantee would clearly be accessory and not a demand guarantee".

[158] Hugo (n 142) 438 par 10.1.1. As regards a definition of accessory guarantees (suretyship agreements) see Forsyth and Pretorius *Caney's Law of Suretyship in South Africa* (2010) 28–29.

[159] This independence is one of two fundamental principles of demand guarantees. See par 2.4.2 below in this regard.

[160] See in general Kelly-Louw "Construing whether a guarantee is accessory or independent is key" in Hugo and Kelly-Louw (eds) *Jopie: Jurist, Mentor, Supervisor and Friend – Essays on the Law of Banking, Companies and Suretyship* (2017) 110–128.

[161] See par 2.3.7.2 below.

2.3.3 Operation of the demand guarantee

The parties to a basic demand guarantee are the applicant, beneficiary and guarantor.[162] In this form it is sometimes referred to as a direct or three-party guarantee.[163] The role of each party is best understood when regard is had to the establishment and discharge of the security undertaking. This may be explained by way of example.

Suppose a company (A) wishes to construct a hospital on land owned by it. After the tendering process, it awards and enters into a construction contract (the underlying contract) with a company (B). In accordance with the underlying contract, A requires of B to provide security for the proper performance of its obligations by procuring the issuance of a guarantee in favour of A. Such security is required to protect A against any financial harm that it may suffer should B's performance be sub-standard or should B not perform at all. B, to comply with this obligation, instructs its bank (C) to issue a guarantee in favour of A.[164] C (after satisfying itself as to B's creditworthiness)[165] issues the guarantee. The guarantee provides that A will be paid upon presentation of a written demand alleging cancellation of the contract due to defective performance by B. During the course of the construction works a dispute as to the quality of construction arises between the parties. On this basis A cancels the contract with B and demands payment in terms of the guarantee. If the above requirements are met (the demand presented is in conformity with the terms of the guarantee), C must pay.

In this example C is the issuer of the guarantee, A the beneficiary and B the applicant. The contract between the applicant and the guarantor is one of mandate. The contract between C and A (the guarantee) is independent[166] of the underlying construction contract as well as the mandate. The implication is that the guarantor in principle may not rely on any term in the underlying contract or the mandate as a basis to reject a claim for payment under the

UNIVERSITY
OF
JOHANNESBURG

---

[162] Marxen (n 10) 51 par 3.3.

[163] Kelly-Louw (n 5) 22 par 2.3.2.1. Many examples of three-party guarantee cases are available in South African law. See, for example, *Raubex Construction (Pty) Ltd v Bryte Insurance Company Ltd* 2019 unreported case no 337/2018 (ZASCA) 14 (20 March 2019); *Phenix Construction Technology Ltd v Hollard Insurance Company Ltd* 2017 unreported case no 10995/2015 (ZAGPJHC) 174 (4 May 2017); *University of the Western Cape v ABSA Insurance Company* (n 149); *Mutual and Federal Insurance Co Ltd v KNS Construction (Pty) Ltd* (n 149); and *Mattress House (Pty) Ltd t/a Mia Bella Interiors v Investec Property Fund Ltd* (n 149).

[164] Enonchong (n 7) 43 par 3.47 similarly states that "[t]he instructions given by the account party to his bank should be in accordance with the terms agreed in the underlying contract otherwise the beneficiary may refuse to accept the guarantee".

[165] See Bertrams (n 150) 22 par 2.3.7.

[166] This fundamental legal principle is discussed at par 2.4.2 below.

guarantee.[167] After the beneficiary[168] has presented the demand for payment the guarantor will examine it. If the guarantor is satisfied that the demand is in conformance with the requirements in the guarantee, it will pay the beneficiary pursuant to the terms of the guarantee, and seek reimbursement from the applicant.[169]

2.3.4 The involvement of other parties

As mentioned above, the applicant, beneficiary and guarantor are the main parties to a demand guarantee. Other parties, however, become involved in the case of so called "indirect" or "four-party" guarantees.[170] The URDG 758 in this regard refers to the advising party and counter-guarantor.[171]

In the event of the applicant and beneficiary being from different countries (the applicant, for example from Germany and the beneficiary from South Africa), the guarantor will mostly be from the applicant's country. In such a case the German guarantor may, for the sake of convenience, employ the services of an *advising bank* in South Africa.[172] The advising bank is mandated to transmit the guarantee to the beneficiary in South Africa, as well as to convey communication from the beneficiary to the guarantor. Its most significant role, however, is that it authenticates the guarantee that it advises. Article 10(a) of the URDG 758 puts it thus:

> "a. A guarantee may be advised to a beneficiary through an advising party. By advising a guarantee, whether directly or by utilizing the services of another party ('second advising party'), the advising party signifies to the beneficiary and, if applicable, to the second advising party, *that it has satisfied itself as to the apparent authenticity of the guarantee and that the*

JOHANNESBURG

[167] Whether in fact company B's performance justified company A to cancel the construction contract is totally irrelevant since the question whether C is liable under the guarantee, due to the independence of the guarantee, is to be determined with reference only to the guarantee and not with reference to the underlying construction contract. However, in certain instances the independence of the guarantee from the underlying contract may be ignored and regard may be had to the underlying contract. See par 2.4.2.3 and 2.4.2.4 below.

[168] See, however, *University of the Western Cape v ABSA Insurance Company* (n 149) where the court acknowledged that a demand may be presented by an authorised agent of the beneficiary. This development is in alignment with the URDG 758. The URDG 758 states that a demand may be presented by a "presenter". A presenter is defined in art 1 as "a person who makes a presentation as or on behalf of the beneficiary or the applicant, as the case may be."

[169] The basis of the guarantors claim for reimbursement is usually an express term to that effect in the contract of mandate. If the contract of mandate does not expressly provide for reimbursement, reimbursement may occur by virtue of an "implied indemnification agreement". See in this regard Enonchong (n 7) 294. See also par 2.3.7.3 below for a discussion of indemnity agreements.

[170] Kelly-Louw (n 5) 24 par 2.3.2.2.

[171] art 1.

[172] Bertrams (n 150) 17 par 2.3.3.

> *advice accurately reflects the terms and conditions of the guarantee as received by the advising party.*"[173]

It is generally accepted that the advising bank must exercise reasonable care and good faith in the performance of its functions.[174] This obligation is restricted to the transmission of the guarantee, conveying communication from the beneficiary to the guarantor, and authenticating the guarantee. The advising bank, therefore, does not undertake or assume any obligations towards the beneficiary as far as the guarantee is concerned.[175] The implication is that the advising bank may not be held liable for any acts or omissions which fall outside of its limited mandate.

A counter-guarantor may also become involved in a demand-guarantee transaction. In certain instances, a potential guarantor may require security of its own before it agrees to bind itself as guarantor under a demand guarantee.[176] The guarantor would typically require security in order to cover itself in the event that the demand guarantee is called up. Such security may take the form of a counter-guarantee.[177] In a counter-guarantee transaction the "instructing party" (as in the terminology of the URDG)[178] will mandate[179] a bank – the *counter-guarantor* – to issue a counter-guarantee. By issuing the counter-guarantee, the counter-guarantor undertakes to pay the guarantor upon the submission of a conforming demand. Hence the guarantor becomes the beneficiary under the counter-guarantee. A counter-guarantee is defined as an undertaking

> "… given by the counter- guarantor to another party to procure the issue by that other party of a guarantee or another counter-guarantee, and that provides for payment upon the presentation of a complying demand under the counter-guarantee issued in favour of that party."[180]

A salient point to note is that the counter-guarantee enjoys autonomy from the demand guarantee as the demand guarantee does from the underlying contract between the applicant

[173] my emphasis.

[174] Bertrams (n 150) 17 par 2.3.3.

[175] Kelly-Louw (n 5) 22 par 2.3.2.1.

[176] Hugo (n 142) 445.

[177] For a case wherein a counter-guarantee was used see *State Bank of India v Denel SOC Limited* (n 151).

[178] Art 1 defines an instructing party as "the party, other than the counter- guarantor, who gives instructions to issue a guarantee or counter-guarantee and is responsible for indemnifying the guarantor or, in the case of a counter-guarantee, the counter-guarantor. The instructing party may or may not be the applicant."

[179] The contract between the instructing party and the counter-guarantor is, accordingly, one of mandate.

[180] art 1.

and the beneficiary.[181] Thus, upon presentation of conforming documents from the guarantor, the counter-guarantor must honour the counter-guarantee,[182] regardless of whether or not the guarantor has honoured its obligations under the demand guarantee.[183] So, too, is the counter-guarantee independent from the contract of mandate between the instructing party and the counter-guarantor.[184] In the latter regard, the exception to the rule is where the terms of the contract of mandate are expressly incorporated into the counter-guarantee.[185]

2.3.5 The use of standard-form guarantees

As previously mentioned,[186] the provisions of the URDG 758 have not gained major traction in domestic South African-guarantee practice. Neither have the provisions of the ISP98 or the UNCITRAL Convention. However, the standard-form guarantees of the Joint Building Contracts Committee (JBCC) suite of agreements[187] and the General Conditions of Contract for Construction Works (GCC) of the South African Institution of Civil Engineering[188] enjoy widespread use in South Africa's construction industry. For this reason South African-guarantee practice, despite the absence of the above-mentioned legal frameworks, is said to have acquired "a reasonable degree of uniformity".[189] These standardised guarantees are carefully formulated by industry experts and professionals who, over many years, have paid

UNIVERSITY OF JOHANNESBURG

[181] Art 5(b) of the URDG expresses this independence as follows: "A counter-guarantee is by its nature independent of the guarantee, the underlying relationship, the application and any other counter-guarantee to which it relates, and the counter-guarantor is in no way concerned with or bound by such relationship. A reference in the counter-guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the counter-guarantee. The undertaking of a counter-guarantor to pay under the counter-guarantee is not subject to claims or defences arising from any relationship other than a relationship between the counter-guarantor and the guarantor or other counter-guarantor to whom the counter-guarantee is issued".

[182] Provided of course the demand is not fraudulent or provides for any other ground for non-payment. For a discussion on the grounds that may allow for an interference in the payment of the guarantee see par 2.4.2.3 and 2.4.2.4 below.

[183] Kelly-Louw (n 5) 72 par 2.5.2.8.

[184] Kelly-Louw (n 5) 72 par 2.5.2.8.

[185] Kelly-Louw (n 5) 72 par 2.5.2.8.

[186] See par 2.1 above.

[187] For a detailed treatise on JBCC contracts and guarantees see Finsen *The Building Contract: A Commentary on the JBCC Agreements* (2018).

[188] See Hugo "Protecting the lifeblood of international commerce: a critical assessment of recent judgments of the South African supreme court of appeal relating to demand guarantees" 2014 *TSAR* 661 662 *et seq*. See further and in general South African Institution of Civil Engineering *Management Guide to the General Conditions of Contract* (2010).

[189] Hugo (n 142) 439.

meticulous attention to the rights and obligations of the parties to construction contracts.[190] The result is that these guarantees generally reflect the interests of all the parties concerned and thus serve them well. The same may not, however, be said in relation to bespoke or ad-hoc guarantees which are often formulated by guarantors or their legal representatives. These guarantees are often drawn up to favour the interests of one of the parties – and sometimes without good industry knowledge. In practice this has often led to disputes between the parties resulting in prolonged and costly litigation that may have been avoided had a standard-form guarantee been used.[191]

Internationally, the standard-form guarantees of the *New Engineering Contract* (NEC),[192] the *Federation Internationale des Ingenieurs-Conseil* (FIDIC),[193] and the adaptable standardised guarantee of the URDG are available for use.[194]

2.3.6 Different types of demand guarantees

2.3.6.1 Introduction

As noted above,[195] international commercial transactions give rise to various risks and uncertainties. Whether the transaction is related to construction, engineering or the sale of goods, the parties involved will often require security. In South African case law the majority of guarantee cases arise from the construction industry. The different types of guarantees encountered in this industry are performance guarantees, payment guarantees, advance payment guarantees, as well as retention, maintenance and tender guarantees.

UNIVERSITY OF JOHANNESBURG

---

[190] See *Hyde Construction CC v Blue Cloud Investments 40 (Pty) Ltd* [2012] JOL 28470 (WCC) 34 where Gamble J observed that JBCC contracts are "a product of many years of industry-wide debate, consideration and ultimately consensus. All of the role players in the construction industry know its ambit and terms [...]."

[191] See *Minister of Transport and Public Works, Western Cape v Zanbuild Construction (Pty) Ltd* (n 15) for a case which clearly underscores the consequences that flow from bespoke guarantees. For a comprehensive discussion on this case see Kelly-Louw (n 155). See Hugo (n 142) 440–443 for a somewhat summarised discussion. See further *Lombard Insurance Co Ltd v Schoeman* 2018 (n 149) for a case where litigation could have been avoided had the parties subjected the guarantee to a standard-form guarantee.

[192] See *Group Five Construction (Pty) Ltd v Transnet SOC Limited* 2019 unreported case no 45879/2018 (ZAGPJHC) 328 (28 June 2019) for a case in which a standard-form guarantee of the NEC was used.

[193] The English translation is "International Federation of Consulting Engineers". These contracts are also encountered in South Africa. See Baird "NEC3 compared and contrasted with African procurement – South Africa" in Forward NEC3 Compared and Contrasted (2015) 115 116, who lists several South African construction and engineering projects which were based on FIDIC contracts. Moreover, the FIDIC has endorsed the URDG. See in this respect Kelly-Louw (n 5) 133 par 3.2.5.2; and Klee *International Construction Contract Law* (2015) 383 par 16.9.

[194] Affaki and Goode (n 8) 438 par 599; and see Hugo (n 142) 440 n 12. The URDG has not featured prominently in South African case law as yet, and, concomitantly, there is no widespread use of the URDG's standard-form guarantee.

[195] See par 2.2.1 above.

2.3.6.2 Performance guarantees

A performance guarantee, or performance bond,[196] is used to ensure proper performance of the underlying contract. It therefore protects the beneficiary against non-performance, late performance or defective performance.[197] The beneficiary of this guarantee is normally the employer. Apart from that, it may also be used to cover the beneficiary against the risk of insolvency on the part of the counterparty. The amount guaranteed is usually between 5 per cent and 15 per cent of the contract value.[198] Although this amount is typically fixed, in which case the guaranteed amount remains the same for the full duration of the guarantee, the guarantee may provide for a variable amount.[199] In the event of a variable amount, the guaranteed amount is reduced as performance of the contract progresses. Performance guarantees are well suited to the construction context, since the certification of completion of phases of the work by the principal agent or engineer is met by a concomitant decrease in the amount of the guarantee.

2.3.6.3 Payment guarantees

A payment guarantee typically assures the beneficiary that it will receive payment upon the completion of performance. In the construction context, the beneficiary of this guarantee is normally the contractor.[200] Thus it can rest assured that it will receive payment following the completion of the construction works. Crucial documents to note in this regard are payment certificates issued by the principal agent or engineer in favour of the beneficiary. These documents certify, *inter alia*, that the construction works or a certain part of the works have been completed satisfactorily thus entitling the beneficiary to payment.[201] In the event that the principal agent does not pay in accordance with the payment certificate or where he fails to issue a payment certificate in circumstances where he should, the beneficiary, by presenting

UNIVERSITY OF JOHANNESBURG

---

[196] Klee (n 193) 374 par 16.3.3. In addition, when used in the construction context they are also commonly referred to as construction guarantees.

[197] Marxen (n 10) 79 par 4.3.1.

[198] Bertrams (n 150) 37 par 3.3; and Hugo (n 142) 443 par 10.2.2.

[199] Hugo (n 142) 443 par 10.2.2. For a case wherein a "variable" performance guarantee was used see *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* (n 149) par 3.

[200] However, a payment guarantee can also be used to secure the interests of an employer. See in this respect Hugo (n 142) 444 at n 40.

[201] Marxen (n 10) 81 par 4.3.2. See further Bailey (n 147) 351 par 5.134 *et seq*.

certain stipulated documents,[202] may call up the guarantee.[203] Although prevalent in the construction industry, Bertrams[204] highlights the increasing demand for payment guarantees in support of sale transactions.

2.3.6.4 Advance payment guarantees

An advance payment guarantee is not to be confused with a payment guarantee.[205] In a construction project it sometimes transpires that an advance payment or a portion of the contract value is required by the contractor, typically to enable certain preliminary or early work under the contract. This advance payment ordinarily ranges from 5 per cent to 30 per cent of the contract value.[206] Where an employer agrees to make an advance payment to the contractor, the contractor may be required to present a guarantee assuring the repayment of the funds in the event of default by the contractor.[207] The beneficiary is therefore the employer. The general idea behind the advance payment guarantee "is to secure the beneficiary's right to repayment of the advance if the performance to which it relates is not provided".[208]

2.3.6.5 Retention guarantees

It is not uncommon for an employer under a construction contract to require security for defects that may emerge later in the execution of the works. In such a situation the construction contract may allow the employer to withhold a percentage of each payment due to the contractor.[209] These retained funds are known as retention moneys and usually amount to between 5 to 10 per cent of the contract value.[210] Payment of retention moneys clearly has a negative effect on

UNIVERSITY OF JOHANNESBURG

[202] These include, for example, a demand alleging non-payment in accordance with a payment certificate, or a demand alleging the non-issue of a payment certificate despite a prior demand to the employer to have such certificate issued. These allegations must typically be annexed to the demand to the guarantor.

[203] *First Rand Bank v Brera* 2013 (5) SA 556 (SCA).

[204] Bertrams (n 150) 41–42 par 3.7. He goes on to state that in recent times parties to sale transactions seem to prefer payment guarantees over letters of credit. He ascribes this development to the comparatively lower transaction costs and bank charges of payment guarantees.

[205] See *Phenix Construction Technology Ltd v Hollard Insurance Company Ltd* (n 163) par 1 wherein the court regarded the guarantee in question as a payment guarantee, despite reference being made in the guarantee to "advance payments".

[206] Bertrams (n 150) 39 par 3.5.

[207] Kelly-Louw (n 5) 28 par 2.4.2.3; Hugo (n 142) 444 par 10.2.4; and Bertrams (n 150) 39 par 3.5.

[208] Kelly-Louw (n 5) 28 par 2.4.2.3.

[209] Hugo (n 142) 444 par 10.2.5.

[210] Hugo (n 142) 444 par 10.2.5.

the contractor's cash flow. Consequently, a retention guarantee can be used instead.[211] The retention guarantee essentially substitutes the retention money.[212] This means that the employer will be entitled to call up the guarantee should a defect subsequently emerge. The guaranteed amount under a retention guarantee may accordingly increase in accordance with the successive releases of retention money.[213]

2.3.6.6 Maintenance (or warranty) guarantees

It is common practice for construction contracts to provide for the retention of a portion of the contract price (another form of retention money) for a certain period after completion of the contract (known as the maintenance or warranty period) as security against emerging defects in that period.[214] Often, however, maintenance guarantees are issued in favour of the employer against these retention moneys, thus permitting the employer to release these moneys to the contractor on completion of the contract.[215] The maintenance guarantee in this regard provides the employer with the assurance that the contractor will "continue to fulfil his obligations during the maintenance or warranty period".[216]

2.3.6.7 Tender guarantees

Major commercial transactions are often awarded through tender procedures.[217] This is especially true in the construction industry, where the employer invites the general public or a select group of potential contractors to tender for a particular construction project. These tenders typically require of a potential contractor (bidder) to "sign a contract if it is awarded to it, to procure the [issuance] of any guarantee required by the contract and not to alter or withdraw his tender in the meantime".[218] In practice, the employer often requires a tender guarantee by a prospective contractor so as to ensure that it will, *inter alia*, honour its bid, sign the necessary documents and provide security undertakings in relation to the underlying

---

[211] Marxen (n 10) 84 par 4.3.6.

[212] Mugasha (n 48) 68.

[213] Bertrams (n 150) 40 par 3.6.

[214] Kelly-Louw (n 5) 29 par 2.4.2.5.

[215] Hugo (n 142) 445 10.2.6.

[216] Kelly-Louw (n 5) 29 par 2.4.2.5. For this reason, Marxen (n 10) 82 par 4.3.3 concludes that "[a] maintenance guarantee can accordingly be regarded as a specific kind of performance guarantee but with a narrower focus on the obligation after the substantial completion of the construction works."

[217] Bertrams (n 150) 36 par 3.2.

[218] Kelly-Louw (n 5) 27 par 2.4.2.1.

transaction, if necessary.[219] The tender guarantee can be called up to provide compensation to the employer if the contractor does not perform these and other obligations under the tender documents. The guaranteed amount under the tender guarantee typically ranges from 1 per cent to 5 per cent of the project value.[220]

2.3.7 Alternative means of security

2.3.7.1 Introduction

While demand guarantees have acquired a dominant position in international and national commerce, other instruments of security, founded upon different principles, are also available. Comparing demand guarantees to other means of security contributes to a deeper understanding of demand guarantees. These alternative means of security are explored immediately below.

2.3.7.2 Accessory guarantees

Suretyship or accessory guarantees may be used to secure various obligations under a contract. Forsyth and Pretorius describe the general nature of a suretyship agreement as

> "an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), that the principal debtor, who remains bound, will perform his obligation to the creditor and that if and so far as the principal debtor fails to do so, the surety will perform it or, failing that, indemnify the creditor".[221]

Akin to this description of a suretyship agreement, an accessory guarantee[222] can be described as a contract in which "a guarantor secures the performance of a debtor to a creditor (the beneficiary of the guarantee) by binding itself to pay the beneficiary a sum of money in the circumstances contemplated in the guarantee".[223] The cardinal features of an accessory guarantee, however, lie in the nature of the guarantor's obligation.

The payment obligation of the guarantor under an accessory guarantee is secondary in nature, since this obligation is triggered when the debtor defaults on its obligations towards the

---

[219] Kelley *Construction Law* (2013) 206 par 19.1.1.

[220] Bertrams (n 150) 36 par 3.2.

[221] (n 158) above (footnotes omitted).

[222] Accessory guarantees are also often referred to as "traditional guarantees", "conditional guarantees", "conditional bonds", or merely "guarantees". In South African law, moreover, the terms "guarantee" and "suretyship" are sometimes used interchangeably. Perhaps this can be ascribed to South Africa's common-law heritage where contracts of guarantee and suretyship are viewed as the same. See Mugasha (n 48) 12 in regard to this common-law notion. In South Africa this practice has in recent times been criticised, however. See Kelly-Louw (n 5) 30 par 2.5.1.

[223] Hugo (n 142) 438.

beneficiary.[224] Consequently, if the default by the debtor is disputed by the guarantor, the beneficiary will be required to prove or verify the debtor's default, which, invariably, will require attention to be paid to the underlying contract.[225] In the case of a demand guarantee, however, the liability of the guarantor is primary in nature owing to the independence principle. The guarantor's payment undertaking is accordingly separate and autonomous from the underlying contract between the debtor and the beneficiary.[226] The implication is that the debtor's default "does not need to be proven but merely stated and often supported (prima facie) by documents pointing to such facts".[227] This is the fundamental difference between accessory guarantees and demand guarantees.[228] Moreover, as, in the case of an accessory guarantee, the guarantor's liability for the debtor's default is dependent on the debtor's obligation,[229] invalidity of the debtor's obligation will result in the discharge of the guarantor's obligation.[230] The result would be the same if the terms of the guarantee are varied without the guarantor's consent and the variation was not contemplated by the initial guarantee.[231] The guarantor, therefore, acquires any defence to payment against the beneficiary that would have been available to the debtor.

The secondary (dependent) nature of the accessory guarantee is, however, its biggest drawback.[232] Parties to large commercial contracts require certainty – certainty that they will be paid regardless of any disputes arising between the parties in relation to the underlying contract. This is particularly the case in the construction industry, where disputes between parties are often complex, resulting in protracted litigation or arbitration processes in order to determine possible liability.[233] The accessory guarantee in this regard, owing to its reliance on

UNIVERSITY OF JOHANNESBURG

[224] Hugo (n 142) 438.

[225] Kelly-Louw (n 160) 113.

[226] See par 2.4.2 below.

[227] Marxen (n 10) 49 par 3.3.

[228] Hapgood *Paget's Law of Banking* (2003) 730; and Kelly-Louw (n 160) 113.

[229] Kelly-Louw (n 160) 112.

[230] Mugasha (n 48) 13, Kelly-Louw (n 160) 112; and Hapgood (n 228) 702.

[231] See Mugasha "Enjoining the beneficiary's claim on a letter of credit or bank guarantee" 2004 *The Journal of Business Law* 515 535 and his analysis of accessory and primary guarantees in this regard.

[232] Bertrams (n 150) 45 par 4.1 explains that "[a]part from the specifically agreed upon terms and conditions, the rights and obligations of parties and more specifically the conditions of payment under a contract of suretyship are fixed by the co-extensiveness principle. By virtue of this principle the underlying relationship is transposed, as it were, to the relationship between surety and beneficiary/creditor, and the content and extent of the surety's liability, both as a matter of substance and as a matter of evidence, are determined by the principal debtor's liability towards the creditor according to the underlying relationship."

[233] Marxen (n 10) 92 par 4.5.1.

the debtor's obligation, fails to provide the parties with an assurance of (swift) payment. It therefore comes as no surprise that "conditional bonds are becoming rare in international contracting".[234] The decreasing use of this form of security has bolstered the need for independent guarantees.[235]

2.3.7.3 Indemnity

An indemnity is a contract in which "one party undertakes to keep another harmless against loss; that is, to make good any loss suffered by that other".[236] Conceptually, any conceivable obligation can be secured by an indemnity agreement.[237] In practice, however, they are often encountered in the construction context, where they are used by the guarantor to secure reimbursement against the applicant after it has discharged its obligations.[238]

There are two essential features of indemnity contracts. In the first place, the obligation assumed under a contract of indemnity is an independent undertaking which is in no way dependent upon the debt of another. This means that the indemnity agreement is primary in nature.[239] In order to trigger the indemnity obligation, moreover, the parties are usually required to advance evidence pointing to such facts. More often than not, such evidence is not required to be documentary in nature.[240] Demand guarantees, in contrast, are documentary in nature.[241] The second is that the beneficiary under an indemnity can only recover the amount of the actual loss suffered or the liability it incurred.[242] In the case of a demand guarantee, however, the amount secured by the guarantee does not necessarily need to equal the actual loss suffered by the beneficiary.[243]

UNIVERSITY
OF
JOHANNESBURG

---

[234] Van der Puil and Van Weele *International Contracting* (2014) 268.

[235] See Marxen (n 10) 92 par 4.5.2 who suggests that in fitting circumstances demand guarantees and accessory guarantees can be jointly used to secure a transaction.

[236] Mugasha (n 48) 14; and Bailey (n 147) 911 par 12.39.

[237] Bailey (n 147) 911 par 12.39.

[238] See, for example, *Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng* [2015] ZAGPJHC 55 (13 February 2015); and *Phenix Construction Technologies (Pty) Ltd v Hollard Insurance Company Limited* (n 163).

[239] Bailey *Construction Law Volume II* (2011) 910 par 12.37; and Affaki and Goode (n 8) 9 par 18.

[240] Affaki and Goode (n 8) 9 par 18. The terms of the indemnity can, however, require the triggering event to be documentary in nature.

[241] See in this regard par 2.3.2 above.

[242] Marxen (n 10) 95 par 4.5.3.

[243] Kelly-Louw "Limiting exceptions to the autonomy principle of demand guarantees and letters of credit" in Visser and Pretorius (eds) *Essays in Honour of Frans Malan* (2014) 197 214 par V; and see further Marxen (n 10) 95 par 4.5.3 who adds that "[e]ven in cases where the beneficiary of a demand guarantee has not sustained

2.3.7.4 Insurance policy

An insurance contract can be described as "a contract between an insurer and an insured, in terms of which the insurer undertakes to render to the insured a sum of money, or its equivalent, on the occurrence of a specified uncertain event in which the insured has some interest, in return for the payment of a premium".[244] In the commercial sense risks are insured due to their significant nature. This "significant nature" may relate to the detrimental impact that these risks could have on legitimate business interests, property and cash flow.[245] Commenting from a construction perspective, Marxen provides the following examples of such risks:

> "[D]efault in making payment by the employer, damage to the site and work, claims due to damages or injury sustained by a third party, or failure to complete the construction works by contractors and subcontractors due to insolvency or quality problems of any kind."[246]

When exacting an insurance policy from an insurer, regard must be had to the insurance premium applicable to such undertakings. Owing to the fact that these premiums are determined commensurate to the scope of the risk covered, the insurance period and the extent of liability for the insured if the risk comes to pass,[247] they are relatively high. As a consequence, insurance policies have been described as the "expensive [security] option".[248]

In assessing the validity of a claim under an insurance policy, an insurer is required to investigate meticulously the merits of the case, in particular the existence and cause of default and the loss and extent of damage.[249] Consequently, the insurer is given a "reasonable" amount of time to assess and process the claim.[250] One can therefore assume that payment is "unlikely to be prompt",[251] especially since the insurer will wish to satisfy itself as to the validity of the claim. Against this background, insurance policies differ fundamentally from demand guarantees in two respects. The guarantor under a demand guarantee, firstly, is not required to investigate the facts giving rise to the demand but simply to examine the demand to ascertain

financial damages, or where the loss does not fully match the amount stipulated in the demand guarantee, it may still be able to claim under the guarantee" (footnotes omitted).

[244] *Lake v Reinsurance Corporation Ltd* 1967 3 SA 124 (W).

[245] Marxen (n 10) 98 par 4.5.6.

[246] Marxen (n 10) 98 par 4.5.6.

[247] Bird *Bird's Insurance Law in the United Kingdom* (2010) 55 par 58 *et seq*.

[248] Andrew and Millett *Law of Guarantees* (2011) 629 par 16–006.

[249] Enonchong (n 7) 35 par 3.18.

[250] Andrew and Millett (n 248) 629 par 16–007.

[251] Enonchong (n 7) 35 par 3.18.

whether it is in conformity with the guarantee.[252] Secondly, the examination of the demand by the guarantor must be done expeditiously, in accordance with the URDG 758 "within five business days following the day of presentation".[253] Hence payment under a demand guarantee, provided the demand is conforming, should be quick.

Another noteworthy aspect is risk allocation. In the case of insurance policies, the insurer is left to bear the ultimate risk of losses.[254] That is to say, the insurer, ironically, provides a security undertaking to the insured but does so without sufficient security for itself. In contrast, the guarantor under a demand guarantee has a claim for reimbursement against the applicant.[255]

2.3.8 Conclusions

Demand guarantees are regularly employed to secure commercial transactions, both in the domestic and international context. The principles of independence and documentary compliance are applicable to them. These principles provide certainty to the parties concerned. This stands in stark contrast to accessory guarantees, where dependence on the underlying contract introduces uncertainty. The demand guarantee's documentary nature, moreover, which ensures a reasonable degree of certainty, sets it apart from the non-documentary indemnity contract. Likewise, its ability to provide fast and easy access to funds renders it superior to insurance policies where insurers require longer periods to assess and process claims. In the premises, the commercial value of demand guarantees cannot be doubted; they are indispensable security instruments in large commercial contracts.

UNIVERSITY
OF
JOHANNESBURG

2.4 Fundamental legal principles of letters of credit and demand guarantees

2.4.1 Comparison between letters of credit and demand guarantees

In the oft-cited English case of *Edward Owen Engineering Ltd v Barclays Bank International Ltd*,[256] Lord Denning MR drew a comparison between letters of credit and demand guarantees. He explained:

---

[252] See par 2.4.3 below.

[253] art 20(a).

[254] Merkin and Steele *Insurance and the Law of Obligations* (2013) 38–39 par 3.2.

[255] Very often, however, this is the "cold comfort of a concurrent claim" (see *Venfin Investments v KZN Resins (642/2010)* [2011] ZASCA 128 (15 September 2011) par 50) and is not worth much against a contractor or other applicant who is insolvent. See, in this regard, Enonchong (n 7) 294 par 12.70.

[256] [1978] QB 159 (CA).

> "A performance bond is a new creature so far as we are concerned. It has many similarities to a letter of credit, with which of course we are very familiar. It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and seller must be settled between themselves. The bank must honour the credit."[257]

He pointed out that this all "leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit",[258] and continued:

> "A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is clear fraud of which the bank has notice."[259]

Letters of credit and demand guarantees clearly share a close relationship. This is particularly true of the principles of independence and documentary compliance, which lay the foundations upon which both instruments rest. In *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd*, Navsa JA explained as follows:

> "The guarantee by Lombard is not unlike irrevocable letters of credit issued by banks and used in international trade, the essential feature of which is the establishment of a contractual obligation on the part of a bank to pay the beneficiary (seller). This obligation is wholly independent of the underlying contract of sale and assures the seller of payment of the purchase price before he or she parts with the goods being sold. Whatever disputes may subsequently arise between buyer and seller is of no moment insofar as the bank's obligation is concerned. The bank's liability to the seller is to honour the credit. The bank undertakes to pay provided only that the conditions specified in the credit are met."[260]

UNIVERSITY OF JOHANNESBURG

It stands to reason that case law relating to the one instrument is frequently considered in cases dealing with the other.

Two differences, however, between letters of credit and demand guarantees merit consideration. Firstly, they differ in function. While letters of credit are used as strong payment instruments in international sales, demand guarantees are employed to provide strong security functions in commercial transactions.[261] The practical implication is that "a letter of credit is concerned with performance, an autonomous guarantee with non-performance. It is expected that payment will be made under a letter of credit; it is hoped that no payment will be claimed

---

[257] 169A–B.

[258] 171A.

[259] 171A–B.

[260] *Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd* (n 149) par 20.

[261] McKendrick (n 2) 1087; Affaki and Goode (n 8) 9 par 19; and Hugo (n 142) 438–439 par 10.1.1.

under an autonomous guarantee."[262] This is the main difference between letters of credit and demand guarantees.

The second difference presents itself in the nature of the documents submitted for payment. When a letter of credit is honoured by the issuer, it acquires documents that are of intrinsic commercial value.[263] This is because some of the documents typically called for under a letter of credit, for example the bill of lading, represent the goods and claims relating to them. In the case of a demand guarantee, however, the documents called for (for example the written demand) neither hold any commercial value, nor embody rights against third parties.[264] The guarantor instead acquires documents which are merely declaratory in nature.[265]

The final point to be made in this paragraph is that the South African judiciary has developed the law of demand guarantees and letters of credit with strong reference to English law in this regard.[266] For this reason the research that follows concerning the fundamental principles of these instruments refers to and discusses English precedent when necessary.

2.4.2 The independence principle

2.4.2.1 Introduction

The independence principle of letters of credit and demand guarantees (also known as the autonomy principle, the doctrine of separation[267] and the doctrine of abstraction[268]) is fundamental to the efficacy of underlying trade and commercial transactions. This principle essentially holds that the payment undertaking of the issuing bank or guarantor to the beneficiary is distinct from the underlying contract as well as from the contract of mandate

UNIVERSITY OF JOHANNESBURG

---

[262] Bridge (n 55) 2199 par 24–001. See also Horowitz *Letters of Credit and Demand Guarantees* (2010) 227 par 8.02 who states: "Letters of credit and guarantees share the characteristic of abstraction from the underlying agreement that called for their use. Nonetheless, they differ on one key aspect. Letters of credit are primary both in form and intent. They do what they appear to do: serve as the payment method for the transaction. By contrast demand guarantees are primary in form, but secondary in intent. They bear the appearance of primary instruments, because they represent an on-demand form of payment. However they are secondary in intent, inasmuch as they serve a 'back-up', or standby, role."

[263] Marxen (n 10) 121 par 5.2.6.

[264] Marxen (n 10) 121 par 5.2.6; and Enonchong (n 7) 34 par 3.14.

[265] Satchwell J in *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited* (n 149) par 30 described the statement alleging breach by the applicant as a "say-so statement".

[266] Much South African case law reflects English case law in this regard. See, for example, *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd* 2002 (3) SA 688 (SCA) at 697G–698C; *Phillips v Standard Bank of South Africa Ltd* 1985 (3) SA 301 (W) 302I–304C; and *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* (n 22) 816A–817H.

[267] Enonchong "The autonomy principle of letters of credit: an illegality exception?" 2006 *LMCLQ* 404 405.

[268] Horowitz (n 262) 1 par 1.01.

between it and the applicant for the credit/guarantee.[269] This means that the issuing bank or guarantor must, provided there is a complying presentation, honour the claim for payment notwithstanding any dispute arising in relation to the underlying contract or any other related contracts[270] – this has been expressed as the "pay first argue later"[271] rule.

The independence principle is embodied in all the above-mentioned frameworks.[272] It has also, however, been the subject of much litigation particularly in South Africa.

2.4.2.2 Case law

One of the earliest and most detailed expositions of the independence principle, in relation to letters of credit, emerges from the 1941 American case of *Sztejn v J Henry Schroder Banking Corporation.*[273] In this seminal case Shientag J put it thus:

> "It is well established that a letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon the presentation of documents, not goods. This is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade... . It would be a most unfortunate interference with business transactions if a bank, before honouring drafts drawn upon it, was obliged or even allowed to go behind the documents at the request of the buyer, and enter into controversies between the buyer and the seller regarding the quality of the merchandise shipped. If the buyer and the seller intended the bank to do this, they could have so provided in the letter of credit itself, and in the absence of such provision, the Court will not demand, or even permit, the bank to delay paying drafts which are proper in form."[274]

In 1985, almost five decades later, the independence principle was recognised in South African law. By relying strongly on the *Sztejn* and *United City Merchants (Investments) Ltd v Royal*

UNIVERSITY
OF
JOHANNESBURG

[269] Kelly-Louw (n 5) 41–48 par 2.5.2.1–2.5.2.3; Bridge (n 55) 2199-2201 par 24-001; Hugo (n 188) 662; and Mugasha (n 48) 24–25.

[270] *Group Five Power International (Pty) Ltd v Cenpower Generation Company Ltd* (n 153) par 89.

[271] Bertrams (n 150) 73 par 6.1.2.

[272] See par 2.1 above. In relation to letters of credit, art 4(a) of the UCP formulates this principle as follows: "A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary." In the demand-guarantee context, the independence principle is clearly provided for in, *inter alia*, art 5(a) of the URDG 758: "A guarantee is by its nature independent of the underlying relationship and the application, and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defences arising from any relationship other than a relationship between the guarantor and the beneficiary."

[273] (1941) 31 NYS 2 Ed 633.

[274] 633–634.

Bank of Canada (The American Accord)[275] cases, Goldstone J, in *Phillips v Standard Bank of South Africa Ltd*,[276] held:

> "The courts should recognise and give effect to the commercial purpose for which the system of irrevocable documentary credits has been devised, viz to facilitate international trade by giving the seller, before he parts with the goods, the assurance that he will be paid and that no dispute as to the performance by him of the contract with the purchaser will constitute a ground for non-payment or delayed payment.[…] Accordingly, where an irrevocable documentary credit constitutes an independent contract between the issuing bank and the seller, the purchaser may not go behind the documents and cause payment to be stopped or suspended because of complaints concerning the quality of the goods or other alleged breaches of a contract by the seller."

Ex Parte Sapan Trading (Pty) Ltd[277] further entrenched the independence principle in South African letter-of-credit law. In this case the court, by importing an implied term in the underlying contract, refused an application by an incola plaintiff, who had established a prima facie case against a peregrine defendant, for the attachment of claims under letters of credit issued by South African banks. The term was implied on the basis of public policy. Commentators generally agree that the South African judiciary's commitment to preserving the sanctity of the independence principle was strongly evidenced by this case.[278]

The independence principle has also been clearly recognised in demand-guarantee cases in South Africa.[279] The *Landmark Holdings* case referred to above[280] presents a good example.

Parties to commercial transactions require certainty of their contractual rights irrespective of the emergence of a dispute originating from especially the underlying contract. Certainty is indeed a paramount consideration in international trade and commerce.[281] The above discussion has shown that the independence principle contributes to ensuring such certainty.

---

[275] [1983] 1 AC 168.

[276] (n 266) above.

[277] 1995 (1) SA 218 (W).

[278] Hugo (n 14) 426; and Oelofse (n 87) 68.

[279] See, for example, *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* 2014 2 SA 382 (SCA); *First Rand Bank v Brera* (n 203); *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* 2014 1 All SA 307 (SCA) par 22–26; *Fast Track Contracting (Pty) Ltd v Constantia Insurance Company Ltd* 2018 unreported case no. 22474/2018 (14 December 2018) par 4; and *Transnet SOC Limited v ABSA Insurance Company Ltd* 2019 unreported case no. 08853/2016 (24 October 2019) par 10.

[280] (n 149) above.

[281] Marxen and Hugo "Exceptions to the independence of autonomous instruments of payment and security: the growing emergence of good faith" in Hugo and Möllers (eds) *Transnational Impacts on Law: Perspectives from South Africa and Germany* (2018) 131 132.

Certainty, however, is not unassailable and must be balanced against considerations of justice, fairness, and equity.[282] Hence, the independence principle cannot be absolute. Exceptions to the independence principle need to be recognised when supported by strong policy considerations. Shientag J, in the *Sztejn* case, put it thus: "[T]he principle of independence of the bank's obligation … should not be extended to protect the unscrupulous seller."[283] Taking into account the "ease with which demand guarantees can be abused by beneficiaries",[284] exceptions to the independence principle are necessary also in the guarantee environment.

2.4.3 The fraud exception

Fraud on the part of the beneficiary is the best-established exception to the independence principle.[285] It has been recognised in many jurisdictions. Interestingly, however, it is not dealt with in either the UCP 600 or the URDG 758. Zhang asserts that this issue was intentionally left for domestic law to determine.[286] While articles 19 and 20 of the UNCITRAL Convention provide for a defence to payment based on fraud,[287] the UNCITRAL Convention can only govern guarantee transactions if the jurisdiction in question has ratified or acceded to it.[288] South Africa has not done so.[289] The development of the fraud exception in South African law is therefore to be sought in case law and the work of legal commentators. In demand-guarantee practice fraud can almost be viewed as the default defence to payment – so often is it relied upon.[290] The result has been the development of two distinct notions of fraud, sometimes referred to as "fraud in the narrow sense" and "fraud in the wide sense".

UNIVERSITY
OF
JOHANNESBURG

---

[282] Enonchong (n 7) 93 par 4.62; Lurie "On demand performance bonds: is fraud the only ground for restraining unfair calls" 2008 *International Construction Law Review* 443 465; Gao *The Fraud Rule in the Law of Letters of Credit* (2002) 30; and Kurkela *Letters of Credit and Bank Guarantees under International Trade Law* (2008) 181.

[283] (n 273) 634.

[284] Hugo (n 142) 450 10.3.3.

[285] Kelly-Louw (n 5) 164 par 5.1; Marxen (n 10) 106; and Lupton "Investec Bank Ltd v Lombard Insurance Company Ltd and Another (case no. 69330/2018) [2019] ZAGPPHC 251 (26 June 2019) [South Africa]" (June 2020) Vol 24(6) *Documentary Credit World* 21 24.

[286] Zhang "Documentary letters of credit fraud exception rules: a comparative study of English and Chinese law" 2015 *Journal of International Banking Law and Regulation* 1 2–3.

[287] Xiang and Buckley "A comparative analysis of the standard of fraud required under the fraud rule in letter of credit law" 2003 *Duke Journal of Comparative and International Law* 293 333; and Kelly-Louw (n 5) 324 par 7.5.

[288] Enonchong (n 7) 41 par 3.40.

[289] Marxen (n 10) 48 par 3.2.3.

[290] See, for example, *Group Five Power International (Pty) Ltd v Cenpower Generation Company Ltd* (n 153); *Phenix Construction Technology Ltd v Hollard Insurance Company Ltd* (n 163); *Group Five Construction (Pty)*

The starting point on the recognition of the fraud exception in South African law is *Loomcraft Fabrics CC v Nedbank Ltd*, a case which concerned letters of credit. In this case Scott AJA endorsed a fraud exception when he held that "the bank will escape liability only upon fraud on the part of the beneficiary".[291] He relied in this regard on the *United City Merchants* case, where Lord Diplock stated that

> "… there is one established exception: that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the ... bank documents that contain, expressly or by implication, material representations of fact that to his (the seller's) knowledge are untrue".[292]

Scott AJA's alignment with the *United City Merchants* case suggests that a fraud exception in relation to letters of credit is confined to the presentation of forged or otherwise fraudulent documents (fraud in the narrow sense).[293] Although this approach to fraud strongly emphasises the independence principle, it does not cover the conceivable situation where the beneficiary's fraudulent *conduct* relates to the underlying transaction and is not apparent from the documents. Thus, Xiang and Buckley's remark that "if fraud is defined too narrowly [...] the effectiveness of the fraud rule will be compromised"[294] has much merit.

In the demand-guarantee environment, fraud mostly has a wider meaning.[295] In this context documentary fraud and the beneficiary's conduct in relation to the underlying contract are relevant (fraud in the wide sense). As Marxen explains, the wide approach to fraud "assesses the behaviour of the parties without necessarily restricting itself to examining the presented documents alone".[296] Hugo ascribes this difference to the fact that "documents play a significantly less prominent role in guarantees than in letters of credit".[297]

In the often-cited English case of *United Trading Corporation SA v Allied Arab Bank Ltd*,[298] Ackner J explained that fraud will succeed only when "the only realistic inference is ... that *the beneficiary could not honestly have believed in the validity of its demand*". The notion

---

Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng (n 238); and *Mattress House (Pty) Ltd t/a Mia Bella Interiors v Investec Property Fund Ltd* (n 149).

[291] *Loomcraft Fabrics CC v Nedbank Ltd* (n 22) 815J. In the earlier case of *Phillips v Standard Bank of South Africa Ltd* (n 266) the judgment of Goldstone J merely acknowledges this exception.

[292] (n 275) 183G.

[293] See, however, *Union Carriage and Wagon Company Ltd v Nedcor Bank Ltd* (n 145) 730–734, for a dictum seemingly in favour of fraud in the wide sense in relation to letters of credit.

[294] Xiang and Buckley (n 287) 334.

[295] Kelly-Louw (n 5) 196.

[296] Marxen (n 10) 109. See further Kelly-Louw (n 5) 219; and Horowitz (n 262) 24.

[297] Hugo (n 13) *BRICS LJ* 15 par 2.3.

[298] (1985) 2 Lloyd's Rep 554 par 561 (my emphasis).

that there must be "no honest belief" in the validity of the demand for the fraud exception to apply has subsequently been followed in several English decisions.[299] In South African law, similarly, where a beneficiary dishonestly submits a claim under a guarantee in the knowledge that it is not entitled to payment, this may satisfy the requirements for the fraud exception. Theron JA in *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* held:

> "It is trite that where a beneficiary who makes a call on a guarantee does *so with knowledge that it is not entitled to payment,* our courts will step in to protect the bank and decline enforcement of the guarantee in question."[300]

The notion that the knowledge of the beneficiary to its lack of entitlement is a prerequisite of the fraud exception was also the approach adopted in *Scatec Solar SA 163 (Pty) Ltd and Another v Terrafix Suedafrika (Pty) Ltd.*[301] It is clear therefore that in the South African demand-guarantee environment, fraud is increasingly determined with reference to the knowledge of the beneficiary to its (dis)entitlement and not simply in relation to forgery or falsification of the documents.[302]

Two further developments concerning the fraud exception in South Africa are noteworthy. In the first place, the question has arisen in South African case law whether a demand under a guarantee can be defended on the basis of either an arbitration award[303] or a final payment certificate[304] showing that no money is owed to the beneficiary in accordance with the underlying contract. The question was finally determined by the Supreme Court of Appeal in the *Coface* case. The court held that such a defence was bad in law due to the independence principle – that is, that a defence based on a payment certificate issued in terms of the underlying contract, or an arbitral award relating to a dispute in the underlying contract is a defence that violates the independence principle. Although this stance has much merit where the guarantee was called up before the arbitral award or issuing of the payment certificate, the position is less clear if the award or certificate preceded the calling up of the guarantee – because in such a case the award or payment certificate may be strong evidence of

[299] See, for example, *Uzinterimpex JSC v Standard Bank plc* [2007] 2 Lloyd's Rep 187 para 107; and *National Infrastructure Development Co Ltd v Banco Santander SA* [2016] EWHC 2990 Comm par 11 *et seq*.

[300] (n 279) par 17 (my emphasis).

[301] [2014] (ZAWCHC) par 63. See also *Raubex Construction (Pty) Ltd v Bryte Insurance Company Ltd* (n 163) par 24.

[302] Marxen (n 10) 107.

[303] *Dormell Properties 282 CC v Renasa Insurance Co Ltd* 2011 1 SA 70 (SCA) par 22.

[304] *Coface* (n 13).

the demand being a dishonest one, a demand made by the beneficiary in the knowledge of the absence of material entitlement.[305]

Secondly, grossly disproportionate demands are to be dealt with pursuant to the principles of the fraud exception. This development emerges from the *Phenix* case in which the court, by relying on payment certificates indicating that a recoupment was due to the subcontractor and had not been paid, found that the beneficiary's demand for the full amount guaranteed was grossly disproportionate to the amount that it was actually entitled to and held that the beneficiary's demand was fraudulent.[306]

2.4.4 Other (potential) exceptions

2.4.4.1 Introductory remarks

The impact of public policy, however, is not limited to fraudulent conduct. Other defences to payment have been raised in South Africa and in other jurisdictions. For the purposes of this thesis, only the bad faith and illegality defences are considered below.[307]

2.4.4.2 Bad faith

Whether bad faith or unconscionable conduct by the beneficiary may provide a defence to payment is a question that has received considerable attention internationally. While unconscionability has been accepted as a valid basis for enjoining payment in some jurisdictions,[308] it has been rejected in others. There have been some dicta in South African

UNIVERSITY
OF
JOHANNESBURG

[305] Hugo (n 16) 666.

[306] (n 163) above. For a discussion on this case see Lupton "Demand guarantees in the construction industry: recent developments in the law relating to the fraud exception to the independence principle" 2019 *SA Merc* 399 404-408. For another case in which the fraud exception succeeded see *Group Five* (n 238).

[307] Other potential exceptions or defences that have been raised, such as the so-called negative stipulation defence (see, for example, *Joint Venture between Aveng* (*Africa*) (*Pty*) *Ltd and Strabag International GmbH v South African National Roads Agency SOC Ltd* 2021 2 SA 137 (SCA); and *SA National Roads Egency SOC Limited v Fountain Civil Engineering (Pty) Ltd (395/2020)* 2021 ZASCA 118 (20 Sep 2021)); prescription (*Investec Bank Ltd v Lombard Insurance* (n 149)); and the final determination of the underlying dispute (see, *inter alia*, *Dormell Properties 282 CC v Renasa Insurance Co Ltd* (n 303), *Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association* (n 279), and *Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd* (n 279)) are not dealt with in this thesis. For a recent comprehensive treatise on these and other potential exceptions and defences to payment see generally Marxen (n 10).

[308] Malaysia, Singapore and Australia have accepted unconscionability as an exception. Under Australian law, however, the unconscionability exception is based on a statute (the Trade Practices Act 51 of 1974). For an overview of the Malaysian, Singaporean and Australian law in this regard see Horowitz (n 262) 130–145 par 6.0 and 6.19 *et seq*.

cases, arising from the good-faith concept in the law of contract,[309] that seem to indicate the possibility of a bad faith exception.

Good faith in South Africa is a cornerstone principle of contract law. Parties in contractual negotiations must, in principle, negotiate in good faith.[310] The precise effect of good faith in South African contract law is, however, heavily debated. In *Brisley v Drotsky*[311] the court explained:

> "Regarding the role of good faith we agree in essence with the view of prof Hutchison in accordance with which good faith is not an independent, or 'free-floating', basis for the rescission or non-application of contractual terms. Good faith is a fundamental principle that underlies the law of contract in general and finds expression in specific rules and principles thereof. Or as he puts it:
>
> > 'What emerges quite clearly from recent academic writing and from some of the leading cases, is that good faith may be regarded as an ethical value or controlling principle based on community standards of decency and fairness that underlies and informs the substantive law of contract. It finds expression in various technical rules and doctrines, defines their form, content and field of application and provides them with a moral and theoretical foundation. Good faith thus has a creative, a controlling and a legitimating or explanatory function. It is not, however, the only value or principle that underlies the law of contract, not, perhaps, even the most important one.'" [312]

It is submitted that case law pointing towards the establishment of a bad faith or unconscionability exception must be contemplated in light of this development in South African contract law. In *Sulzer Pumps v Covec-Joint Venture,*[313] Jansen J referred to a possible unconscionability exception in relation to demand guarantees:

> "What the old authorities do demonstrate though, is that not only fraud may prohibit the calling up of a construction guarantee, but also unconscionable conduct ... the court holds it clear that when it is unconscionable to rely on the literal wording of a contract without reading such wording within the context of the background facts, the surrounding circumstances and the purpose of the agreement, then a construction guarantee cannot be called up."[314]

Regrettably, Jansen J did not provide any authority for her proposition. The judgment attracted further criticism from Kelly-Louw and Marxen, who argued that it was "not a well-reasoned

[309] Marxen (n 10) 173 par 5.6.2.

[310] Hutchison and Pretorius (eds) *The Law of Contract in South Africa* (2017) 27–28.

[311] 2002 4 SA 1 (SCA).

[312] 144–145 (as translated by Marxen and Hugo (n 281) 145). See further the cases of *Barkhuizen v Napier* 2007 5 SA 323 (CC) par 51; and *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (CC) par 71 (per Moseneke CJ) and par 22-23 (per Yacoob J); and *Beadica 231 CC and Others v Trustees, Oregon Trust and Others* 2020 (9) BCLR 1098 (CC) par 61-70 and par 72 *et seq* wherein the court gave guidance as to the development and substantive role of good faith in South African contract law.

[313] 2014 ZAGPPHC (2 September 2014).

[314] par 125.

judgment”,[315] since “the ‘unconscionable’ and ‘bad faith’ exceptions have not been dealt with or even raised as a possibility in the South African case law”.[316]

A more recent case dealing with this exception is *Bryte Insurance Company Ltd v Raubex Construction* (*Pty*) *Ltd.*[317] In this case the beneficiary called up the guarantee. In response, the guarantor instituted legal proceedings aimed at preventing payment of the guarantee, on the basis that the beneficiary’s demand was not *bona fide* in that it was not in conformity with clause 2(c)(ii) of the guarantee. Furthermore, the guarantor argued that “the lack of *bona fides* by [the beneficiary], in any event, constituted fraud and thus [the guarantor] had no obligation to comply with the demand”.[318] The court stated that regard must be had to the meaning of *bona fides* “before … decid[ing] whether the demand *in casu* complied with the terms”.[319] In doing so, the court applied the rules of interpretation as they apply to contracts in general in South Africa.[320] Ultimately the court concluded that the demand was made with knowledge that the estimate was not *bona fide*, thus rendering the demand fraudulent. On appeal to the Supreme Court of Appeal,[321] however, the court held that the demand was conforming and payment was accordingly to be made by the guarantor unless fraud could be established on the part of the beneficiary. After considering the arguments of fraud raised by the guarantor,[322] they were dismissed by the court, which stated that to successfully rely on fraud “[a] party has to go further and show that the representor advanced the contentions in bad faith, knowing them to be incorrect”.[323]

Despite the Supreme Court of Appeal not expressly stating so, the formulation of its finding suggests that bad faith can conceivably be dealt with under the wide approach to fraud. So viewed there would be no need for a bad faith exception to be recognised in South African

[315] Kelly-Louw and Marxen “General update on the law of demand guarantees and letters of credit” in Hugo (ed) *Annual Banking Law Update* (2015) 276 292.

[316] Kelly-Louw and Marxen (n 315) 293.

[317] unreported, case no. 13787/2015 (ZAGPJHC) 373 (8 December 2017). See Lupton (n 306) 410–415 for a full discussion on this case.

[318] par 6 (my emphasis).

[319] par 17.

[320] par 18. In this regard, the court cited Wallis JA in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 par 18.

[321] *Raubex Construction (Pty) Ltd v Bryte Insurance Company Ltd* (n 163) above.

[322] The arguments of fraud can be found at pars 9–23.

[323] par 24.

law. However, the growing list of decisions ostensibly in favour of a bad faith exception,[324] it is suggested, calls for clarity in this regard from the Supreme Court of Appeal – and such clarity was not provided in this case.[325]

2.4.4.3 Illegality

The question whether illegality of the underlying contract may serve as a basis to reject a claim for payment under a letter of credit or demand guarantee received attention in English law. The case of *Mahonia Ltd v JP Morgan Chase Bank*[326] is of particular interest in this regard. Here a standby letter of credit was used to secure a credit-swap (underlying) transaction. The underlying transaction was alleged to be in breach of United States (US) security laws and the General Accepted Accounting Practice (GAAP). During a summary judgment application the court, per Colman J, commented strongly in favour of recognising an illegality exception:

> "If a beneficiary should as a matter of public policy (ex turpi causa) be precluded from utilizing a letter of credit to benefit from his own fraud, it is hard to see why he should be permitted to use the courts to enforce part of an underlying transaction which would have been unenforceable on grounds of its illegality if no letter of credit had been involved, however serious the material illegality involved. To prevent him doing so in an appropriate serious case such as one involving international crime could hardly be seen as a threat to the lifeblood of international commerce."[327]

The trial court nevertheless found that illegality had not been sufficiently proven.[328] Despite this finding, commentators generally agree that this case supports the notion that illegality of the underlying contract may constitute a valid defence to payment in the English law of letters of credit and demand guarantees.[329]

A similar position was taken in the South African case of *Mattress House (Pty) Ltd t/a Mia Bella Interiors v Investec Property Fund Ltd.* The case concerned a demand guarantee in support of a lease agreement. The demand guarantee, procured in favour of Investec, was used to secure due compliance with the terms and conditions of the lease agreement. During the transaction a dispute between the parties arose in relation to compliance with applicable

UNIVERSITY OF JOHANNESBURG

---

[324] In addition to the *Sulzer Pumps* and *Bryte* cases discussed above, see Cloete JA's mention of "bad faith" in *Dormell* (n 303) 65.

[325] See in this regard Hugo (n 142) 452 with reference to the *exceptio doli generalis*.

[326] (n 145) above. See also *Group Josi Re v Walbrook Insurance Co Ltd & Others* [1996] 1 Lloyd's Rep 345 (CA) ([1996] 1 WLR 1152.

[327] 927 par 68.

[328] [2004] EWHC 1938.

[329] Bridge (n 55) 2057 par 23–083; Horowitz (n 262) 224 par 7.80; and Carr *International Trade Law* (2010) 478.

municipal zoning laws. From the judgment it is clear that the premises was required to be rezoned but had not been. Mattress House contended that at the time it entered into the lease agreement it was unaware that the premises required rezoning and that it was made to believe that the premise had been properly zoned.

On 28 September 2017 the High Court of South Africa (court *a quo*), per Opperman J, temporarily interdicted Investec from enforcing its rights in terms of the guarantee and from making any further demands in terms thereof, until such time as the main application was to be finalised. The matter later served before Siwendu J to determine whether final relief should be granted.

Mattress House argued, *inter alia*, that Investec's failure to comply with the municipal zoning laws served as evidence of the fact that the lease agreement was entered into for an illegal purpose, thereby providing a defence to payment. The court rejected this argument and refused to intervene in the payment of the guarantee. It held that the illegality relied on related to an alleged failure by Investec to comply with the municipal zoning laws. It added that correspondence furnished by the municipality indicated that the apparent contravention could be rectified by submission of the required site development plan, and that the contravention did not mean that the underlying contract and demand guarantee were entered into for criminal purposes or in furtherance of an unlawful purpose. The application was accordingly dismissed. The court, in the following obiter dictum, nevertheless seems to have recognised in principle that illegality may provide an exception to independence:

> "It seems to me that at the very least, to receive consideration, the illegality complained of can only be a valid defence where it extends to and directly affects the Guarantee. The Guarantee must have been entered into for a criminal purpose or in furtherance of an unlawful purpose. Even though I do not purport to set out a general principle, it is conceivable that there may be instances where the nature of the illegality complained of vitiates the Guarantee. An example would be where the issuing bank becomes aware of the transaction as part of a money laundering scheme or in the case of a breach of exchange control regulations. This is not such a case."[330]

Lupton and Kelly-Louw welcomed the judgment in relation to the illegality finding.[331] They suggest, moreover, that an illegality defence should be given narrow application and apply only in cases where the only reasonable inference to be drawn is that of illegality. The authors further recommend a set of minimum requirements for successful reliance on this defence, namely,

[330] *Mattress House* (n 149) par 30.

[331] Lupton and Kelly-Louw "Emergence of illegality in the underlying contract as an exception to the independence principle of demand guarantees" 2020 *Comparative and International Law Journal of Southern Africa* 1 27.

that the alleged illegality must (i) be clearly established, (ii) sufficiently serious, and (iii) directly affect or taint the guarantee.[332]

2.4.4.4 Conclusions

It is trite that the independence principle is a fundamental principle of letters of credit and demand guarantees. It is not, however, unassailable. Fraud has been conclusively recognised as an exception in South Africa, with the wide approach seemingly gaining ground. Furthermore, bad faith and illegality have emerged as potential defences to payment in the demand-guarantee environment. While illegality has been recognised as an exception in principle, bad faith has still not been clearly recognised. Overall, it would be fair to say that the independence principle is well protected by South African courts.

2.4.5 Documentary compliance

2.4.5.1 Introduction

Another fundamental principle of letters of credit and demand guarantees relates to "documentary compliance".[333] In terms of this principle if the documents conform to the requirements of the instrument, the bank is under an obligation to pay.[334] And if the documents do not conform, the bank is entitled to reject payment.

The requirement of conforming documents has received much attention from the South African courts in the last few years in the context of demand guarantees. From the case law at least two important questions emerge: To what extent should the documents comply with the letter of credit or demand guarantee? Against what standard is documentary compliance examined? The dominant standard for compliance, as emerges from case law and academic commentary, is strict compliance, in accordance with the so-called "doctrine of strict compliance".[335] However, what exactly "strict compliance" entails is not clear, since the courts have often handed down conflicting judgments in this regard. Moreover, the above questions have generally not been analysed sufficiently by the courts. There is, fortunately, a recent

---

[332] 30–31.

[333] Hugo (n 14) 414; Hugo (n 142) 455 par 10.4; and Mugasha (n 48) 23–24.

[334] See Van Niekerk and Schulze (n 118) 295 in this regard on letters of credit; and Kelly-Louw (n 153) 307 on demand guarantees.

[335] On this doctrine see in relation to letters of credit Oelofse (n 33) 288–290; Van Niekerk and Schulze (n 118) 300; Enonchong (n 7) 80–86; Adodo (n 55) 174; and Ellinger and Neo (n 37) 229. As regards demand guarantees see generally Kelly-Louw (n 153), Kelly-Louw (n 5) 49–72; Hugo (n 142) 455–458; and Marxen (n 10) 69–72. For case law see 2.4.3.3 below.

UNIVERSITY OF JOHANNESBURG

doctoral thesis[336] on the issue of conformity of demands presented under letters of credit and demand guarantees that is instructive and should be taken note of in this regard.

The purpose of this section is to set out the approaches to compliance as contemplated in the international rules and case law. Specific issues in South African law relating to conformity of demands will also be canvassed.

First, however, it is necessary to comment briefly on so-called non-documentary conditions. A non-documentary condition can be described as a requirement in a letter of credit or demand guarantee that does not refer to the presentation of a document. Non-documentary conditions are in principle unacceptable since they require of issuing banks and guarantors to establish facts outside of the documents. The effect of a non-documentary condition is that the bank or guarantor could be drawn into the underlying contract, which would necessarily infringe upon the independence principle.[337] International legal frameworks contain the so-called "disregard rule" in terms of which issuing banks and guarantors are required to disregard a non-documentary condition.[338] Of course, the disregard rule applies only in cases where the relevant set of rules has been expressly incorporated. Where this is not the case, issuers and guarantors will probably have to comply with the non-documentary condition, since an attempt to disregard an express term will mostly fail.[339] Non-documentary conditions lead to uncertainty and unpredictability particularly in relation to payment, and therefore should be avoided.[340]

UNIVERSITY
OF
JOHANNESBURG

2.4.5.2 International rules

In terms of article 14*(a)* of the UCP 600 banks must "examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation". Moreover, it requires banks to determine conformity

---

[336] Chivizhe *A Comparative Study of the Law and Practice Relating to the Compliance of Documents Calling for Payment under Letters of Credit and Demand Guarantees* (2021 thesis NWU).

[337] Kelly-Louw (n 5) 51.

[338] art 14(h) of the UCP 600; art 7 of the URDG 758; and rule 4.11 of the ISP98.

[339] This is in accordance with the maxim *pacta servanda sunt*, which requires that the provisions of a freely concluded agreement must be enforced. See Van Huyssteen *et al Contract: General Principles* (2020) 210. Note, however, the interesting development in English demand-guarantee law to the effect that compliance with the non-documentary condition should emerge from the written demand presented for payment. See, in this regard, *Lukoil Mid-East Ltd v Barclays Bank Plc* 2016 (EWHC) 166 (TCC). For an analysis in point see Chivizhe and Hugo "Non-documentary conditions in letters of credit and demand guarantees" in Hugo (ed) *Annual Banking Law Update* (2021) 1 13–15.

[340] Chivizhe and Hugo (n 339) 16.

"with reference to the terms and conditions of the credit, the applicable provisions of the UCP and international standard banking practice".[341] As referred to above,[342] the ICC issued the *International Standard Banking Practice*, or ISBP 745, as a "necessary companion"[343] to the UCP. While its status is uncertain, commentators generally agree that it comprises "international standard banking practice".[344]

It is not only the ISBP 745 that indicates departures from strict compliance,[345] so does the UCP 600. Article 14(d), for example, provides that "[d]ata in a document, when read in context with the credit, the document itself and international standard banking practice, *need not be identical to, but must not conflict with*, data in that document, any other stipulated document or the credit."[346]

The URDG 758,[347] ISP 98[348] and UNCITRAL Convention[349] all essentially align in relation to their approach to conformity of demands presented under demand guarantees. This is especially true in relation to the point that documents should be examined "on their face" and should conform to the requirements of the guarantee. While the term "strict compliance" is avoided, the provisions seem to give effect to this standard. The frameworks also indicate that compliance must be determined with reference to international practice. In this regard, the *International Standard Demand Guarantee Practice for URDG 758*, or ISDGP 814, states that the definition of "complying presentation" in the URDG 758 does not imply literal compliance in all cases.[350] Moreover, where the need to determine whether an examination accords with

UNIVERSITY
OF
JOHANNESBURG

[341] art 2.

[342] (n 3) above.

[343] See the introduction to the UCP 600.

[344] Malek and Quest (n 90) 174; and Chivizhe (n 336) 104.

[345] See, for instance, par A23 (of 2013 version), which relates to misspellings and typing errors. It provides: "A misspelling or typing error that does not affect the meaning a word or the sentence in which it occurs, does not make a document discrepant. For example, a description of the goods as 'mashine' instead of 'machine', 'fountan pen' instead of 'fountain pen' or 'modle' intead of 'model' would not be regarded as a conflict of data under UCP 600 sub-article 14(d). However, a description shown as, for example, 'model 123' instead of 'model 321' will be regarded as a conflict of data under that sub-article."

[346] my emphasis. See further arts 14*(e)* and 30.

[347] art 2 as read with art 19*(a)*.

[348] rule 4.01.

[349] art 16(1).

[350] par J141 of the ISDGP 814 (n 9).

international practice arises, official ICC Opinions and DOCDEX may prove useful in this regard.[351]

2.4.5.3 Case law

Within South African documentary credit practice, the doctrine of strict compliance was clearly recognised in *OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd*, when Nugent JA held:

> "A bank ... that establishes a letter of credit at the request and on the instructions of a customer thereby undertakes to pay a sum of money to the beneficiary against the presentation to the issuing bank of stipulated documents. ... The documents that are to be presented ... are stipulated by the customer and the issuing bank generally has no interest in their name or in their terms ... Its interest is confined to ensuring that the documents that are presented conform with its clients' instructions (as reflected in the letter of credit) in which event the issuing bank is obliged to pay the beneficiary. If the presented documents do not conform with the terms of the letter of credit the issuing bank is neither obliged nor entitled to pay the beneficiary without its customer's consent."[352]

Nugent JA went on to refer to the obligation of the issuing bank as expressed by the English court in *Midland Bank Ltd v Seymour*:[353]

> "There is, of course, no doubt that the bank has to comply strictly with the instructions that it is given by its customer. It is not for the bank to reason why. It is not for it to say: 'This, that or the other does not seem to us very much to matter.' It is not for it to say: 'What is on the bill of lading is just as good as what is in the letter of credit and means substantially the same thing.' All that is well established by authority. The bank must conform strictly to the instructions which it receives."[354]

The doctrine of strict compliance can generally be traced back to the English case of *Equitable Trust Company of New York v Dawson Partners Ltd*,[355] wherein Lord Sumner stated that "[t]here is no room for documents which are almost the same, or which will do just as well". Commenting on Lord Sumner's formulation, Parker J in *Banque de l'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd*,[356] however, took the following view:

> "I also accept … that Lord Sumner's statement cannot be taken as requiring rigid meticulous fulfilment of precise wording in all cases. *Some margin must and can be allowed*, but it is slight, and *banks will be at risk in most cases where there is less than strict compliance*. They may pay on a reasonable interpretation … where instructions are ambiguous, but where

[351] J141.

[352] (n 266) par 697G.

[353] (n 56) above.

[354] 698C.

[355] [1926] 27 LI L Rep 49 (HL) 52.

[356] [1983] 1 QB 711 (CA).

> instructions are clear they are obliged to see to it that the instructions are complied with and entitled to refused payment to the beneficiary unless they are."[357]

Although the dictum holds that there may be warranted instances where a lesser standard of compliance is required, it is submitted that it still endorses a strict standard of compliance. Put differently, the adoption of a lesser standard is the exception rather than the rule. Be that as it may, Lloyd LJ in *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran*[358] adopted a different view when he held that, due to the absence of the letter-of-credit number and name of the buyer on the documents in terms of it, "I cannot regard as trivial something which, whatever may be the reason, the credit specifically requires".[359] This is indeed language favouring strict compliance. What is apparent from letter-of-credit case law, however, is that there is a growing tension between strict compliance on the one hand and minor deviations from the requirements of the credit on the other.[360] Hugo's suggestion in this respect that presentee banks should in principle require exact compliance and, if necessary, seek a waiver from the buyer in respect of minor discrepancies[361] is probably sensible.

Against this background, it must be reiterated that South African courts regularly regard English case law as conclusive authority in the law of letters of credit.[362] Therefore, the development of this doctrine as set out in English law is strong authority in South Africa – an important fact bearing in mind the paucity of case law in South Africa.[363]

The extent to which the doctrine of strict compliance applies to demand guarantees, however, is rather controversial.[364] Bridge questions whether "the nature of the demand documents that may be expected to be required under an autonomous guarantee … may support an interpretation of a guarantee that affords the required documents a greater degree of latitude in achieving compliance".[365] Demand guarantees usually only require a written demand and perhaps a statement alleging breach on behalf of the applicant (in contrast to letters of credit

UNIVERSITY
OF
JOHANNESBURG

---

[357] 721E-G (my emphasis).

[358] [1993] 1 Lloyd's Rep 236 (CA).

[359] 240.

[360] For a concise discussion on this tension in English letter-of-credit case law, see Hugo (n 14) 416–418.

[361] Hugo (n 14) 420.

[362] See par 2.4.1 above.

[363] Hugo (n 14) 414.

[364] Chivizhe (n 336) 193.

[365] Bridge (n 55) 2228.

which typically require more documents). Moreover, the documents under a demand guarantee (as opposed to a letter of credit) do not hold commercial value.

Various South African courts have had the opportunity to deal with conformity of demands in relation to demand guarantees. In *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* the issue was whether the requirements in the guarantee in relation to the demand had been complied with. More particularly, whether the beneficiary's failure to attach a copy of the liquidation court order, as was required by the guarantee,[366] meant that the demand was non-conforming.[367] The High Court accepted that the demand was conforming, despite the beneficiary's failure to attach the court order to it. On appeal to the Supreme Court of Appeal (SCA), however, the court held that the requirements in the guarantee "were absolutely clear and there was in fact no compliance, let alone strict compliance".[368] The appeal was thus upheld with costs.

On the basis that the judgment required, *inter alia,* proper compliance with a clearly stipulated requirement in the guarantee, Hugo submits that despite the court's reluctance to say so, "the case has given impetus to the recognition of the doctrine of strict compliance in South Africa".[369] In *State Bank of India v Denel SOC Limited*,[370] it was held that a guarantor's obligation to pay is triggered only "where a demand meets the terms of the guarantee" and further that the determination of the documentary compliance "will turn on the interpretation of the guarantee".[371] These *dicta*, it is submitted, lean towards application of the doctrine of strict compliance to guarantees in South Africa.[372]

Other judgments, however, postulate a different standard: namely, substantial compliance. In *Lombard Insurance Co Ltd v Schoeman*[373] a demand guarantee was procured in terms of a facility agreement. Additional security was provided in the form of a counter-

UNIVERSITY OF JOHANNESBURG

[366] *Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd* (n 149) par 4.

[367] par 3.

[368] par 13.

[369] Hugo (n 142) 457.

[370] (n 151) above.

[371] Both statements can be found at par 9.

[372] In English demand-guarantee law, the question as to the standard of compliance has not been clearly settled. Enonchong (n 7) pars 4.52–4.57 and Kelly-Louw (n 5) 69 conclude that, despite earlier case law favouring a less strict standard, it would seem that the test today is strict. For this view the authors rely on *Maradive & Oil Services (SAE) v CAN Insurance Co Europe Ltd* [2002] EWCA Civ 369 par 10 and 51; and *Frank Maas (UK) Ltd v Habib Bank AG Zurich* [2001] Lloyd's Rep (banking) 14.

[373] *Lombard Insurance Co Ltd v Schoeman* 2018 (n 149). For a comprehensive discussion of this case see Hugo "Conformity of demands submitted under independent guarantees" 2018 *TSAR* 680–690.

indemnity to indemnify the guarantor against any claim against it arising from the guarantee, suretyships executed in favour of the guarantor securing the indemnifier's debt against the guarantor under the counter indemnity, and two other suretyships executed on behalf of a trust in favour of the guarantor.[374] Clause 1 of the guarantee stated that "[p]ayment shall be made under this guarantee upon receipt by the guarantor, at the above stated address, of the beneficiary's first written demand".[375] The only address appearing above clause 1 was the *beneficiary's* business address.[376] The parties subsequently entered into a dispute and the beneficiary called up the guarantee by presenting its demands to the *guarantor's* business address, where they were in fact received by the guarantor.[377] The guarantor examined the demands, found them to be "good and compliant", and duly honoured them.[378] After the indemnifier failed to pay the guarantor's claims in accordance with the counter-indemnity and the facility agreement respectively, the guarantor sought payment from the sureties pursuant to the suretyship agreements. The sureties' defence in this regard was that the demand made by the beneficiary amounted to a non-conforming demand, with the result that the indemnifier's obligation to pay in terms of the counter-indemnity was not triggered.[379]

The court, per Maier-Frawley AJ, dealt with the question whether anything is to be gained from attempts to determine the essential distinction between letters of credit and demand guarantees, "or whether 'strict' or 'substantial' compliance will suffice in the present matter".[380] Both questions were answered in the negative:

> "The issue to be determined is simply whether there was compliance with the terms of the guarantee under circumstances where the beneficiary's demands for payment were made to the guarantor at its address, rather than at the address of the beneficiary as stated in the Sasol guarantee. This is a matter of construction …"[381]

After considering whether the demand was conforming, Maier-Frawley AJ held that "*there was sufficient compliance with the terms of the [demand] guarantee*, given that the demand was made at one address rather than the other, under circumstances where such demand,

[374] See par 1, 2, 4, and 19.

[375] par 26.

[376] par 27.

[377] par 28.

[378] par 33.

[379] par 7. The other defence raised by the sureties related to the premium and guarantee fees. For the purposes of the present discussion, this defence is not dealt with. See Hugo (n 374) 683–684 in this respect.

[380] par 48.

[381] par 48.

wherever it occurred, was in fact presented to the correct party".[382] It is submitted that although the court expressly states that there is nothing to be gained from deciding whether "strict" or "substantial" compliance is to be applied to guarantees, its conclusion "that there was *sufficient* compliance with the terms of the guarantee" arguably favours substantial compliance. In other words, substantial compliance and sufficient compliance in this context can essentially be viewed as one and the same. On appeal the SCA, per Plasket AJA (Tshiqi, Swain, Mathopo and Makgoka JJA concurring), cited with approval from the judgment of the court a quo as follows:

> "I am in agreement with Maier-Frawley AJ in the court below that there is 'little to gain from attempts to divine the essential distinction between letters of credit, on the one hand, and demand guarantees, on the other': the real issue, which involves an interpretation of this particular demand guarantee, is 'simply whether there was compliance with the terms of the guarantee under circumstances where the beneficiary's demands for payment were made to the guarantor at its address, rather than at the address of the beneficiary'".[383]

After considering the purpose for the procurement of the demand guarantee,[384] the court found that the court a quo "correctly concluded that the demands had been properly presented, with the result that the guarantor's obligation to pay was effectively triggered".[385]

Substantial compliance was also expressed as the degree of compliance by the High Court, per Satchwell J, in the earlier case of *Group Five Construction (Pty) Ltd v MEC for Public Transport, Roads and Works Gauteng*.[386]

In addition to the above case law, South African courts have laid down clear principles concerning conformity of demands in at least two other decisions. The first case is *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Ltd.*[387] In this case, the provisions of the guarantee required the employer to attach a copy of the notice of cancellation to the written demand. The notice of cancellation was, however, delivered prior to the date the demand was presented. The question before the court, per Satchwell J, was therefore "whether or not 'prior' compliance rather than 'contemporaneous' compliance in the

[382] par 55 (my emphasis).

[383] *Schoeman v Lombard Insurance Co Ltd* 2019 (n 149) par 22.

[384] par 24–26.

[385] par 29.

[386] *Group Five Construction (Pty) Ltd v MEC for Public Transport, Roads and Works Gauteng* (n 238) par 25–26. Satchwell J, moreover, was hesitant to accept a demand that was unclear. At par 30 she explains: "Firstly, I note the extent of time and energy spent at the hearing of this application debating the content and meaning of this summons and particulars of claim. If the cancellation was easily apparent therefrom, this would not have been necessary. The particulars of claim hardly furnish a clear and unequivocal notice of cancellation."

[387] *Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Ltd* (n 149) above.

context of this particular matter means there has not been the required compliance with the [...] guarantee."[388] Before making her finding Satchwell J spent a significant amount of time distinguishing the case in casu from the *Compass Insurance* case. She held in this respect that

> "[i]n the present case, the notice of cancellation did exist. It was sent to the guarantor and received by the guarantor. Guarantor's attorneys were also copied on the correspondence arranging meetings to discuss this cancellation in May 2014. The existence of the cancellation and the reasons therefore were known to the guarantor at the time demand was made."[389]

In view of the above, she concluded:

> "[...] to find that failure to attach a written cancellation already received and under discussion, constitutes complete non-compliance with the terms of the guarantee and therefor disentitles the beneficiary [...] from proceeding with its demand under that guarantee is, I believe, a step too far. The reason requiring compliance with terms of the guarantee, especially as restated by the Supreme Court of Appeal in Compass supra, are carefully kept in mind in the present instance.
>
> Accordingly, I find that the prior presentation of the cancellation by applicant to respondent (and to respondent's attorneys) instead of contemporaneous presentation with the demand constitutes, in these circumstances, compliance with the guarantee."[390]

Accordingly, the court found that the demand submitted complied with the requirements of the guarantee despite the earlier presentation of the notice of cancellation.

The second case is *University of the Western Cape v Absa Insurance Company Ltd*.[391] The issue in this case was that the guarantee required a demand from the employer, whereas a demand was made by the employer's agent on its own letterhead. The court held that "[t]he issue is therefore whether performance by a representative can be regarded as strict compliance with the terms of the guarantee".[392] The court found that a demand can validly be made by means of representation or through agency where a principal agent acts on behalf of an employer.

2.4.5.4 Conclusions and analysis

From the research it is apparent that the case law on conformity of demands presented under letters of credit and demand guarantees is riddled with confusion, conflicting views, and uncertainty. Although the international rules discussed above somewhat align in approach and therefore can be said to promote uniformity in relation to the examination and conformity of

[388] par 25.

[389] par 34.

[390] par 38-39.

[391] *University of the Western Cape v Absa Insurance Company Ltd* (n 149) above.

[392] par 10.

documents, the rules relating to demand guarantees in particular do not enjoy strong usage in South Africa.

It is also particularly clear that the issue or doctrine of strict compliance is fraught with inconsistencies and uncertainty. Chivizhe submits that, in view of the "conflicting baggage" that these terms carry, the question as to the level of compliance of documents in relation to both letters of credit and demand guarantees is a "sterile debate that has no practical use."[393] He offers the following suggestion:

> "The proper approach is to acknowledge the importance of both letters of credit and guarantees, as lifeblood of commerce, and to recognise that for both of them to retain their strong security reputation a high level of conformity is required. On the other hand, too strict a standard, with a concomitant high number of rejections of demands and documents, is likely to stifle their use and usefulness. In determining the level of conformity required, the purpose of the instrument concerned must also be considered as part of a *purposive approach*."[394]

Further principles relating to conformity of demands can be drawn from the South African case law: firstly, the guarantor is entitled to reject the demand where the requirements of the guarantee are clear and have not been met (*Compass Insurance* case). Secondly, a demand presented to an address other than the address stipulated in the guarantee can be conforming, provided it is presented to the correct party (guarantor) and such presentation accords with the purpose of the guarantee (*Schoeman* case). Thirdly, the stipulated documents do not need to be delivered contemporaneously (*Kristabel Developments* case read with *Compass Insurance* case). Finally, a valid and conforming demand may be made by the agent of the beneficiary (*University of the Western Cape* case).

UNIVERSITY
OF
JOHANNESBURG

2.5 Conclusion

Letters of credit and demand guarantees are regularly encountered in trade and commercial transactions. These instruments are similar in many respects.[395] This is especially true regarding their documentary nature and the two fundamental principles upon which they are built – that is, independence and documentary compliance. Owing to public policy, exceptions to the independence principle have emerged in both demand-guarantee and letter-of-credit law. The best-established exception in this respect is fraud. Other defences to payment have also emerged (such as bad faith and illegality) but have not as yet been clearly recognised as exceptions in South African law. The independence principle cannot, however, function

[393] Chivizhe (n 336) 291.

[394] Chivizhe (n 336) 291.

[395] See par 2.4.1 above.

efficiently without the principle of documentary compliance. The research has shown that, although subject to inconsistencies and uncertainty in relation to the standard of compliance, documentary compliance is integral to the system of letters of credit and demand guarantees.

These principles have contributed to the value of credits and guarantees to international trade and commerce.

UNIVERSITY
OF
JOHANNESBURG

CHAPTER THREE: OVERVIEW OF TARGETED FINANCIAL SANCTIONS WITH PARTICULAR FOCUS ON THE LEGAL AND REGULATORY FRAMEWORKS WITHIN WHICH THEY OPERATE

3.1 General introduction

Sanctions have long enjoyed widespread use by international organisations and individual countries acting on their own. Sanctions are fundamentally intended to incentivise change.[1] Through the use of economic, trade or other restrictions or embargoes, this can mean "*coercing* a change in behaviour or policy; *constraining* proscribed activities; *signalling opposition* against a sanctioned target; or *stigmatising* them or others about the violation of an international norm".[2] Sanctions are a powerful weapon in the hands of their user. Their prevalence, moreover, has led to a decrease in traditional warfare, that is direct military action. Consequently, commentators have aptly described sanctions as a form of "lawfare".[3]

Not all sanctions regimes have, however, been successful in incentivising change. In this regard, the use of broad-based sanctions especially has been discouraged due to the fact that the impact of such sanctions often extends beyond targeted individuals or entities to civilian populations and the economies of neighbouring jurisdictions. To mitigate such consequences, targeted sanctions were developed. These measures are intended to target directly sanctioned persons and entities and not also other non-sanctioned persons and entities.[4] Targeted sanctions can entail financial restrictions, travel restrictions, trade restrictions and/or arms embargoes. These measures are routinely implemented as enforcement mechanisms by the United Nations (UN).[5]

Targeted *financial* sanctions are the focus of this thesis. The term "targeted financial sanctions" refers to "asset freezing and prohibitions to prevent funds or other assets from being made available, directly or indirectly, for the benefit of designated persons and entities".[6] In

---

[1] Spruyt "A legal analysis of the duty on banks to comply with targeted financial sanctions" 2020 *TSAR* 1 1.

[2] (n 1) above.

[3] See, *inter alia,* Dunlap "Lawfare today: a perspective" 2008 *Yale J Int'l Affairs* 146.

[4] Hersey "No universal target: distinguishing between terrorism and human rights violations in targeted sanctions regimes" 2013 *Brook J Int'l L* 1231 1241.

[5] Hersey (n 4) 1242.

[6] Financial Action Task Force (FATF) *Glossary of the FATF Recommendations*.

effect, targeted financial sanctions prevent the target from using its financial resources and assets, and from participating in trade and commerce.

This chapter aims to provide an overview of targeted financial sanctions, with a particular focus on the legal and regulatory frameworks within which these instruments operate. It begins by investigating the contribution of the UN, through resolutions of the Security Council, to the development of targeted sanctions. This is followed by an analysis of the legal and regulatory frameworks of the targeted financial sanctions regimes of the European Union (EU), United States of America (US), United Kingdom (UK) and South Africa. The sanctions regimes of the EU, US and UK are undoubtedly the most sophisticated and progressive in the world. These analyses will therefore serve as essential comparative background to the analysis of the South African targeted financial sanctions regulatory framework. Ultimately, this chapter, in conjunction with Chapter Two (*Introduction to letters of credit and demand guarantees*) and Chapter Four (*Key international organisations on targeted financial sanctions*), provides the background against which the broader question of the impact of targeted financial sanctions on letters of credit and demand guarantees is investigated in Chapter Five.

3.2 United Nations

3.2.1 Background

The UN is an international organisation tasked with the maintenance of international peace and security.[7] It currently consists of 193 member states, making it the largest inter-governmental organisation in the world.[8] In terms of the UN Charter, the UN is empowered to settle disputes relating to breaches of the peace "by peaceful means, and in conformity with the principles of justice and international law", and "to take effective collective measures for the prevention and removal of threats to the peace".[9] To give effect to this purpose, the UN has established various organs. These are, *inter alia*, the General Assembly, the Secretary-General and the Security Council.[10] The work of the UN Security Council (UNSC) is particularly important to this thesis.

UNIVERSITY
OF
JOHANNESBURG

---

[7] See the following general works on the UN: Higgins *The Development of International Law through the Political Organs of the United Nations* (1963); Simma (ed) *The Charter of the United Nations: A Commentary* (2002); Chesterman, Franck and Malone *Law and Practice of the United Nations* (2008); and Kolb *An Introduction to the Law of the United Nations* (2010).

[8] See https://www.un.org/en/about-us/member-states (accessed on 10 May 2020).

[9] Both quotes can be found in art 1(1) of the UN Charter.

[10] See https://www.britannica.com/topic/United-Nations/Principal-organs (accessed on 10 May 2020). The other organs are the Economic and Social Council, the Trusteeship Council and the International Court of Justice.

3.2.2 Security Council and the development of targeted sanctions

The work of the UNSC is central to the maintenance of international peace and security. The UNSC is in fact the organ that the UN Charter vests with the "primary responsibility for the maintenance of international peace and security".[11] While the General Assembly comprises all UN member states, the UNSC consists of fifteen UN member states. The US, the UK, France, the People's Republic of China, and Russia are the permanent members of the UNSC. Ten other UN members are elected by the General Assembly as non-permanent members. The election criteria for non-permanent members include efforts made by such UN members to maintain international peace and security and equitable geographical distribution.[12]

Chapter VII of the UN Charter provides the UNSC with the necessary authority to impose far-reaching measures in order to maintain or restore international peace and security.[13] Article 39 of the UN Charter provides as follows:

> "[T]he Security Council shall determine the existence of any threat to the peace, breach of the peace, or act of aggression and shall make recommendations, or decide what measures shall be taken in accordance with Articles 41 and 42, to maintain or restore international peace and security".

Article 41 enables the UNSC to implement measures that do not involve the use of armed force, including "complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations". The UNSC issues sanctions in accordance with article 41. Sanctions issued pursuant to article 41 may take different forms, the most noteworthy of which are "trade embargoes",[14] "financial restrictions"[15] and "diplomatic sanctions".[16] Measures adopted in article 42 of the UN Charter, on the other hand, may involve the use of force. Article 42 provides:

> "Should the Security Council consider that measures provided for in Article 41 would be inadequate or have proved to be inadequate, it may take such action by air, sea, or land forces as may be necessary to maintain or restore international peace and security."

[11] UN Charter art 24(1).

[12] art 23. In accordance with the criteria, the non-permanent members usually comprise five African and Asian countries, one Eastern European country, two Latin American countries, as well as two Western European countries and other countries.

[13] Eckert "The evolution and effectiveness of UN targeted sanctions" in Van Den Herik (ed) *Research Handbook on UN Sanctions and International Law* (2017) 52 52.

[14] for example, general or specific trade restrictions.

[15] These restrictions, as mentioned above, are the most important for the purposes of this thesis.

[16] which may entail severance or suspension of diplomatic relations.

It follows that measures adopted pursuant to Chapter VII may either be with or without force. The focus in this thesis is on the measures, particularly sanctions, that flow from article 41, namely those that do not entail using force. Article 25 of the UN Charter provides that these measures, which may take the form of UNSC resolutions, impose legal obligations on all UN member states. Some of these resolutions, which have informed the development of targeted sanctions, are dealt with immediately below.

Towards the end of the nineteenth century sanctions became known to the world.[17] It was, however, especially during the Cold War (1947 to 1991) that their use became synonymous with various international organisations.[18] This is, of course, especially true concerning the UN.[19] This can be ascribed to the fact that, in the wake of the Cold War, economic sanctions were perceived as more humane than military action.[20] History further reveals that since 1966, the UNSC has established 30 sanctions regimes.[21] Some of these sanctions have been fully lifted[22] or suspended, while others are still currently in force.

The sanctions imposed against Iraq are of particular interest for this study. Inasmuch as this precedent gave impetus to the re-evaluation of the UN's conventional sanctions regimes, it is perhaps customary in any discussion relating to the development of targeted sanctions to begin with a discussion of this sanctions regime. Triggered by the invasion of Kuwait by the military forces of Iraq, on 6 August 1990 the UNSC issued, in terms of Resolution 661 (1990), broad-based or comprehensive sanctions against Iraq.[23] These sanctions included measures broadly prohibiting transactions and other forms of financial arrangements with Iraq. Effectively, save for trade dealings relating to food and medicine, Iraq was economically isolated and prevented from participating in international trade and commerce. This period of the UN sanctions regime for Iraq extended from 1990 up to 1997 and brought with it enormous

UNIVERSITY OF JOHANNESBURG

---

[17] Davis and Engerman "Sanctions: neither war nor peace" 2003 *Journal of Economic Perspectives* 187 188. See further Hufbauer *et al Economic Sanctions Reconsidered* (2007) 9.

[18] Hersey (n 4) 1248.

[19] Giumelli "Understanding United Nations targeted sanctions: an empirical analysis" 2015 *International Affairs* 1351 1352.

[20] Joyner "United Nations sanctions after Iraq: looking back to see ahead" 2003 *Chicago Journal of International Law* 329 333.

[21] For a list of all the jurisdictions which have been or currently are subject to UN sanctions see https://www.un.org/securitycouncil/sanctions/information (accessed on 4 May 2020).

[22] For example, the sanctions imposed on South Africa were fully lifted after State President FW de Klerk took the decision to abandon apartheid in February 1990. See Dugard *International Law: A South African Perspective* (2012) 6.

[23] SC Res 661 (1990) 6 August 1990.

devastation on the general Iraqi population. In May 1996 the so-called Oil-for-Food Programme was introduced to the sanctions regime. This programme, which was implemented in April 1997, provided for the supervision by the UNSC of Iraq's importation of humanitarian goods and the facilitation of payment in respect of those imports. Payment was processed from an escrow account maintained by the UNSC containing funds generated from Iraqi oil. The Oil-for-Food Programme essentially prohibited the importation of ordinary goods that could conceivably be used for military purposes, so-called dual-use items.[24]

Throughout the 1990s, however, worldwide criticism mounted against the imposition of broad-based sanctions. The criticism can, with reference to the Iraqi sanctions regime, be separated into various categories. Firstly, not only was the Iraqi government affected by these restrictions, but also individuals and juristic entities within its jurisdiction.[25] Especially noteworthy in this regard was the negative effect that these sanctions had on Iraqi women and children.[26] Secondly, humanitarian efforts and initiatives were increasingly restricted.[27] Thirdly, the sanctions regime inflicted serious destruction on the economies of neighbouring jurisdictions. Finally, these measures "often conflicted with the UN's own development objectives".[28] UN Secretary-General Boutros-Ghali observed in this regard:

> "Sanctions, as is generally recognized, are a blunt instrument. They raise the ethical question of whether suffering inflicted on vulnerable groups in the target country is a legitimate means of exerting pressure on political leaders whose behaviour is unlikely to be affected by the plight of their subjects."[29]

For these reasons the UN was strongly motivated to re-evaluate its sanctions.

The re-evaluation sparked a fundamental shift in the UN's sanctions policy; restrictions were now contemplated with reference to the notion of "smart" or targeted sanctions. Targeted

UNIVERSITY OF JOHANNESBURG

[24] SC Res No 1051 UN Doc No S/RES/1051 (1996). See further on dual-use goods United Nations *Letter Dated 3 May 2002 from the Deputy Permanent Representative of the United States of America to the United Nations Addressed to the President of the Security Council* UN Doc No S/2002/515.

[25] Hufbauer and Oegg "Targeted sanctions: a policy alternative?" 2000 *Law and Policy in International Business* 11 12.

[26] It was reported that roughly 500 000 Iraqi children died because of the UN's sanctions against Iraq, more particularly the Oil-for-Food Programme. See Ali and Iqbal "Sanctions and childhood mortality in Iraq" 2000 *The Lancet* 1851–1857. See further Magnusson "Targeted sanctions and accountability of the United Nations Security Council" 2008 *ARIEL* 35 39–43.

[27] Mallard, Sabet and Sun "The humanitarian gap in the global sanctions regime" 2020 *Global Governance* 121 122.

[28] Spruyt (n 1) 3–4.

[29] Boutros-Ghali *Supplement to an Agenda for Peace* (1995) par 70.

sanctions, as indicated above,[30] are intended to apply only to sanctioned individuals and entities and not also to non-sanctioned persons and entities.

The imposition of targeted sanctions became more pronounced with the adoption of counter-terrorism measures in the wake of the 9/11 terrorist attack in 2001 in the US by the Al-Qaida terrorist organisation.[31] They are also increasingly used to combat the proliferation of weapons of mass destruction. Since 2001, the UN has established more targeted sanctions regimes than ever before.[32] Some of these targeted sanction regimes are discussed below.[33]

Targeted sanctions have emerged as a salient weapon used by the UN.[34] The ability to target individuals and entities directly has proved to be "highly effective".[35] Moreover, the targeted sanctions of the UN are versatile in scope and application. This versatility is demonstrated immediately below.

3.2.3 Scope and application of targeted sanctions

As referred to above, UNSC targeted sanctions are versatile instruments and typically encompass any of the following restrictions: financial restrictions, arms embargoes, and travel bans.

The UNSC has included targeted financial sanctions in all except one of its sanctions regimes.[36] Targeted financial sanctions may take two forms, namely, asset freezing and prohibitions. The asset freeze, firstly, is intended to "deny listed individuals, groups, undertakings and entities the means to support terrorism"[37] or weapon proliferation. "Listed" in this regard refers to being sanctioned for the purposes of the UN. The assets freeze thus

> "applies to all assets owned or controlled by listed individuals, groups, undertakings and entities. It also applies to the funds that derive from property that they own or control, directly

---

[30] See par 3.1 above.

[31] See, *inter alia*, Strydom "Counter-terrorism measures and human rights" in Maluwa, Du Plessis and Tladi (eds) *The Pursuit of a Brave New World: Essays in Honour of John Dugard* (2017) 395 395.

[32] See, for example, SC Res 1363 (2001) 30 July 2001; 1452 (2002) 20 December 2002; 1455 (2003) 17 January 2003; 1526 (2004) 30 January 2004; 1566 (2004) 8 October 2004; 1617 (2005) 29 July 2005; 1624 (2005) 14 September 2005; 1699 (2006) 8 August 2006; 1730 (2006) 19 December 2006; 1822 (2008) 30 June 2008; 1904 (2009) 17 December 2009; 1988 (2011) 17 June 201; 2082 (2012) 17 December 2012; 2160 (2014) 17 June 2014; 2253 (2015) 17 December 2015; and 2255 (2015) 21 December 2015.

[33] See par 3.2.3 below.

[34] Magnusson (n 26) 35–36.

[35] Spruyt (n 1) 4.

[36] Guinea-Bissau, established in accordance with SC Res 2048 (2012).

[37] SC Res 2161 (2014) par 1 *(a)*; and *United Nations Assets Freeze: Explanation of Terms* (2015) par 1–3, approved by the Al-Qaida Sanctions Committee on 24 February 2015.

> or indirectly, or that are owned or controlled by persons acting on their behalf or at their direction."[38]

Prohibitions in this context, secondly, refer to the obligation on member states to ensure that "no further funds, financial assets or economic resources of any kind may be made available to targeted persons for so long as they remain subject to the applicable measures."[39] "Economic resources" has been defined widely to include "assets of every kind, whether tangible or intangible, movable or immovable, actual or potential".[40]

Although targeted financial measures have emerged as a quintessential restriction used by the UN, arms embargoes and travel bans are two other restrictions available for use. *Arms embargoes* "prevent the direct or indirect supply, sale or transfer of all types of weapons and ammunition and related material to designated individuals and entities".[41] *Travel bans*, on the other hand, curtail the movement of listed individuals. This is done by preventing listed individuals entry into and transit through the territories of member states, regardless of the method or point of entry. Visas or travel permissions issued by the member state pursuant to its domestic laws do not constitute an exception in this regard.[42]

Targeted sanctions are currently implemented in 14 UN sanctions regimes.[43] The aim of these restrictions is to proscribe or limit targeted individuals or entities by requiring member states to take necessary action as contemplated in UNSC resolutions. Although targeted sanctions have been employed by the UNSC for various purposes,[44] they are prolific in the context of the combating and financing of terrorism (and counter-terrorism regimes), as well as the non-proliferation of weapons of mass destruction. Bearing in mind that it is the mission of the UNSC to maintain *international* peace,[45] and the significant impact that terrorism and the proliferation of weapons of mass destruction may have on the international community, this development appears to be apposite. Furthermore, the UNSC resolutions giving effect to targeted sanctions are akin to legislative measures in that they are formulated strictly and

UNIVERSITY OF JOHANNESBURG

---

[38] par 3. See further par 17 for a detailed description of "funds and other financial assets".

[39] par 2.

[40] par 18.

[41] SC Res 1390 (2002) par 2; and United Nations *Arms Embargoes: Explanation of Terms* (2015) par 18, approved by the Al-Qaida Sanctions Committee on 24 February 2015.

[42] SC Res 2161 (2014) par 1*(b)*; and United Nations *Travel Bans: Explanation of Terms* (2015) par 1-3, approved by the Al-Qaida Sanctions Committee on 24 February 2015.

[43] See https://www.un.org/securitycouncil/sanctions/information (accessed on 15 June 2020).

[44] See https://www.un.org/securitycouncil/sanctions/information (accessed on 15 June 2020).

[45] See par 3.2.1 above.

comprehensively. This approach is aimed at ensuring the effective implementation of targeted sanctions and the concomitant mechanisms by member states. Against this background, the combating and financing of terrorism and non-proliferation are considered immediately below.

The combating and financing of terrorism

The first endorsement of targeted sanctions in this context emerged from UNSC Resolution 1267 (1999) on 15 October 1999. In terms of this resolution, targeted financial sanctions and a limited air embargo were imposed against the Taliban in Afghanistan in response to its provision of sanctuary and training for international terrorists and terrorism-related activities, most notably its harbouring of Osama bin Laden (bin Laden) and his associates following the bombings of the US embassies in Nairobi and Dar es Salaam in 1998. The targeted financial sanctions required of UN member states to freeze funds and other assets (such as funds originating from property owned or controlled by the Taliban, or by any undertaking owned or controlled by the Taliban) as designated by a committee established under UNSC Resolution 1267 (the 1267 Committee), as well as to ensure that such funds are not available for use or benefit by the Taliban.[46] By the early 2000s, UNSC Resolution 1267 was further reinforced and expanded by the adoption of additional measures against bin Laden and his associates, as well as against individuals and entities associated with the Al-Qaida terrorist organisation. These additional measures, which are similar to the sanctions imposed in terms of resolution 1267, are encapsulated in UNSC Resolutions 1333 (2000) of 19 December 2000, 1373 (2001) of 28 September 2001, and 1390 (2002) of 16 January 2002.

While these additional measures, in essence, provide for the continuing application of the sanctions imposed in resolution 1267, targeted sanctions under resolution 1373 (2001) particularly may be implemented on a wider basis than resolution 1267 (1999) in that (i) association with Al Qaida, the Taliban or ISIL (Da'esh) is not necessarily a prerequisite under this regime;[47] and (ii) individuals or groups may be designated not only to prevent acts of terrorism, but also to prevent the financing of such acts.[48]

Unfortunately, the targeted sanctions regime imposed against Al Qaida is not entirely consistent with human rights norms and considerations. Much of the criticism levelled against

[46] SC Res 1267 (1999) 15 October 1999 par 4(b).

[47] Spruyt (n 1) 6.

[48] Png "International legal sources II – the United Nations Security Council resolutions" in Blair, Brent and Grant (eds) *Banks and Financial Crime: The International Law of Tainted Money* (2017) 35 par 3.06.

the sanctions regime in this regard directs attention to the accountability gap in the designation process, the absence of equitable processes relating to the inclusion and removal of individuals and entities from sanctions lists, as well as a procedure for enabling humanitarian exceptions.[49] One of the most interesting precedents in point is the *Kadi* case[50] in which the European Court of Justice held that a failure to afford a designated individual (for the purposes of asset freezes and prohibitions) an opportunity to present his/her case to the competent authorities constitutes an unjustified restriction of such a person's right to property.[51] The *Kadi* case serves as an ongoing reminder of the need to balance UN objectives with human rights norms and considerations.

Targeted sanctions are not only applied in relation to acts of terrorism and the financing thereof, but also as counter-terrorism measures. In this context, the application of targeted sanctions is not narrowly construed as restricting only the economic activity of terrorist organisations. Instead, the FATF[52] recognises additional benefits derived from such an imposition:

> "[D]eterring non-designated parties who might otherwise be willing to finance terrorist activity; exposing terrorist financing 'money trails' that may generate leads to previously unknown terrorist cells and financiers; dismantling terrorist financing networks by encouraging designated persons or entities to disassociate themselves from terrorist activity and renounce their affiliation with terrorist groups; terminating terrorist cash flows by shutting down the pipelines used to move terrorist related funds or other assets; forcing terrorists to use more costly and higher risk means of financing their activities, which makes them more susceptible to detection and disruption; and fostering international cooperation and compliance with UNSC obligations."[53]

UNIVERSITY OF JOHANNESBURG

So viewed, the counter-terrorism context lends itself to a significantly wider scope for targeted financial sanctions to be employed.

---

[49] See generally Strydom (n 31); Fassbender *Targeted Sanctions and Due Process: the Responsibility of the UN Security Council to Ensure that Fair and Clear Procedures are Made Available to Individuals and Entities Targeted With Sanctions Under Chapter VII of the UN Charter* (20 March 2006) www.un.org/law/counsel/Fassbender_study.pdf (accessed on 23 June 2022); and Cameron "UN targeted sanctions, legal safeguards and the European Convention on human rights" 2003 *Nordic Journal of International Law* 159 *et seq*.

[50] Joined Cases C–402/05P and C–415/05P, Yassin Abdullah *Kadi and Al Barakaat International Foundation v Council of the European Union and Commission of the European Communities* [2008] ECR I–06351. For a good case discussion see Eden "United nations targeted sanctions, human rights and the Office of the Ombudsperson" in Happold and Eden (eds) *Economic Sanctions and International Law* (2016) 135 139–145.

[51] par 364–372.

[52] The FATF is an intergovernmental body that focuses on combating money laundering, terrorist financing and the proliferation of weapons of mass destruction. For a discussion on the FATF, see par 4.2 below.

[53] FATF *International Best Practices: Targeted Financial Sanctions Related to Terrorism and Terrorist Financing (Recommendation 6)* (2013) par 4.

Non-proliferation

The proliferation of weapons of mass destruction can be described as "an attempt to develop, acquire, manufacture, possess, transport, transfer or use nuclear, chemical or biological weapons and their means of delivery, in particular for terrorist purposes".[54] A two-fold approach has been adopted to prevent and detect proliferation activities.[55] Firstly, SC resolution 1540 (2004) broadly prohibits states from "providing any form of support to non-State actors" that are involved in proliferation activities. Proliferation financing in turn is defined as the act of

> "providing funds or financial services which are used, in whole or in part, for the manufacture, acquisition, possession, development, export, transhipment, brokering, transport, transfer, stockpiling or use of nuclear, chemical or biological weapons and their means of delivery and related materials (including both technologies and dual-use goods used for nonlegitimate purposes), in contravention of national laws or, where applicable, international obligations".[56]

Spruyt terms this first approach the "global approach".[57] Secondly, SC resolutions 1718 (2006) and 2231 (2015) call upon all member states to give effect to non-proliferation measures in their respective domestic laws. This "country-specific"[58] approach is currently employed against the Islamic Republic of Iran (Iran) and the Democratic People's Republic of Korea (North Korea).

The restrictive measures imposed in the proliferation context may generally relate to one of two categories. In the first place, restrictions may be imposed on *activities* that facilitate proliferation efforts. Trade embargoes are routinely used in this regard.[59] Secondly, financial restrictions (that is, targeted financial sanctions) are imposed against a *target* which raises suspicion or concern for the purposes of the UNSC. These measures impose of member states the obligation to freeze the funds and economic resources of such persons or entities and also to ensure that the funds and economic resources are not made available to the target.

UNIVERSITY OF JOHANNESBURG

---

[54]See https://www.un.org/disarmament/wmd/sc1540/ (accessed on 15 June 2020).

[55] Spruyt (n 1) 6.

[56] FATF *Combating Proliferation Financing: A Status Report on Policy Development and Consultation* (2010) 11.

[57] Spruyt (n 1) 6.

[58] Spruyt (n 1) 6.

[59] In this respect, SC resolution 1540 (2004) requires member states to enact "appropriate laws and regulations to control export, transit, transshipment and reexport and controls on providing funds and services related to such export and transshipment such as financing".

Finally, although the proliferation of weapons of mass destruction appears, mostly, to be closely linked to terrorism, it may emerge against the background of any conceivable context.[60]

3.2.4 Conclusions

The above research indicates that the UN, and the UNSC in particular, has been instrumental in the development of targeted financial sanctions. These measures have proven to be highly effective in the face of reprehensible behaviour on the part of targets. This is especially true of individuals, entities or organisations involved in the facilitation of terrorism and proliferation activities.

The following sections examine the legal and regulatory targeted financial sanctions enforcement frameworks of the EU, the US, the UK and South Africa.

3.3 European Union

3.3.1 General

Although arguably the most important and impactful supranational jurisdiction in the world, the precise legal nature of the EU is unclear.[61] In terms of public international law it can be regarded as an international (intergovernmental) organisation.[62] Yet, its supranational powers and the fact that member states have transferred (rather than delegated) competence to it over specific matters[63] renders it peculiar in this regard. The EU, on the other hand, regards itself as an "*ordre juridique proper*",[64] thereby constituting an independent legal system with its own

UNIVERSITY
OF
JOHANNESBURG

---

[60] See https://www.un.org/disarmament/wmd/sc1540/ (accessed on 20 June 2020).

[61] Peročević "European Union legal nature: EU as *sui generis* – a platypus-like society" 2017 *Journal for the International and European Law, Economics and Market Integrations* 101 102.

[62] See, for instance, the International Law Commission in its Articles on the Responsibility of International Organisations (Draft Articles on the Responsibility of International Obligations, art 2(a), UN DOC A/66/10 (2011) par 87) which defines an "international organization" as "an organization established by a treaty or other instrument governed by international law and possessing its own international legal personality". In this regard the Lisbon Treaty expressly states that the EU possesses "legal personality" and the "legal capacity to conclude contracts with third countries or international organizations" (see Consolidated version of the Treaty on the Functioning of the European Union, (OJ C 326, 26/10/2012) art 3, read with declaration 24 ("Declaration concerning the legal personality of the European Union").

[63] See, for example, UN Convention on the Law of the Sea, which provides in Annex IX, art 1:

> "For the purposes of article 305 and of this Annex, 'international organization' means an intergovernmental organization constituted by States to which its member States have transferred competence over matters governed by this Convention, including the competence to enter into treaties in respect of those matters.
>
> The only such international organization to have become a party to the UN Convention on the Law of the Sea is the EU […]."

[64] *Costa v ENEL* [1964] ECR 585 593.

unique characteristics. This is to say that its legal order is not framed with reference to international law, nor does it constitute a municipal legal order. Indeed, the EU has escaped precise legal classification. Legal scholars have resorted to describing its legal nature as "*sui generis*".[65] It is nevertheless clear from the perspective of EU member states that EU actions constitute an international source of obligations for member states, typically with direct effect in members states' domestic legal order.

This is particularly true of the sanctions implemented by the EU. Today, the legal basis upon which the EU adopts restrictive measures against third-party states and non-state individuals and entities emerges in relation to the Lisbon Treaty, which comprises amendments of two treaties that form the constitutional basis of the EU, that is, the *Treaty on European Union* (TEU) and the *Treaty Establishing the European Community* (TEC), which has been renamed the *Treaty on the Functioning of the European Union* (TFEU).[66] Articles 75 and 215 of TFEU (as amended by the Lisbon Treaty) are especially relevant in this regard. Article 215 provides:

> "1. Where a decision, adopted in accordance with Chapter 2 of Title V of the Treaty on European Union, provides for the interruption or reduction, in part or completely, of economic and financial relations with one or more third countries, the Council, acting by a qualified majority on a joint proposal from the High Representative of the Union for Foreign Affairs and Security Policy and the Commission, shall adopt the necessary measures. It shall inform the European Parliament thereof.
> 2. Where a decision adopted in accordance with Chapter 2 of the Title V of the Treaty on European Union so provides, the Council may adopt restrictive measures under the procedure referred to in paragraph 1 against natural or legal persons and groups or non-State entities.
> 3. The acts referred to in the Article shall include necessary provisions on legal safeguards."

UNIVERSITY OF JOHANNESBURG

Article 75 provides:

> "Where necessary to achieve the objectives set out in Article 67, as regards preventing and combating terrorism and related activities, the European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall define a framework for administrative measures with regard to capital movements and payments, such as the freezing of funds, financial assets or economic gains belonging to, or owned or held by, natural or legal persons, groups or non-State entities.
> The Council, on proposal from the Commission, shall adopt measures to implement the framework referred to in the first paragraph.
> The acts referred to in this Article shall include necessary provisions on legal safeguards."

The EU therefore has been given the authority to implement restrictive financial measures against "natural or legal persons, groups or non-state entities." Prior to the Lisbon Treaty, to

[65] See, for instance, Hlavac "Less than a state, more than an international organization: the sui generis nature of the European Union" 2010 *Georgetown Public Policy Institute* 1 3; and Peročević (n 61) 114.

[66] The Treaty of Lisbon was signed by EU member states on 13 December 2007 and entered into force on 1 December 2009.

give effect to such restrictive measures, or targeted financial sanctions, the EU would adopt a Common *Position* within the framework of Common Foreign and Security Policy (CFSP) in accordance with (former) article 15 of TEU, which it would then proceed to implement by way of regulation.[67] These regulations were directly applicable in the domestic legal order of EU member states.[68] Today, post-Lisbon, targeted financial sanctions are imposed by way of CFSP *Decisions*, pursuant to Chapter 2 of Title V of TEU,[69] which are then implemented by means of regulation. This legal basis to impose sanctions extends, it seems, both to instances where the EU implements UN sanctions and where it implements unilateral sanctions. The targeted financial sanctions of the EU are considered below against the background of this categorisation.

3.3.2 Implementation of UN and unilateral EU sanctions

The EU, in the first place, implements UN sanctions. Although it is not a member of the UN and consequently not bound by UNSC resolutions, the EU has opted to interpose itself between the UN and its member states (all of which are members states of the UN) with respect to, *inter alia*, terrorist sanctions regimes. The EU has taken the view that action on its part is necessary in the implementation of UNSC resolutions by EU member states. To this end, several CFSP Positions[70] (prior to the Lisbon Treaty) and Decisions[71] (post the Lisbon Treaty) were taken and subsequently given effect to by way of regulation in terms of which the EU implemented UNSC resolutions. The important regulations in this regard are Council Regulation (EC) 881/2002[72] (as amended by Council Regulation 561/2003),[73] which implements the sanctions against bin Laden, Al-Qaeda, and the Taliban in UNSC Resolution 1267, and Council Regulation (EC) 2580/2001[74] (as amended by, *inter alia*, Commission Implementing

UNIVERSITY OF JOHANNESBURG

---

[67] The competence of the EU to do so was found in arts 60 and 301 of the TEC.

[68] In this regard, art 288 of the TFEU reads as follows: “A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.”

[69] art 29.

[70] Council Common Position of 15 November 1999, concerning Restrictive Measures against the Taliban (1999/727/CFSP) 1999 OJ L294/1; Council Common Position of 27 December 2001 on the Application of Specific Measures to Combat Terrorism (2001/931/CFSP) [2001] OJ L344/93; and Council Common Position of 27 December 2001 on the Application of Specific Measures to Combat Terrorism (2001/930/CFSP) [2001] OJ L344/90.

[71] Council Decision (SFSP) 2016/368 [2016] OJ L68/17.

[72] [2002] OJ L139/9.

[73] [2003] OJ L82/1.

[74] [2001] OJ L344/70.

Regulation (EU) 646/2013),[75] which implements the counter-terrorist sanctions regime in UNSC Resolution 1373. These regulations were immediately applicable in the domestic legal order of EU member states and directly binding upon on all natural persons and legal entities within member states.

Implementing UNSC Resolution 1267 and the resolutions that followed,[76] Council Regulation 881/2002 imposes substantive asset-freezing obligations in relation to individuals and entities contemplated by UNSC Resolution 1267. In this regard, an Annex to the EU regulation reproduces the 1267/1989/2253 Consolidated List of Individuals and Entities designated by the relevant UN Sanctions Committee and is regularly updated by the EU Commission by way of regulation to reflect any changes made to the UNSC list.[77] Council Regulation 2580/2001, on the other hand, does not contain an Annex of this nature. This is because the UNSC does not itself designate targets in respect of UNSC Resolution 1373 but places the onus on member states to identify targets for the purposes of this resolution. Accordingly, the EU Council has established a list of designated targets for the purposes of resolution 1373 which is regularly reviewed and amended.[78] It is noteworthy that article 2(2) of the Council Regulation specifically prohibits financial institutions from providing financial services to individuals, legal entities and groups included in the list.

Secondly, as indicated above, the EU implements unilateral sanctions.[79] The legality of unilateral sanctions in general is an issue that is not settled in international law. A detailed analysis of this issue falls outside the scope of this thesis.[80] A basic overview is nevertheless apposite. There are essentially two schools of thought. The first argues that unilateral sanctions are unlawful under international law since the UN Charter assigns the power to impose sanctions under article 41 exclusively to the UNSC. The implication is therefore that sanctions are not to be administered unilaterally by individual states. The second contends that although express authority is given to the UNSC, the UN Charter does not prohibit individual states from

UNIVERSITY OF JOHANNESBURG

[75] [2013] OJ L187/4.

[76] for example, SC Res 1333 (2000) of 19 December 2000; and 1390 (2002) of 16 January 2002.

[77] Council Regulation (EC) 881/2002 art 7.

[78] Council Regulation (EC) 2580/2001 art 2(3). On the binding nature of EU regulations post the Lisbon Treaty see Council Implementing Regulation (EC) 2016/20 [2016] OJ L106/1.

[79] also referred to as "unilateral coercive measures".

[80] See Mohamad "Unilateral sanctions in international law: a quest for legality" in Marossi and Bassett (eds) *Economic Sanctions under International Law: Unilateralism, Multilateralism, Legitimacy, and Consequences* (2015) 71 *et seq*; and Nakanishi "The construction of the sanctions regime against Iran: political dimensions of unilateralism" in Marossi and Bassett (eds) *Economic Sanctions under International Law: Unilateralism, Multilateralism, Legitimacy, and Consequences* (2015) 23 *et seq*.

imposing sanctions unilaterally. Moreover, that the unilateral employment of sanctions is a well-established practice which to date has not been prohibited by any binding rule or obligation of international law. On the basis of this argument, therefore, unilateral sanctions can hardly be regarded as unlawful. It is suggested that the view of the second school of thought is supported by strong logic and is also the view accepted in this thesis.

The consistency of unilateral sanctions is another contentious issue in international law jurisprudence. Consistency of unilateral sanctions means that where two or more states are similarly in breach of an international norm they should be sanctioned in the same manner and not treated discriminately. The essential question is whether there are limits in practice to comply with such a requirement.[81]

For the purposes of EU unilateral sanctions, a distinction can be made between those sanctions which (i) add to existing UN sanctions regimes, and those which (ii) operate without an underlying UN sanctions regime, thus independently of the UN. The best example of the former concerns the sanctions regime against Iran. As discussed above,[82] the UNSC has imposed sanctions on Iran due to its activity relating to proliferation of weapons of mass destruction. This requires of UN members states to, *inter alia*, target designated individuals and entities with asset freezes. Not only has the EU implemented the relevant UN sanctions,[83] but it has gone further by, for example, targeting individuals and entities not designated by the relevant UNSC sanctions committee.[84] In this way the EU supplemented the UN sanctions regime against Iran by imposing asset freezes on individuals and entities it was not strictly required to sanction under the UN regime. As the UN tightened and adjusted its sanctions regime on Iran,[85] the EU continued to implement the UN sanctions regime as well as adding to it.[86] This continued until 20 July 2015, when UNSC Resolution 2231 (2015) was adopted. In terms of this resolution all UN sanctions against Iran were lifted for as long as the conditions

UNIVERSITY OF JOHANNESBURG

---

[81] A detailed discussion of this issue falls outside the scope of this thesis. See in this regard Moret "Unilateral and extraterritorial sanctions in crisis: implications of their rising use and misuse in contemporary world politics in Beaucillion (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 19 19-36.

[82] par 3.2.3 above ("Non-proliferation").

[83] See Common Position 2007/140/CFSP art 5(1)(a) and Council Regulation (EC) 423/2007 Annex IV.

[84] See Common Position 2007/140/CFSP art 5(1)(b) and Council Regulation (EC) 423/2007 Annex V.

[85] See, for instance, UNSC Res 1929 (2010).

[86] See, for example, Council Regulation 2010/413/CFSP.

under the snapback provision in the resolution were not met – in other words, if the conditions were met, the sanctions regime against Iran would be revived.[87]

A good example of the latter is provided by the EU sanctions regime against Russia as a consequence of its use of force in relation to, and recent invasion of, Ukraine. The EU has progressively taken action against Russia in this regard since 2014. Its actions, however, are without the backing of a UN sanctions regime;[88] hence, sanctions emanating from these EU regimes are completely autonomous. In the first place, the EU requires of its member states to implement asset freezes pursuant to Council Decision 2014/145/CFSP,[89] as amended,[90] which is given effect to by Council Regulation (EU) 269/2014,[91] as amended,[92] targeting individuals, entities and bodies "supporting, materially or financially, actions which undermine or threaten the territorial integrity, sovereignty and independence of Ukraine".[93] Secondly, it has imposed on its member states an obligation not to export arms and related material to Russia in accordance with Council Decision 2014/512/CFSP,[94] as amended,[95] and implemented by

---

[87] UNSC Res 2231 (2015) par 7 *et seq*. This resolution was adopted in light of the Joint Comprehensive Plan of Action of 14 July 2015 concluded between Iran, the EU and several other non-EU jurisdictions relating to Iran's nuclear programme, also referred to as the "Iran Nuclear Deal". In fact, the UNSC resolution referred to in this footnote endorsed the Iran Nuclear Deal.

[88] since it would be almost impossible for the UNSC to impose sanctions against Russia as a permanent member of the UNSC.

[89] of 17 March 2014 "concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine" [2014] OJ L78/16.

[90] See, for example, Council Decision (CFSP) 2022/265 of 23 February 2022 amending Decision 2014/145/CFSP "concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine".

[91] of 17 March 2014 "concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine" [2014] OJ L78/6.

[92] See, for example, Council Regulation (EU) 2022/259 of 23 February 2022 amending Regulation (EU) No 269/2014 "concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine".

[93] art 3(1).

[94] of July 2014 "concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine" [2014] OJ L229/13.

[95] See Council Decision (CFSP) 2022/264 of 23 February 2022 amending Decision 2014/512/CFSP "concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine". *Article 1aa* of this council decision goes even further and reads as follows:

"1. It shall be prohibited to directly or indirectly engage in any transaction with:

(a) a legal person, entity or body established in Russia, which is publically controlled or with over 50 % public ownership or in which Russia, its Government or the Russian Central Bank has the right to participate in profits or with which Russia, its Government or the Russian Central Bank has other substantial economic relationship, as listed in Annex X;

(b) a legal person, entity or body established outside the Union whose proprietary rights are directly or indirectly owned for more than 50 % by an entity listed in Annex X; or

UNIVERSITY OF JOHANNESBURG

Council Regulation (EU) 833/2014,[96] as amended.[97] The export ban is aimed at preventing Russia's accumulation of, *inter alia*, weapons and military equipment in order to de-escalate the Russia–Ukraine situation.

Since EU sanctions (both UN-mandated and unilateral) are not intended to be punitive and do not have an economic agenda,[98] but are instead aimed at coercing "a change in policy or activity by the targeted country, part of country, government, entities or individuals, in line with the objectives set out in the CFSP Council Decision",[99] many commentators support the view that they conform to the general notion of countermeasures for breach of *erga omnes* norms in international law.[100] "Countermeasures" have been observed by the UN International Law Commission as

> "measures that would otherwise be contrary to the international obligations of an injured State vis-à-vis the responsible State, if they were not taken by the former in response to an internationally wrongful act by the latter in order to procure cessation and reparation. Countermeasures are a feature of a decentralized system by which injured States may seek to vindicate their rights and to restore the legal relationship with the responsible State which has been ruptured by the internationally wrongful act."[101]

So viewed, sanctions, as countermeasures, are aimed at pressuring the compliance of a state responsible for a breach of an international obligation with the secondary obligations of cessation of the wrongful act, provision of assurances of non-repetition and ultimately reparation.[102]

(c) a legal person, entity or body acting on behalf or at the direction of an entity referred to in point (a) or (b) of this paragraph."

UNIVERSITY
OF
JOHANNESBURG

[96] of 31 July 2014 "concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine" [2014] OJ L229/1.

[97] See, for instance, Council Regulation (EU) 2022/259 of 23 February 2022 amending Regulation (EU) No 269/2014 "concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine".

[98] Council of the European Union "Guidelines on implementation and evaluation of restrictive measures (sanctions) in the framework of the EU Common Foreign and Security Policy" of 15 June 2012 https://data.consilium.europa.eu/doc/document/ST-5664-2018-INIT/en/pdf par 5 (accessed on 14 May 2022).

[99] par 4.

[100] See generally, for example, Dawidowics "Public law enforcement without public law safeguards? an analysis of state practice on third-party countermeasures and their relationship to the UN Security Council" 2007 *British Yrbk Int'l L* 333; and Tams *Enforcing Obligations Erga Omnes in International Law* (2005).

[101] Report of the International Law Commission on the work of its Fifty-Third Session (23 April-1 June-10 August 2001) UN Doc A/56/10 reproduced in (2001) II(2) *Ybk ILC* 128.

[102] art 49 of Articles on the Responsibility of States for Internationally Wrongful Act. For commentary on this specific issue, see, generally, Tzanakopoulos "Sanctions imposed unilaterally by the European Union: implications for the European Union's responsibility" in Marossi and Bassett (eds) *Economic Sanctions and International Law* (2015) 145–161.

While the EU is not a member of the UN, the enforcement of UN sanctions by countries that are both member states of the EU and UN can be justified under the UN Charter where such implementation gives rise to a breach of an agreement entered into between the EU and the specific member state or targeted state such as, for example, the World Trade Organization Covered Agreements. Article 103 of the UN Charter is paramount in this respect. It provides:

> "In the event of a conflict between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement, *their obligations under the present Charter shall prevail*".[103]

The same cannot, however, be said in relation to unilateral EU sanctions, since they do not fall within the scope of the provisions of the UN Charter and consequently will require some other justification. There are at least two possibilities in this respect. The first is that unilateral EU sanctions may conceivably fall within the ambit of an exception (if any) provided for in the relevant international agreement. In such instances the imposition of unilateral sanctions may be justified. The second possibility is that unilateral EU sanctions are to be approached as countermeasures under international law.[104] In this way unilateral sanctions are, as referred to above, viewed as necessary responses to an internationally wrongful act committed by the target, which has injured the reacting state or international organisation.

3.3.3 Directives

In the era of the Lisbon Treaty, EU action pertaining to money laundering and terrorist financing has also taken the form of directives.[105] These directives contribute to uniformity in the implementation of EU sanctions regimes by its member states. In accordance with article 288 of the TFEU, they are binding upon EU member states in so far as giving effect to the desired result is concerned, but allow national authorities flexibility with regard to the form and methods by which the desired result can be achieved.

In the context of this thesis, three directives are noteworthy: (i) the Fourth Money Laundering Directive, which was adopted on 20 May 2015 and came into force on 26 June

---

[103] my emphasis.

[104] See Orakhelashvili "Sanctions and fundamental rights of states: the case of EU sanctions against Iran and Syria" in Happold and Eden (eds) *Economic Sanctions and International Law* (2016) 13 24.

[105] Before the Lisbon Treaty, EU action relating to money laundering and terrorist financing often took the form of so-called framework decisions which were based on "Joint Actions" adopted under former art K.3(2)(b) of TEU. Framework decisions were binding upon member states and required implementation by member states into their domestic legal order. In fact, some of these decisions remain in force today. On framework decisions in the context of financial crime, see generally Borgers "Confiscation of proceeds of crime: the European Union framework" in King and Walker (eds) *Dirty Assets: Emerging Issues in the Regulation of Criminal and Terrorist Assets* (2014) 27 *et seq*.

2015 in accordance with its article 68;[106] (ii) the Fifth Money Laundering Directive, which was adopted and came into force on 9 July 2018 in accordance with its article 5;[107] and (iii) the Directive on Freezing and Confiscation of Proceeds of Crime, which was adopted on 3 April 2014 and entered into force on 20 May 2014 in accordance with its article 15.[108]

The Fourth Money Laundering Directive was primarily adopted to ensure compliance by EU member states with the 2012 FATF recommendations.[109] Repealing the Third Money Laundering Directive,[110] it essentially requires of member states to: (i) implement anti-money laundering and counter-terrorism mechanisms through domestic regulatory frameworks;[111] (ii) require "obliged entities", which includes, *inter alia*, banks, financial service providers and professional service persons (such as lawyers, accountants, trust or company service providers), to perform customer due diligence investigations in the stipulated circumstances;[112] (iii) require such persons and entities to report any knowledge or suspicious activity for the purposes of financial crime to the relevant authority;[113] (iv) require such persons and entities to retain customer due diligence information;[114] and (v) require such persons and entities to establish appropriate policies which enable them to meet their obligations in terms of the directive, and to establish appropriate penalties for transgressors in this regard.[115]

Further to the above, the Fourth Money Laundering Directive introduced in Chapter III the obligation on member states to ensure that "corporate and other legal entities incorporated within their territory are required to obtain and hold adequate, accurate and current information

UNIVERSITY
OF
JOHANNESBURG

[106] Directive 2015/849/EU of 20 May 2015 "on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing" [2015] OJ L141/73 (henceforth "Fourth Money Laundering Directive").

[107] Directive 2018/843/EU of 30 May 2018 amending Directive (EU) 2015/849 "on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU" [2018] OJ L156/43 (henceforth "Fifth Money Laundering Directive").

[108] Directive 2014/42/EU of 3 April 2014 "on the freezing and confiscation of instrumentalities and proceeds of crime in the European Union" [2015] OJ L127/39 (henceforth "Directive on Freezing and Confiscation of Proceeds of Crime").

[109] Fourth Money Laundering Directive (n 106) recital 4. On the FATF and its recommendations, see par 4.2 below.

[110] Directive 2005/60/EC of 26 October 2005 "on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing" [2005] OJ L309/15.

[111] Fourth Money Laundering Directive (n 106) art 1.

[112] Ch II.

[113] Ch IV.

[114] Ch V.

[115] Ch VI.

on their beneficial ownership, including the details of the beneficials interests held".[116] Other notable changes include the obligation on member states to require obligated persons and entities to conduct and document risk assessments; provision for a wide definition of "politically exposed persons", personal data retention and deletion provisions, and the restrictions on obligated entities and persons to undertake "simplified" due diligence (as opposed to "enhanced" due diligence).

The Fifth Money Laundering Directive did not repeal the Fourth Money Laundering Directive but amended it. The amendments relate to: the scope of persons to which the directives are applicable;[117] the implementation of public and national beneficial ownership registers and other related issues;[118] the implementation of centralised bank account registers;[119] the requirement for member states to issue lists indicating the "specific functions which qualify as prominent public functions";[120] and the identification and due diligence investigations relating to high-risk countries and transactions.[121] Although the Fourth, supplemented by the Fifth, Money Laundering Directive is presently at the centre of the EU's fight against money laundering and terrorist financing, a Sixth Money Laundering Directive has been proposed and is intended to repeal the Fourth Money Laundering Directive.[122]

Finally, the Directive on Freezing and Confiscation of Proceeds of Crime is intended to enable member states' authorities to confiscate and recover proceeds from cross-border organised crime through the approximation of their confiscation regimes.[123] To that end, it sets out procedures on the freezing of property and on the concomitant issue of confiscation of property.[124]

UNIVERSITY
OF
JOHANNESBURG

---

[116] art 30.

[117] Fifth Money Laundering Directive (n 107) art 1 subsection 1–2.

[118] ss 15.

[119] ss 19.

[120] ss 13.

[121] ss 11.

[122] European Union Commission "Proposal for a Directive of the European Parliament and of the Council on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849" (2021) *https://eur-lex.europa.eu/resource.html?uri=cellar:05758242-ead6-11eb-93a8-01aa75ed71a1.0001.02/DOC_1&format=PDF* (accessed on 15 May 2022).

[123] Directive on Freezing and Confiscation of Proceeds of Crime (n 108) recital 5.

[124] art 1.

3.3.4 Position of the European Union on extraterritorial sanctions

The EU has adopted a strong stance against extraterritorial sanctions. "Extraterritorial sanctions" means the enforcement of one country's sanctions policies and laws on persons and entities of another.[125] The US is notorious for applying its sanctions extraterritorially.[126]

The first exposition of the EU's approach to extraterritorial sanctions emerged in 1996 when it enacted Council Regulation (EC) 2271/1996[127] (commonly referred to as the "blocking statute") to assist in "protecting against the effects of the extraterritorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom". This regulation, as amended in 2018,[128] is intended to protect natural persons residing and juristic entities incorporated in Europe.[129] Thus it applies also to financial institutions and banks within the EU.

Essentially the regulation provides that all persons and entities within the EU are barred from complying with certain sanctions policies imposed by countries outside the EU. The legislation or regulations to be disregarded are contained in an Annex to the regulation. Article 5 of the regulation provides as follows:

> "No person referred to in Article 11 shall comply, whether directly or through a subsidiary or other intermediary person, actively or by deliberate omission, with any requirement or prohibition, including requests of foreign courts, based on or resulting, directly or indirectly, from the laws specified in the Annex or from actions based thereon or resulting therefrom. […] Persons may be authorized, in accordance with the procedures provided in Articles 7 and 8, to comply fully or partially to the extent that non-compliance would seriously damage their interests or those of the Community. [...]."

UNIVERSITY
OF
JOHANNESBURG

[125] See Beaucillon "An introduction to unilateral and extraterritorial sanctions: definitions, state of practice and contemporary challenges" in Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 5 5–6; and Schmidt "The legality of unilateral extra-territorial sanctions under international law" 2022 *Journal of Conflict and Security Law* 53 54.

[126] See the discussion in par 3.4 below.

[127] of 22 November 1996 "protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom".

[128] Commission Delegated Regulation (EU) 2018/1100 of 6 June 2018. Art 1 of the amendment reads as follows: "This Regulation provides protection against and counteracts the effects of the extra-territorial application of the laws specified in the Annex of this Regulation, including regulations and other legislative instruments, and of actions based thereon or resulting therefrom, where such application affects the interests of persons, referred to in art 11, engaging in international trade and/or the movement of capital and related commercial activities between the Community and third countries." The EU recently announced that it was contemplating amending the blocking statute. See in this regard EU "Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: The European economic and financial system: fostering openness, strength and resilience" https://eur-lex.europa.eu/TodayOJ / (accessed on 14 March 2022).

[129] art 11.

Moreover, decisions from foreign judicial or administrative authorities which run counter to the regulation are deemed unenforceable and, therefore, without legal authority.[130]

At present, the Annex contains only international sanctions enacted by the US against Cuba and Iran. Natural persons and entities within the EU are required to disregard these specified sanctions with extraterritorial application, which emerge from, amongst others, the "Cuban Liberty and Democratic Solidarity Act of 1996", the "Iran Sanctions Act of 1996", and the "Iran Freedom and Counter-Proliferation Act of 2012". Reference to specific laws in this regard does not mean that EU persons and entities are permitted to comply with other extraterritorial US sanctions not included in the Annex. Marxen concludes that

> "[t]he fact that other extra-territorial US sanctions are not included in the Annex should not be interpreted to convey the EU's tacit agreement with all other US sanctions. It rather shows that for now the attention of the European Union is focused on undermining certain US sanctions aimed solely at Cuba and Iran – but a simple revision of the Annex could expand the ambit of the EU blocking statute."[131]

3.3.5 Conclusions

From the research presented above it is clear that the sanctions framework of the EU is comprehensive. In this regard, it goes further than merely adopting and requiring the implementation by member states of UN sanctions; it adds to UN regimes by targeting actors not designated by the UNSC. Moreover, it requires the implementation of its own autonomous sanctions which are not underscored by UN obligations. This, it is submitted, is indicative of the EU's commitment to fighting international crimes, especially money laundering, terrorism and the financing thereof, and the proliferation of nuclear weapons.

It is also clear that the EU's approach to extraterritorial foreign sanctions and its consequent blocking statute may emerge as contentious in relation to international trade and commerce, especially considering that the US – through which the majority of international financial transactions are facilitated and processed – is notorious for applying its sanctions extraterritorially.

UNIVERSITY OF JOHANNESBURG

[130] art 4 states: "No judgment of a court or tribunal and no decision of an administrative authority located outside the Community giving effect, directly or indirectly, to the laws specified in the Annex or to actions based thereon or resulting there from, shall be recognized or be enforceable in any manner."

[131] Marxen "Europe's blocking statute and its impact on international commercial transactions" (July/August 2021) *Documentary Credit World* 39 40.

3.4 United States of America

3.4.1 Historical background

The US, through its Department of Treasury, has been using sanctions as a foreign policy tool for centuries. Its long sanctions history can be divided into four basic, successive stages: the stage prior to the War of 1812, during which US sanctions were imposed against Great Britain as a result of British violations of US citizens' maritime rights;[132] the Civil War stage (1861 to1865), during which US laws were enacted to, *inter alia*, prevent the exchange of goods and trade engagement with the Confederacy;[133] the Office of Foreign Funds Control (FFC) stage, which was established in terms of Executive Order No. 8389 in the wake of the German invasion of Norway in 1940, and which essentially prohibited transactions relating to property of Demark and Norway and their nationals;[134] and, finally, the Office of Foreign Assets Control (OFAC) stage, which was officially established in 1950 at the advent of China's involvement in the Korean War, when all Chinese and North Korean assets subject to US jurisdiction were frozen in accordance with a national emergency declared by President Truman.[135]

The OFAC, an office within the Department of Treasury, is accordingly the successor to the FFC and is still currently in operation. The OFAC sanctions mostly arise independently of the UN. Especially the financial sanctions of the OFAC have emerged strongly following the terrorist attacks of 9/11.[136] This strong emergence can also be attributed to the dramatic increase in international financial transactions over the last two decades.

UNIVERSITY
OF
JOHANNESBURG

3.4.2 The OFAC sanctions

3.4.2.1 Operation and extraterritorial effect

The US sanctions regime rests primarily on two statutes, namely, the Trading with the Enemy Act[137] (TWEA) and the International Emergency Economic Powers Act[138] (IEEPA), both of

---

[132] See https://www.treasury.gov/resource-center/faqs/Sanctions/Documents/faq_all.html (accessed on 20 June 2020).

[133] The Confederacy, also referred to as the Southern Confederacy, refers to the period between 1860 to 1861 during which 11 US states sought to establish themselves as an independent nation. Protecting the institution of slavery was a strong motivation in this regard.

[134] Reeves "The control of foreign funds by the United States Treasury" 1945 *Law and Contemporary Problems* 17 22.

[135] (n 132) above.

[136] Carter and Farha "Overview and operation of the evolving US financial sanctions, including the example of Iran" *Proceedings of the Annual Meeting (American Society of International Law)* (2013) 315 315.

[137] of 1917.

[138] of 1977.

which grant the President wide authority to implement sanctions in response to different circumstances. The OFAC carries the primary responsibility of implementing US sanctions. Implementation is achieved through, *inter alia*, publication of regulations. The OFAC's principal mission is stated on its official website as follows:

> "The Office of Foreign Assets Control (OFAC) of the US Department of the Treasury administers and enforces economic and trade sanctions based on US foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy or economy of the United States."[139]

In pursuance of its principal mission, the OFAC maintains on its official website a regularly updated list of "specially designated nationals" (SDNs) that are targeted.[140] Its website provides:

> "As part of its enforcement efforts, OFAC publishes a list of individuals and companies owned or controlled by, or acting for or on behalf of, targeted countries. It also lists individuals, groups, and entities, such as terrorists and narcotics traffickers designated under programs that are not country-specific. Collectively, such individuals and companies are called "Specially Designated Nationals" or "SDNs." *Their assets are blocked and U.S. persons are generally prohibited from dealing with them*."[141]

The SDN list contains a vast number of natural persons, juristic persons (including import and export companies, shipping companies, financial institutions and banks), as well as vessels (ships and aircrafts).[142] In addition, jurisdictions may be subjected to the OFAC sanctions and listed.[143]

All persons must comply with the OFAC regulations. "Persons" are deemed to include

> "all U.S. citizens and permanent resident aliens regardless of where they are located, all persons and entities within the United States, all U.S. incorporated entities and their foreign branches [as well as in the case of certain sanctions] … foreign subsidiaries owned or controlled by U.S. companies … [and] foreign persons in possession of U.S.-origin goods … ."[144]

---

[139] See https://www.treasury.gov/about/organizational-structure/offices/pages/office-of-foreign-assets-control.aspx (accessed on 21 June 2020).

[140] https://www.treasury.gov/ofac/downloads/sdnlist.pdf (accessed on 21 June 2020). There is much activity in relation to the imposition and relaxation of the OFAC sanctions. See for example the overview by Boscariol *et al* "Export controls and economic sanctions" in *The Year in Review: An Annual Publication of the ABA/Section of International Law* (Spring 2016) 27 34–39.

[141] https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx (accessed on 21 June 2020, my emphasis).

[142] https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx (accessed 21 June 2020) 1238 *et seq*. In addition to this SDN list, the OFAC maintains other sanctions lists. These can be found at https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/Other-OFAC-Sanctions-Lists.aspx (accessed on 21 June 2020).

[143] See https://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx (accessed on 21 June 2020).

[144] https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx (accessed 21 June 2020).

It is clear therefore that not only persons and entities within the national borders of the US must comply with the OFAC sanctions, but also those persons and entities located outside of it linked to a US institution or which have in their possession US goods.

As set out below, the OFAC sanctions are invariably applied extraterritorially. Extraterritorial application, generally, can be direct or indirect. Direct extraterritorial application refers to the application of a specific, for example, US authority (statute, regulation or executive order) on an otherwise foreign person or entity.[145] Indirect extraterritorial application, on the other hand, relates to the extraterritorial *effect* generated by US authorities on foreign persons or entities, thus without the direct application of a particular US authority.[146] In this respect, non-compliance with extraterritorial US sanctions may have significant commercial consequences for foreign persons and institutions. Such consequences include restrictions placed on access to US dollar payment systems; prohibitions relating to business engagement with US financial institutions; the imposition of harsh fines or penalties; suspension of banking licenses or the threat thereof; and serious reputational risks – to name a few. The specific issue of the impact of extraterritorial US sanctions on international trade has been the subject of debate and scholarly writing in recent years.[147] For the present purposes this issue must be borne in mind but need not be explored in any detail. It is, however, investigated in the specific context of letters of credit and demand guarantees below in this study.[148]

UNIVERSITY
OF
JOHANNESBURG

[145] This notion requires one to determine whether Congress, which has to the power to make laws applicable beyond the territory of the US, has indeed exercised that authority. This determination is achieved through statutory interpretation. To aid in interpreting statutes, US courts apply a presumption against extraterritorial application. For case law on this presumption see, *inter alia*, *EEOC v Arabian American Oil Co* 499 US (1991); *Foley Bros, Inc v Filardo* 336 US (1949); *Blackmer v United States* 284 US (1932); and *Hartford Fire Insurance Co v California* 509 US (1993) 764.

[146] Dinh and Wold "Extraterritorial application of US law" in Blair, Brent and Grant (eds) *Banks and Financial Crime: The International Law of Tainted Money* (2017) 485 485.

[147] See, for instance, Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021); and Subedi (ed) *Unliteral Sanctions in International Law* (2021), both of which consist of several research contributions on the topic of extraterritorial sanctions. See further Kittrie "New sanctions for a new century: treasury's innovative use of financial sanctions" 2014 *Journal of International Law* 789–815; Amariles and Winkler "U.S. economic sanctions and the corporate compliance of foreign banks" 2018 *The International Lawyer* 497 535; and Dinh and Wold (n 146) 485–524.

[148] See par 5.3 below.

3.4.2.2 Trading with the Enemy Act and related regulations

As mentioned above, the TWEA constitutes a primary statutory instrument from which US sanctions originate. This act, as the name suggests, prohibits trade with enemies of the US. Initially the TWEA authorised the President to investigate, regulate and prohibit commercial transactions with enemy states during both wartime and national emergencies. However, by virtue of the enactment of the IEEPA (as discussed below), the TWEA's application was limited in 1977 to wartime only.

With regard to international trade transactions, the TWEA makes it unlawful

> "for any person in the United States, except with the license of the President, granted to such person, or to the enemy, or ally of enemy, as provided in this chapter, to trade, or attempt to trade, either directly or indirectly with, to, or from, or for, or on account of, or on behalf of, or for the benefit of, any other person, with knowledge or reasonable cause to believe that such other person is an enemy or ally of enemy, or is conducting or taking part in such trade, directly or indirectly, for, or on account of, or on behalf of, or for the benefit of, an enemy or ally of enemy."[149]

A "person" includes natural persons and juristic persons such as partnerships, associations, companies and corporations,[150] and the "United States" refers broadly to all land and water in any way within the jurisdiction of the US or occupied by its military or naval forces.[151]

Especially relevant to banking institutions, the TWEA permits the President to establish regulations with the aim to:

> "… investigate, regulation, or prohibit, any transactions in foreign exchange, transfers of credit or payments between, by, through, or to any banking institution, and the importing, exporting, hoarding, melting, or earmarking of gold and silver coin or bullion, currency or securities […] by any person, or with respect to any property, subject to the jurisdiction of the United States."[152]

UNIVERSITY OF JOHANNESBURG

The regulations published in this regard (namely, the *Foreign Assets Control Regulations*,[153] *Transaction Control Regulations*,[154] and *Cuban Assets Control Regulations*[155]) impose on banks the obligation to block and freeze assets transferred in contravention of the TWEA. Moreover, they provide for the prohibition of certain financial and commercial transactions with enemies of the US. However, in accordance with Proclamation 8271 by which the

[149] 50 USC § 4303(a).

[150] 50 USC § 4302.

[151] 50 USC § 4302.

[152] 50 USC § 4305.

[153] 31 CFR § 500.

[154] 31 CFR § 505.

[155] 31 CFR § 515.

President terminated his competence to impose restrictive measures under the TWEA in relation to North Korea,[156] the Foreign Assets Control Regulations and Transaction Control Regulations are no longer in force in so far as they apply to North Korea. Instead, sanctions against North Korea have been imposed in terms of the IEEPA.[157] The Cuban Assets Control Regulations, on the other hand, remain in force but adjustments to the concomitant sanctions appear to be influenced by the evolving relationship between the US and Cuba.[158]

In terms of the Cuban regulations, commercial engagements involving Cuba or Cuban nationals are prohibited. Banks in the US are accordingly under an obligation not to process payments involving blocked property. Recently, however, these regulations have been amended to permit certain financial transactions that were previously prohibited. Firstly, banks subject to US jurisdiction may process transactions which "originate and terminate outside the United States, but pass through one or more US financial institutions", provided "neither the originator nor the beneficiary is a person subject to U.S. jurisdiction". [159] Secondly, banks subject to US jurisdiction may "accept, process, and give value to U.S. dollar monetary instruments presented for processing and payment by a banking institution located in a third country that is not a person subject to U.S. jurisdiction or a Cuban national" when such institution maintains a correspondent account in the US and received monetary instruments as part of an unprohibited transaction.[160] Finally, banks are permitted to establish and maintain bank accounts with Cuban nationals residing in Cuba.[161]

A wilful contravention of the TWEA or any of its regulations by any person may, upon conviction, warrant a fine not exceeding $1million. Moreover, persons, including corporate officials and directors, who knowingly participate in TWEA contraventions may be the subject of penalties, including fines of up $100,000 or imprisonment for up to ten years, or both.[162] Where, in conjunction with the TWEA, other US laws become relevant, these criminal

UNIVERSITY OF JOHANNESBURG

[156] 76 Federal Register 35739.

[157] See Executive Orders 13466 of 26 June 2008; and 13551 of 30 August 2010.

[158] See, in this regard, the President's 2014 statement relating to increasing engagement with Cuba https://obamawhitehouse.archives.gov/the-press-office/2014/12/17/statement-president-cuba-policy-changes (accessed on 31 March 2022).

[159] 31 CFR § 515.584(d) (both quotes).

[160] 31 CFR § 515.578(g).

[161] 31 CFR § 515.579(h).

[162] 31 CFR § 501.701(a)(1).

penalties can be increased "to a greater of either $250,000 for individuals and $1,000,000 for organizations or twice the pecuniary gain or loss from the violation".[163]

In the case of extraterritorial violations, penalties, especially monetary fines and forfeitures, are also significant. The best example in this respect relates to the 2015 BNP Paribas SA saga in which BNP forfeited $8.83 billion and paid a fine of $140 million for conspiring to contravene the TWEA and IEEPA from 2004 to 2012.[164] In 2019, more recently, Standard Chartered Bank forfeited $657 million to the OFAC due to sanctions contraventions relating, *inter alia*, to Iran.[165]

3.4.2.3 International Emergency Economic Powers Act and related regulations

The enactment of the IEEPA in 1977 established a limited presidential authority to institute emergencies under the IEEPA. This in turn meant, as mentioned above,[166] that the President's powers under the TWEA had been restricted to wars only. Much of the substantive sanctions currently in place emanate from the IEEPA.

The authority of the President under the IEEPA may be used

> "to deal with any unusual or extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States, if the President declares a national emergency with respect to such threat".[167]

Therefore, it is only when the President issues a declaration of a national emergency that he may exercise his authority under the IEEPA.[168]

The exact powers of the President during the pendency of a proclaimed national emergency are broad. Firstly, he may:

> "… investigate, regulate, or prohibit (i) any transactions in foreign exchange, (ii) transfers of credit or payments between, by, through, or to any banking institution, to the extent that such transfers or payments involve any interest of any foreign country or national thereof, (iii) the importing or exporting of currency or securities, by any person, or with respect to any property, subject to the jurisdiction of the United States."[169]

---

[163] 31 CFR § 501.701(b).

[164] http://www.reuters.com/article/us-bnp-paribas-settlement-setnencing-idUSKBN0NM41K20150501 (accessed on 28 June 2021).

[165] "Standard Chartered Agrees to settlement in US, fine in UK" (May 2019) *Documentary Credit World* 4.

[166] See par 3.4.2.2 above.

[167] 50 USU § 1701(a).

[168] 50 USU § 1701(b).

[169] 50 USU § 1702(1)(A).

He may secondly:

> "… investigate, block during the pendency of any investigation, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest by any person or with respect to any property, subject to the jurisdiction of the United States."[170]

Finally, the President is given the authority to confiscate property of a foreign person, organisation, or even country if the US is engaged in armed conflict with such a foreign country or its nationals.[171]

Regulations and executive orders implementing the IEEPA are adopted in respect of various national emergencies declared by the President. Consequently, targeted sanctions emerging in this regard have been applied in support of various objectives.[172] It is, however, the combating and financing of terrorism and non-proliferation regimes that continue to receive the most attention.[173]

Combating and financing of terrorism

The OFAC administers three terrorism-related sanctions regimes:[174] the sanctions imposed under Executive Order 13224 – Specially Designated Global Terrorists (SDGTs);[175] Executive Orders 12947, 13099, and 13886 – Specially Designated Terrorists (SDTs);[176] as well as those imposed under the Antiterrorism and Effective Death Penalty Act of 1996 – Foreign Terrorist Organisations (FTOs).[177] Each of these is discussed immediately below.

Specially Designated Global Terrorists

On 23 September 2001, the President declared a national emergency in Executive Order 13224 under the title "Blocking Property and Prohibiting Transactions with Persons who Commit,

---

[170] 50 USU § 1702(1)(B).

[171] 50 USU § 1702(1)(C).

[172] For example, to counter cyber-related crimes, narcotics trafficking and US election interference.

[173] See Strydom (n 31) above.

[174] OFAC "Terrorists Assets Report Calendar Year 2020 Twenty-ninth Annual Report to the Congress on Assets in the United States Relating to Terrorist Countries and Organizations Engaged in International Terrorism" (2020) 2 https://home.treasury.gov/system/files/126/tar2020.pdf (accessed on 31 March 2022).

[175] 31 CFR Part 594.

[176] 31 CFR Part 595.

[177] 8 USC § 1189, 18 USC § 2339B.

Threaten to Commit, or Support Terrorism". Executive Order 13224 imposes "economic sanctions" on persons who commit or pose a significant risk of committing acts of terrorism, and on persons "owned or controlled" by or who provide support to such persons. It prohibits "transactions or dealings in property or interests[178] in property" of designated persons, and it "blocks" all property in the US or "within the possession or control of a U.S. person" in which there is an interest of any designated person.[179] A "U.S. person" is defined as "any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States."[180] The SDGTs are listed in the Annex to the Order.

Specially Designated Terrorists

On 23 January 1995, the President declared a national emergency in accordance with the IEEPA and Executive Order 12947 under the title "Prohibiting Transactions with Terrorists who Threaten to Disrupt the Middle East Peace Process". This executive order designates individuals or groups "threatening the Middle East peace process". It prohibits "dealings in property or interests in property" of any individual or entity designated in terms of it. Furthermore, it blocks all property in the US or within the possession or control of a "US person" in which there is an interest of any designated person. The SDTs are listed in the Annex to the Order.

Executive Order 12947 was amended on 20 August 1998 by Executive Order 13099 entitled "Prohibiting Transactions with Terrorists who Threaten to Disrupt the Middle East Peace Process" by adding three individuals and one organisation to the Annex. It was further amended on 10 September 2019 by Executive Order 13886 under the title "Modernizing Sanctions to Combat Terrorism". Executive Order 13886 terminated the national emergency declared in Executive Order 12947, which led to the conversion of 33 SDTS to SDGTs.[181]

UNIVERSITY OF JOHANNESBURG

---

[178] The term "interest" is defined as follows in 31 CFR § 510.304: "Except as otherwise provided in this part, the term *interest*, when used with respect to property (e.g., 'an interest in property'), means an interest of any nature whatsoever, direct or indirect."

[179] Executive Order (EO) 13372 was issued to provide for prohibitions relating to donations, an issue not dealt with in Executive Order 13224.

[180] 31 CFR § 560.314.

[181] See OFAC "Executive order amending counter terrorism sanctions authorities; counter terrorism designations and designation updates; Iran-related designation; Syrian designation updates" https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20190910 (accessed on 31 March 2022).

Foreign Terrorist Organizations

The Antiterrorism and Effective Death Penalty Act[182] came into force on 24 April 1996. This Act authorises the Secretary of State to designate organisations meeting the stipulated requirements as Foreign Terrorist Organisations (or FTOs). Section 303 of the Act[183] makes it a crime for persons "within the US or subject to US jurisdiction knowingly to provide material, support or resources" to a FTO designated under section 302. US financial institutions in possession or control of the funds of an FTO are consequently required to freeze or block such funds.

Against this background it is clear that the underlying rationale for the imposition of targeted sanctions by the OFAC extends far beyond the need to extinguish or limit the activities of terrorists or terrorist-related organisations. In fact, the OFAC has identified further benefits derived from these restrictive measures:

> "Designating individuals or organizations as SDGTs, SDTs, or FTOs notifies the U.S. public and the world that these parties are either actively engaged in or supporting terrorism or that they are being used by terrorists and their organizations. Public notification exposes and isolates these individuals and organizations, deters would-be supporters, and forces these groups to expend time and resources to find new sources of revenue and channels for moving these funds. These sanctions are also magnified by the central role of the U.S. dollar in the international financial system, as terrorist-related funds transfers that neither originate from nor are destined for the United States can nevertheless pass through or otherwise touch a U.S. financial institution, which reacts by blocking the transaction. Beyond the U.S. financial system, these designations help protect the international financial system from terrorist abuse, as banks and other private institutions around the world frequently consult OFAC's SDN List and report denying listed persons access to their institutions to minimize their own risk, and U.S. terrorism designations will often be implemented multilaterally by foreign partners or listed at the UN."[184]

UNIVERSITY
OF
JOHANNESBURG

Non-proliferation

Several sanctions programmes are implemented by the OFAC to combat the proliferation of weapons of mass destruction. However, three cardinal sanctions programmes can be identified.[185] These include the sanctions imposed under Executive Orders 13382 "Blocking Property of Weapons of Mass Destruction Proliferators and their Supporters" and 13883 "Administration of Proliferation Sanctions and Amendment of Executive Order 12851"; the

---

[182] of 96. See Pub L 104–132, 110 Stat 1247–1258.

[183] 18 USC § 2339B.

[184] OFAC https://www.treasury.gov/resource-center/sanctions/Programs/Pages/wmd.aspx (accessed on 3 July 2020).

[185] OFAC https://www.treasury.gov/resource-center/sanctions/Programs/Pages/wmd.aspx (accessed on 3 July 2020).

Weapons of Mass Destruction Trade Control Regulations;[186] as well as those imposed under Executive Order 13608 "Prohibiting Certain Transactions with and Suspending Entry into the United States of Foreign Sanctions Evaders with respect to Iran and Syria".

Before proceeding any further, it must be noted that all of these sanctions programmes are founded upon Executive Order 12938 entitled "Proliferation of Weapons of Mass Destruction" in which the President, on 14 November 1994, declared a national emergency in relation to "the proliferation of nuclear, biological and chemical weapons" and the means of delivering them. Executive Order 12938 prohibits the importation into the US of, *inter alia*, goods, technologies and services from targeted persons originating from foreign jurisdictions. These persons will have been targeted due to proliferation activities.

Executive Order 13382 and Executive Order 13883

Executive Order 13382 of 28 June 2005 expands on Executive Order 12938 providing for the blocking of property of specially designated proliferators of weapons of mass destruction and members of their support networks. It effectively denies proliferators access to the US financial system. To this end, "US persons" are enjoined from transacting with persons designated in terms of the order. In addition, "all property within the possession or control of any US person in which a target has an interest is blocked and must be reported to the OFAC within ten days".[187]

Executive Order 13383 of 1 August 2019 goes even further by, *inter alia*, prohibiting US banks from "making any loan or providing any credit" to designated jurisdictions, save for loans or credits intended to be used for the financing of food or other agricultural commodities.[188]

Weapons of Mass Destruction Trade Control Regulations

The OFAC issued the Weapons of Mass Destruction Trade Control Regulations to put the import ban imposed under Executive Order 12938 into force. The regulations prohibit the "direct or indirect importation into the U.S., including for transshipment or transit, of any

[186] 31 CFR Part 539.

[187] Presidential documents "Executive Order 13382 28 June 2005 Blocking Property of Weapons of Mass Destruction Proliferators and Their Supporters" (2005) 38567 section 1 (a).

[188] Presidential Order "Executive Order 13383 of August 1, 2019 Administration of Proliferation Sanctions and Amendment of Executive Order 12851" (2019) https://www.treasury.gov/resource-center/sanctions/Programs/Documents/13883.pdf (accessed on 31 March 2022).

goods, technology, or services produced or provided by a designated foreign person".[189] Where the US importer has knowledge that the goods contain "raw materials, components, or technology produced or provided by a designated foreign person", such importation is also prohibited. Moreover, "US persons" are prohibited from "financing, acting as a broker for, transporting or otherwise participating in the importation into the U.S. of any goods, technology or services produced or provided by a designated foreign person".[190]

For the purposes of the regulations, services will be deemed imported into the US where either the services or their benefit are received in the US, irrespective of the jurisdiction in which the service is performed. The benefit of services performed is received in the US if

> "the services are performed on behalf, or for the benefit, of a person located in the U.S., received by a person located in the U.S., received by a person located outside the U.S. on behalf of or for the benefit of an entity organised in the U.S., or received by an individual temporarily located outside the US for the purpose of obtaining such services for use in the U.S."[191]

Executive Order 13608

Executive Order 13608 of 1 May 2012 *inter alia* "prohibits all transactions or dealings, whether direct or indirect, involving a foreign person who has violated, attempted to violate, conspired to violate, or caused a violation of any license, order, regulation, or prohibition contained in, or issued pursuant to"[192] any executive order including, *inter alia*, Executive Order 12938 and 13382. "All transactions or dealings" include any "exporting, reexporting, importing, selling, purchasing, transporting, swapping, brokering, approving, financing, facilitating, or guaranteeing, in or related to (i) any goods, services, or technology in or intended for the [US], or (ii) any goods, services, or technology provided by or to U.S. persons, wherever located".[193] These prohibitions relate specifically to the sanctions regimes against Iran and Syria.

Contravention of, or conspiracy to contravene, the IEEPA may necessitate the imposition of civil and criminal penalties. As regards civil penalties, a person who contravenes the IEEPA will be subject to a fine not exceeding $250,000 or an amount twice the value of the transaction upon which the contravention is based, whichever is greater.[194] As for criminal

---

[189] 31 CFR §538.301.

[190] 31 CFR §538.201.

[191] OFAC "What you need to know about Treasury restrictions" (2012) 2 https://www.treasury.gov/resource-center/sanctions/Programs/Documents/wmd.pdf (accessed on 31 March 2022).

[192] Presidential Documents "Executive Order 13608 of May 1, 2012 Prohibiting Certain Transactions with and Suspending Entry into the United States of Foreign Sanctions Evaders with respect to Iran and Syria" (2012) 26409 26410 https://www.treasury.gov/resource-center/sanctions/Programs/Documents/fse_eo.pdf. section 1(a)i.

[193] Presidential documents (n 187) section 1(b).

[194] 50 USC § 1705(b).

penalties, a person who commits a wilful violation, or conspiracy to commit a wilful violation, of the IEEPA will be subject to a fine of not more than $1,000,000 or, in the case of a natural person, imprisonment not exceeding twenty years, or both.[195] In relation to extraterritorial contraventions of the IEEPA, penalties (and the extent thereof) appear to be informed by the value of the violating transaction as well as the gravity of the contravention.[196]

3.4.3 Compliance responsibilities

To ensure compliance with the OFAC sanctions, banks, in the first place, typically make use of specialised software systems designed to detect and prevent financial crime.[197] Many of these automated systems consist of screening controls which enable banks to screen names and transactions against the OFAC sanctions lists.[198] In the case the system identifies a listed name, the bank is required to reject the transaction concerned and direct a reviewer to evaluate the transaction. In the event that it fails to identify the sanctioned individual or entity, however, use of such systems cannot serve as a legal defence. The OFAC nevertheless "does favourably consider a bank's business decision to use interdict software as well as other good faith manual and electronic compliance efforts in determining mitigation".[199] "Manual" compliance efforts in this respect, secondly, may refer to manual screening processes. While in the case of automated screening much reliance is placed on the capabilities of software systems, manual screening requires the expertise of experienced and knowledgeable professionals.[200] Observing the importance of manual screening in relation to automated screening, the Hong Kong Association of Banks states:

> "[Authorized institutions such as banks] should be aware of the limitations of automated systems. In particular, owing to the complexity involved in trade-related activities, transaction monitoring involves a higher level of human effort and judgment for the effective identification of unusual or suspicious activities. Automated systems should only act as a 'complement' to those efforts."[201]

UNIVERSITY
OF
JOHANNESBURG

[195] 50 USC § 1705(c).

[196] See the examples discussed in par 3.4.2.2 above.

[197] OFAC "Regulations for the Financial Community" (2012) 2–3 https://home.treasury.gov/system/files/126/facbk.pdf (accessed on 5 April 2022).

[198] One can therefore discern two different screening controls: customer screening and transaction screening. Customer or name screening is used to identify targeted individuals or entities during on-boarding or the course of the customer relationship with the bank. Transaction screening is designed to identify transactions involving targeted individuals or entities. See Wolfsberg Group *Wolfsberg Guidance on Sanctions Screening* (2019) 1.

[199] OFAC (n 197) above.

[200] Byrne and Berger *Trade Based Financial Crime Compliance* (2017) 107.

[201] "Guidance paper on combating trade-based money laundering" (1 February 2016) 1 10.

This is to say, therefore, that both automated and manual screening systems should be implemented during a bank's due diligence investigations, at least as far as trade finance transactions are concerned.

To promote and facilitate the effective implementation and application of, *inter alia*, sanctions compliance controls such as screening processes, "financial institutions should have an end-to-end [financial crime risk] management programme".[202] Such programmes are crucial in the mitigation of money laundering and terrorist financing risks since they serve as "the foundation of an accountable institution's efforts to comply with its obligations"[203] under sanctions laws and regulations. Compliance programmes typically provide for the specific industries and industry-related products most susceptible to abuse. Commenting from a trade-based financial crime compliance perspective, Byrne and Berger state:

> "Trade related issues may be integrated into the existing plan or separate appendices, or may combine both since there are some aspects that are unique to trade while other aspects fall within the category of general compliance. An example of general compliance would be compliance policies regarding advising banks, negotiating banks, confirming banks, and documentary collections (bank collections)."[204]

To ensure sufficient compliance with these programmes, it is recommended that banks provide on-going training to relevant personnel.[205]

The OFAC has also recommended the following steps for ensuring compliance with its sanctions lists and concomitant sanctions regimes:[206]

UNIVERSITY OF JOHANNESBURG

i) Banks should designate a "compliance officer" responsible for overseeing blocked funds and other financial assets;
ii) Internal auditing departments should assist in the development of "corporate compliance memoranda" and verify that procedures, once established, are being followed; and
iii) "In-depth" audits of each department in the bank should be conducted annually.

[202] Wolfsberg Group, ICC and BAFT *Trade Finance Principles* (2019) 8. See also Wolfsberg Group (n 198) above.

[203] Financial Intelligence Centre *Guidance Note 7: On the Implementation of Various Aspects of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* (2017) par 180.

[204] Byrne and Berger (n 200) 87.

[205] Byrne and Berger (n 200) 81.

[206] OFAC (n 197) above.

Banks subject to US jurisdiction, however, do not only have sanctions-specific legal obligations, but also concomitant reporting and record-keeping requirements relating to the prevention and detection of international crimes such as terrorism (and the financing thereof) and money laundering. In this regard, the Bank Secrecy Act,[207] the Money Laundering Control Act,[208] and the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act)[209] are of particular interest. At the outset, it is important to note that these statutes: (i) are administered by the Financial Crime and Enforcement Network (FinCEN); (ii) carry extraterritorial application; and (iii) have been amended and updated over the years.

The Bank Secrecy Act empowers the Secretary of Treasury to require banks or financial institutions to make reports that will be useful in "criminal, tax, or regulatory investigations or proceedings".[210] It also, by virtue of subsequent amendments,[211] imposes reporting obligations on banks specifically in situations where "certain reports or records" would "have a high degree of usefulness … in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism".[212] Domestic banks are further required to file so-called currency transaction reports in respect of any transaction "for the payment, receipt, or transfer of United States coins or currency (or other monetary instruments the Secretary of Treasury prescribes), in an amount, denomination, or amount and denomination, or under circumstances the Secretary prescribes by regulation".[213] Currently, the amount triggering this reporting requirement is $10,000.[214] The Act also empowers the Secretary to impose the requirement of "reports on foreign currency transactions conducted by a United States person or a foreign person controlled by a United States person".[215] Additionally, the Bank Secrecy Act authorises the Secretary to impose additional "special measures" on

[207] 12 USC §§ 1951–1959 (originally published at Pub L 91–508).

[208] of 1986, 31 USC § 5324, 18 USC §§ 1956 and 1957.

[209] Title III: International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, 31 USC §§ 5301 *et seq* (Pub L 107–156).

[210] 12 USC § 1952. In this regard, 12 USC § 1951 provides that the purpose of the Bank Secrecy Act is to "require the maintenance of appropriate types of records and the making of appropriate reports by such businesses in the United States where such records or reports have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings".

[211] 31 USC § 5311 *et seq*.

[212] 31 USC § 5311.

[213] 31 USC § 5313.

[214] 31 CFR § 1010.311.

[215] 31 USC § 5315.

domestic financial institutions involved in transactions relating to non-US jurisdictions which carry a money laundering risk.[216] These special measures include additional recording-keeping, identification and reporting requirements, as well as further prohibitions on payable-through accounts and correspondent accounts.

The Money Laundering Control Act was promulgated to criminalise money laundering. It has done this by including two additional provisions to the federal criminal code, namely, 18 USC § 1956 and 18 USC § 1957. The Act generally prohibits the failure to file a report relating to financial transactions with the aim of evading reporting requirements, filing of a required report containing misstatements or omissions, and "structure[ing] or assist[ing] in structuring … any transaction with one or more domestic financial institutions, for the purpose of evading reporting requirements".[217] The first provision, as indicated above, criminalises conduct or attempted conduct "relating to a financial transaction involving unlawful activity with the intent to engage in unlawful activity while knowing that the transaction is designed in whole or in part to conceal or disguise" a significant feature under the transaction (such as location, source, control or ownership) so as to avoid transaction reporting requirements.[218] A contravention of this provision may necessitate a criminal fine of up to $500,000 or imprisonment not exceeding 20 years, or both.[219] The second provision criminalises knowing engagement "in a monetary transaction involving criminally derived property" of a value exceeding $10,000.[220] Punishment in this regard may take the form of a fine or imprisonment not exceeding 10 years, or both.[221]

The purpose of the USA PATRIOT Act, in part, is "to strengthen the provisions put in place by the Money Laundering Control Act of 1986, especially with respect to crimes by non-United States nationals and foreign financial institutions" and "to provide a clear national mandate for subjecting to special scrutiny those foreign jurisdictions, financial institutions operating outside of the United States, and classes of international transactions or types of accounts that pose particular, identifiable opportunities for criminal abuse".[222] As the present discussion is modest in its purpose, regard will be had only to sections 311, 312 and 313 of the

[216] See 31 USC § 5318 in general.

[217] 31 USC § 5324(a).

[218] 18 USC § 1956(a).

[219] 18 USC § 1956(a).

[220] 18 USC § 1957(a).

[221] 18 USC § 1957(b).

[222] 31 USC § 5311(b)(3) and (4).

USA PATRIOT Act. Section 311[223] empowers the Secretary of Treasury to take one or more "special measures" provided for in the section "if the Secretary finds that reasonable grounds exist for concluding that a jurisdiction outside of the United States … is of primary money laundering concern".[224] These special measures include, *inter alia*: record-keeping and reporting requirements in respect of certain financial transactions, requiring financial institutions to obtain and retain information relating to beneficial ownership of specific accounts, requiring domestic financial institutions to identify its customers and obtain the same information in relation to each customers' permitted use of correspondent accounts maintained in the US by a foreign financial institution; or requiring domestic financial institutions to prohibit or maintain certain correspondent or payable-through accounts in the US.[225]

Section 312 of the USA PATRIOT Act concerns private banking accounts and correspondent accounts. It requires

> "[e]ach financial institution that establishes, maintains, administers, or manages a private banking account or a correspondent account in the United States for a non-United States person, including a foreign individual visiting the United States, or a representative of a non-United States person [to] establish appropriate, specific, and where necessary, enhanced due diligence policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering through those accounts."[226]

The USA PATRIOT Act, moreover, provides that additional due diligence policies and procedures should, at the very least, include: (i) a determination as to the identity of the owners of the foreign bank and the nature and extent of their interests; (ii) where appropriate, enhanced due diligence to deter money laundering and report suspicious transactions; and (iii) a determination as to whether the foreign bank provides correspondent services to other foreign banks and the identity of those banks, if any, as well as related due diligence information.[227]

Finally, section 313 of the USA PATRIOT Act prohibits financial institutions from "establishing, maintaining, administering, or managing a correspondent account in the [US] for, or on behalf of, [a] foreign bank that does not have a physical presence in any country",[228] so-called shell banks.

---

[223] 31 USC § 5318A.

[224] 31 USC § 5318A(a)(1).

[225] 31 USC § 5318A(b).

[226] 31 USC § 5318(i).

[227] 31 USC § 5318(i)(2).

[228] 31 USC § 5318(j).

3.4.4 Conclusions

US sanctions are aimed at furthering US foreign policy and national security goals. The research presented above has shown that in the enforcement of US sanctions, the approach of the OFAC has been to deny targeted individuals and entities access to the US dollar and US banking institutions, as well as access to the international financial system in which the dollar plays a dominant role. Consequently, targeted financial sanctions have emerged prominently in US foreign and national policy in the last few decades.

It has also been shown that the OFAC sanctions carry extraterritorial application. Firstly, the OFAC sanctions impose on "US persons" the obligation not to supply prohibited goods, services or technology to sanctioned persons and entities. The term "US person" has been defined broadly and includes even foreign branches of US institutions. Secondly, the sanctions apply to trade and commercial transactions throughout the world, provided the jurisdictional links of the specific sanctions regime are satisfied. In addition to the OFAC sanctions, provisions of the Bank Secrecy Act, Money Laundering Control Act and USA PATRIOT Act also carry extraterritorial application and impose extensive reporting and record-keeping obligations on banking institutions. It follows that non-US persons and entities to international trade and commercial transactions will do well to consult meticulously the US sanctions framework to determine the precise scope and coverage of the sanctions.

3.5 United Kingdom

3.5.1 General

On 31 January 2020, after nearly five decades as a member state, the UK officially withdrew from the EU, an event commonly referred to as "Brexit".[229] Prior to Brexit, the UK's sanctions regime originated from the EU, through EU regulations that had direct effect over member states.[230] It is widely recognised that the UK, as an EU member state, played a leading role in developing EU sanctions policy.[231] Consequently, the UK and EU agreed to coordinate their sanctions policy post Brexit.[232]

[229] See EU Council "Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community" https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12019W/TXT(02)&from=EN (accessed on 16 June 2022).

[230] On the EU and some of its sanctions-related regulations, see par 3.3 above.

[231] *Brexit: Sanctions Policy* https://publications.parliament.uk/pa/ld201719/ldselect/ldeucom/50/5004.htm par 67 (accessed on 4 April 2022).

[232] *Brexit: Sanctions Policy* (n 231) par 146.

To enable the UK to give effect to its UN obligations post Brexit, it adopted a financial sanctions regime independent of the EU through the Sanctions and Anti-Money Laundering Act.[233] This legislation provided the UK government with the necessary legal authority to establish its own sanctions framework. Although the Sanctions and Anti-Money Laundering Act is currently the primary legislation relating to the enforcement of UK financial sanctions, other statutes also impose or contribute (by way of statutory amendment) to the development of UK financial sanctions and are therefore also relevant.[234] These include the Anti-Terrorism, Crime and Security Act,[235] the Counter Terrorism Act,[236] as well as the recently enacted Economic Crime (Transparency and Enforcement) Act.[237] These statutes, including the Sanctions and Anti-Money Laundering Act, are discussed below, before commenting on The Protecting against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations.[238]

The authority vested with the responsibility for implementing financial sanctions in the UK is the Office of Financial Sanctions Implementation (OFSI), on behalf of HM Treasury. In carrying out this responsibility, the OFSI maintains on its open website two lists of those subject to financial sanctions.[239] The first is the "Consolidated List", which lists those individuals and entities subject to asset freezes in terms of UK domestic financial sanctions and UN sanctions. The individuals and entities on this list are referred to as "designated persons". The list is intended to ensure compliance by businesses and individuals with UK financial sanctions.[240] The second list maintained by the OFSI relates to those "entities subject to specific capital market restrictions".

UNIVERSITY
OF
JOHANNESBURG

[233] 2018.

[234] The following legislative instruments do not necessarily impose financial sanctions but are nevertheless important to the UK's counter-terrorism regime: the Terrorism Act 2000; the Prevention of Terrorism Act 2005; the Terrorism Act 2006; and the Counter-Terrorism and Security Act 2015. They may occasionally be referred to in this chapter.

[235] 2001.

[236] 2008.

[237] 2022.

[238] 2020.

[239] OFSI *UK Financial Sanctions General Guidance for Financial Sanctions under the Sanctions and Anti-Money Laundering Act 2018* (2020) 11.

[240] As to the updating of the list, the OFSI (n 239) above states that it "aims to update the Consolidated List within one working day for all new UN and UK listings coming into force in the UK, and within three working days for all other amendments."

3.5.2 Anti-Terrorism, Crime and Security Act

The Terrorist Act is central to the UK's counter terrorist regime. It contains key provisions criminalising the financing of terrorism.[241] These relate to the provision or receiving of money or property intended or reasonably suspected to be used in relation to terrorism.

The Anti-Terrorism, Crime and Security Act (ATCSA) was formally introduced in the UK Parliament on 19 November 2001 and received royal assent and came into force on 14 December 2001. This legislation was promulgated in the wake of the terrorist attacks in the US on 11 September 2001. The purpose of the ATCSA was not only to amend the Terrorist Act but also –

> "to make further provision about terrorism and security; to provide for the freezing of assets; to make provision about immigration and asylum; to amend or extend the criminal law and powers for preventing crime and enforcing that law; to make provision about the control of pathogens and toxins; to provide for the retention of communications data; to provide for implementation of Title VI of the Treaty on European Union; and for connected purposes."[242]

The overarching objective of the ATCSA was accordingly to ensure that the UK government has the necessary powers to counter the increasing terrorist threat to the UK.

Parts one, two and three of the ATCSA are especially relevant for the purposes of this discussion. Entitled "Terrorist Property", part one introduces schedule one and two, which expands and replaces the provisions in the Terrorism Act[243] in relation to the seizure and forfeiture of terrorist cash. "Terrorist cash" is described as "cash which is intended to be used for the purposes of terrorism, cash which consists of the resources of a proscribed organisation or cash which is or represents property obtained through terrorism".[244] "Property obtained through terrorism" is defined as "property obtained by or in return for acts of terrorism or by or in return for acts carried out for the purposes of terrorism".[245]

Part two, entitled "Freezing Orders", contains measures to enable the UK to take action to freeze the assets of foreign persons or governments who threaten the economic interests of the UK or the life or property of UK residents. Section 5(1) describes a freezing order as "an order which prohibits persons from making funds available to or for the benefit of a person or persons specified in the order". Treasury is authorised to make a freezing order if two conditions are met. The first is that Treasury must "reasonably" believe that "action to the

[241] s 15–18 of the Terrorism Act 2000.

[242] See ATCSA (n 235) Introductory Text.

[243] 2000.

[244] s 1(1) of the ATCSA (n 235).

[245] par 11 of Schedule 1.

UNIVERSITY OF JOHANNESBURG

detriment of the UK's economy or an action constituting a threat to the life or property of one or more UK nationals or residents" has occurred or is likely to occur by a person or persons. The second is that the person or persons contemplated in the first requirement must be foreign individuals or entities, in other words residents of, or incorporated in terms of the laws of, a country outside of the UK.[246] The order *may* specify the person or persons to whom or for whose benefit funds are not to be made available,[247] but it *must* provide that all persons in the UK or elsewhere who are nationals or incorporated in terms of the law of the UK must comply with the relevant order.[248]

A person commits an offence if he/she fails to comply with the provisions of an order,[249] or engages in activity "knowing and intending" that it will enable and facilitate the commission by another person of an offence in terms of the ATCSA.[250] On summary conviction, such a person will be liable to a term of imprisonment not exceeding 12 months or a fine not exceeding the statutory maximum, or both. On conviction on indictment, such a person will be liable to a term of imprisonment not exceeding seven years or a fine or both.[251]

Part three, entitled "Disclosure of Information", enables the disclosure of information held by HM Customs and Excise and the Inland Revenue for the purposes of law enforcement.[252] Moreover, it clarifies and extends the authority of various other "gateways" in relation to disclosure of information from public authorities to agencies involved in criminal investigations and proceedings.[253] The gateways are intended to ensure the disclosure of certain otherwise confidential information where this is necessary for the purposes of combating terrorism and other crimes.

An order may provide that a person must make available and disclose certain information and/or documents where such information and documents are reasonably necessary to ascertain whether an offence under the order has been committed.[254]

[246] s 4(2)–(3).

[247] s 5(3).

[248] s 5(2).

[249] par 7(2) of Schedule 3.

[250] par 7(3) of Schedule 3.

[251] See s 154(1) of the Criminal Justice Act 2003. Prior to this legislation, on summary conviction the imprisonment sentence was limited to 6 months and conviction on indictment, 2 years. See, in this regard, par 6(a)-(b) of schedule 3 of ATCSA (n 235).

[252] s 19.

[253] s 18.

[254] See pars 5 and 6 of Schedule 3.

Finally, designations made under the ATCSA can be found in the Consolidated List.[255]

3.5.3 Counter Terrorism Act

The purpose of the Counter Terrorism Act (CTA) is set out in the Introductory Text to the legislation. It reads as follows:

> "An Act to confer further powers to gather and share information for counter-terrorism and other purposes; to make further provision about the detention and questioning of terrorist suspects and the prosecution and punishment of terrorist offences; to impose notification requirements on persons convicted of such offences; to confer further powers to act against terrorist financing, money laundering and certain other activities; to provide for review of certain Treasury decisions and about evidence in, and other matters connected with, review proceedings; to amend the law relating to inquiries; to amend the definition of "terrorism"; to amend the enactments relating to terrorist offences, control orders and the forfeiture of terrorist cash; to provide for recovering the costs of policing at certain gas facilities; to amend provisions about the appointment of special advocates in Northern Ireland; and for connected purposes."

Schedule 7 of the CTA is particularly important for the purposes of the present discussion since it empowers the Treasury to implement measures to combat especially money laundering and terrorist financing[256] by providing a "direction" to any person or persons or all persons "operating in the financial sector"[257] (collectively referred to in the CTA as "relevant persons") where any of the following conditions are met:

> "(2) The first condition is that the Financial Action Task Force has advised that measures should be taken in relation to the country because of the risk of terrorist financing or money laundering activities being carried on—
> (a) in the country,
> (b) by the government of the country, or
> (c) by persons resident or incorporated in the country.
> (3) The second condition is that the Treasury reasonably believe that there is a risk that terrorist financing or money laundering activities are being carried on—
> (a) in the country,
> (b) by the government of the country, or
> (c) by persons resident or incorporated in the country,
> and that this poses a significant risk to the national interests of the United Kingdom.
> (4) The third condition is that the Treasury reasonably believe that—
> (a) the development or production of nuclear, radiological, biological or chemical weapons in the country, or
> (b) the doing in the country of anything that facilitates the development or production of any such weapons,
> poses a significant risk to the national interests of the United Kingdom.

---

[255] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1047234/UK_Freezing_Orders.pdf (accessed on 4 April 2022).

[256] s 62 of the CTA (n 236).

[257] par 3(1)(a)–(c) of Schedule 7. Par 4(1) provides: "Any reference in this Schedule to a person operating in the financial sector is to a credit or financial institution that —

(a) is a United Kingdom person, or

(b) is acting in the course of a business carried on by it in the United Kingdom."

> (5)The power to give a direction is not exercisable in relation to an EEA state."[258]

"A direction under Schedule [7] may impose requirements in relation to transactions or business relationships with a person carrying on business in the country, the government of the country, [and] a person [residing] or incorporated in the country".[259] Requirements that may be imposed in this regard can take the form of customer due diligence,[260] on-going monitoring,[261] systematic reporting,[262] and limiting or ceasing business[263] with a "designated person".[264]

Specifically in relation to the requirement to limit or cease business, relevant persons may be required not to enter into or continue to participate in a specific transaction or business relationship with a designated person, or any transaction or business relationship with such a person.[265] Moreover, directions given to persons operating in the financial sector "must be contained in an order made by the Treasury".[266] An order containing requirements of "limiting or ceasing business" must, after being made, be approved by a resolution of each House of Parliament. If the order is not so approved, it ceases to have effect at the end of the prescribed time-period.[267] This strict parliamentary procedure, it is submitted, demonstrates the seriousness with which the UK views the imposition of sanctions on designated persons.

Finally, Treasury is required to take appropriate steps to publicise the making of the order under which a direction has been made.[268]

UNIVERSITY OF JOHANNESBURG

3.5.4 Sanctions and Anti-Money Laundering Act

The Sanctions and Anti-Money Laundering Act (SAMLA) is introduced as follows:

> "An Act to make provision enabling sanctions to be imposed where appropriate for the purposes of compliance with United Nations obligations or other international obligations or

[258] par 1 of Schedule 7.

[259] par 9 of Schedule 7.

[260] par 10 of Schedule 7.

[261] par 11 of Schedule 7.

[262] par 12 of Schedule 7.

[263] par 13 of Schedule 7.

[264] A "designated person" is described as "any person in relation to whom the direction is given." See par 9(3) of Schedule 7.

[265] par 13(a)–(c) of Schedule 7.

[266] par 14(1) of Schedule 7.

[267] par 14(2) of Schedule 7.

[268] par 16(2) of Schedule 7.

> for the purposes of furthering the prevention of terrorism or for the purposes of national security or international peace and security or for the purposes of furthering foreign policy objectives; to make provision for the purposes of the detection, investigation and prevention of money laundering and terrorist financing and for the purposes of implementing Standards published by the Financial Action Task Force relating to combating threats to the integrity of the international financial system; and for connected purposes."[269]

The SAMLA constitutes the primary legislation to enable the UK to establish its own sanctions framework (thus, independent of the EU) to comply with its UN obligations, as well as to advance its activities on the prevention of terrorism in the UK or elsewhere and protection of UK national security interests. It is also evident from the above that the SAMLA aims to support the UK in complying with its UN and FATF obligations, rather than adopting and implementing EU directives.

The SAMLA consists of three parts. Part 1, entitled "Sanctions Regulations", confers upon the Secretary of State and Treasury broad powers to impose sanctions regulations

> "that are considered appropriate for compliance with a UN obligation, for compliance with any other international obligation, or for a purpose that would prevent terrorist acts in the UK or elsewhere, be in the interests of national security, further the interests of global peace and security, assist a UK government foreign policy goal, promote the end of a war or protect civilians caught up in a conflict zone, discourage gross abuses of human rights, promote compliance with international human rights law or international humanitarian law, contribute to mutual international endeavours to thwart the spread and use of weapons and materials of mass destruction, [and] foster respect for democracy and the rule of law.[270]

The sanctions available to the Secretary of State are financial sanctions, trade sanctions, immigration sanctions, aircraft sanctions, shipping sanctions and "other sanctions to aid the meeting of UN obligations".[271]

The Secretary of State and the UN can designate any individual or entity which in their view should be the target of sanctions. In terms of the SAMLA, a "designated person" means "[a person] designated under any power contained in the regulations that authorises an appropriate Minister to designate persons for the purposes of the regulations or of any provisions of the regulations, or a [person] who [is] designated under any provision included in the regulations by virtue of section 13 (persons named by or under resolutions)".[272] The

UNIVERSITY OF JOHANNESBURG

[269] SAMLA (n 233) Introductory Text.

[270] s 1 (2)(a)–(i).

[271] s 5(a)–(g).

[272] s 9(2)(a)(b).

SAMLA provides for the designation of persons by name and by description.[273] Designation by description is, however, subject to the fulfilment of certain conditions.[274]

Part 2 concerns anti-money laundering and terrorist financing. It enables the UK government – through the enactment of "statutory instruments" or regulations – to impose on certain persons and entities compliance and reporting obligations. Most noteworthy in this regard is The Counter-Terrorism (Sanctions) (EU Exit) Regulations[275] which repealed Part 1 of the Terrorist Asset-Freezing etc Act[276] (TAFA) after EU exit. The TAFA implemented the asset-freezing obligations under UNSC Resolution 1373. The Regulations came into force on 31 December 2020 and are substantially similar to the TAFA. Using the powers under section 56 of the SAMLA,[277] these new regulations enable a more effective sanctions regime.

They also ensure that the UK sanctions framework implements its international obligations under UNSC Resolution 1373. This is done, *inter alia*, by prohibiting persons from dealing "with funds or economic resources held or controlled by a designated person if the designated person knows, or has reasonable cause to suspect, that it is dealing with such funds or economic resources".[278] Also, by prohibiting the making of funds or financial services available to, and for the benefit of, designated persons, as well as by prohibiting the making of economic resources available to, and for the benefit of, designated persons in circumstances where a person has knowledge or "reasonable cause to suspect that it is making the funds, financial services or economic resources so available".[279] A person who contravenes any of these prohibitions commits an offence.[280] Furthermore, any person who intentionally participates in activities knowing that the object or effect of them, whether directly or indirectly, is to circumvent any of these prohibitions or to enable or facilitate any similar prohibition, commits an offence.[281] A person who commits any of these offences is, on

[273] s 11 and 12, respectively.

[274] s 12(2)–(5).

[275] 2019 no. 577 (henceforth: "Counter-Terrorism Regulations" or "Regulations").

[276] 2010.

[277] s 56(1) of the SAMLA (n 233) provides: "If the appropriate Minister making a statutory instrument containing (whether alone or with other provision) any regulations under section 1 considers it is appropriate to do so in consequence of, or otherwise in connection with, the withdrawal of the United Kingdom from the EU, the instrument may provide that it comes into force, or that any provision of regulations contained in the instrument comes into force, on such day as that Minister may by regulations under this section appoint."

[278] s 11 of Counter-Terrorism Regulations (n 275).

[279] s 12-15

[280] See s 11(3), 12(3), 13(3), 14(3) and (15(3), respectively.

[281] s 16.

summary conviction, liable to imprisonment for a term not exceeding 12 months or a fine not exceeding the statutory maximum or both.[282] On conviction on indictment, such a person is liable to imprisonment for a term not exceeding seven years or to a fine or both.[283]

In relation to these prohibitions, the Regulations impose reporting obligations on firms. The term "firm" refers to a multitude of institutions and persons who perform various functions, including currency exchange officers, money transmitters (that is, banks), legal and accounting services (that is, lawyers and accountants), trust or company services (such as company formation and arrangements), estate agency services, and activities in relation to precious metals (such as gold, silver, platinum and so forth).[284] The relevant section requires the following:

> "21(1) A relevant firm must inform the Treasury as soon as practicable if—
> (a) it knows, or has reasonable cause to suspect, that a person—
> (i) is a designated person, or
> (ii) has committed an offence under any provision of Part 3 (Finance) or regulation 20 (finance: licensing offences), and
> (b) the information or other matter on which the knowledge or cause for suspicion is based came to it in the course of carrying on its business.
> (2) Where a relevant firm informs the Treasury under paragraph (1), it must state—
> (a) the information or other matter on which the knowledge or suspicion is based, and
> (b) any information it holds about the person by which the person can be identified.
> (3) Paragraph (4) applies if—
> (a) a relevant firm informs the Treasury under paragraph (1) that it knows, or has reasonable cause to suspect, that a person is a designated person, and
> (b) that person is a customer of the relevant firm.
> (4) The relevant firm must also state the nature and amount or quantity of any funds or economic resources held by it for the customer at the time when it first had the knowledge or suspicion.
> (5) A relevant institution must inform the Treasury without delay if that institution—
> (a) credits a frozen account in accordance with regulation 17(4) (finance: exceptions from prohibitions), or
> (b) transfers funds from a frozen account in accordance with regulation 17(6)."[285]

UNIVERSITY OF JOHANNESBURG

It is therefore clear that, especially in the bank-customer-relationship context, information submitted in relation to a designated person or a person who has committed an offence in terms of the SAMLA (sections 11-16) must be comprehensive and include all relevant transactional details so as to enable Treasury to conduct a thorough investigation into the matter. Where relevant transactional information is absent or has been omitted, Treasury may, in accordance with the Regulations, request such information for the purposes of establishing the nature and extent of any funds or economic resources owned, held or controlled by or on behalf of, or

[282] s 28(1)(a)(b).

[283] s 28(d).

[284] s 22.

[285] s 21.

made available to, a designated person. It may also request information in order to monitor compliance with, or detect evasion of, the SAMLA.[286]

Effectively, the submission of information to Treasury for the purposes of complying with the reporting obligations under the Regulations will trigger the obligation to freeze the account and discontinue engagement with the specific entity. A person who fails to comply with its reporting obligations commits an offence[287] and is liable, on summary conviction, to imprisonment for a term not exceeding six months or to a fine or both.[288]

In accordance with section 30 of the SAMLA, the Counter-Terrorism Regulations underwent annual review[289] and on 13 January 2022 the relevant minister decided to retain these regulations. He concluded as follows:

> "14. The UN obligations implemented by the 2019 Regulations are unchanged and the Minister considers that the regime remains appropriate for the purpose of implementing those obligations.
> 15. The Minister considers that carrying out the non-UN purposes of the 2019 Regulations continues to meet one or more of the conditions set out in paragraph (a) to (i) of section 1(2) of the Sanctions Act.
> 16. The Minister considers that the 2019 Regulations are still appropriate for those purposes, that there are good reasons to pursue those purposes, and that the imposition of sanctions is a reasonable course of action in support of those purposes.
> 17. The policy intention is that sanctions remain in place to further the prevention of terrorism, in the United Kingdom or elsewhere, and in the interests of national security, and comply with relevant UN obligations under UNSCR 1373.
> 18. In order for the above to be realised, the threat to the UK and its international partners from terrorism would need to be deemed to be substantially diminished."[290]

Finally, Part 3 of the SAMLA, as indicated above, provides for general matters in relation to, *inter alia*, the commencement, application, and interpretation of the SAMLA as well as matters relating to the implementation of regulations.

3.5.5 Economic Crime (Transparency and Enforcement) Act

The Economic Crime (Transparency and Enforcement) Bill received royal assent and came into force as the Economic Crime (Transparency and Enforcement) Act (ECTEA) on 15 March

[286] s 23(7).

[287] s 21(6).

[288] s 28(3)(a)–(b).

[289] See "The Counter-Terrorism (Sanctions) (EU Exit) Regulations 2019 annual review under section 30 of the Sanctions and Anti-Money Laundering Act 2018" (henceforth: "Annual Review of Counter-Terrorism Regulations") https://service.betterregulation.com/document/553864 (accessed on 4 April 2022).

[290] Annual Review of Counter-Terrorism Regulations (n 289) pars 14–18.

2022. The ECTEA was fast-tracked partly in response to Russia's recent invasion of Ukraine.[291]

The ECTEA is introduced as follows:

> "An Act to set up a register of overseas entities and their beneficial owners and require overseas entities who own land to register in certain circumstances; to make provision about unexplained wealth orders; and to make provision about sanctions."[292]

The ECTEA consists of four parts. Part 1 concerns the registration of overseas entities. Part 2 deals with "unexplained wealth orders" and amends existing legislation[293] in that regard. Part 4 provides for matters of general concern.

Part 3 is the focus of this discussion and provides for amendments to the SAMLA in relation to designations by the Minister in section 11 ("Designations by name") and 12 ("Designations by description"). The requirements in section 11(2)(a) and 12(5)(a) that the Minister must have "reasonable grounds to suspect" that a person is an "involved person" for the purposes of designation and in section 11(2)(b) and 12(5)(b) that the Minister must consider the appropriateness of a designation with reference to the effect that a designation would have on that person, are removed. This is substituted by new sections 11(1A) and 2, and 12(1A) and (5A-E), respectively, which provide for two procedures: a standard procedure and an urgent procedure. In terms of the standard procedure the Minister may give effect to a designation only where the Minister "has reasonable grounds to suspect" that the person concerned is an involved person for the purposes of subsection 3 of the SAMLA (referred to as "condition A"). Under the urgent procedure, however, the Minister may give effect to a designation without complying with condition A, provided before the end of the stipulated period the Minister certifies that condition A is satisfied, or that conditions B and C continue to be satisfied. Condition B is that relevant provision (whenever made) applies to, or in relation to, the person under the law of the US, EU, Australia, Canada and any other country specified in the regulations to be made by the Minister. Condition C is that the Minister considers that it is in the public interest to make designations under the urgent procedure.

The urgent procedure in effect enables the Minister to make designations easily and swiftly in response to actions taken by involved persons. This procedure is practical and likely

---

[291] https://www.nortonrosefulbright.com/en/knowledge/publications/19dd871c/economic-crime-transparency-and-enforcement-act-2022 (accessed on 5 April 2022).

[292] the ECTEA (n 237) Introductory Text.

[293] Proceeds of Crime Act 2002.

to be effective, particularly in those instances where immediate action in relation to involved persons is necessary.

3.5.6 The Protecting Against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations

In accordance with section 8(1) of, and paragraph 21(b) of Schedule 7 to, the European Union (Withdrawal) Act,[294] the Secretary of State gave effect to The Protecting against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations.[295] These Regulations entered into force on 1 January 2021.

The Regulations constitute amendments to the retained EU legislation, that is EU Regulations 2271/1996[296] and 2018/1100[297] (blocking statute). The blocking statute, as discussed above,[298] prohibits compliance with sanctions emanating from the extraterritorial legislation specified in the Annex.[299] It further permits EU persons to recover damages from other EU persons that have complied with the relevant extraterritorial sanctions in violation of the blocking statute and invalidates in the EU foreign court rulings in this regard.

To mitigate the deficiencies in relation to the retainment of the blocking statute that would otherwise have arisen due to the UK's exit from the EU, the Regulations alter the provisions in so far as they relate to powers of the EU and EU persons – provisions which would have been inappropriate or redundant upon the UK's exit. The explanatory note to the Regulations is instructive in this regard:

> "These Regulations make amendments to the EU rules prohibiting persons from complying with the trade sanctions legislation of third countries to the extent that that legislation purports to have extraterritorial effects, together with amendments (consequent upon withdrawal) to the related UK implementing legislation. The changes to these EU rules are made to ensure that these rules operate as UK rules after withdrawal. For instance, the provisions prohibiting EU persons from complying with the relevant third country legislation become provisions prohibiting UK persons from doing so; powers on the part of the European Commission to make EU tertiary legislation to amend the annex of third country legislation (compliance with which is proscribed) becomes a power, exercisable by the Secretary of State, to amend the annex by domestic secondary legislation; obligations to provide information to the Commission become obligations to provide information to the Secretary of State; and provisions whereby persons may apply to the Commission to be allowed to comply with the third country legislation become provisions whereby persons may apply to the Secretary of State for permission to do so."

---

[294] 2018.

[295] (n 238) above. (Henceforth: "Extraterritorial Regulations or Regulations")

[296] (n 127) above.

[297] (n 128) above.

[298] See par 3.3.4 above.

[299] Currently, the Annex contains only international sanctions enacted by the US against Cuba and Iran.

The Regulations are accordingly substantially similar to the blocking statute in that they (i) prohibit UK persons from complying with sanctions emanating from foreign legislation which purport to have extraterritorial effect; (ii) enable UK persons to recover damages from other UK persons who have complied with the relevant extraterritorial sanctions legislation in violation of the Regulations; and (iii) invalidate in the UK any foreign court rulings relating to the relevant sanctions.

3.5.7 Conclusions

There can be no doubt that Brexit is a significant event in UK history. This is also true of the impact it has had on the UK sanctions regime, which is no longer driven by EU enactments, but an independent UK regulatory framework.

The above research has provided an overview of the targeted financial sanctions regulatory framework of the UK. The framework consists of at least three statutes, with the SAMLA as the primary instrument. This framework, together with the regulations promulgated under the SAMLA, enables the UK to give effect to its international obligations on targeted financial sanctions.[300] Moreover, the recent amendments to the SAMLA enable the relevant minister, more easily and swiftly, to designate persons as targets of restrictive measures – an amendment that may prove useful especially in instances where immediate action in relation to the prospective designee is necessary.

The overview has further demonstrated that the financial prohibitions under the Counter-Terrorism Regulations are extremely broad and impose burdensome compliance and reporting obligations on especially banking and other financial institutions.

Finally, by retaining the EU blocking statute through the enactment of the relevant regulations, the UK has expressed its legal position in relation to compliance with sanctions arising from foreign legislation that is applied extraterritorially. It is expected that the UK and EU will coordinate actions in response to issues relating to the relevant extraterritorial sanctions.

[300] See generally FATF "Anti-money laundering and counter-terrorist financing measures: mutual evaluation report of (United Kingdom)" (2018) https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf (accessed on 14 May 2022).

3.6 South Africa

3.6.1 General

To enable South Africa to meet its UN and FATF obligations, three statutes were enacted: the Prevention of Organised Crime Act,[301] the Financial Intelligence Centre Act,[302] as amended,[303] and the Protection of Constitutional Democracy against Terrorist and Related Activities Act.[304] Since the Prevent of Organised Crime Act does not provide for targeted financial sanctions, the focus below falls on the Protection of Constitutional Democracy against Terrorist and Related Activities Act and the Financial Intelligence Centre Act as amended.

3.6.2 Protection of Constitutional Democracy against Terrorist and Related Activities Act

The Protection of Constitutional Democracy against Terrorist and Related Activities Act (POCDATARA) was signed into law on 14 February 2005 and came into force on 20 May 2005. It was, in accordance with its preamble, enacted for the following reasons:

> "To provide for measures to prevent and combat terrorist and related activities; to provide for an offence of terrorism and other offences associated or connected with terrorist activities; to provide for Convention offences; to give effect to international instruments dealing with terrorist and related activities; to provide for a mechanism to comply with United Nations Security Council Resolutions, which are binding on member States, in respect of terrorist and related activities; to provide for measures to prevent and combat the financing of terrorist and related activities; to provide for investigative measures in respect of terrorist and related activities; and to provide for matters connected therewith."

Against this background two points need to be made. The first is that the POCDATARA establishes various offences which did not previously exist. These offences are grouped under the following headings: "Offence of terrorism and offences associated or connected with terrorist activities";[305] "Convention offences";[306] and "Other offences".[307] The second is that the offence of terrorism seemingly has extraterritorial application.[308] This would mean that the

[301] 121 of 1998.

[302] 38 of 2001.

[303] See Financial Intelligence Centre Amendment Act 1 of 2017.

[304] 33 of 2004.

[305] s 2 and 3 of the POCDATARA (n 304). For comprehensive commentary on these offences, see De Koker and Smit "Key terror financing and international financial sanctions offences" in de Koker (ed) *Money Laundering and Terror Financing: Law and Compliance in South Africa* (2020) 75 76–90.

[306] s 4–10.

[307] s 11–14.

[308] Spruyt (n 1) 13.

POCDATARA not only applies to acts of terrorism committed against South Africa and South African individuals and entities, but also acts of terrorism committed against foreign governments, individuals and entities. In this context, the POCDATARA empowers South African courts to adjudicate cases concerning acts of terrorism irrespective of the jurisdiction in which the terrorist act was committed.[309]

Through the POCDATARA, South Africa saw its first legislative mechanism used to give effect to UN targeted sanctions.[310] It therefore sets several important compliance obligations in this regard. Section 25 provides a mechanism to communicate the designation of persons or entities, by requiring the following:

> "25. The President must, by Proclamation in the Gazette, and other appropriate means of publication, give notice that the Security Council of the United Nations, under Chapter VI1 of the Charter of the United Nations, has identified a specific entity as being –
> *(a)* an entity who commits, or attempts to commit, any terrorist and related activity or participates in or facilitates the commission of any terrorist and related activity; or
> *(b)* an entity against whom Member States of the United Nations must take the actions specified in Resolutions of the said Security Council, in order to combat or prevent terrorist and related activities."

From the formulation of this section, it can be seen that the President is not afforded discretionary powers to determine whether to provide notice of such a resolution. In contrast, section 26 affords a discretion in ratifying the section 25 proclamation to parliament. The section reads: "every proclamation issued under section 25 shall be tabled in parliament for its consideration and decision and parliament may thereupon take such steps as it may consider necessary". However, the parameters and extent of this discretion is uncertain.[311]

Section 4 comprehensively sets out the offences pertaining to the financing of the specified offences, which mostly relate to the financing of terrorism. The first offence relates to "the making available of property, financial or other service, or economic support". "Property" is defined as "money or any other movable, immovable, corporeal or incorporeal thing, and includes any rights, privileges, claims and securities and any interest therein and all proceeds thereof."[312] In terms of section 4(1), a person commits this offence if

[309] The preamble thus observes: "terrorist and related activities are an international problem, which can only be effectively addressed by means of international co-operation".

[310] Financial Intelligence Centre *Guidance Note 6: On Terrorist Financing and Terrorist Property Reporting Obligations in Terms of Section 28A of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* 7.

[311] See Powell "Terrorism and the separation of powers at the national and international level" 2005 *SACJ* 151 153 who argues that "the appearance of discretion may be illusory". She contends that the steps available to parliament in this respect are scant and "it is highly unlikely that section 26 allows parliament to amend the list".

[312] s 1, with reference to s 1 of the Prevention of Organised Crime Act (n 301).

> "he engages in certain [commercial acts or transactions] in relation to property or services, intending that the property, financial or other service or economic support be used, or while he knows or should have known or suspected that they will be used (directly or indirectly, in whole or in part) to facilitate the commission of a specified offence; for the benefit of, or on behalf of, or at the direction of, or under the control of an entity which commits or attempts to commit or facilitates the commission of a specified offence; or for the benefit of a specific entity identified in a notice issued by the president under section 25."[313]

The second offence relates to facilitation or support in any form that would make property available. The relevant prohibition provides:

> "4(2). Any person who, directly or indirectly, in whole or in part, and by any means or method
> *(a)* deals with, enters into or facilitates any transaction or performs any other act in connection with property which such person knows or ought reasonably to have known or suspected to have been acquired, collected, used, possessed, owned or provided –
> i. to commit or facilitate the commission of a specified offence;
> ii. for the benefit of, or on behalf of, or at the direction of, or under the control of an entity which commits or attempts to commit or facilitates the commission of a specified offence; or
> iii. for the benefit of a specific entity identified in a notice issued by the President under section 25 of POCDATARA; or
> *(b)* provides financial or other services in respect of property referred to in paragraph *(a)*,
> is guilty of an offence."

Section 4(3) criminalises conduct in relation to property that is, *inter alia*, acquired or used to carry out a specified offence or to benefit terrorists or terrorist organisations. The relevant prohibition provides:

> "4(3). Any person who knows or ought reasonably to have known or suspected that property is property referred to in subsection (2)*(a)* and enters into, or becomes concerned in, an arrangement which in any way has or is likely to have the effect of –
> *(a)* facilitating the retention or control of such property by or on behalf of –
> (i) an entity which commits or attempts to commit or facilitates the commission of a specified offence; or
> (ii) a specific entity identified in a notice issued by the President under section 25 of POCDATARA;
> *(b)* converting such property;
> *(c)* concealing or disguising the nature, source, location, disposition or movement of such property, the ownership thereof or any interest anyone may have in the property;
> *(d)* removing such property from a jurisdiction; or
> *(e)* transferring such property to a nominee,
> is guilty of an offence."

Failure to comply with the three offences outlined above may result in a fine not exceeding R100 million or imprisonment not exceeding 15 years.[314]

Especially noteworthy against the background of these offences are the supporting provisions set forth in the act. In accordance with section 17, these offences are committed

[313] An extensive list of relevant "commercial acts or transactions" is provided at s 4(1)(*a*)(i).

[314] s 18(1)(*c*).

notwithstanding whether (i) "the terrorist activity occurs or not";[315] (ii) "the actions of the accused actually enhance the ability of any person to commit a specified offence";[316] or (iii) "the accused knows or ought reasonably to have known about or suspected the specific offence that may be committed".[317]

Section 12 requires a person who suspects that another person has committed or intends to commit any of these offences to report such suspicion to any police official.[318] A person required to make such a report "may continue with and carry out any transaction to which such a suspicion relates, unless directed … not to proceed with such a transaction by an authorised police official".[319]

Finally, on the procedure to implement an asset freeze, section 23 provides:

> "(1) A High Court may, on *ex parte* application by the National Director to a judge in chambers, make an order prohibiting any person from engaging in any conduct, or obliging any person to cease any conduct, concerning property in respect of which there are reasonable grounds to believe that the property is owned or controlled by or on behalf of, or at the direction of-
>
> (a) any entity which has committed, attempted to commit, participated in or facilitated the commission of a specified offence; or
>
> *(b)* a specific entity identified in a notice issued by the President undersection 2.5.
>
> (2) An order made under subsection (I) may include an order to freeze any such property.
>
> (3) A High Court may make an interim order under subsection (I) pending its final determination of an application for such an order."

3.6.3 Financial Intelligence Centre Act

The Financial Intelligence Centre Act (FICA)[320] serves as South Africa's founding legislative effort to implement the FATF's recommendations, especially in relation to its anti-money laundering and counter-terrorist financing obligations in this regard. The purpose of the act is two-fold. In the first place, the FICA sought to establish the financial intelligence centre (FIC)[321] to fight money laundering, terrorism financing and other financial crimes.[322] Its primary objective in this regard is to "assist in the identification of the proceeds of unlawful activities and the combating of money laundering activities and the financing of terrorist and

[315] s 17(2).

[316] ss 3(*a*).

[317] ss 3(*b*).

[318] s 1(*a*)–(*b*).

[319] ss 5.

[320] (n 302) above.

[321] The FIC is described in s 2(1) as "as institution outside the public service but within the public administration as envisaged in section 195 of the Constitution [of the Republic of South Africa, 1996]" and is categorised as "a juristic person".

[322] s 2-16 of the FICA (n 302).

related activities".[323] Once identified, the FIC consolidates and appraises the information collected in order to disseminate financial intelligence to law-enforcement and investigative authorities.[324]

Secondly, the FICA establishes various obligations for so-called accountable and institutions. The First Schedule to the act sets out the institutions that are regarded as accountable institutions. Banks and insurance companies are listed in this regard.[325] Since banking and insurance facilities are susceptible to financial-crime abuse, the inclusion of especially these institutions in the list is important.[326]

For the purposes of this thesis, the most important obligations of accountable institutions, which are set out in chapter 3, are those which relate to customer due diligence.[327] At its core, customer due diligence entails a process whereby customer and transactional information is evaluated for indications of financial crime.[328] This process is facilitated through customer identification and verification measures.[329]

Other obligations of accountable institutions relate to retaining records;[330] access to information;[331] promotion of a compliance "culture";[332] and supervision.[333]

Prior to its 2017 amendments, the FICA did not specifically provide for compliance with targeted financial sanctions. Neither did it prescribe any specific obligations or requirements in this respect. However, when the FICA is considered against the background of

UNIVERSITY
OF
JOHANNESBURG

[323] s 3(1).

[324] s 3(2).

[325] Other listed institutions include casinos, attorneys, estate agents, dealers in motor vehicles, and other financial service providers.

[326] For example, letters of credit and demand guarantees, as products of financial institutions, may lend themselves to abuse by money launderers and terrorism financiers.

[327] s 21.

[328] This form of due diligence was commonly known as the "know-your-client" or "KYC" standard. The use of this terminology is generally attributed to the FATF by virtue of the reference to same in its interpretative notes and recommendations.

[329] Prior to the 2017 amendments, customer identification and verification measures were applied in terms of a rule-based approach. This approach required of banks to implement these measures in a "check-list" like manner and failed to take into account the risk attached to clients or their transactions. The 2017 amendments to this act, however, abolished the rule-based approach and substituted it with the risk-based approach. See Spruyt "The Financial Intelligence Centre Amendment Act and the application of a risk-based approach" in Hugo and du Toit (eds) *Annual Banking Law Update* (2017) 26. The risk-based approach is discussed in par 3.6.4 below.

[330] FICA (n 302) s 22–26.

[331] s 27–41.

[332] s 42–43B.

[333] s 44–45.

the POCDATARA, certain compliance-related inferences can be drawn. Firstly, the due diligence obligations placed on accountable institutions under section 21 of the FICA were somewhat bolstered by the POCDATARA.[334] In accordance with the POCDATARA, since it is an offence to engage listed individuals or entities, accountable institutions are required to "screen" client names against the UN sanctions lists to determine whether they have been designated in this regard.[335] Secondly, various amendments to the reporting obligations under the FICA were necessitated by the POCDATARA. Initially, the reporting obligations under section 29 were limited to suspicious and unusual transactions, and to property related to terrorism, but was subsequently amended to also include transactions known to be, or suspected of being, closely associated with terrorism financing. Moreover, a further reporting obligation emerges from the new section 28(A):

> "28A(1). An accountable institution which has in its possession or under its control property owned or controlled by or on behalf of, or at the direction of –
> *(a)* any entity which has committed, or attempted to commit, or facilitated the commission of a specified offence as defined in the Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004; or
> *(b)* a specific entity identified in a notice issued by the President, under section 25 of the Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004, must within the prescribed period report that fact and the prescribed particulars to the [Financial Intelligence] Centre."

As is apparent from the above, engagement with property identified in a report submitted in terms of section 28A will amount to a violation of section 4 of the POCDATARA. This means that the presentation of the report triggers the asset freezing requirement under the POCDATARA and as such will require of accountable institutions to cease all business activity with the entity concerned.

One is inclined to agree with Spruyt, who asserts that "these requirements and amendments somewhat strengthened the targeted financial sanctions regime introduced through the Protection of Constitutional Democracy against Terrorist and Related Activities Act".[336] Nevertheless, South Africa's sanctions regime was not fully compliant with the FATF's recommendations.[337] This necessitated the Financial Intelligence Centre Amendment Act, which is discussed immediately below.

UNIVERSITY
OF
JOHANNESBURG

[334] Spruyt (n 1) 18.

[335] Spruyt (n 1) 18.

[336] Spruyt (n 1) 19.

[337] See FATF *Financial Action Task Force Mutual Evaluation Report (South Africa)* (2009).

3.6.4 Financial Intelligence Centre Amendment Act

Signed into law on 26 April 2017, the primary purpose of the Financial Intelligence Centre Amendment Act (FICAA)[338] was to address the shortcomings of South Africa's anti-money laundering and terrorism framework. The shortcomings cited in the mutual evaluation report of 2009 mostly concerned the effectiveness of the due diligence investigations required by accountable institutions.[339] Consequently, the amendments introduced by the FICAA primarily deal with aspects relating to customer due diligence.

Most noteworthy in this regard are the following: additional duties for accountable institutions at the time of establishing a new business relationship;[340] the identification and verification of the so-called beneficial owner and the determination of the extent and nature of his/her ownership or control of a legal entity, so as to determine the scope of the financial-crime risk and implement the necessary mitigation measures;[341] clarification of the nature and scope of ongoing due diligence;[342] and procedural steps pertaining to business relationships with "foreign prominent public officials" and "domestic prominent influential persons" respectively.[343] The most fundamental change, however, was the introduction of a new approach to the identification and assessment of money-laundering and terrorist-financing risks: a risk-based approach (which is discussed below).

The FICAA also empowers the FIC to implement UN-mandated targeted financial sanctions.[344] Against this background the FICAA is aimed at enabling South Africa to meet its international obligations.[345] This is especially true of Recommendation 7 of the FATF recommendations, which requires the implementation of targeted financial sanctions in the context of nuclear weapons proliferation financing. The FICAA also makes provision for additional mechanisms and measures to the South African sanctions regime. Although similar to those encountered in the POCDATARA, these mechanisms and measures are a necessary

---

[338] (n 303) above.

[339] Mutual Evaluation Report (n 337) 88 *et seq*.

[340] s 21A.

[341] s 21B of the FICA (n 302).

[342] s 21C, read with 21D and 21E.

[343] s 21F and 21G.

[344] Financial Intelligence Centre (FIC) *Guidance Note 7: On the Implementation of Various Aspects of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* (2017) par 191.

[345] par 199.

addition to South Africa's sanctions framework relating to money laundering and nuclear weapons proliferation financing.[346]

Following the adoption of a UNSC resolution providing for new designations, the Minister of Finance must[347] announce such an adoption in the "government gazette and any other appropriate means of publication".[348] In turn, the director of the FIC must give notice of

> "*(a)* persons and entities being identified by the Security Council of the United Nations pursuant to a resolution contemplated in subsection (1); and
> *(b)* a decision of the Security Council of the United Nations to no longer apply a resolution contemplated in subsection (1) to previously identified persons or entities."[349]

The purpose of such a notice, accordingly, is to notify targeted individuals and entities and accountable institutions of any updates on the sanctions list maintained by the FIC – known as the "targeted financial sanctions list".[350]

An accountable institution must "scrutinise its information concerning clients with whom the accountable institution has business relationships in order to determine whether any such client is a person or entity mentioned in the proclamation by the President [in terms of the POCDATARA] or the notice by the Director [of the FIC]".[351] This section should not be narrowly interpreted to mean that scrutinisation is only required upon the issuance of a proclamation or notice. Owing to the frequency with which accountable institutions such as, for example, banks establish new client relationships or new business relationships with existing clients, screening should probably occur as often as such relationships are established. The FIC appears to be of a similar view:

> "Accountable institutions must therefore determine the likelihood that their client base and intended target market may include sanctioned persons or entities. This should assist the accountable institution in determining the amount of effort and resources it requires in order to determine whether they have sanctioned persons or entities as a clients [sic] or whether prospective clients are sanctioned persons or entities. Accountable institutions that have business relationships with foreign persons and entities are more vulnerable to dealing with sanctioned persons and entities."[352]

[346] Spruyt (n 1) 21.

[347] in accordance with s 26A(1).

[348] To distinguish this section from section 25 of the POCDATARA, ss 2 provides that "this section does not apply to resolutions of the Security Council of the United Nations contemplated in section 25 of [the POCDATARA]". Unlike section 25, moreover, ratification is not a requirement for such a proclamation.

[349] ss 3.

[350] https://www.fic.gov.za/International/sanctions/Pages/search.aspx (accessed on 4 August 2020).

[351] s 28A(3) of the FICA (n 302).

[352] FIC *Guidance Note 7* (n 344) par 199.

Section 26B comprehensively prohibits the provision of financial services or economic support to designated persons.[353] Strikingly similar to the offences created by section 4 of the POCDATARA, three separate prohibitions are created by section 26B. The relevant sections read as follows:

> "26B. (1) No person may, directly or indirectly, in whole or in part, and by any means or method—
> *(a)* acquire, collect, use, possess or own property;
> *(b)* provide or make available, or invite a person to provide or make available property;
> *(c)* provide or make available, or invite a person to provide or make available any financial or other service;
> *(d)* provide or make available, or invite a person to provide or make available economic support; or
> *(e)* facilitate the acquisition, collection, use or provision of property, or the provision of any financial or other service, or the provision of economic support, intending that the property, financial or other service or economic support, as the case may be, be used, or while the person knows or ought reasonably to have known or suspected that the property, service or support concerned will be used, directly or indirectly, in whole or in part, for the benefit of, or on behalf of, or at the direction of, or under the control of a person or an entity identified pursuant to a resolution of the Security Council of the United Nations contemplated in a notice referred to in section 26A(1).
> (2) No person may, directly or indirectly, in whole or in part, and by any means or method deal with, enter into or facilitate any transaction or 5 perform any other act in connection with property which such person knows or ought reasonably to have known or suspected to have been acquired, collected, used, possessed, owned or provided for the benefit of, or on behalf of, or at the direction of, or under the control of a person or an entity identified pursuant to a resolution of the Security Council of the 10 United Nations contemplated in a notice referred to in section 26A(1).
> (3) No person who knows or ought reasonably to have known or suspected that property is property referred to in subsection (1), may enter into, or become concerned in, an arrangement which in any way has or is likely to have the effect of [allowing a person sanctioned identified pursuant to any UNSC resolution to retain control or convert, conceal, remove or transfer such property]."

Simply put, no person may acquire, collect or use the property of persons subject to any UNSC resolution. This prohibition also includes the making available of financial products and services to a prohibited person or entity. This means that persons must "freeze"[354] funds or property or otherwise prevent the transfer of funds or property of a prohibited person or entity. In this respect, the FIC observed:

> "[T]his means that accountable institutions are not allowed to transact with a sanctioned person or entity or to process transactions for such a person or entity. The status quo as at the time of the imposition of the sanction in relation property or funds of the sanctioned person or entity must be maintained and no financial services may be provided to the person or entity."[355]

[353] s 26B(1–3) of FICA (n 297).

[354] This term, according to the FATF glossary (n 6), means "to prohibit the transfer, conversion, disposition or movement of any funds or other assets that are owned or controlled by designated persons or entities on the basis of, and for the duration of the validity of, an action initiated by the United Nations Security Council or in accordance with applicable Security Council resolutions by a competent authority or a court."

[355] FIC *Guidance Note 7* (n 344) par 196.

Every "person" must comply with these prohibitions and not only accountable institutions. This is evident where the provisions refer to *no person* instead of accountable institution. There is, however, one definitive difference between section 26B of the FICA and section 4 of the POCDATARA. Section 26B prohibitions apply to designated individuals and entities and to any person "acting on behalf of, at the direction of, or to the benefit of" the listed individual or entity. Section 4 prohibitions, on the other hand, relate only to designated persons and entities. Therefore, in this sense, section 26B is broader in scope than section 4. The practical implication is that a bank may be legally required to also identify and verify these concomitant persons.

A violation of any provision in section 26B may constitute an offence,[356] in which case imprisonment of not more than 15 years or a fine capped at R100 million may be imposed.[357] An accountable institution may not raise as a defence to such an offence "a commercially available screening capability or the fact that it had considered the risk of being exposed to [targeted financial sanctions-related] obligations to be low".[358]

As previously commented, section 28A of the FICA requires of accountable institutions to report suspicious and unusual transactions and property related to terrorism and terrorism financing pursuant to the POCDATARA, more specifically section 25. The FICAA has extended this reporting obligation to also include the reporting of property relating to a person or entity identified in terms of section 26A of the FICA:

> "28A(1). An accountable institution which has in its possession or under its control property owned or controlled by or on behalf of, or at the direction of –
> *(a)* any entity which has committed, or attempted to commit, or facilitated the commission of a specified offence as defined in the Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004;
> *(b)* a specific entity identified in a notice issued by the President, under section 25 of the Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004,; or
> *(c) a person or an entity identified pursuant to a resolution of the Security Council of the United Nations contemplated in a notice referred to in section 26A(1)*,
> must within the prescribed period report that fact and the prescribed particulars to the [FIC]."

Importantly, section 28A does not replace section 29 but rather operates alongside it. Should an instance arise where the section 28A requirements have not been met, the reporting obligations under section 29 may still exist. This will be the case particularly when an *unusual* transaction or activity has occurred which does not necessarily amount to the commission of,

[356] s 49A of FICA (n 302).

[357] s 68.

[358] FIC *Guidance Note 7* (n 344) par 200.

or attempted commission of, an offence under the POCDATARA; is not performed by an entity specified under a section 25 proclamation; and/or is not carried out by an entity identified by any UNSC resolutions. This position was substantially confirmed by the FIC: "All businesses must in terms of section 29 of the FIC Act, report suspicious or unusual activities or transactions or series of transactions related to money laundering, the financing of terrorist and related activities and contraventions of prohibitions to financial sanctions to the [FIC]." [359] A failure to report property relating to terrorists in terms of section 28A may constitute an offence.[360]

The aforegoing has canvassed the sanctions-related legal obligations and compliance requirements imposed on accountable institutions. The vast majority of these obligations and requirements relate to customer due diligence; this means that accountable institutions must subject their customers to identification and verification requirements to ensure that they do not provide financial or economic support to a client who is a listed or sanctioned party. The need to adopt a sound approach to these customer-due-diligence investigations is best conceptualised when approached from the perspective of the burden placed on accountable institutions, their expertise as well as their resources. Spruyt noted concisely that

> "[i]t would be unreasonably burdensome – and often completely impossible – to perform such detailed due diligence, especially in the case of large and complex corporate structures. No accountable institution has the time, expertise or resources available to do this – not to mention the extremely negative impact that this would have in terms of the customer experience."[361]

UNIVERSITY OF JOHANNESBURG

Using Spruyt's statement as a point of departure, the necessary approach to these due diligence investigations must therefore stem from a less onerous and more reasonable methodology. It must also be flexible enough to "target [accountable institutions'] resources more effectively and apply preventative measures that are commensurate to the nature of risks, in order to focus their efforts in the most effective way".[362]

Prior to the 2017 amendments client identification and verification was dealt with in accordance with a rule-based approach.[363] This approach, as indicated above, did not take into account the risk relating to the particular transactions or party. This tick-the-box approach

---

[359] See Financial Intelligence Centre (FIC) *Guidance Note 4B: On Reporting of Suspicious and Unusual Transactions and Activities to the Financial Intelligence Centre in Terms of Section 29 of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* par 103.

[360] s 51A of the FICA (n 302).

[361] Spruyt (n 1) 25.

[362] FATF Recommendations (n 12) "Introduction".

[363] See footnote 329 above.

proved inefficient and cost-ineffective.[364] The risk-based approach introduced by the 2017 amendments requires that due diligence should be conducted with special reference to the risk attached to the particular business relationship in lieu of the application of rigid regulations and requirements.[365] Spruyt explains this approach best:

> "Where the risk is higher, the client identification and verification requirements should also be stricter and more extensive, to ensure that the institution creates an accurate client profile. The higher risk would also inform the nature of ongoing due diligence, by for example requiring that the client's information be kept up to date more frequently and that the client's behaviour be monitored more closely. Where the risk is lower, less onerous identification and verification requirements may be set, as the lower risk justifies a less detailed client profile. Similarly, the client's behaviour would be monitored less closely."[366]

Although there is currently no standardised methodology applied in relation to the assessment of risk, it is well-established practice that risk indicators (or so-called red flags) should inform this risk assessment.[367] Prominent risk indicator lists have been issued by the FATF[368] and the United Nations Commission on International Trade Law (UNCITRAL).[369] Domestically, several possible risk indicators have also been provided by the FIC.[370] The most common risk indicators include the utilisation of specific products or services by the client – for instance, cross-border transactions, correspondent banking services and international trade and finance are construed as high-risk;[371] the nature of the jurisdiction from which the client operates – for example, a jurisdiction which has an inadequate anti-money laundering framework will be considered a high-risk jurisdiction;[372] and the industry which the client operates in – for example, precious metals, stones, and real estate are regarded as high-risk industries.[373]

---

[364] FIC *A New Approach to Combat Money Laundering and Terrorist Financing* (2017) 1.

[365] Marxen "Traditional trade finance instruments a high risk? a critical view of current international initiatives and regulatory measures to curb financial crime" in Hugo (ed) *Annual Banking Law Update* (2018) 161 172.

[366] Spruyt (n 1) 27.

[367] FATF *Guidance for a Risk-Based Approach: The Banking Sector* (2014) 17; and *Guidance Note* 7 (n 344) par 37.

[368] Risk indicators have been included in many of the FATF's publications. See, for example, those in FATF *Report on Money Launder/Terrorist Financing Risks and Vulnerabilities Associated with Gold* (2015) 20–23; FATF *Report on Risk of Terrorist Abuse in Non-Profit Organisations* (2014) 68–73; and FATF *Report on Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals* (2013) 77–82; and FATF *Money Laundering & Terrorist Financing Through the Real Estate Sector* (2007) 34–37.

[369] UNCITRAL *Recognizing and Preventing Commercial Fraud* (2013) 11 *et seq*. For a discussion on the role and contribution of the UNCITRAL, see par 4.4 below.

[370] FIC Guidance Note 7 (n 344).

[371] 17 and 20.

[372] Symington, Basson and de Koker "Risk and the risk-based approach to AML/CFT" in de Koker (ed) *Money Laundering and Terror Financing: Law and Compliance in South Africa* (2020) 201 218.

[373] See the FATF publications referred to in n 368 above which identify several high-risk industries.

Although the POCDATARA, the FICA and the changes made by the FICAA contribute to enabling the fulfilment of South Africa's international obligations, much more needs to be done in this regard. This is the general theme that emerges from the 2021 FATF mutual evaluation report of South Africa.[374] The aim of the report was to analyse South Africa's level of compliance with the FATF 40 Recommendations and the level of effectiveness of its anti-money laundering and counter-terrorism financing system.[375] To this end, the report strategically assesses South Africa's technical compliance against each individual recommendation.

Specifically in relation to South Africa's targeted financial sanctions regime, the report is highly critical. As regards Recommendation 6, which requires the implementation of targeted financial sanctions relating to terrorism and terrorist financing, the report identifies three main issues. The first is that the current framework enables significant delays in relation to the implementation of UNSC resolutions.[376] There is no provision requiring the implementation of targeted financial sanctions "without delay", as envisaged in UNSC Resolution 1373. Consequently, implementation can take several months. Secondly, there are no mechanisms establishing a domestic process for identifying targeted persons and entities.[377] Section 25 of the POCDATARA simply places an obligation on the President to publish a notification – through proclamation in the government gazette – whenever the UNSC designates an individual or entity under its resolutions. There are also no mechanisms or procedures for designation proposals. The report emphasises South Africa's failure to demonstrate an application of an evidentiary standard of proof or "reasonable grounds" or "reasonable basis" when determining whether or not to make a proposal for designation.[378] South Africa, at the time of the publication of the report, proposed no names for designation. The third issue is that the mechanism used to implement UNSC Resolution 1373 (that is, section 4(2) of the POCDATARA) focuses only on identified property and not also on all property or assets of a designated person.[379] A further implication is that the prohibition "does not cover funds or

[374] "Anti-money laundering and counter-terrorist financing measures: mutual evaluation report (South Africa)" (2021) https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-South-Africa.pdf (accessed on 20 May 2022)

[375] For background on these mutual evaluation reports, the FATF recommendations and the FATF in general, see par 4.2 below.

[376] (n 374) 169.

[377] 167.

[378] 167.

[379] 169.

other assets of persons or entities acting on behalf of, or at the direction, of a designated person".[380] The report concludes the analysis of South Africa's compliance with Recommendation 6 as follows:

> "South Africa has major shortcomings for this recommendation. There are delays in the implementation of TFS for UNSCRs 1267, 1989 and 1998, and no domestic process for making proposals nor identifying targets for designation under these resolutions. For UNSCR 1373, South Africa relies on a freezing mechanism that does not amount to proper designations for TFS as it focuses on identification of property rather than on designated entities.
>
> **Recommendation 6 is rated non-compliant**."[381]

In relation to Recommendation 7, which requires the implementation of targeted financial sanctions relating to proliferation, the report identifies three main issues. The first two issues are similar to those identified under Recommendation 6, namely, that the current processes present delays in implementing targeted financial sanctions relating to proliferation (though not to the same extent as in the case of Recommendation 6),[382] and that the relevant prohibition fails to provide for moneys and other financial assets of persons "acting on behalf of, or at the direction of a designated person or entity".[383] The third issue, however, relates to weaknesses identified in the processes for de-listing. In accordance with section 26A of the FICA, the Director of the FIC must give notice of a decision of the UNSC resolution to de-list a person or entity under an existing UNSC resolution. This is done by publishing a notice on the FIC website. The main problem identified in this respect is that the FICA and the guidance notes of the FIC do not clarify precisely financial institution's obligations to respect a de-listing or unfreezing action.[384] There is also no provision or procedure relating to de-listing petitions, as envisaged in UNSC Resolution 1730.[385] The report concludes the analysis of South Africa's compliance with Recommendation 7 as follows:

> "South Africa has moderate shortcomings as there are some delays in the implementation of TFS. In addition, the prohibition does not extend to funds and other assets of persons acting on behalf of, or at the direction of a designated person or entity, guidance does not provide enough sector specific details for all AIs and RIs for AIs, and there are no provisions nor publicly known procedures enabling or informing listed persons and entities to petition a request for de-listing. There are measures for monitoring and ensuring compliance for most FIs and DNFBPs with the requirements of R.7.

[380] 169.

[381] 171

[382] In relation to Recommendation 7, it is reported that on weekdays publication of UNSC resolutions can be done in a matter of days. On weekends, the process can take from three to five days.

[383] 171–172.

[384] 173.

[385] 172.

Recommendation 7 is rated partially compliant."[386]

Overall, the mutual evaluation report reflects serious flaws in the South African anti-money laundering and counter-terrorist financing system. In the wake of this report South Africa, it is submitted, is in danger of moving into the so-called "grey list". Jurisdictions included in the grey list are subject to increased monitoring and work closely with the FATF to address critical issues.[387] The FATF encourages its members and all jurisdictions to take into account the information presented in the grey-listing.[388] The practical implication for banks and other financial institutions in grey-listed jurisdictions is that they may experience hardship in continuing to participate in the international financial system.

3.6.5 Conclusions

This section analysed the South African targeted financial sanctions regime. The analysis shows that there are various compliance obligations for so-called accountable and reporting institutions as well as, in certain instances, other persons. These obligations are to be carried out with reference to the so-called risk-based approach, which requires of banks to conduct intensive customer relationship risk assessments. Overall, however, the South African sanctions regime is not fully compliant with its international obligations. This is evident from the 2021 FATF mutual evaluation report of South Africa.

UNIVERSITY OF JOHANNESBURG

3.7 Comparative analysis and remarks

As is clear from the overview provided above, the US, UK and South Africa have each provided for targeted financial sanctions in their domestic laws. The EU also has a targeted financial sanctions regime and requires EU member states to implement it. Unlike the US, UK and South Africa, the EU is not a member of the UN but has seen it fit to enforce UN sanctions as intermediary between the UN and EU member states. All four jurisdictions are members of the FATF.

Against this background, it is probably correct to say that in principle the sanctions regimes of all four jurisdictions align in purpose: namely, to maintain international peace and

[386] 173.

[387] See par 4.2 below.

[388] De Koker and Smit "The combating of money laundering, financing of terrorism and proliferation financing" in de Koker (ed) *Money Laundering and Terror Financing Law and Compliance in South Africa* (2020) 1 13.

security[389] and, more specifically for the purposes of this thesis, to protect the integrity of the international financial system.[390] Hence, threats to international peace and to the international financial system – the most prominent of which are terrorism, the financing of terrorism, nuclear weapons proliferation and money laundering – should generally trigger the imposition of sanctions and especially targeted financial sanctions in all four legal systems.

Alignment in purpose, however, does not imply similarity in enforcement and function. In this regard, the four legal systems diverge in relation to two key issues: (i) the imposition of unilateral sanctions and (ii) the approach to extraterritorial sanctions. Some comparative remarks on these issues follow.

The sanctions frameworks of the EU, US and UK empower the relevant authority to implement both UN and unilateral sanctions. Two sets of unilateral sanctions can be discerned in this regard, namely, those which complement an existing UN sanctions regime, and those which are applied without the backing of a UN sanctions regime. In the case of the former, sanctioning authorities go further than implementing the relevant UN sanctions by targeting persons and entities likely to be associated with, but which have not been classified by the UNSC as, designated persons. In case of the latter, sanctioning authorities impose sanctions completely independently of the UN. It is particularly noteworthy that in the UK the SAMLA confers upon the Secretary of State and Treasury broad powers in relation to the imposition of sanctions. The imposition of unilateral financial sanctions may in this regard fall within the scope of any of a number of categories provided in the act.[391]

South Africa's sanctions regime, on the other hand, appears to be restricted to the imposition of UN sanctions. Both the POCDATARA and the FICA expressly provide for UN sanctions but are silent on the adoption of unilateral sanctions.[392] Moreover, sanctions implementation mechanisms and controls are articulated with specific reference to UN regimes and resolutions.[393] Terminology employed in this regard is clear and unambiguous. Therefore, the logical inference to be made is that the legislature did not intend for South Africa to

---

[389] See art 39 of the UN Charter.

[390] This ultimately is the aim of the FATF. See par 4.2 below.

[391] See s 1 (2)(a)–(i) of the SAMLA (n 333).

[392] s 25 of the POCDATARA (n 304); and s 26A(1) of the FICA (n 302).

[393] See, for instance, FIC *Guidance Note 7* (n 344) par 194 which provides: "Mechanisms for the implementation of the UNSC Resolutions include the publication in the Government Gazette by the Minister of Finance of a Notice of the adoption of the UNSC Resolution, and the publication of a Notice by the Director of the Centre of persons who are subject to the sanction measures (the sanctions list). These Notices may be revoked if it is considered that they are no longer necessary to give effect to the applicable UNSC Resolutions. Otherwise the sanctions announced in these Notices remain in effect indefinitely."

implement unilateral financial sanctions. South Africa's position on unilateral sanctions can be attributed to, or is at least influenced by, its membership with the Non-Aligned Movement[394] and the African Union,[395] both of which have consistently advocated against the use of unilateral coercive measures.[396]

The approaches of the four legal systems also, as indicated above, deviate in relation to extraterritorial sanctions. It is trite that the US generally implements its sanctions-related legislation (for example, the TWEA and the IEEPA) extraterritorially. And that in instances where the jurisdictional links provided for in such legislation have been satisfied, the OFAC may visit non-compliant foreign persons and entities with harsh penalties and fines. The EU and UK, on the other hand, oppose the notion of extraterritorial sanctions. This is evident on two fronts. Firstly, compliance with EU and UK sanctions is generally restricted to persons and entities within the borders, or those entities incorporated in terms of the laws, of the EU and UK, respectively. Persons and entities outside of the EU and UK, therefore, are under no legal obligation to comply with EU and UK sanctions. Secondly, both the EU and UK have enacted regulatory instruments which prohibit EU and UK persons from complying with sanctions emanating from certain US legislation which purport to have extraterritorial effect. Compliance by EU and UK persons with the relevant US sanctions will give rise to serious consequences, including to allow EU and UK persons to recover damages from other EU and UK persons who have complied with the relevant US extraterritorial sanctions and to invalidate in the EU and UK any foreign court rulings in this regard.

The fact that the world's leading jurisdictions differ so strongly on an issue that bears much international and national significance is remarkable. The US's position in this regard

UNIVERSITY OF JOHANNESBURG

[394] The South African Department of International Relations and Cooperation (DIRCO) provides the following on its official website in relation to the Non-Aligned Movement: "The Non-Aligned Movement (NAM) with its 118 member States, is the largest grouping of countries outside of the United Nations itself, making of it an important lobby in global affairs. […] Since its inception in 1961, the Movement has played a crucial and highly visible political role in representing the interests of developing countries, particularly in the eradication of colonialism, supporting struggles for liberation and self-determination, the pursuit of world peace and the search for a more equitable and just global order. […] In this regard, the Movement also strongly supported the causes of democracy and justice in South Africa and from the outset South African liberation movements participated as observers in its activities. …" See http://www.dirco.gov.za/foreign/Multilateral/inter/nam.htm (accessed on 31 May 2022).

[395] The African Union describes itself as "a continental body consisting of the 55 member states that make up the countries of the African Continent. It was officially established in 2002 as a successor to the Organisation of African Unity (1963–1999)." See https://au.int/en/overview (accessed on 22 June 2022).

[396] For a discussion of the Non-Aligned Movement and the African Union in relation to their respective positions on the use of unilateral coercive measures, see Strydom "South Africa's position and practice with regard to unilateral and extraterritorial coercive sanctions" in Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 37 46–50.

reflects its strong grip on the international financial system, which is currently dominated by the US dollar and US financial institutions.[397] Noting the growing popularity of decentralised currencies and alternative non-US remittance systems, however, it is conceivable that US extraterritorial sanctions may, at some stage, become less relevant and impactful. Goldman and Lindblom write:

> "Although US sanctions programmes continue to target trade and financial links, leveraging the use of the dollar, to achieve national security outcomes, changes in the sources of adversaries' economic power may diminish the utility of sanctions as a tool of statecraft."[398]

Citing China and North Korea as examples in this regard, they continue:

> "Specifically, China's economic strength is increasingly derived from the development and dissemination of advanced technologies – 5G telecommunications infrastructure, artificial intelligence, mobile application and payment systems, among others – rather than the export of goods around the world. The contribution the creators of these technologies make to the power of the Chinese state, through the data they are able to provide, wittingly or unwittingly, to the Chinese government, and through their economic heft, depends less on access to the dollar-denominated global trade and finance system than did the sources of Chinese government power in previous generations. Additionally, trends in the international commercial and political systems are increasingly 'decoupling' sanctions targets from the United States – again, China, but also North Korea – in ways that make them less vulnerable to the use of sanctions to incentivize changes in behaviour."[399]

The US, therefore, will need to seriously reconsider and perhaps adapt its sanctions policies so as to enable US extraterritorial sanctions to remain relevant and effective even in times of advanced technologies.

The South African legislature has not made clear its position on extraterritorial sanctions.[400] The statutes giving effect to targeted financial sanctions do not purport to carry extraterritorial application. Neither has legislation or regulation been enacted to prohibit South African individuals and entities from complying with foreign extraterritorial sanctions. Consequently, when confronted with the decision whether or not to comply with the OFAC sanctions, South African individuals and entities must make such decisions independently.

---

[397] HSBC *Global Report – Navigator Now, Next and How for Business* (2018) 6 *et seq* www.business.hsbc.com/trade-navigator (accessed on 15 June 2020); and Drezner "Targeted sanctions in a world of global finance" 2015 *International Interactions* 755 761, who describes the US dollar as the "world's reserve currency".

[398] Goldman and Lindblom "The US position and practice with regards to unilateral and extraterritorial sanctions: reimagining the US sanctions regime in a world of advanced technology" in Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 130 130.

[399] (n 398) above.

[400] By its association with the African Union, the argument can be made that South Africa is in principle against the application of extraterritorial sanctions. It has not, however, taken an official position in this regard. On the African Union and extraterritorial sanctions, see Strydom (n 396) 49–50.

South African banks often resort to complying.[401] This is ascribed to the significant business and reputational risks that typically follow a decision not to comply.

The final comparative remarks to be made concern the complexity of the sanctions regimes of the different legal systems. Although essentially based on two statutes (the TWEA and IEEPA), the US financial-sanctions regime consists also of a significant number of regulations, each applied in different contexts, and which pose different requirements and obligations on banks. The complexity of the regime is exacerbated when regard is had to concomitant statutes dealing with money laundering, terrorist financing and other financial crimes.[402] For banks subject to US jurisdiction it is therefore "becoming increasingly difficult to assess, and comply with, all current expectations and legal requirements".[403] Within the context of unilateral US sanctions and non-US banks, the UN Special Rapporteur has expressed her concern about "the increase in overcompliance with sanctions".[404] She explains that the effects of overcompliance "can hardly be overcome even after the adoption of laws prohibiting compliance with other States' unilateral sanctions."[405]

The EU financial-sanctions framework also comprises several different authorities, including CFSP positions and decisions, regulations, directives as well as other substantial pronouncements. So, too, may EU banking and financial institutions find it difficult to comply fully with EU financial sanctions and related requirements.

The UK and South African targeted financial sanctions regimes are less complex. They each consist of not more than three statutes and, in the case of the UK, a few supporting regulations. This is not, however, an indication that the UK's sanctions regime is inferior and unable to deal sufficiently with the threats faced by the country. In this regard, the FATF, in its 2018 mutual evaluation report of the UK, stated the following:

> "The UK has been a leader in designating terrorists at the UN and EU level, and takes a leading role promoting effective global implementation of proliferation-related [targeted financial sanctions]. The UK has frozen assets and other funds pursuant to its proliferation financing sanctions program and taken steps to increase the overall effectiveness of its targeted financial

UNIVERSITY OF JOHANNESBURG

401 See, for example, *Breedenkamp v Standard Bank of South Africa Ltd* 2009 5 SA 304 (GSJ); *Breedenkamp v Standard Bank of South Africa Ltd* 2009 6 SA 277 (GSH); and *Bredenkamp v Standard Bank of South Africa Ltd* 2010 4 SA 468 (SCA) in which Standard Bank unilaterally terminated Bredenkamp's bank account following Bredenkamp's listing on the OFAC sanctions list.

402 Here reference is made specifically to the Bank Secrecy Act (n 207), Money Laundering Control Act (n 208), and USA PATRIOT Act (n 209) as dealt with in par 3.4.3 above.

403 Marxen (n 365) 171. Although the author's remarks were made in relation to financial crime-related legislative and regulatory activities in general, they are especially applicable in relation to US sanctions laws and policies.

404 *Report of the Special Rapporteur on the negative impact of unilateral coercive measures on the enjoyment of human rights, Alena Douhan* UN Doc A/HRC/48/59 (8 July 2021) par 63.

405 (n 404) above.

> sanctions (TFS) regime, including through the creation of the Office of Financial Sanctions Implementation and the strengthening of penalties for breaching TFS. However, minor improvements are required in relation to applying penalties for sanctions breaches, ensuring consistent application of TFS and communicating designations immediately. The UK has a good understanding of the TF risks associated with NPOs and has been effective in taking action to protect the sector from abuse. The UK also has a robust confiscation regime through which it can and does deprive terrorists of assets."[406]

In contrast, the FATF described South Africa's terrorist financing framework as one which suffers from "deficiencies".[407] It also found that the framework is not well-aligned to South Africa's terrorist financing risk profile.[408] The essential point to be made against this background is that the key to an effective sanctions regime lies not in outward complexity or form but in substance.

The above comparative analysis has shown that the EU, US, UK and South Africa have each adopted a legal framework to give effect to their international obligations and expectations as they relate to targeted financial sanctions. The four sanctions regimes diverge on the key issues of unilateral sanctions and extraterritorial sanctions. While the sanctions regimes of the EU, US and UK enable the imposition of UN *and* unilateral sanctions, the South African sanctions regime appears to be restricted to the implementation of UN sanctions. On the issue of extraterritorial sanctions, the US has emerged as the primary enforcer of extraterritorial sanctions. The EU and UK, however, have adopted regulatory instruments to counter the effects of certain US extraterritorial sanctions and to prohibit compliance by EU and UK persons with these sanctions. South Africa does not apply its financial sanctions extraterritorially and has not adopted a legal position in relation to the application of foreign extraterritorial sanctions on its subjects. As such, South African persons and entities must, as and when the need arises, decide on their own whether or not to comply with foreign extraterritorial sanctions. Finally, the financial sanctions regimes vary in relation to the number of legislative and regulatory instruments that inform the regimes. Complexity in this regard is not necessarily an indicator of effectiveness. Rather, the substance of the regime is what matters.

UNIVERSITY
OF
JOHANNESBURG

---

[406] (n 300) above.

[407] (n 374) 9.

[408] (n 374) 9.

3.8 Conclusion

This overview of targeted financial sanctions has, against the background of the role and contribution of the UN to the development of targeted sanctions, introduced and provided for the concept, scope and application of targeted financial sanctions. This was followed by analyses of the legal and regulatory frameworks giving effect to targeted financial sanctions in the EU, US, UK and South Africa. The results of the comparative analysis indicate that although the sanctions regimes of these jurisdictions are principally aimed at fulfilling the same purpose, they deviate in relation to unilateral sanctions and extraterritorial sanctions. They also deviate on the issue of complexity.

UNIVERSITY
OF
JOHANNESBURG

CHAPTER FOUR: KEY INTERNATIONAL ORGANISATIONS ON TARGETED FINANCIAL SANCTIONS

4.1 Introduction

It is trite that targeted financial sanctions are implemented into national legal systems to comply with international obligations.[1] This is especially true of United Nations (UN) obligations. As was seen in the previous chapter, targeted financial sanctions (whether UN-mandated or unilateral) translate into complex compliance requirements and controls for specifically banking institutions and other financial service providers. In an attempt to facilitate the effective implementation of such requirements and controls, certain inter-governmental and non-governmental organisations or international groups and bodies have contributed different initiatives of their own in this regard. These initiatives, which may or may not be binding on banks, often deal also with consequential issues – in other words, issues arising due to or in connection with a bank's compliance (or non-compliance) with targeted financial sanctions. Bearing in mind the onerous nature of financial sanctions compliance requirements and controls, activities of such international organisations, it is submitted, make a meaningful contribution to international coordination and collaboration in the area of targeted financial sanctions, as well as to a better understanding of the issues involved.

This chapter aims to evaluate the role and contribution of the most important international organisations and groups in relation to targeted financial sanctions. The role of the UN, and the UN Security Council (UNSC) in particular, in the development of targeted financial sanctions was discussed at length in Chapter Three.[2] The European Union and its targeted financial sanctions framework also received sufficient attention in that chapter.[3] They accordingly will not be discussed below.

4.2 Financial Action Task Force

While countries' *primary* source of targeted financial sanctions obligations emanates from the UN, a *secondary* source of obligations emerges by virtue of membership of, or alliance with the recommendations of, the Financial Action Task Force (FATF). At present, the FATF

[1] This, of course, is not the case regarding unilateral sanctions which are implemented outside of the relevant international obligations.

[2] See par 3.2 above.

[3] See par 3.3 above.

comprises 39 members: 37 states and two regional organisations. The member states are Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Denmark, Finland, France, Germany, Greece, Hong Kong (China), Iceland, India, Ireland, Israel, Italy, Japan, the Republic of Korea (South Korea), Luxembourg, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Portugal, the Russian Federation, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The European Commission and Gulf Cooperation Council are the regional organisations.

Additionally, nine so-called FATF-style regional bodies (FSRBs) have been established, in most instances with the assistance of the FATF, to perform functions for their members similar to what the FATF does for its own membership.[4] These are the Asia/Pacific Group on Money Laundering; the Caribbean Financial Action Task Force; the Financial Action Task Force for Latin America (GAFILAT); the MONEYVAL Committee of the Council of Europe; the Intergovernmental Action Group Against Money Laundering in West Africa (GIABA); the Middle East and North Africa Financial Action Task Force (MENAFATF); the Eurasian Group on Combating Money Laundering and Financing of Terrorism; the Task Force on Money Laundering in Central Africa; and the Eastern and South African Anti-Money Laundering Group (ESAAMLG). These FSRBs have the status of FATF associate members. "In setting standards, FATF depends on input from FSRBs as much as from its own members. However, FATF remains the only standard-setting body."[5]

The FATF was established by the G7 Economic Summit[6] in Paris in July 1989. This autonomous inter-governmental body seeks to set standards and "promote effective implementation of legal, regulatory and operational measures to combat threats to the integrity of the international financial system".[7] "Threats to the integrity of the international financial system" were initially limited to concerns of money laundering but have subsequently been widened to include terrorist financing and, more recently, the financing of nuclear weapons proliferation.[8]

UNIVERSITY OF JOHANNESBURG

[4] De Koker and Smit "The combating of money laundering, financing of terrorism and proliferation financing" in de Koker (ed) *Money Laundering and Terror Financing Law and Compliance in South Africa* (2020) 1 14.

[5] FATF *High-Level Principles and Objectives for FATF and FATF-style regional bodies* (as updated in February 2019) 1.

[6] The summit was joined by the President of the Commission of the European Communities and is occasionally referred to as a G7+1 meeting.

[7] https://www.fatf-gafi.org/about/whatwedo/ (accessed on 10 July 2020).

[8] Commenting on its recently expanded mandate, the FATF stated the following: "Recognising the serious threat to international peace and security posed by the proliferation of weapons of mass destruction, we commit to further action to strengthen the global response to WMD proliferation financing. This reflects multiple calls by the United

To give effect to its objectives, the FATF issues standards or recommendations aimed at combating financial crime in the banking system. It also conducts so-called mutual evaluations of members' progress in implementing the recommendations, and assesses the overall effectiveness of members' anti-money laundering and counter-terrorist financing regimes. Furthermore, the FATF regularly publishes guidance notes to enable the effective implementation of its recommendations.

The contribution of the FATF to combating money laundering and terrorist financing has been significant. Not only has it been instrumental in harmonising the initiatives used to tackle the illicit use of countries' financial systems, it has also contributed greatly to the transparency of these financial systems.[9] Harmonisation and transparency in this regard are vital to the integrity of any financial system, particularly in the context of international trade and finance, and for relationships between correspondent banks internationally. Consequently, Ellinger, Lomnicka and Hare have described the FATF as the "lead institution for international initiatives" focused on combating financial crimes such as international terrorist financing and proliferation financing.[10]

Failure to comply or insufficient compliance with FATF recommendations may lead to punitive action by the FATF. Two types of high-risk jurisdictions can be discerned in this regard.[11] The first is non-cooperative jurisdictions. These jurisdictions are subjected to countermeasures[12] by FATF-compliant jurisdictions and are listed on the so-called "black list". The second relates to jurisdictions with "strategic deficiencies" in their regimes. These jurisdictions are subject to increased monitoring and work closely with the FATF to address deficiencies. The list on which such high-risk jurisdictions emerge is the so-called "grey list". The imposition of countermeasures is expected in relation to jurisdictions on the first list, but

Nations Security Council for Member States to focus more attention on CPF measures. We will further work to ensure that members of the FATF Global Network have appropriate policies and controls in place to address the threat posed by proliferation financing". See, in this respect, FATF *Mandate* (2019) 2.

[9] More than 190 countries around the world subscribe to these standards.

[10] Ellinger, Lomnicka and Hare *Ellinger's Modern Banking Law* (2011) 93.

[11] De Koker and Smit (n 4) 13.

[12] The Interpretative Note to Recommendation 18 provides a list of examples of countermeasures. These include a refusal to establish branches or subsidiaries of financial institutions from jurisdictions subject to the countermeasures, restricting business relationships with persons or entities from the jurisdiction or even terminating correspondent relationships with financial institutions in the particular jurisdiction. See https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf 86 (as updated in March 2022).

not the second list. FATF members are, however, encouraged to pay attention to the information presented in the grey-listing.[13]

The FATF's *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*[14] (typically referred to as the "FATF recommendations") contains a comprehensive framework of measures for jurisdictions to implement to combat money laundering, terrorism financing and nuclear weapons proliferation. While all 40 recommendations provide necessary measures to combat money laundering, terrorism financing and the proliferation of nuclear weapons, only two relate specifically to the implementation of targeted financial sanctions: these are recommendations 6 and 7.

It must be stressed that the requirements underlying these two recommendations are not "intended to replace other measures or obligations that may already be in place for dealing with funds or other assets in the context of a criminal, civil or administrative investigation or proceeding", but to serve as "preventive measures that are necessary and unique in the context of stopping the flow of funds or other assets […] and the use of funds or other assets by [terrorist groups and proliferators]".[15]

Recommendation 6 deals with targeted financial sanctions in relation to terrorism and terrorist financing. It reads as follows:

> "Countries should implement targeted financial sanctions regimes to comply with United Nations Security Council resolutions relating to the prevention and suppression of terrorism and terrorist financing. The resolutions require countries to freeze without delay the funds or other assets of, and to ensure that no funds or other assets are made available, directly or indirectly, to or for the benefit of, any person or entity either (i) designated by, or under the authority of, the United Nations Security Council under Chapter VII of the Charter of the United Nations, including in accordance with resolution 1267 (1999) and its successor resolutions; or (ii) designated by that country pursuant to resolution 1373 (2001)."[16]

Recommendation 6 is therefore applicable to the targeted financial sanctions imposed in resolution 1267 (1999) and its successor resolutions. It will also be applicable to future resolutions implementing targeted financial sanctions against a terrorism and terrorism financing background.

---

[13] De Koker and Smit (n 4) 13.

[14] (n 12) above.

[15] See FATF Recommendations (n 12) ("Interpretive Note to Recommendation 6") 43 and ("Interpretive Note to Recommendation 7") 51, respectively.

[16] FATF Recommendations (n 12) 13.

The FATF has, moreover, identified various requirements necessary for the development of an effective domestic targeted financial sanctions regime. For the purposes of the present discussion only two requirements are noteworthy. The first reads as follows:

> "Countries should require all natural and legal persons within the country to freeze, without delay and without prior notice, the funds or other assets of designated persons and entities. This obligation should extend to: all funds or other assets that are owned or controlled by the designated person or entity, and not just those that can be tied to a particular terrorist act, plot or threat; those funds or other assets that are wholly or jointly owned or controlled, directly or indirectly, by designated persons or entities; and the funds or other assets derived or generated from funds or other assets owned or controlled directly or indirectly by designated persons or entities, as well as funds or other assets of persons and entities acting on behalf of, or at the direction of, designated persons or entities."[17]

The second reads as follows:

> "Countries should prohibit their nationals, or any persons and entities within their jurisdiction, from making any funds or other assets, economic resources, or financial or other related services, available, directly or indirectly, wholly or jointly, for the benefit of designated persons and entities; entities owned or controlled, directly or indirectly, by designated persons or entities; and persons and entities acting on behalf of, or at the direction of, designated persons or entities."[18]

These two requirements clearly align with the asset-freezing obligations and other financial restrictions under UNSC resolutions.

Finally, countries should implement mechanisms for communicating designations to *inter alia* the financial sector immediately following such an action.[19] They must require reporting "to competent authorities [of] any assets frozen or actions taken in compliance with the prohibition requirements of the relevant Security Council resolutions, including attempted transactions, and ensure that such information is effectively used by the competent authorities".[20] Further, they must implement measures which safeguard "the rights of *bona fide* third parties acting in good faith when implementing the obligations under Recommendation 6."[21]

Recommendation 7, on the other hand, provides for targeted financial sanctions in relation to proliferation. The recommendation reads as follows:

> "Countries should implement targeted financial sanctions to comply with United Nations Security Council resolutions relating to the prevention, suppression and disruption of proliferation of weapons of mass destruction and its financing. These resolutions require countries to freeze without delay the funds or other assets of, and to ensure that no funds and

[17] FATF Recommendations (n 12) 47.

[18] FATF Recommendations (n 12) 47.

[19] FATF Recommendations (n 12) 47.

[20] FATF Recommendations (n 12) 48.

[21] FATF Recommendations (n 12) 48.

> other assets are made available, directly or indirectly, to or for the benefit of, any person or entity designated by, or under the authority of, the United Nations Security Council under Chapter VII of the Charter of the United Nations."[22]

The requirements in this respect substantively mirror the financial measures dealt with under recommendation 6[23] and are currently applicable to the UN sanctions regimes against North Korea and Iran.[24]

As mentioned above, the FATF conducts mutual evaluations. These mutual evaluations are essentially on-going peer reviews conducted for the purposes of analysing the extent to which the particular country is compliant with the recommendations and how successful it is in maintaining a strong anti-money laundering and counter-financing of terrorism system.[25] The methodology employed for these mutual evaluations comprise two complementary components. The first is to assess technical compliance with the recommendations, and the second to assess whether and how the anti-money laundering and counter-financing of terrorism system is effective. The parameters of each component are set out as follows:

> "The technical compliance assessment addresses the specific requirements of the FATF Recommendations, principally as they relate to the relevant legal and institutional framework of the country, and the powers and procedures of the competent authorities. These represent the fundamental building blocks of an [anti-money laundering and counter financing of terrorism] system.
>
> The effectiveness assessment differs fundamentally from the assessment of technical compliance. It seeks to assess the adequacy of the implementation of the FATF Recommendations, and identifies the extent to which a country achieves a defined set of outcomes that are central to a robust [anti-money laundering and counter financing of terrorism] system. The focus of the effectiveness assessment is therefore on the extent to which the legal and institutional framework is producing the expected results." [26]

UNIVERSITY OF JOHANNESBURG

The outcome of these mutual evaluations serves as essential evidence indicating whether or not a jurisdiction's banks are secure, reliable, and impervious to abuse by unscrupulous persons or criminals.[27] This is especially appropriate in the context of international trade and finance where international correspondent banks require satisfaction that their dealings with financial

---

[22] FATF recommendations (n 12) 11.

[23] FATF Recommendations (n 12) 52–54.

[24] See par 3.2.3 above, specifically at "Non-proliferation".

[25] See "Anti-money laundering and counter-terrorist financing measures: mutual evaluation report (South Africa)" (2021) https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-South-Africa.pdf (accessed on 30 May 2022).

[26] See FATF *Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems* (as updated in October 2021) 5.

[27] Hugo and Spruyt "Money laundering, terrorist financing and financial sanctions: South Africa's response by means of the Financial Intelligence Centre Amendment Act 1 of 2017" 2018 *TSAR* 227 234.

institutions of a particular jurisdiction "will not expose them to undue and unacceptable regulatory risks in their own jurisdictions".[28] In instances where they are not confident that this is the case, alternatively where the outcome of an evaluation is negative, several adverse consequences may emerge for these financial institutions. Increased compliance costs, de-risking,[29] and regulatory uncertainty are merely some of these.[30]

Central to an *effective* anti-terrorism system is the ability to identify terrorists and terrorist-related organisations and networks.[31] Conversely, the inability to properly identify terrorist and terrorist-related organisations and networks presents obstacles to the enforcement of targeted financial sanctions. To this end, the FATF requires the following:

> "A country properly identifies, assesses and understands its money laundering and terrorist financing risks, and co-ordinates domestically to put in place actions to mitigate these risks. This includes proper implementation of targeted financial sanctions against persons and entities designated by the United Nations Security Council and under applicable national or regional sanctions regimes. The country also has a good understanding of the terrorist financing risks and takes appropriate and proportionate actions to mitigate those risks, including measures that prevent the raising and moving of funds through entities or methods which are at greatest risk of being misused by terrorists. Ultimately, this reduces terrorist financing flows, which would prevent terrorist acts."[32]

This position applies *mutatis mutandis* to the counter-proliferation context.[33]

Alongside recommendations the FATF also publishes guidance notes. These notes are aimed at assisting countries with the implementation of recommendations by, *inter alia*, explaining their purpose and relevance as well as outlining best practice in relation to the implementation of recommendations. Of particular interest to this thesis are the guidance notes that have been published in relation to targeted financial sanctions.[34] These notes have the

[28] Spruyt "A legal analysis of the duty on banks to comply with targeted financial sanctions" 2020 *TSAR* 1 11.

[29] The FATF has defined de-risking as "the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF's risk-based approach." See in this regard FATF "FATF clarifies risk-based approach: case-by-case, not wholesale de-risking" www.fatf-gafi.org/documents/documents/rba-and-de-risking.html (accessed on 2 June 2022).

[30] FATF Guidance *Correspondent Banking Services* (2016) 4.

[31] See FATF *International Best Practice: Targeted Financial Sanctions Related to Terrorism and Terrorism Financing (Recommendation 6)* (2013) 6.

[32] FATF *Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems* (n 26) 96.

[33] FATF *FATF Guidance on Counter Proliferation Financing – The Implementation of Financial Provisions of United Nations Security Council to Counter Proliferation of Weapons of Mass Destruction* (2018) 8.

[34] See, for example, FATF *International Best Practice: Targeted Financial Sanctions Related to Terrorism and Terrorism Financing (Recommendation 6)* (n 31); and FATF *FATF Guidance on Counter Proliferation Financing – The Implementation of Financial Provisions of the United Nations Security Council Resolutions to Counter Proliferation of Weapons of Mass Destruction* (n 33).

potential to be helpful to any jurisdiction seeking to implement and develop a targeted financial sanctions framework consistent with the FATF's recommendations and more broadly UNSC resolutions.

4.3 International Chamber of Commerce

The International Chamber of Commerce, commonly known as the ICC, is an international, non-governmental organisation focused on harmonising international trade practices through the formulation and publication of uniform rules and guidelines for specific areas of commerce.[35]

The pivotal role played by the ICC in the international commercial community is indisputable. Many of its efforts and initiatives are prolific in their respective fields of application. This is especially true of its uniform rules. McKendrick puts it thus:

> "At the international level the prime mover in the codification of international trade usage is the International Chamber of Commerce (ICC) […]. Working through its specialist commissions, the ICC has produced numerous uniform rules which are adopted by incorporation into contracts."[36]

Especially noteworthy are the uniform rules emanating from the ICC's Banking Commission.[37] From a demand-guarantee perspective, two sets of rules are especially important in this regard. The first is the *Uniform Rules on Demand Guarantees.* The current revision dates back to 2010 and is typically referred to as the URDG 758.[38] A competing set of rules is the *International Standby Practices* (ISP98). These rules were formulated and published in 1998 by the Institute of International Banking Law and Practice[39] in the United States of America. The ISP98 was endorsed by the Banking Commission in 1998 and published as an ICC text.[40] The Banking

[35] https://iccwbo.org (last accessed on 30 May 2022). On this function, see further Hugo "Non-governmental initiatives towards the harmonisation of international trade law" 2003 *Journal of Juridical Science* 142 149; and, by the same author, "Letters of credit and demand guarantees: a tale of two sets of rules of the International Chamber of Commerce" 2017 *TSAR* 1 5–16.

[36] McKendrick *Goode on Commercial Law* (2017) 14.

[37] The ICC's Banking Commission meets annually at different designated locations. These annual gatherings feature prominent speakers, industry experts and leaders from the world of business and finance who discuss industry developments and provide relevant updates and insights. Most importantly, these annual gatherings advance the work agenda of the Banking Commission.

[38] ICC Publication 758 (2010). It was preceded by an earlier version, URDG 458 (ICC Publication 458 (1992)). For a comprehensive guide to URDG 758 see Affaki and Goode *Guide to ICC Uniform Rules for Demand Guarantees (URDG 758)* (2011). See further in general on the URDG Hugo (n 35) 14-16.

[39] For background on this organisation and its work, see par 4.6 below.

[40] ICC Publication 590 (1998). On the drafting timeline and process, see Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* (2008 thesis UNISA) 114–117.

Commission, moreover, has formulated rules intended to govern letters of credit. The most current revision of these rules, entitled *Uniform Customs and Practice for Documentary Credits*, dates back to 2007 and is commonly referred to as the UCP 600. To govern the transaction, these rules must be contractually incorporated into the demand guarantee or letter of credit.

As to the role of the Banking Commission in this context, the ICC's official website succinctly explains: "The ICC Banking Commission is a leading global rule-making body for the banking industry, *producing universally accepted rules and guidelines for international banking practice*."[41]

Issuance of "guidelines for international banking practice" is another important function of the Banking Commission. Guidelines may take the form of opinions (answers to questions mostly from banks) and formal guidance notes, both of which are published on a regular basis. Although they do not carry the force of law, these guidance notes are beneficial to banks and other financial institutions as they deal with various areas and aspects of banking law and practice. Important guidance notes have been issued in relation to the use of sanctions clauses in trade finance-related instruments such as letters of credit and demand guarantees.[42] These notes provide much-needed direction to navigate this vexing problem,[43] thus underscoring the general need for, and relevance of, ICC guidance notes.

Lastly, aside from its individual work, the ICC has been known to collaborate with other reputable international organisations. The most important contributions in this respect emerge from its collaboration with the Bankers Association for Finance and Trade and the Wolfsberg Group,[44] both of which are discussed below. The ICC also has observer status at the UN.[45]

---

[41] https://iccwbo.org/global-issues-trends/banking-finance/icc-banking-commission-annual-meeting/ (accessed on 14 August 2020 – my emphasis).

[42] ICC "Guidance paper on the use of sanctions clauses in trade finance-related instruments subject to ICC rules" Document 470/1238 (2014) https://cdn.iccwbo.org/content/uploads/sites/3/2014/08/Guidance-Paper-on-The-Use-Of-Sanctions-Clauses-In-Trade-Finance-Related-Instruments-Subject-To-ICC-Rules.pdf (accessed on 30 May 2022); and ICC "Addendum to guidance paper on the use of sanctions clauses (2014)" (2020) *https://iccwbo.org/content/uploads/sites/3/2020/05/20200504-addendum-to-sanction-clauses-paper.pdf* (accessed on 30 May 2022).

[43] These guidance notes are particularly important for the purposes of this thesis. They are referred to and explored in more detail in par 5.4.2 below.

[44] Wolfsberg Group, ICC and BAFT *Trade Finance Principles* (as amended in 2019).

[45] See https://iccwbo.org/global-issues-trends/global-governance/business-and-the-united-nations/ (accessed on 11 April 2022).

4.4 United Nations Commission on International Trade Law

Established in 1966 by the UN General Assembly, the United Nations Commission on International Trade Law (UNCITRAL) is the main legal body of the UN mandated "to further the progressive harmonization and unification of the law of international trade".[46] The UNCITRAL meets annually to carry out its work. These sessions are held either at the UN headquarters in New York or at the Vienna International Centre in Vienna.[47] Additionally, UNCITRAL working groups have been established to deal with specific topics on international trade. The working groups normally hold one or two sessions a year. UNCITRAL sessions are attended by members as well as by non-members and other interested international organisations invited as observers. Observers may engage in discourse at UNCITRAL sessions and working group sessions to the same extent as members.[48]

In pursuance of its mandate, the UNCITRAL has developed and contributed conventions, model laws and other instruments relating to the law and practice of international trade. Two of these contributions are especially relevant for the purposes of this thesis.

In the first place, the UNCITRAL developed and promoted the adoption of a legal framework entitled: *United Nation's Convention on Independent Guarantees and Stand-by Letters of Credit* (UNCITRAL Convention).[49] The UNCITRAL Convention was finalised by the UNCITRAL Working Group on International Contract Practices in 1995 following almost seven years of negotiation and review.[50] It was primarily intended to govern international demand guarantees and standby letters of credit.[51] It further solidified recognition of common basic principles and characteristics shared by demand guarantees and standby letters of credit. For the UNCITRAL Convention to govern any such an undertaking, countries must first accede to it. To date, very few countries have ratified or acceded to this convention.[52] Because it has

[46] https://uncitral.un.org/en/about (accessed 10 August 2020).

[47] (n 46) above.

[48] (n 46) above.

[49] See Gao *The Fraud Rule in the Law of Letters of Credit: A Comparative Study* (2002) 15.

[50] Bertrams *Bank Guarantees in International Trade* (2013) 28 par 2–12. For background on this Convention, see Bergsten "A new regime for international independent guarantees and stand-by letters of credit: the UNCITRAL Draft Convention on Guaranty Letters" (1993) 27 *International Lawyer* 859; and Byrne "The International Standby Practices (ISP98): new rules for standby letters of credit" (Fall 1999) 32 *Uniform Commercial Code Law Journal* 149 150–151.

[51] See art 1(1)(a)–(b) of the UNCITRAL Convention.

[52] including South Africa.

attracted little support, the UNCITRAL Convention can hardly be seen to have contributed significantly, in practice, to the body of international trade law.[53]

Secondly, the UNCITRAL has prepared and issued a publication on commercial fraud, which is also relevant to other financial crimes such as bribery, corruption, money laundering and terrorism financing. The reason for the publication was explained by the UNCITRAL as follows:

> "Through a series of consultations with experts and government officials who regularly encountered and combated commercial fraud and who represented different regions, perspectives, and disciplines, UNCITRAL became aware of the widespread existence of commercial fraud and its significant worldwide impact, regardless of a country's level of economic development or system of government. In considering possible responses to this threat, it was felt that education and training could play significant roles in fraud prevention, and that the identification of common warning signs and indicators of commercial fraud could be particularly useful in combating fraud."[54]

The publication lists 23 indicators of commercial fraud. This fraud indicator list is relevant to the due diligence investigations of financial institutions.[55] More specifically, it is likely to inform the risk assessments relating to financial institutions' business relationships. Considering the widespread emergence of commercial fraud, the fraud indicator list may prove to be of considerable importance to banks, especially in cases involving convoluted transactions where the possibility of obfuscated fraudulent conduct or engagements is heightened.

Both initiatives support the conclusion that the UNCITRAL accurately and decisively identifies cardinal developments and changes to commercial practice and develops appropriate responses in the form of model laws, conventions and other commercial instruments.

UNIVERSITY
OF
JOHANNESBURG

[53] A reason for its lack of support is perhaps because the Convention has made provision for defences to payment – an area which has largely been avoided by other uniform rules that favour the approach that this issue is best left to domestic law. For criticism of UNCITRAL's attempt to legislate fraud and illegality in particular, see Dolan "The UN Convention on international independent undertakings: do states with mature letter-of-credit regimes need it?" (1998) *Banking and Finance Law Review* 1 13.

[54] UNCITRAL *Recognizing and Preventing Commercial Fraud* (2013) 1.

[55] 86.

4.5 Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision (Basel Committee)[56] is "a committee of supervisory authorities that was established by the central-bank governors of the Group of 10 countries in 1974".[57] The Basel Committee convenes four times a year at the Bank for International Settlements[58] in Basel, Switzerland, where its permanent secretariat is located.[59] The Basel Committee accounts to the G10 central-bank governors and consequently seeks their blessing in relation to major efforts and initiatives.

The objective of the Basel Committee "is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability."[60] It is focused on identifying and addressing key risks faced by the international banking community. This is achieved through various activities and initiatives. However, it is primarily accomplished through "establishing and promoting global standards for the regulation and supervision of banks".[61]

Because the Basel Committee "does not possess any formal supranational authority",[62] its standards and guidelines do not have legal force. This means that the formal status of these initiatives is reduced to mere recommendations.[63] However, one should not underestimate the influential and international nature of the Basel Committee's initiatives. In this regard, Schulze has observed that "the prestige and economic power of the central banks and regulators represented by the Committee's members have meant that in practice many other countries adopt its standards [and rely on its guidelines]".[64]

The work of the Basel Committee is not limited to a specific field of banking law. On the contrary, its standards and guidelines cover a vast deal of banking law, including the

[56] initially named the Committee on Banking Regulations and Supervisory Practices.

[57] The Group of 10 (G10) countries are the ten countries who met in 1961 in Paris to arrange the special drawing rights of the International Monetary Fund. These were: Belgium, Canada, France, Italy, Japan, the Netherlands, Sweden, the United Kingdom, the United States of America, and West Germany (today Germany).

[58] The Bank for International Settlements (BIS) was established in 1930 with the aim of fostering international financial stability and cooperation among member central banks. For more information on the Bank for International Settlements, see http://www.bis.org/bcbs/dboutbcbc.htm (accessed on 18 August 2020).

[59] Wadsley and Penn *The Law Relating to Domestic Banking* (2000) par 1–019.

[60] https://www.bis.org/bcbs/charter.htm (accessed on 19 August 2020).

[61] https://www.bis.org/bcbs/charter.htm (accessed on 19 August 2020).

[62] (n 58) above.

[63] See, for instance, Cranston *Principles of Banking Law* (2007) 2002 who describes the pronouncements of the Basel Committee as "'soft law' par excellence".

[64] Schulze "The nature of banking law and its sources" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 23 49.

following areas: supervision of international banks by local regulators; general prudential requirements;[65] international standardisation to ensure capital adequacy standards;[66] standardisation in the control of money laundering and financing of terrorism; and bolstering the regulation, supervision and risk management of the banking sector.

In relation to targeted financial sanctions, two recent activities of the Basel Committee are noteworthy. The first is its publication entitled *Guidelines for Sound Management of Risk related to Money Laundering and Financing of Terrorism*.[67] The Basel Committee's intention in issuing these Guidelines was "to promote the implementation of sound anti-money laundering and countering financing of terrorism policies[68] and support national implementation of the FATF's standards by exploring complementary areas and leveraging the expertise of both organisations".[69] These guidelines accordingly are not intended to modify or alter the FATF recommendations but to supplement them.[70]

Secondly, the Basel Committee has formulated three sets of Accords, which are generally referred to as Basel I, Basel II, and Basel III. Basel III is a comprehensive set of reform measures used "to strengthen the regulation, supervision and risk management of the banking sector".[71] These measures are specifically geared towards ensuring that the banking sector is able to deal with global economic stress effectively, improve its risk management and governance policies and incorporate policies and procedures that give effect to transparency and disclosures. Though Basel III has not yet been fully implemented,[72] it promises to be an influential instrument.

UNIVERSITY
OF
JOHANNESBURG

[65] To regulate international banks, the Basel Committee, in 1975, formulated a set of principles (the 1975 Concordat) which was replaced by the 1983 Concordat and further supplemented in 1992. The underlying notion of these principles was that the soundness of an international bank cannot be fully ascertained unless its business worldwide can be scrutinised. See Wadsley and Penn (n 59) 1–020 *et seq* for a discussion of the provisions of the 1983 Concordat.

[66] See Cranston (n 63) 92.

[67] June 2017.

[68] The Basel Committee has a longstanding history of promoting standards to combat the abuse of financial services. See, for instance, Basel Committee *Prevention of criminal use of the banking system for the purpose of money-laundering* (December 1988), and Basel Committee *Core principles for effective banking supervision* (2012).

[69] Basel Committee (n 67) 1.

[70] 1.

[71] Schulze (n 64) 50.

[72] Implementation has been repeatedly deferred: to 31 March 2019, 1 January 2022 and then again to 1 January 2023.

4.6 Institute of International Banking Law and Practice

Through various projects, programmes and publications the Institute of International Banking Law and Practice (IIBLP) has contributed to the harmonisation of letter-of-credit law and practice.[73] Established in 1987 with its headquarters in the United States, this non-governmental institution has over many years consistently brought together various industry role players (including legal professionals, academics, bankers and regulators) to assist in or contribute to the efforts of the IIBLP. In recent years, however, the IIBLP's mandate has expanded to include the harmonisation of the law and practice of demand guarantees and standby letters of credit.[74]

In line with this expanded mandate, the IIBLP conducts two annual conferences: *The Annual Survey of Letter of Credit Law & Practice* and *The Annual Guarantee and Standby Forums*. The aim of these conferences is to bring together experts in the of field of international trade and commerce to foster and promote the exchange of ideas. The IIBLP also hosts workshops and conferences on trade-based financial crime and the concomitant compliance issues for banks.[75]

The IIBLP's work includes "amicus curiae briefs, rulemaking, advice to judicial, legislative, and regulatory bodies, risk management assessment, and products and systems evaluations".[76] Its best-known project in this regard, probably, is the *International Standby Practices* rules, which it formulated and published in 1998. This set of rules, often referred to as the ISP98, was, as mentioned above,[77] subsequently endorsed by the ICC's Banking Commission in 1998 and published as an ICC text.[78] These rules are intended to govern standby letters of credit; to do so, however, they must be contractually incorporated into the credit. To date, the ISP98 has gained considerable acceptance by large banking institutions in the United States.[79] In addition to the ISP98, several other projects of the IIBLP are worthy of mention. These include: its assistance in the adoption and interpretation of the UNCITRAL

---

[73] https://iiblp.org/about-us/ (accessed on 19 August 2020).

[74] This is an apt development, as letters of credit and demand guarantees (and standby letters of credit) are similar in many respects. On the fundamental principles they share, see par 2.4 above.

[75] In this respect, the IIBLP has endorsed a publication entitled: Byrne and Berger *Trade Based Financial Crime Compliance* (2017).

[76] (n 73) above.

[77] See par 4.3 above.

[78] See (n 40) above.

[79] Ellinger "British business law: banking law" (November 2005) *Journal of Business Law* 704 704; and Gao (n 49) 20.

UNIVERSITY OF JOHANNESBURG

Convention;[80] the "ISO 20022 guarantee and standby XML messaging project"; its recommended oil fluctuation clauses; and its works on letter-of-credit (and demand-guarantee) sanction clauses.[81]

Finally, reference must be made to the IIBLP's electronic monthly journal: *Documentary Credit World*. In a comprehensive manner, this journal provides content relating to recent developments and changes in letter-of-credit and demand-guarantee law and practice as well as general developments in banking, international trade and commerce. Such content typically includes case law discussions, notifications pertaining to commercial rules and guidelines, international trade and trade finance regulatory trends, and banking practice updates. Through its partnership with the Bankers Association for Finance and Trade, a similarly focused international organisation which is discussed immediately below, this journal receives widespread attention.

4.7 Bankers Association for Finance and Trade

The Bankers Association for Finance and Trade, often referred to as the BAFT, was established by a group of ten bankers from various cities in the United States who met to adopt articles of association for the BAFT on 22 June 1921. Formed as a result of the merger between the BAFT and the International Financial Services Association,[82] the initiatives of the BAFT have been especially important to the United States' banking sector. They are, however, also vital to the international banking community. After all, the BAFT has established itself as "the leading *international* transaction banking association".[83]

With its focus on transactional banking, the BAFT aims to bring the financial community together to collaborate on shaping market practices and influencing regulation and legislation. This objective is fulfilled through

> "global advocacy, developing and adapting new and existing instruments that facilitate the settlements of products and service offerings for clients, providing education and training and contributing to the safety and soundness of the global financial system."[84]

[80] See par 4.4 above.

[81] The IIBLP has conducted several surveys on the use of sanctions clauses and has also issued a standardised sanctions clause. This clause is referred to and discussed in par 5.4.2 below.

[82] Founded in 1924, and formerly known as the United States Junior Committee and the United States Council on International Banking, the International Financial Services Association was essentially established to develop measures and methods to better facilitate international commerce.

[83] https://www.baft.org/about-baft (accessed on 21 August 2020 – my emphasis).

[84] https://www.baft.org/about-baft/mission-overview (accessed on 24 August 2020).

UNIVERSITY OF JOHANNESBURG

Given the dynamic and vast nature of transactional banking, the BAFT committees and working groups are organised around specific products or operational areas. For example, "Trade Committees" were established to deal with commercial instruments such as commercial letters of credit and standby letters of credit.[85] The Standby Letter of Credit/Guarantee Committee and the Commercial Letter of Credit Committee focus on issues and respond to questions that directly impact the processing environment relating to commercial and standby letters of credit. These committees provide comments on various ICC rules, practices and queries relating to commercial and standby letters of credit operations, including bank-to-bank reimbursements and collections. The committees also develop input and case study material and organise expert speakers for workshops as well as ensure participation in conference sessions on trade. They meet regularly to discuss different initiatives of the BAFT, share best practices and provide industry updates.

The working groups established, on the other hand, deal primarily with trade compliance and anti-money laundering best practices. In this regard, the BAFT's *Guidance for Identifying Potentially Suspicious Activity in Letters of Credit and Documentary Collections* is particularly noteworthy. As the first publication to focus specifically on the risks associated with letters of credit, the principles outlined in the Guidance are implemented and referred to by banking institutions throughout the world. The risk indicators it identified, furthermore, have been endorsed and cited in recent international works.[86] Subsequently, in 2017, the BAFT published *Combating Trade Based Money Laundering: Rethinking the Approach*, a paper which was reprinted in the 2018 edition of the IIBLP's *Annual Review of International Banking Law and Practice.* Backed by the IIBLP's strong international following, this paper has received substantial readership from bankers, lawyers and regulatory authorities around the globe.

Finally, as mentioned above, the BAFT has partnered with the ICC and the Wolfsberg Group to provide guiding principles relating to trade finance compliance. The aim of the partnership was to expand the reach of these principles. This was deemed necessary because the initial Wolfsberg publication, *The Wolfsberg Trade Finance Principles*,[87] was perceived to have related only to "large global banks" and not "smaller, local banks."[88] Thus, the view was

---

[85] https://www.baft.org/committees-councils/committees (accessed on 24 August 2020).

[86] See, for example, Wolfsberg Group, ICC and BAFT (n 44) 45.

[87] 2011.

[88] Both quotes can be found in Wolfsberg Group, ICC and BAFT (n 44) 5.

that if the Wolfsberg Group collaborated with the BAFT and ICC more financial institutions would deem it important to follow that publication.

4.8 Wolfsberg Group

The Wolfsberg Group (Wolfsberg) is an association of eleven banks[89] that took its name from the Château Wolfsberg in north-eastern Switzerland, where its annual forum has consistently been held since 1999. Although Wolfsberg started out with the aim of addressing only money-laundering risks in private banking, its activities have since addressed other financial-crime risks within the financial industry, including terrorist financing and corruption.[90]

In support of this expanded aim, Wolfsberg has published a significant number of materials. The most noteworthy are the following: *Statement on the Suppression of the Financing of Terrorism*;[91] *RBA Guidance*;[92] *Notification of Correspondent Banking Customers*;[93] *SWIFT Relationship Management Application Due Diligence Guidance*;[94] *Sanctions Screening Guidance*;[95] and *Trade Finance Principles*.[96] Financial-crime risk management is a fundamental consideration of these materials. Due to the dynamic nature of financial crime, moreover, they are regularly updated and amended to deal with emerging trends and changes.

The nature and impact of these materials warrants consideration. Although Wolfsberg comprises only eleven banks, the majority of which are American institutions, it would be a dangerous oversimplification to conclude that its impact is limited to the United States and the

[89] These are Banco Santander, Bank of Tokyo-Mitsubishi-UFJ, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Société Générale and UBS.

[90] Aiolfi and Bauer "The Wolfsberg Group" in Pieth (ed) *Collective Action: Innovative Strategies to Prevent Corruption* (2012) (unpaginated) at 2.

[91] 2002. See https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/wolfsberg-standards/16.%20Wolfsberg_Statement_on_the_Suppression_of_the_Financing_of_Terrorism_%282002%29.pdf (accessed on 30 May 2022).

[92] 2006. The RBA acronym stands for "risk-based approach". See https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/wolfsberg-standards/15.%20Wolfsberg_RBA_Guidance_%282006%29.pdf (accessed on 30 May 2022).

[93] 2007. See https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/wolfsberg-standards/14.%20Wolfsberg_Notification_Correspondent_Bank_Customers_%282007%29.pdf (accessed on 30 May 2022).

[94] 2016. See https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/wolfsberg-standards/7.%20SWIFT-RMA-Due-Diligence.pdf (accessed on 30 May 2022).

[95] 2019. See https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/Wolfsberg%20Guidance%20on%20Sanctions%20Screening.pdf (accessed on 30 May 2022).

[96] (n 44) above.

jurisdictions where subsidiaries of these banks have been incorporated. Because Wolfsberg has developed some "very original concepts in specific areas, especially on 'correspondent banking' and on 'agents and introducers'",[97] its contribution to the area of financial-crime compliance has been influential and relevant to other jurisdictions as well. Furthermore, its work relating to the meaning of risk-based due diligence has solidified its position in the international standard-setting arena in this regard. This is evidenced by the continued willingness of other highly regarded international organisations such as the ICC and BAFT to collaborate with Wolfsberg.[98]

4.9 Conclusion

This chapter has examined the role and contribution of several, and perhaps the most important, international organisations on targeted financial sanctions. The organisations examined are the FATF, ICC, UNCITRAL, Basel, IIBLP, BAFT and Wolfsberg.[99] Except in the case of ratification of the UNCITRAL Convention, the works of these organisations do not carry the force of law. They are nevertheless vital to banking regulators throughout the world and are relied upon by many industry role players, including bankers, bank examiners, law enforcement officials and legal practitioners, for at least two reasons. The first is that these works accurately reflect developments and changes in banking practice.[100] Secondly, as a consequence of the first reason, they often inform banking policy. Remarking on the influence of the Basel Committee from a South African perspective, Schulze writes:

> "It has become standard banking procedure worldwide, also in South Africa, to adhere to the Basel recommendations and guidelines. Where amendments to national legislation are necessary they are usually done on the basis of the guidelines and recommendations of the Basel Committee, In an indirect way, and in the absence of formal legislative recognition, the guidelines of the Basel Committee have become part of our municipal law."[101]

---

[97] Pieth and Aiolfi "The private sector becomes active: the Wolfsberg process" (2003) *Journal of Financial Crime* 359 365.

[98] See Wolfsberg Group, ICC and BAFT (n 44).

[99] As mentioned in par 4.1 above, the activities and efforts of the UN and European Union in relation to targeted financial sanctions have been outlined in par 3.2 and 3.3 above, respectively.

[100] See Marxen "Traditional trade finance instruments a high risk? a critical view of current international initiatives and regulatory measures to curb financial crime" in Hugo (ed) *Annual Banking Law Update* (2018) 161 171.

[101] See Schulze (n 64) 51. Similar sentiments have been expressed by Ellinger, Lomnicka and Hare (n 10) 77: "[The Basel Committee] has neither formal legal status nor authority, but its recommendations (so-called 'soft law') are enormously influential and are followed by banking regulators throughout the world."

It is submitted, in conclusion, that on the basis of their widespread use, the work of these organisations may – with varying degrees of appropriateness – approach the status of international banking usage or trade usage, at least between banks themselves.

CHAPTER FIVE: IMPACT OF TARGETED FINANCIAL SANCTIONS ON LETTERS OF CREDIT AND DEMAND GUARANTEES

5.1 General introductory remarks

The use of targeted financial sanctions is a well-established feature in the fight against financial crime. The resultant impact that these measures have on especially independent trade finance devices such as letters of credit and demand guarantees, however, has not been considered sufficiently. The aim of Chapter Five, therefore, is to investigate fully the extent to which targeted financial sanctions impact upon letters of credit and demand guarantees. This chapter can be described as the focal point of this study.

The fundamental link between targeted financial sanctions and trade finance is provided by the banking industry. Banks[1] are pivotal to the enforcement of targeted financial sanctions. Criminals and unscrupulous persons use banking facilities, products and services to perpetrate financial crimes such as money laundering and terrorism financing. In this study, the focus falls on letters of credit and demand guarantees as banking products and facilities. The extent to which these instruments are perceived to be susceptible to financial-crime abuse has rendered them "high-risk" in the view of most commentators.[2] Consequently, when such transactions are encountered, the bank's sanctions compliance mechanisms[3] must be heightened and applied

UNIVERSITY OF JOHANNESBURG

[1] In this chapter, unless the context indicates otherwise, the terms "bank" and "financial institution" are used interchangeably.

[2] See the following publications where trade finance instruments are labelled "high-risk": Chatain *et al Preventing Money Laundering and Terrorist Financing – A Practical Guide for Bank Supervisors* (2009) 223 and Wolfsberg Group, ICC and BAFT *Trade Finance Principles* (2019) 8. There are, however, dissenting views. See Sindberg "Combating trade based money laundering: rethinking the approach" www.lcviews.com/index/php?page_id=599 (accessed on 1 April 2021) who argues that claims made suggesting that trade finance instruments are high-risk are "without any kind of evidence to that effect". Also see FATF and Egmont Group *Trade-Based Money Laundering Trends and Developments* (2020) 42 in which it is stated that "… paying methods like letters of credit or documentary collection … are often seen by the private sector as less vulnerable to [trade-based money laundering]".

[3] which include due diligence investigations, screening and identification and verification processes. For a detailed treatment of these compliance mechanisms in South Africa, see De Koker and Smit "Key terror financing and international financial sanctions offences" in de Koker (ed) *Money Laundering and Terror Financing: Law and Compliance in South Africa* (2020) 75 75–93. For a concise analysis of same, see Spruyt "A legal analysis of the duty on banks to comply with targeted financial sanctions" 2020 *TSAR* 1 *et seq.* See further par 3.6 above. The approach to these mechanisms is one of risk. For background on the risk-based approach, see generally FINTRAC *Risk-Based Approach Guide* (June 2017); FATF *Guidance for a Risk-Based Approach: The Banking Sector* (2014); Financial Intelligence Centre *Guidance Note 7: On the Implementation of Various Aspects of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* (2017); Hugo and Spruyt "Money laundering, terrorist financing and financial sanctions: South Africa's response by means of the Financial Intelligence Centre Amendment Act 1 of 2017" 2017 *TSAR* 227 336 *et* seq; and Spruyt "The Financial Intelligence Centre Amendment Act and the application of a risk-based approach" in Hugo and du Toit (eds) *Annual Banking Law Update* (2017) 26. See also the discussion in 3.6.4 above.

frequently and with much stringency.[4] A sanctions violation in this regard will mostly necessitate an interference with performance – especially in relation to payment – under letters of credit and demand guarantees.

Compliance with targeted financial sanctions can, however, be approached from two perspectives. The first relates to a bank's compliance with *domestic* targeted financial sanctions. Banks are clearly under a legal obligation to adhere to such sanctions. The second refers to a bank's compliance with *foreign* targeted financial sanctions. Compliance in this respect is not legally binding but arises on the basis of strong business and reputational considerations. Such considerations relate to, for instance, the imposition of monetary fines, freezing or forfeiture of assets, suspension of banking licences and disconnection from vital banking communication networks. Given the conceptual differences in the nature of compliance with domestic and foreign sanctions, they are dealt with separately below.

Although the thesis is undertaken primarily from a South African viewpoint, it may prove to be relevant to other jurisdictions as well. This is so for two reasons: the first is that letters of credit and demand guarantees are international in nature.[5] Any study relating to them naturally merits consideration, regardless of the jurisdiction from which it originates. The second is that the intersection of targeted financial sanctions and trade finance – which includes letters of credit and demand guarantees – has emerged as a dominant theme in international commerce in recent years.[6] This study is intended to contribute to the scholarly debate regarding this intersection.

UNIVERSITY
OF
JOHANNESBURG

[4] See Wolfsberg Group, ICC and BAFT (n 2) 33–46 concerning documentary credits and 59–68 regarding demand guarantees, especially where reference is made to enhanced due diligence.

[5] As pointed out in par 2.1 above, they are mostly governed by international rules such as the International Chamber of Commerce's (ICC) *Uniform Custom's and Practice for Documentary Credits* (2007) (UCP 600); the *Uniform Rules for Demand Guarantees* (2010) (URDG 758); and the *International Standby Practices* (1998) (ISP 98). On the application of these instruments in an international context, see, *inter alia*, Horowitz *Letters of Credit and Demand Guarantees* (2010); Enonchong *The Independence Principle of Letters of Credit and Demand Guarantees* (2011); Marxen and Hugo "Exceptions to the independence of autonomous instruments of payment and security: the growing emergence of good faith" in Hugo and Möllers (eds) *Transnational Impacts on Law: Perspectives from South Africa and Germany* (2018) 131; and Kelly-Louw "Limiting exceptions to the autonomy principle of demand guarantees and letters of credit" in Visser and Pretorius (eds) *Essays in Honour of Frans Malan* (2014) 197.

[6] This can be demonstrated by the frequent discussions in *Documentary Credit World* pertaining to trade-finance-related sanctions. See, for example, "International updates" (May 2015) *Documentary Credit World* 8; "International updates" (April 2019) *Documentary Credit World* 8; "OFAC announces settlements for apparent US sanctions violations" (May 2019) *Documentary Credit World* 7; "Compliance concerns? contact OFAC" (April 2020) *Documentary Credit World* 7; "ICC updates its sanctions clause guidance" (May 2020) *Documentary Credit World* 3–4; "French bank agrees to settlement with OFAC for apparent Syria-related sanctions violations" (January 2021) *Documentary Credit World* 3–4; and "US treasury sanctions additional entities in Burma (Myanmar)" (March 2021) *Documentary Credit World* 11.

5.2 Compliance with domestic targeted financial sanctions

5.2.1 Introduction

Banks must comply with all domestic law applicable to them.[7] This includes the law giving effect to targeted financial sanctions. As set out above,[8] the South African law in this regard is to be found in the Protection of Constitutional Democracy against Terrorist and Related Activities Act (POCDATARA),[9] and the Financial Intelligence Centre Act (FICA).[10] These statutes impose several onerous compliance and reporting obligations on South African banks to ensure compliance with these sanctions. Any act performed by a South African bank in contravention of these statutes will naturally be unlawful.

Compliance by banks with domestic targeted financial sanctions laws, however, may present serious challenges for letter-of-credit and demand-guarantee transactions. More particularly, a South African bank's compliance with targeted financial sanctions may interfere with its payment obligations under these instruments. Inevitably, reimbursement may also become problematic. This may cause serious problems for the beneficiary of the credit or guarantee who runs the risk of being left with insufficient payment or security. These vexing problems are explored in this section.

But before doing so, it is necessary to examine the bank's legal obligation to comply with domestic targeted financial sanctions, specifically in the context of letter-of-credit and demand-guarantee transactions. This leads to a discussion of the legal impossibility of the bank to perform its contractual obligations in the event of the involvement of a sanctioned individual or entity, as well as of the issue of criminal liability on the part of a bank that performs its contractual obligations in contravention of sanctions laws.

UNIVERSITY OF JOHANNESBURG

5.2.2 Legal obligation to comply

In terms of section 4 of the POCDATARA, banks are prohibited from engaging[11] an entity identified in a notice issued under section 25 of the POCDATARA – a targeted entity for the

---

[7] For a concise overview of the law relating to South African banks, see Schulze "The nature of banking law and its sources" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 23 27 *et seq.* For more detailed treatises, see, though somewhat dated, Hahlo and Khan *The South African Legal System and Its Background* (1968) 142–303; and Hosten *et al Instruction to South African Law and Legal Theory* (1995) 376–541.

[8] See par 3.6 above.

[9] 33 of 2004.

[10] 38 of 2001. See also Financial Intelligence Centre Amendment Act 1 of 2017 (FICAA).

[11] More particularly, from the "making available of property, financial or other service, or economic support".

purposes of the United Nations Security Council. These provisions relate broadly to the financing of terrorism and have been dealt with above.[12] Similarly, as set out in more detail above,[13] section 26B of the FICA prohibits banks from engaging an entity identified pursuant to a resolution of the United Nations Security Council. These provisions operate in a broader context and are therefore applicable in relation also to proliferation financing.

These two provisions further indicate that the obligation to impose targeted financial sanctions may arise in two instances. The first is where a bank has knowledge that an individual or entity is sanctioned.[14] In this regard the bank must actually have known this (had material knowledge) or "believed that there was a reasonable possibility" that the individual or entity was sanctioned.[15] The second is where there is a reasonable suspicion that an individual or entity is sanctioned. Absent a statutory definition, the FIC defines "suspicion" as "a state of mind of someone who has an impression of the existence or presence of something or who believes something without adequate proof, or the notion of a feeling that something is possible or probable".[16] Suspicion in this context can be compared to the doctrine of constructive knowledge in the law of insurance in relation to the duty of disclosure where knowledge is imputed to the insured if the insured ought to have had that knowledge in the circumstances of the particular case.[17] The application of the doctrine entails that the insured must deal with the consequences attached to having the requisite knowledge. Likewise, where a suspicion amounts to a conviction or belief, this may trigger the bank's sanctions obligations.

A conviction or belief will be informed by "several factors that may on their own seem insignificant but, taken together, may raise suspicion concerning that situation".[18] Naturally, such factors will provoke a sense of doubt and circumspection. And, in this way, they may demonstrate or suggest the likelihood of unusual or suspicious activity which in turn may signal

UNIVERSITY OF JOHANNESBURG

---

[12] See par 3.6.2 above.

[13] See par 3.6.3 above.

[14] Financial Intelligence Centre *Guidance Note 4B: On Reporting of Suspicious and Unusual Transactions and Activities to the Financial Intelligence Centre in Terms of Section 29 of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* par 17. It is noteworthy that, in the context of defences to payment under demand guarantees, the well-established defence of fraud has also developed within the ambit of "knowledge" of the beneficiary to its disentitlement to payment. The defence of fraud has gained momentum from the dictates of public policy in South Africa. On the fraud defence, see par 2.4.2.4 above.

[15] s 1(2) of the FICA (n 10); and s 1(6) of the POCDATARA (n 9). A deliberate failure to acquire information relating to the sanctioned status of an individual or entity could constitute "wilful blindness". See in this regard *Frankel Pollak Vinderine Inc v Stanton NO* 1996 2 All SA 582 (W). See also par 5.2.4.2 below.

[16] See Finance Intelligence Centre (n 14) above.

[17] Reinecke, Van Niekerk and Nienaber *South African Insurance Law* (2013) 140–141.

[18] Financial Intelligence Centre (n 14) par 23.

the possibility that the individual or entity concerned is sanctioned. The context in which a situation arises and an understanding of the business and behaviour of the customer will therefore be important in assessing suspicion.

Within the context of documentary-trade finance instruments (such as letters of credit and demand guarantees), the most noteworthy factors or indicators[19] that may give rise to a suspicion are excessive amendments and extensions,[20] partial and multiple demands, altered documents, unusual trade activity,[21] irregular trade structures, nonsensical non-standard clauses,[22] the absence of standard supporting documents,[23] transactions involving high-risk jurisdictions, and dual-use goods.[24] While the presence of one of these indicators may not alone warrant suspicion, the presence of several is likely to lead to a "reasonable"[25] suspicion which may require of the bank to impose the targeted financial sanctions.

One must be cognisant of the fact that the bank's ability to acquire actual knowledge or to form a reasonable suspicion that a party is sanctioned is largely dependent on the information and data it collects during its customer due diligence proceedings.[26] Where the resultant client profile contains insufficient information and data, the bank may not be well positioned to detect unlawful, suspicious or unusual activity and, in turn, to acquire the necessary knowledge or suspicion. This holds true particularly for letter-of-credit and demand-guarantee transactions

[19] These indicators, or red flags as they are occasionally referred to, feature in the bank's risk assessment of its customers. On this point, see par 3.3.3.4.3 above.

[20] While amendments and extensions are common in letter-of-credit and, perhaps to a lesser extent, demand-guarantee practice, too many may warrant suspicion.

[21] or a deviation from usual trade patterns.

[22] Byrne and Berger *Trade Based Financial Crime Compliance* (2017) 160 provide the following examples: "'LC is unconditional, divisible, and assignable'; the request for a 'ready, willing and able' message; and 'good, clean and cleared of non-criminal origin'."

[23] for example, an insurance document, since insurance documents are almost always called for in documentary credit transactions.

[24] For a list containing indicators specific to letters of credit, see Byrne and Berger (n 22) 159–160. Although reference is made only to letters of credit, these indicators are *mutatis mutandis* relevant to demand guarantees. For more general indicators, see Financial Intelligence Centre (n 14) par 42.

[25] FATF "Trade-based money laundering: risk indicators" (March 2021) https://www.fatf-gafi.org/media/fatf/content/Trade-Based-Money-Laundering-Trends-and-Developments.pdf 2 (accessed on 10 March 2022). See also MAS "Guidance on anti-money laundering and countering the financing of terrorism controls in trade finance and correspondent banking" (October 2015) https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Monographs-and-Information-Papers/Guidance-on-AML-CFT-Controls-in-Trade-Finance-and-Correspondent-Banking.pdf 19 (accessed on 11 March 2022).

[26] Customer due diligence is performed during the onboarding phase of a new client as well as when an existing client intends to enter into a new business transaction. In the event of the client or transaction appearing to be high-risk (due to the presence of risk indicators), moreover, this would signal the need for on-going and enhanced due diligence. Risk is central in this context. On the risk-based approach in general, see the authorities cited in ft 3 above.

UNIVERSITY OF JOHANNESBURG

where banks, as a fundamental principle, deal only with the documents tendered for payment. As explained above,[27] the documents contracted for under letters of credit typically include the commercial invoice, transport document, insurance document, quality certificate, certificate of origin and inspection certificate. These documents normally contain, *inter alia*, an accurate description of the goods and the contract value, who the consignor or exporter is, who the consignee is (and the buyer if it is someone other than the consignee), the country from which the goods originate, the carrier, the country to which the goods are destined, the port of loading and discharge of the goods and the names of contact persons of the buyer and the consignor.[28] Demand guarantees, in contrast, mostly only call for one document, namely a demand by the beneficiary containing certain specified allegations.[29]

Despite the vast number of documents required under letters of credit, they contain insufficient information for the bank to reach a decision on giving effect to the sanctions concerned. This is even more so in the case of guarantees. The letter of credit and demand guarantee themselves contain very little information. For this reason, banks increasingly examine the underlying transaction as well,[30] because it will specify many transactional details not covered in the documents and the credit or guarantee.

The problem with this development, however, is that banks are generally ill equipped to conduct extraneous investigations. Such investigations require unexpected expenses, procedures and expertise.[31] They also hold the inherent danger that they cannot be completed

UNIVERSITY
OF
JOHANNESBURG

[27] See par 2.2.2 above.

[28] Hugo and Strydom "Sanctions, ships, international sales and security of payment" in Vrancken and Hugo (eds) *African Perspectives on Selected Marine, Maritime and International Trade Law Topics* (2020) 109 120.

[29] Breach of contract and insolvency are common specified allegations. See par 2.3.2 above. See also Hugo and Kobilski "A critical evaluation of the law and practice of transferring independent guarantees" in Hugo and du Toit (eds) *Annual Banking Law Update* (2020) 23 25.

[30] Marxen "Traditional trade finance instruments a high risk? a critical view of current international initiatives and regulatory measures to curb financial crime" in Hugo (ed) *Annual Banking Law Update* (2018) 161 165. See also Byrne and Berger (n 23) 174 who, in the context of trade-based money laundering, submit that "bank trade based services [such as letters of credit and demand guarantees] undergo a great deal more scrutiny of the *underlying transaction* and documentation …" (my emphasis).

[31] Wolfsberg Group, ICC and BAFT (n 2) 44.

within the time frame for determining whether payment must be made,[32] which contradicts the very purpose of the letter of credit or demand guarantee.[33]

FICA prohibitions, in contrast to those under the POCDATARA, apply to designated individuals and entities and to any person "acting on behalf of, at the direction of, or to the benefit of" the listed individual or entity. The practical implication is that a South African bank's compliance requirements and obligations are extended to these additional persons. In the letter-of-credit context this means that the South African bank, whether involved as issuing bank, confirming bank, nominated bank, transferring bank or reimbursement bank, must identify and consequently screen other parties involved in the transaction, including the other banks.

The question as to the extent to which the bank should perform a due diligence, identification and verification, or screening exercise on other banks is influenced by at least two factors. The first relates to the bank's compliance programme.[34] In South Africa, all banks are legally required to establish a "risk management and compliance programme" (RMCP).[35] The RMCP is aimed at ensuring compliance with the targeted financial sanctions regulatory framework by setting policies and standards for industry-specific clients, transactions and relationships.[36] Hence, the policy requirements which underlie the programme must define the extent to which compliance mechanisms should be exercised on other banks.

Because compliance programmes are established internally (typically with the assistance of competent external advisors), it is conceivable that banks may engage industry-

UNIVERSITY
OF
JOHANNESBURG

[32] See par 2.3.7.4 above. See also UCP 600 (n 5) art 16(c) and URDG 758 (n 5) art 20 (a) which provide that the documents must be examined "within five days following the day of presentation …". Marxen "Electronic bills of lading in international trade transactions – critical remarks on digitalisation and the blockchain technology" 2020 *Coventry Law Journal* 31 38 makes the point that replacing paper-based documents such as bills of lading with digitally issued documents can make data acquisition and processing easier and less time-consuming, which should assist banks in this respect.

[33] Guarantees, especially, are intended to provide payment swiftly and with relative ease. See, in this regard, Lupton "Demand guarantees in the construction industry: recent developments in the law relating to the fraud exception to the independence principle" 2019 *SA Merc LJ* 399 401–402 ("Furthermore, their ability to provide funds almost immediately and with relative ease brings about much-needed certainty to the construction transaction.") The same argument can be made in relation to letters of credit.

[34] Byrne and Berger (n 22) 125 s 5.8.3.

[35] s 42A of the FICAA (n 10). The previous section 42 made reference to "internal rules". Accountable institutions must ensure that an RMCP is in place, and that it covers all those aspects provided for in section 42(2) of the FICAA. However, having an RMCP is not enough; the accountable institution must be able to evidence the implementation of the RMCP in its day-to-day operations.

[36] s 42A of the FICAA (n 10).

specific issues and questions differently.[37] This is detrimental to uniformity and consistency regarding the treatment of independent trade-finance undertakings in the context of sanctions.

Be that as it may, the answer to the above question should, as a first port of call, be sought from the bank and its RMCP. South Africa's Financial Intelligence Centre highlights the place and importance of the RMCP as follows:

> "An accountable institution's ability to apply a risk-based approach effectively is largely dependent on the quality of its RMCP. An accountable institution's RMCP must be sufficient for countering the ML/TF risks facing the institution. It is important for accountable institutions to bear in mind that a RMCP not only comprises of policy documents, but also of procedures, systems and controls that must be implemented within the institution. The RMCP can therefore be described as the foundation of an accountable institution's efforts to comply with its obligations under the FIC Act on a risk sensitive basis."[38]

The second factor is whether the other bank is a correspondent bank. If it is, a relationship already exists involving due diligence and an ongoing review cycle which should include trade-based risk.[39] Therefore, the South African bank need do nothing further unless additional information comes to its attention. Where it is not a correspondent bank, however, the situation becomes more problematic since the bank has no relationship with this bank and naturally little information on it. The only information at its disposal will be that in the letter of credit, the documents tendered for payment and the underlying contract. Yet, because the parties' names, their registration or identity numbers, and their business addresses will mostly form the basis of the identification processes,[40] these contracts and documents may suffice for the purposes of the identification and verification of the banks concerned.

UNIVERSITY
OF
JOHANNESBURG

[37] For a comprehensive treatment concerning best practice in relation to trade finance compliance, see generally Wolfsberg Group, ICC and BAFT (n 2).

[38] Financial Intelligence Centre *Guidance Note 7* (n 3) par 180.

[39] Correspondent banking relationships are usually facilitated through the Society for Worldwide Interbank Financial Telecommunications (SWIFT). This takes place through the exchange of SWIFT test keys or a SWIFT RMA (Risk Management Application) which is used to transmit information and data such as, for example, payment instructions between banks. For background on SWIFT test keys and RMA's, see Byrne and Berger (n 22) 110-112. On compliance expectations in connection to correspondent banking, see Wolfsberg Group "Wolfsberg anti-money laundering principles for correspondent banking" (2014) https://www.wolfsberg-principles.com/sites/default/files/wb/Wolfsberg-Correspondent-Banking-Principles-2014.pdf (accessed on 14 March 2022).

[40] Lawack "The South African banking system" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 63 100; and Wolfsberg Group "Wolfsberg anti-money laundering principles for private banking" (2012) https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/wolfsberg-standards/10.%20Wolfsberg-Private-Banking-Prinicples-May-2012.pdf 2 (accessed on 23 March 2022). Although the latter publication is dealt with in the context of private banking, the principles are equally applicable in the trade finance context. It is not uncommon for banks to make use of external sources to corroborate such information and to perform due diligence in general, including google searches, independent websites maintained by international standard-setting bodies, for example, the FATF and Wolfsberg, public court documents, and professional oversight bodies such as law societies. Banks should, however, ensure that the information obtained is reliable and verifiable. See ACAMS *Study Guide CAMS Certification Exam* (2019) 209.

Once the identification processes have been completed, the other banks' particulars may be screened[41] against the relevant sanctions lists to determine their sanctions status.[42] Should the screening processes reveal that another is a sanctioned entity, this will constitute actual knowledge of the fact and will require of the bank not to process or facilitate the transaction. Where, on the other hand, the identification and screening processes are successfully cleared but the bank determines from the letter of credit, the documents and/or the underlying contract the presence of risk indicators or unusual activity in connection with the transaction, this may constitute a reasonable suspicion which may, in law, require of the bank not to process or facilitate the transaction.

It would be prudent, in conclusion, to sound the following alarm:

> "[Banks] should be mindful of the fact that failure to comply with [targeted financial sanctions] obligations is a criminal offence under section 49A of the FIC Act. The fact that [a bank] had relied on a commercially available screening capability or that it had considered the risk of being exposed to [targeted financial sanctions]-related obligations to be low, would not be a defence against such a criminal charge."[43]

A bank found guilty of such a criminal offence will be liable to pay a fine of not more than R100 million.[44]

5.2.3 Legal impossibility of performance

As explained above,[45] the POCDATARA and the FICA prohibit South African banks from processing or facilitating any transaction about which they have knowledge or a reasonable suspicion of the involvement of a sanctioned person or entity. A South African bank that processes a letter of credit or demand guarantee involving a sanctioned person or entity will therefore have acted unlawfully. In the South African law of contract, the inability to perform due to the application of a legislative prohibition may be approached as an instance of legal impossibility.[46]

UNIVERSITY
OF
JOHANNESBURG

---

[41] Screening entails automated and manual processes. See in this regard par 3.4.3 above.

[42] The Financial Intelligence Centre *Guidance Note 7* (n 3) 68 par 201 states the following: "The Centre will maintain an updated sanctions list which will be available on its website and which will reflect available identity particulars of persons and entities contained in notices published by the Director."

[43] Financial Intelligence Centre *Guidance note 7* (n 3) par 200.

[44] s 18(1)(c) of POCDATARA (n 9); and s 68 of FICA (n 10). The Acts also make provision for imprisonment not exceeding 15 years.

[45] par 5.2.2 above.

[46] *Bayley v Harwood* 1954 (3) SA 498 (A). See also Ramsden *Supervening Impossibility of Performance in the South African Law of Contract* (1985) 59–61.

To properly understand the notion of legal impossibility of performance in the context of this thesis, regard must as a point of departure be had to the broader doctrine of impossibility of performance from which legal impossibility stems. The doctrine was first laid down in South African law in *Peter, Flamman and Co v Kokstad Municipality*,[47] where Solomon ACJ explained:

> "By the Civil Law a contract is void if at the time of its inception its performance is impossible: impossibilium nulla obligatio (D. 50.17.185). So also where a contract has become impossible of performance after it had been entered into the general rule was that the position is then the same as if it had been impossible from the beginning…"[48]

Accepting that the doctrine of impossibility of performance was applicable to South African law, the Acting Chief Justice continued:

> "Unfortunately the rules of the Civil Law appear to have been ignored in several cases on this subject which have come before our Courts, which have been guided entirely by the decisions of the English Courts."[49]

Prior to the *Peter, Flamman* case South African courts followed the English rule of absolute contracts. In terms of this rule a contract was absolute if performance would have been prevented for any reason, including impossibility of performance.[50] Post the *Peter, Flamman* case, however, South African courts have embraced and applied the doctrine of impossibility of performance in cases where a contract is struck by an event of impossibility.[51]

Events of impossibility can take different forms. The concepts of *vis maior* and *casus fortuitus* are especially relevant in this regard.[52] In *New Heriot Gold Mining Co Ltd v Union Government*[53] the court provided meaning to these concepts. It explained:

> "Casus fortuitus, which is a species of vis maior, is a term well understood and needing no formal definition. It includes all direct acts of nature, the violence of which could not reasonably have been foreseen or guarded against. The doctrine that the operation of such visitations excludes civil liability overlies the fields both of contract and of tort."[54]

UNIVERSITY
OF
JOHANNESBURG

[47] *Peter, Flamman and Co v Kokstad Municipality* 1919 AD 427.

[48] 434. The text from the Digest means "impossibility gives rise to no obligation".

[49] 435.

[50] *Paradine v Jane* 1647 Aleyn 26.

[51] See, for example, *Hersman v Shapiro* 1926 TPD 375–377; and *Transnet Ltd t/a National Ports Authority v Owner of MV Snow Crystal* 2008 (4) SA 111 (SCA) par 28.

[52] See Ramsden (n 46) 49 at n 44 for a list of old authorities on the meaning of these terms.

[53] 1916 AD 415.

[54] 433.

A distinction is generally made between physical impossibility and legal impossibility. The former refers to the situation where performance is not possible due to, for example, the complete destruction of the goods under a contract of sale by an unforeseen event. Physical impossibility may occur at the conclusion of the contract (referred to as "initial impossibility of performance") or sometime during the life of the contract (referred to as "supervening impossibility of performance"). The latter (that is, legal impossibility) refers to the situation where, due to a legislative enactment, performance is rendered impossible.[55] Despite their divergence in nature, legal impossibility and physical impossibility operate on similar foundations. Most important in this regard is the threshold required to discharge performance, which is that performance must be *objectively* impossible.[56] In other words, the impossibility must be such that no other person can render the performance.[57] Subjective impossibility (that is, when it is only impossible for the particular contracting party to perform) or any other lesser standard will not suffice. Another shared principle is that the event of impossibility must not have been caused by the fault of the other contracting party.

As the court in *Peter, Flamman* makes clear, an event that makes a contract impossible will render that contract void. Thus, a contract struck by an event of legal impossibility will be invalid. Against this background it is submitted that it would be legally impossible for a South African bank involved in a letter-of-credit transaction, whether as issuing bank, confirming bank, nominated bank, transferring bank or reimbursement bank, or that is involved in a demand-guarantee transaction, whether as guarantor, advising bank or counter-guarantor, to perform its contractual obligations if the transaction involves a sanctioned individual or entity.[58] Since this is an objective fact, the impossibility does not depend on the knowledge of the bank or its negligence. The letter-of-credit or demand-guarantee contract will consequently be invalid.

Two consequences follow a contract that is invalid due to impossibility and more specifically legal impossibility. The first is that no obligations are created[59] and the parties will

[55] For an early study on physical and legal impossibility of performance see Ramsden (n 46) 59–61.

[56] *Hersman* (n 51); and *Transnet Ltd t/a National Ports Authority* (n 51).

[57] Van Huyssteen *et al Contract: General Principles* (2020) 204.

[58] See Hugo and Strydom (n 28) 125 who highlight the relevance of legal impossibility in cases where payment under a letter of credit is declined by virtue of a reference in the stipulated documents to a so-called blocked (or sanctioned) vessel in terms of the relevant laws.

[59] Van Huyssteen *et al* (n 57) 223.

be excused from performing under the contract.[60] In the context of this thesis, this means that the South African issuing bank or guarantor's refusal to process payment or to facilitate the transaction on account of the manifestation of a sanctioned individual or entity is legally justified even if the beneficiary has tendered conforming documents. Put differently, there is no duty on the bank or guarantor to effect payment or, in the case of an advising bank, to satisfy itself as to the authenticity of the letter of credit or demand guarantee.[61]

The second relates to the situation where the bank processes payment in purported compliance with the invalid letter of credit or demand guarantee. This could have been done negligently, for example, due to the bank being unaware of the sanctioned status of a contracting party. Or it could have been done intentionally, in other words in the knowledge that performance was legally impossible.[62] In any of these two events the bank runs the risk that it will not be reimbursed for the transaction. Since the transfer of funds would have been based on an invalid contract, the bank cannot reclaim the funds or institute contractual damages based on breach of contract. Neither can it claim damages in terms of the law of delict. The bank may, it is submitted, be able to reclaim the funds in accordance with the principles of unjustified enrichment. This submission finds support in the law relating to supervening impossibility where an enrichment action may be used to reclaim a benefit that has been transferred to the other party.[63]

Since South African law has not currently recognised a general enrichment action,[64] reliance must be placed on any of the existing condictiones. The locus classicus on enrichment claims relating to contracts discharged because of supervening impossibility is the *Kudu Granite* case.[65] In this case the court held that the *condictio ob causam finitam* is the appropriate condictiones in cases of supervening impossibility.[66] The *condictio ob causam finitam* is a

[60] *Peter, Flamman and Co v Kokstad Municipality* (n 47) 434–435; and *Transnet Ltd t/a National Ports Authority* (n 51).

[61] On the role and duty of the advising bank, see par 2.2.3.1 (in relation to letters of credit) and 2.3.4 (in relation to demand guarantees) above.

[62] Negligence and intention are concepts relevant to the question of criminal liability on the part of the bank. See par 5.2.4 below.

[63] *Kudu Granite Operations (Pty) Ltd v Caterna Ltd* 2003 (5) SA 193 (SCA) 15.

[64] *McCarthy Retail Ltd v Shortdistance Carriers CC* 2001 (3) SA 482 (SCA) 8–10. But the court in this case did indicate that if it was confronted in future by a situation not covered by an existing condictiones in which the claim should succeed, it may well recognise a general enrichment action.

[65] (n 63) above.

[66] (n 63 above). In *Pucjlowski v Jonnston's Executors* 1946 WLD 1 6, Van den Heever J described *causa non secuta* and *causa finita* as follows: "The object of condiction is the recovery of property in which ownership has

"narrower" branch of the *condictio sine causa specialis*.[67] The court in *Kudu Granite* also stated that the *condictio causa data causa non secuta* may in certain circumstances be applicable in cases of supervening impossibility, but was careful to note the criticism levelled against the use of this action.[68] Unfortunately, the court did not expressly endorse a specific condictiones for cases of supervening impossibility since, so it held, the requirements of proof of both condictiones were the same.[69] Commentators nevertheless accept the *condictio ob causam finitam* as the applicable action in cases of supervening impossibility.[70]

It is submitted that the enrichment considerations applicable to supervening impossibility should apply also to legal impossibility. The difference in relation to the event of impossibility should not be over-emphasised in this regard since both belong to the broader doctrine of impossibility of performance and operate on similar legal principles. Thus, if the bank in the letter-of-credit or demand-guarantee transaction has processed payment in circumstances where one of the contracting parties is a sanctioned individual or entity for the purposes of domestic sanctions laws, the bank should be able to reclaim funds using the *condictio ob causam finitam*. If a general enrichment action is in future recognised in South African law, the bank's claim may then be based on this cause of action.

Regard must also be had to the so-called defence of "loss of enrichment". In terms of this defence the party seeking to reclaim its performance (impoverished party) may be unsuccessful in its pursuit if the performance no longer exists.[71] The impoverished party therefore carries the risk of loss. Visser argues that in the case of supervening impossibility the defence of loss of enrichment should not be available to the party to whom performance has been transferred (enriched party) and that such a party should be liable to restore the performance it has received or, if it is unable to do so, the value thereof.[72] The risk is shifted to

UNIVERSITY OF JOHANNESBURG

been transferred pursuant to a juristic act which was *ab initio* unenforceable or had subsequently become inoperative."

[67] See *EBJ Mining Construction (Pty) Ltd v Hattingh* (42/17) [2017] ZANWHC 91 (23 November 2017) par 10.

[68] (n 63) above.

[69] 16.

[70] Sonnekus *Unjustified Enrichment in South African Law* (2017) 195; and Visser *Unjustified Enrichment* (2008) 481.

[71] Visser (n 70) 498. For example, that the payment made by the bank has, at the time of the enrichment claim, already been used.

[72] 499–500.

the enriched party (for example, the beneficiary that receives payment under a letter-of-credit or demand-guarantee contract discharged due to legal impossibility).[73]

5.2.4 Criminal liability on the part of the bank

5.2.4.1 General

The offences established in section 4 of the POCDATARA and section 26B of the FICA regarding (financial, economic or property-related) engagement with a sanctioned party can only be committed by a person who "ought reasonably to have known or suspected" that it was dealing with such a party. In establishing criminally liability on the part of a person who has committed such an offence, fault is particularly significant.[74] The question whether the offence was committed intentionally or negligently is paramount in this context.[75]

This section explores the issue of the fault on the part of the bank in instances where it processes payment in terms of a letter of credit or demand guarantee involving a sanctioned individual or entity. It differentiates between cases where payment is processed in the knowledge of the legal impossibility (*intentionally*) and cases where payment is processed without knowledge of the legal impossibility (*negligently*).

Where criminal liability is established on the part of the bank, it will be liable to a fine not exceeding R100 million.[76] Relevant banking officials may in turn be liable to imprisonment not exceeding 15 years or a fine or both.

UNIVERSITY OF JOHANNESBURG

5.2.4.2 Processing a letter of credit or demand guarantee in the knowledge that performance was legally impossible

In accordance with the POCDATARA and the FICA a person will have had knowledge of a fact if the person has actual knowledge of that fact or the court is satisfied that the person believes that there was a reasonable possibility of the existence of that fact and it fails to obtain information to confirm the existence of that fact.[77] Knowledge for the purposes of the

---

[73] 500–501.

[74] South African criminal law recognises four requirements for establishing criminal liability: namely, (i) an act (actus reus); (ii) which is unlawful (unlawfulness); (iii) causing the crime (causation); and (iv) committed with the necessary intent or culpa (fault). A detailed discussion of these requirements falls outside the scope of this thesis. For commentary in this regard see generally Hoctor *Snyman's Criminal Law* (2021).

[75] In this regard, criminal law in South Africa is based on personal liability (being accountable in one's own capacity for one's own unlawful conduct which must comply with fault) and not strict liability. On this issue see Hoctor (n 74) 208–212.

[76] s 18(1)(c) of the POCDATARA (n 9); and s 68 of the FICAA (n 10).

[77] s 1(2) of the FICA (n 10); and s 1(6) of the POCDATARA (n 9).

POCDATARA and the FICA may therefore entail actual knowledge or what is generally referred to as "wilful blindness". The bank's knowledge of the legal impossibility (or sanctioned individual or entity) may take one of these forms.

Actual knowledge has been described as "an awareness, conviction or belief that may stem from a personal participation in the crime or from information conveyed by the actual criminals or that may be generated by particular circumstances and facts."[78] Watermeyer CJ in *R v Patz*[79] commented in this regard as follows:

> "Knowledge is not confined to that mental state of awareness produced by personal participation in the theft or by information derived from the actual thieves, but includes also a conviction or belief engendered by the attendant circumstances … On the other hand mere suspicion not amounting to conviction or belief is not knowledge."[80]

This means that a bank will have actual knowledge of a sanctioned individual or entity if a suspicion is supported by information disclosing the sanctioned individual or entity from the credit or guarantee, or from any of the supporting documents or transactional information.

Usually, a mere suspicion will not be sufficient to constitute actual knowledge of the fact. But if the suspicion can be justified as a conviction or belief, it may amount to actual knowledge.[81] As explained by the court in *SVV Construction v Attorneys, Notaries and Conveyancers Fidelity Guarantee Fund*:[82]

> "'Belief or conviction' connotes something less than certainty in mind, but at least that which amounts to 'mental acceptance of a proposition, statement or fact as true, on the ground of authority or evidence' (*OED sv* 'belief'); 'conviction' is 'strong belief on the ground of satisfactory reasons or evidence' (*OED*); just as this is more, considerably more, than mere suspicion (however well founded that suspicion may subsequently prove to be) so also is it stronger than an impression."[83]

UNIVERSITY OF JOHANNESBURG

Thus, a suspicion supported by compelling reasoning and evidence may constitute actual knowledge of the fact. In the context of this study evidence pointing to a sanctioned individual or entity may emerge from the documents presented to the bank for payment as well as the underlying contract and may take the form of excessive amendments or extensions, irregular

---

[78] De Koker and Smit "Key money laundering offences" in de Koker (ed) *Money Laundering and Terror Financing Law and Compliance in South Africa* (2020) 31 57.

[79] 1946 AD 845.

[80] 857.

[81] 857.

[82] 1993 (2) SA 577 (C).

[83] 585F–H.

trade structures, nonsensical non-standard clauses and the absence of standard documentation, to name a few.

If the suspicion of the involvement of a sanctioned individual or entity is so strong that it necessitates the need to make enquiries, a bank should be careful to proceed without making reasonable enquiries, since a deliberate failure or refusal to make such enquiries may constitute "wilfully blindness". The court in *Frankel Pollak Vinderine Inc v Stanton NO*[84] gave meaning to the concept of "wilfully blind":

> "Where a person has a real suspicion and deliberately refrains from making inquiries to determine whether it is groundless, where he or she sees red (or perhaps amber) lights flashing but chooses to ignore them, it cannot be said that there is an absence of knowledge of what is suspected or warned against."

While a person who is wilfully blind is not regarded as having actual knowledge of the particular fact, the relevant knowledge is imputed to that person. The court in *Stannic v SAMIB Underwriting Managers (Pty) Ltd*[85] explained:

> "Actual knowledge may be proved in a number of different ways. It may be inferred from the facts proven: the facts and circumstances may be such that the reasonable inference to be drawn is that the person whose conduct is in issue had actual knowledge of a matter …."

Therefore, if a bank refrains from making enquiries as to the sanctioned status of an individual or entity in circumstances where a strong suspicion exists that the individual or entity has such status, that bank will be deemed to have known of the sanctioned individual or entity. The bank will therefore be held to have intentionally contravened the relevant sanctions laws.

UNIVERSITY
OF
JOHANNESBURG

5.2.4.3 Processing a letter of credit or demand guarantee without the knowledge that performance was legally impossible

A bank that processes a letter of credit or demand guarantee without the knowledge that performance was legally impossible will not have acted intentionally but negligently. The test for negligence was introduced in section 1(3) of the Proceeds of Crime Act (POCA)[86] and subsequently adopted in the FICA[87] and the POCDATARA.[88]

---

[84] (n 15) 596C–D. See also *R v Myers* 1948 (1) SA 375 (A).

[85] [2003] 3 All SA 257 (SCA) par 17.

[86] 76 of 1996.

[87] s 1(3) of the FICA (n 10).

[88] s 1(7) of the POCDATARA (n 9).

In accordance with this test, a person is negligent if the conclusions reached by him or her on the illicit nature of the property or transaction differ from the conclusions which a reasonably diligent and vigilant person, having both "the general knowledge, skill, training and experience that may reasonably be expected of a person in his or her position […] and the general knowledge, skill, training and experience that he or she in fact has", would have reached.

Applied to the targeted-financial-sanctions situation, the conduct of the person responsible for the execution of sanctions compliance exercises – and especially sanctions screening exercises – is especially relevant. In the event such a person fails to identify a sanctioned individual or entity the essential question would be whether a reasonably diligent and vigilant employee would also have failed to identify the sanctioned individual or entity. If the relevant person has specific knowledge or expertise (for instance, training in the identification of sanctioned individuals or entities) that the ordinary employee would not have, this is also imputed to the hypothetical reasonable employee conducting the sanctions compliance exercises. This is ascribed to the dual objective/subjective test for negligence.[89]

It follows that if the hypothetical reasonable employee conducting sanctions compliance exercises would have identified the sanctioned individual or entity, then the relevant employee and consequently the bank itself could be found negligent for not identifying the sanctioned individual or entity. Spruyt argues that this is a problematic approach, since such an employee typically would not have a discretion in relation to the steps to be taken to identify sanctioned individuals or entities.[90] He submits that these steps are usually provided for in the policies that underlie the bank's compliance programme.[91] "The question therefore is not so much the reasonable conduct of employees, but the reasonableness of the institution's policy requirements as they relate to client due diligence."[92] Owing to the significant consequences to be borne by the employee that is found negligent in failing to identify a sanctioned individual or entity, regulatory guidance or clarity in this regard is warranted.

UNIVERSITY OF JOHANNESBURG

[89] *Savoi and Others v National Director of Public Prosecutions* [2014] ZACC 5 par 90–91. On this test see De Koker and Smit (n 78) 58–59.

[90] Spruyt (n 3) 26.

[91] Spruyt (n 3) 26.

[92] Spruyt (n 3) 26.

5.2.5 Interference with payment under letters of credit

The practical implication of the manifestation of a sanctioned individual or entity in a letter-of-credit transaction is, as indicated above,[93] that payment may be refused by the South African bank since processing payment would be unlawful in terms of South African law. A refusal to process payment may also necessitate a refusal to reimburse. The issue, however, becomes more complex when further banks, which are outside of South Africa and not subject to South African law, are involved in the transaction. In this respect, a bank may be requested to act as confirming bank, nominated bank, transferring bank, reimbursing bank or collecting bank. Moreover, instances where the South African bank is not the issuing bank but some other bank also render the situation problematic. Clearly, this indicates that there are many permutations. The scenarios most likely to emerge in letter-of-credit transactions are examined below.

First, however, an overview of the rules of South African private international law is provided. This is necessary because the parties' legal position in relation to a sanctions interference may be affected by the proper law of the particular contractual relationship.

5.2.5.1 South African private international law

The UCP is invariably incorporated into letters of credit.[94] Although it addresses important aspects of the letter-of-credit transaction, it does not regulate every conceivable matter in this regard. For example, the UCP fails to regulate exceptions to the independence principle of letters of credit. It also does not address the potential impact of targeted financial sanctions on payment under letters of credit. This then gives rise to the need to determine which national legal system should be applied in order to deal with the matter concerned. Although the parties are in principle free to choose a legal system to govern their contract,[95] they do not always do so. Where a legal system is not chosen by the parties, a legal system may be determined to apply to their contract in accordance with the rules of private international law.

In South African private international law two approaches have developed to determine the applicable legal system. The first entails a presumption by the court that the parties intended for a specific legal system to apply to their contract. The case of *Standard Bank of SA Ltd v Efroiken and Newman*[96] is of particular interest in this regard. The case concerned a contract

[93] par 5.2.1 above.

[94] On the other hand, in the demand-guarantee environment no single set of rules has attained anything close to the dominance achieved by the UCP in relation to letters of credit. See par 2.1 above.

[95] The choice in this regard may be express or tacit, as determined by the text and interpretation of the contract.

[96] 1924 AD 171.

of sale of flour between an American seller and a South African buyer.[97] The contract was concluded in Cape Town, South Africa. At the instance of the buyer, Standard Bank issued a letter of credit in favour of the seller. The letter of credit was available for payment at Standard Bank's New York branch. One of the documents to be presented under the letter of credit was a bill of lading. The New York branch paid against a document akin to a multimodal or combined transport document, even though the most important leg of the transport covered by the document was the sea leg. The buyer refused to accept the documents and to reimburse the bank. The Appellate Division held that as the bank had to perform in New York, its contract with the buyer was to be determined with reference to American rather than South African law. In reaching this finding the court relied upon "what ought, reading the contract by the light of its subject matter and of the surrounding circumstances, to be presumed to have been the intention of the parties".[98] On this basis, since it was assumed without evidence to the contrary that the term "bill of lading" meant marine bill of lading both in terms of American and South African law, the buyer was entitled, so the court held, to reject the documents.

The effect of this judgment is that although the parties clearly had no intention regarding an applicable legal system, the court presumed that one had to have been intended by the parties. Oelofse states that the court effectively worked with a "fictional" intention of the parties.[99]

The second approach, as indicated above, is that the applicable legal system is determined by establishing the law with which the contract has the "closest and most real connection",[100] or by establishing "the centre of gravity of the contract".[101] This approach was endorsed obiter in *Improvair (Cape)(Pty) Ltd v Establissements Neu*[102] and *Laconian Maritime Enterprises Ltd v Agromar Lineas Ltd*,[103] although in both cases the court considered itself bound by the *Standard Bank* case. The Appellate Division itself expressed its support for this test in *Ex parte Spinazze*,[104] where Corbett CJ in passing referred to "the system with which

[97] There were two contracts of sale, but only one is relevant to the present discussion.

[98] 185.

[99] Oelofse *The Law of Documentary Letters of Credit in Comparative Perspective* (1997) 531 fn 120.

[100] This test is rooted in art 4(1) of the Convention on the Law Applicable to Contractual Obligations (1980) (Rome Convention).

[101] Forsyth *Private International Law: The Modern Roman-Dutch Law Including the Jurisdiction of the High Courts* (2012) 331.

[102] 1983 (2) SA 138 (C).

[103] 1986 (3) SA 509 (D).

[104] 1985 (3) SA 650 (A).

UNIVERSITY OF JOHANNESBURG

the contract had its closest and most real connection".[105] This second approach is, it is suggested, most appropriate and should be endorsed by the Supreme Court of Appeal when an opportunity to do so presents itself.

To determine the proper law of a contract (whether this entails a determination of the intention of the parties or of the law most closely connected to the contract), Fredericks and Neels[106] suggest a host of factors as extracted from South African and foreign sources for consideration,[107] but are careful to indicate that the most important of these is the *locus solutionis* (the place of performance). The *locus solutionis* usually corresponds with the presumed intention of the parties but is also not inflexible in that it enables courts to, in appropriate instances, assign to the contract a law different to that of the *locus solutionis*.[108] One such instance can be found in the case of *Collisons (SW) Ltd v Kruger*,[109] where the concurring *lex domicilii* of the contracting parties was preferred to both the *lex loci solutionis* and the *lex loci contractus*.

In international commercial transactions it often happens that the *locus solutionis* for the "characteristic performance"[110] (i.e., delivery) differs from the *locus solutionis* for payment.[111] In these instances the *locus solutionis* will need to be applied with reference to one of two principles – the scission principle or the unitary principle.[112] In terms of the scission principle, each obligation is subjected to a different legal system. The applicable law will depend on the claim in question. For instance, if an action is instituted for payment, the proper law will most likely be the *locus solutionis* in relation to payment. Alternatively, if an action is

UNIVERSITY OF JOHANNESBURG

[105] 665.

[106] Fredericks and Neels "The proper law of the documentary letter of credit (part 1)" 2003 *SA Merc LJ* 63 67–68.

[107] 67–69. They cite the following factors: "(a) *the locus solutionis* (the place of performance); (b) *the locus contractus* (the place of the conclusion of the contract); (c) the place of the offer; (d) the place of the acceptance; (e) the place of agreed arbitration; (f) the choice of jurisdiction; (g) the domicile of the parties; (h) the place where the parties carry on business; (i) the domicile of the agents or mandatories of the parties; (j) the future domicile of the parties; (k) the (habitual) residence of the parties; (l) the nationality of the parties; (m) the form, terminology, and language of the contract; (n) the *locus rei sitae* (the place where the property is situated); (o) the *locus libri siti* (the place where the property is registered); (p) the *locus expeditionis* (the place of despatch); (q) the *locus destinationis* (the place of destination); (r) the place of registration of the vehicle (means of conveyance) by which the *res vendita* is transported; (s) the currency in which the contractual obligation of payment is expressed; and (t) the incorporation of a statute in the contract." This is not a closed and exhaustive list of connecting factors.

[108] (n 101) above.

[109] 1923 PH A 78 (SWA).

[110] This term is used in art 4(2) of the Rome Convention to describe the performance for which payment is due.

[111] Fredericks and Neels (n 106) 69.

[112] Both principles find support in South African law. See *Standard Bank* (n 96) 188; and *Laconian Maritime* (n 103) 528–529 and 530HI (scission principle); and *Improvair* (n 102) 147BG (unitary principle).

instituted for delivery of the goods, the law applicable to the contract will most likely be the *lex loci solutionis* in relation to delivery.[113] The unitary principle, on the other hand, entails that the same proper law will govern both or all the obligations in terms of the contract.

This thesis supports the unitary principle for the simple reason that having more than one proper law to a contract, which is the outcome of the scission principle, unnecessarily complicates matters. The unitary principle also reflects an appreciation for the fact that the obligations of the parties are normally closely connected.[114]

The question remains, how is the proper law determined under the unitary principle in instances where the *locus solutionis* for delivery is different to the *locus solutionis* for payment? The feasible solution would appear to be to consider all the relevant factors, including the *lex loci solutionis*.[115] If the factors other than the *loci solutionis* do not convincingly indicate a proper law then, as Sykes and Pryles suggest, "an ad hoc rule in favour of the *lex loci solutionis* in respect of payment must be applied".[116]

The closest and most real connection test and the unitary principle will in future most likely be applied by South African courts.[117] Thus, in the absence of either an express or a tacit choice of a legal system, the proper law of a letter of credit or demand guarantee in terms of South African private international law should be informed by the *lex loci solutionis*.

For the purposes of this study, the proper law governing the contractual relationships in the scenarios immediately below is South African law. So, too, is South African law the applicable national law in respect of the scenarios that deal with compliance with foreign sanctions.[118]

UNIVERSITY
OF
JOHANNESBURG

[113] Fredericks and Neels (n 106) 69.

[114] Fredericks and Neels (n 106) 70.

[115] This is the approach proposed by Forsyth (n 101) 334–335, which is partly based on the following obiter dictum in *Laconian Maritime* (n 103) 529EF, per Booysen J: "Be that as it may, the lex loci solutionis of all payments is English law whereas the performance of applicant's obligations of carriage and delivery had to take place in Argentine, upon the high seas and in Columbia. If I have to strike a balance it seems to tilt towards English law from amongst the leges loci solutionis."

[116] Sykes and Pryles *Australian Private International Law* (1991) 607, with reference to *Mendelson-Zeller Co Inc v T & C Providores Pty Ltd* (1981) 1 NSWLR 366.

[117] This, too, is the view of Fredericks and Neels (n 106) 72; and Forsyth (n 101) 332. See also Fredericks and Neels "The proper law of a documentary letter of credit (part 2)" 2003 *SA Merc LJ* 207 *et seq* where the closest and most real connection test and the unitary principle are applied to determine the proper law of the letter of credit.

[118] See in this regard pars 5.3.5 and 5.3.6 below.

5.2.5.2 Transactions involving only an issuing bank

One scenario in relation to the issuing bank and the manifestation of a sanctioned individual or entity in the documents is examined below.

A South African buyer enters into a contract of sale with a South African seller in terms of which payment is to be effected by means of a letter of credit. The buyer (applicant) procures the issuance of the letter of credit from a South African bank. After relinquishing control of the goods, the seller (beneficiary) presents conforming documents to the South African issuing bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. The bank is legally barred from processing payment. Since the beneficiary cannot enforce payment against the issuing bank, it may need to institute legal proceedings against the applicant on the basis of unjustified enrichment law to reclaim the goods.[119]

5.2.5.3 Transactions involving confirming banks

When dealing with confirmations one must distinguish between proper confirmations and silent confirmations. As explained above,[120] in the case of proper confirmations the confirming bank is instructed by the issuing bank to confirm the credit. In the case of silent confirmations it is the seller that so instructs the confirming bank. The legal effect of these confirmations differs. The two scenarios below relate to proper confirmations, and will each also consider the position in terms of a silent confirmation.

UNIVERSITY
OF
JOHANNESBURG

(i) A South African buyer enters into a contract of sale with an English seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a South African bank in favour of the seller – the beneficiary of the credit. On instruction from the issuing bank, the letter of credit is confirmed by an English bank. The beneficiary presents conforming documents to the English bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. If the English bank pays the beneficiary it will not be reimbursed by the South African bank since the latter is legally unable to process the transaction. On the other hand, if it does not pay the beneficiary it will be in breach of its contractual obligations towards the beneficiary in terms of its confirmation of the letter of credit – this is the case as performance of the English confirming bank's obligations are not unlawful under English

[119] For a comprehensive treatise on the South African law relating to unjustified enrichment see Sonnekus (n 70).

[120] par 2.2.3.1 above.

law. Since South African law governs the transaction, however, the beneficiary will also not be able to enforce payment against the English confirming bank. It is legally impossible for it to do so. This position applies *mutatis mutandis* in relation to cases involving silent confirmations. In both instances, therefore, the beneficiary may need to institute an action to recover the goods from the applicant based on unjustified enrichment law.

(ii) An English buyer enters into a contract of sale with a South African seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from an English bank in favour of the seller – the beneficiary of the credit. On instruction from the issuing bank, the letter of credit is confirmed by a South African bank. The beneficiary presents conforming documents to the South African bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. The South African bank is legally prohibited from paying; therefore, the beneficiary will not be able to enforce payment against it. An attempt by the South African beneficiary to enforce payment against the English bank will constitute a breach of South African law. This position applies *mutatis mutandis* in relation to cases involving silent confirmations.

5.2.5.4 Transactions involving nominated banks

At least two permutations in relation to the nominated bank[121] and the manifestation of a sanctioned individual or entity in the documents are conceivable.

UNIVERSITY OF JOHANNESBURG

(i) A South African buyer enters into a contract of sale with an English seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a South African bank in favour of the seller – the beneficiary of the credit. The issuing bank nominates a bank in England to pay the beneficiary. The beneficiary presents conforming documents to the English bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. Should the English bank pay the beneficiary it will not be reimbursed by the South African issuing bank, as the latter is legally precluded from processing the transaction. There is, however, no reason why the English nominated bank should pay the beneficiary since it has made no payment

[121] On the role and legal aspects of nominated banks see par 2.2.3.1 above.

undertaking towards the beneficiary.[122] The beneficiary may therefore institute an action based on the principles of unjustified enrichment to recover the goods from the applicant.

(ii) An English buyer enters into a contract of sale with a South African seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from an English bank in favour of the seller – the beneficiary of the credit. A South African bank is nominated to pay. The beneficiary presents conforming documents to the South African bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. As the South African bank is prohibited from facilitating the transaction, the beneficiary is unable to enforce payment against it.[123] Payment also cannot be enforced against the English bank because South African law, the law in terms of which the sanctioned individual or entity has been identified, governs the transaction. It would therefore be unlawful for the beneficiary to do so.

5.2.5.5 Transactions involving transferring banks

Two scenarios relating to the transferring bank[124] and the manifestation of a sanctioned individual or entity in the documents are explored below.

(i) An English buyer enters into a contract of sale with a South African seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from an English bank in favour of the seller – the (original) beneficiary of the credit. The seller, however, does not produce the goods itself but acquires it from its South African supplier. Consequently, the issuing bank mandates a South African transferring bank to make the same credit available in whole to the South African supplier (the second beneficiary).[125] The second beneficiary presents conforming documents to the transferring bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. As the second beneficiary will not receive payment, the documents will not be forwarded to the original beneficiary. The original beneficiary will in turn not be able to

[122] See Hugo "Payment in and financing of international sale transactions" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 395 405 who states that "the *nominated bank* is also not contractually bound as against the seller [beneficiary] to pay it or accept its draft. It does so by virtue of its contract of mandate with the issuing bank" (footnotes omitted).

[123] In any event, it has made no payment undertaking towards the beneficiary.

[124] On transferrable credits see par 2.2.4 above.

[125] resulting in a completely new and independent credit.

tender documents to the issuing bank. The implication is that the original beneficiary will not receive the goods and will simply be in breach of the contract of sale.

(ii) A South African buyer enters into a contract of sale with an English seller. A letter of credit is issued by a South African bank in favour of the seller – the (original) beneficiary of the credit. The issuing bank mandates an English transferring bank to make the same credit available in whole to the English supplier (the second beneficiary). The second beneficiary presents conforming documents to the transferring bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. If the English bank pays the second beneficiary, the original beneficiary will need to reimburse the English bank to gain possession of the documents. Whether the South African bank will pay the original beneficiary upon presentation of its conforming documents depends on whether those documents reflect the sanctioned individual or entity.

5.2.5.6 Transactions involving reimbursing and claiming banks

As explained above,[126] letters of credit occasionally provide for so-called bank-to-bank reimbursement. Such an arrangement envisages that the nominated bank will claim reimbursement not from the issuing bank but from a reimbursing bank.[127] A failure by the reimbursing bank to reimburse the nominated bank, however, does not relieve the issuing bank from reimbursing the nominated bank (in this context – the *claiming bank*).[128]

Three permutations relating to the reimbursing bank and the claiming bank, and the manifestation of a sanctioned individual or entity in the documents are analysed below.

(i) A South African buyer enters into a contract of sale with an English seller. There is a South African issuing bank and an English nominated bank. The credit further provides for bank-to-bank reimbursement and, as such, an English reimbursing bank is mandated. The beneficiary presents conforming documents to the English nominated bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. The South African issuing bank is legally unable to process the transaction. If the

[126] See par 2.2.3.1 above.

[127] Such reimbursement may or may not be governed by special rules emanating from the ICC, namely the *Uniform Rules for Bank-to-bank Reimbursement* (URR) ICC Publication 725 (2008).

[128] See art 13 of the UCP 600 (n 5).

English nominated bank pays the beneficiary it will most likely be reimbursed by the English reimbursing bank. This is because the reimbursement bank will not be afforded an opportunity to examine the documents for itself since the nominated bank will return the documents to the issuing bank directly. [129] However, if the reimbursing bank pays the nominated bank it will not be able to recover moneys paid from the South African issuing bank. In any event, there is no reason why the English nominated bank should pay the beneficiary as it has made no payment undertaking towards the beneficiary. On this premise, the beneficiary will not be able to enforce payment against any of the banks involved. It may sue the applicant of the credit (buyer) on the basis of unjustified enrichment law to reclaim the goods.

(ii) A South African buyer enters into a contract of sale with an English seller. There is a South African issuing bank and an English confirming bank, the latter instructed by the issuing bank. In accordance with the credit, an English reimbursing bank is mandated. The beneficiary presents conforming documents to the English confirming bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. The South African issuing bank is precluded from facilitating the transaction. If the English confirming bank pays the beneficiary it will probably be reimbursed by the English reimbursing bank because the latter will not have had an opportunity to view the documents and, accordingly, will be unaware of the sanctioned individual or entity. In this case, however, the reimbursing bank will not be able to recover moneys paid from the issuing bank. Conversely, if the English confirming bank does not pay the beneficiary it will be in breach of its contractual obligations towards the beneficiary in terms of its confirmation of the letter of credit. The beneficiary will not, however, be able to enforce payment against the English bank because South African law, the law in terms of which the sanctioned individual or entity has been identified, is the proper law of the transaction.

(iii) In cases where the reimbursing bank is a South African bank, it will not process reimbursement on account of the legal prohibition to do so. However, the nominated or confirming bank in such cases will in any event mostly be South African and thus also legally prohibited from processing the transaction. Hence, a claim for reimbursement will

[129] See in this regard Hugo (n 122) 407.

not be made. Since the beneficiary will probably be South African as well, it will also not be able to enforce payment against the English issuing bank.

5.2.5.7 Transactions involving collecting banks

On the request of the beneficiary, a bank may be authorised to present the documents and receive payment on behalf of the beneficiary. This bank is referred to as the collecting bank.[130] Such a bank acts as the beneficiary's agent and accordingly possesses the rights of the beneficiary in so far as presenting the documents and receiving payment is concerned. Consequently, any defence available against the beneficiary is available against the collecting bank.

Two permutations relating to the collecting bank and the manifestation of a sanctioned individual or entity in the documents are examined below.

(i) A South African buyer enters into a contract of sale with an English seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a South African bank in favour of the seller – the beneficiary of the credit. The beneficiary requests its own bank to tender the documents and receive payment on its behalf (the collecting bank). After the seller relinquishes control of the goods, the collecting bank presents conforming documents to the South African issuing bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. The South African issuing bank is legally barred from processing the transaction. The collecting bank accordingly cannot enforce payment against the issuing bank, but it may seek reimbursement from the beneficiary in so far as it delivered the documents to the issuing bank.

(ii) An English buyer enters into a contract of sale with a South African seller. An English bank issues a letter of credit in favour of the seller – the beneficiary of the credit. The beneficiary requests its own bank to tender the documents and receive payment on its behalf (the collecting bank). The documents disclose a sanctioned individual or entity in terms of South African law and consequently the collecting bank refuses to collect. The beneficiary will not be able to enforce payment against it. Neither can the beneficiary do

[130] Mugasha *The Law of Letters of Credit and Bank Guarantees* (2003) 205.

so against the English issuing bank. This would amount to unlawful conduct in terms of South African law.

5.2.5.8 Acceptance credit transactions

Acceptance credits are a special type of letter of credit. As discussed above,[131] they are special for at least two reasons. First, they involve the use of a bill of exchange.[132] In a typical acceptance-credit situation the beneficiary will present, together with the documents, a term bill of exchange drawn on the nominated bank in favour of the beneficiary. Where the beneficiary presents conforming documents to the nominated bank, the nominated bank will accept the bill of exchange. If the nominated bank refuses to accept the bill, the beneficiary can enforce payment against the issuing bank.[133] Secondly, acceptance credits are often discounted. Discounting refers to the practice whereby the beneficiary negotiates the bill of exchange to a third party, for example, another bank, by indorsing it at a discounted amount before maturity of the bill. Therefore, it can be said that the third party, as holder of an accepted bill of exchange (a banker's acceptance), steps into the shoes of the beneficiary and can present the banker's acceptance to the nominated bank for payment on maturity.[134]

Two scenarios relating to the manifestation of a sanctioned individual or entity in the documents are examined below.

(i) A South African buyer enters into a contract of sale with an English seller. As required under the contract of sale, the buyer procures the issuance of an acceptance letter of credit from a South African bank in favour of the seller – the beneficiary of the credit. An English bank is nominated to receive the documents and, if they are in order, to accept the bill of exchange and to pay it on maturity. The beneficiary presents conforming documents to the English bank together with the bill of exchange drawn on the English bank payable 90 days after acceptance. The documents, however, disclose a sanctioned individual or entity in terms of South African law. If the English bank pays the

[131] par 2.2.3.3 above.

[132] For general background on these credits, see Adodo *Letters of Credit: The Law and Practice of Compliance* (2014) 19 pars 1.38–1.39; and Bridge *Benjamin's Sale of Goods* (2014) 2022 par 23–018.

[133] In this regard, art 7(*a*)(iv) of the UCP 600 (n 5) provides as follows: "Provided that the stipulated documents are presented to the nominated bank or to the issuing bank and that they constitute a complying presentation, the issuing bank must honour if the credit is available by: … iv. acceptance with a nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted a draft drawn on it, does not pay at maturity".

[134] Discounting can be with or without recourse to the seller. For a discussion in this regard see par 2.2.3.3 above.

beneficiary or any subsequent holder (who may have purchased it in a discounting transaction)[135] on maturity of the bill of exchange it will not be reimbursed by the South African bank. The nominated bank is under no obligation to accept the bill of exchange and, in light of the fact that it will not be reimbursed for any payment, would be wise to dishonour the bill by refusing to accept it. However, once it has accepted the bill it is bound to pay it on maturity to the beneficiary or any holder who has purchased it in a discounting transaction.

(ii) An English buyer enters into a contract of sale with a South African seller. An English issuing bank and South African nominated bank are involved. The beneficiary presents conforming documents to the South African bank together with the bill of exchange drawn on the South African bank payable 90 days after acceptance. The documents, however, disclose a sanctioned party in terms of South African law. The South African bank is prohibited from processing the transaction. If the English bank pays the beneficiary in terms of the bill of exchange or a subsequent holder in terms of the banker's acceptance, it will forgo reimbursement. On account of South African law governing the transaction, the beneficiary or any subsequent holder will not, on maturity of the bill of exchange, be able to enforce payment against the English bank if the English bank elects not to pay.

UNIVERSITY OF JOHANNESBURG

5.2.5.9 Back-to-back credit transactions

Two scenarios relating to the manifestation of a sanctioned individual or entity in the documents are assessed below.

(i) An English buyer enters into a contract of sale with a South African seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from an English bank in favour of the seller – the (original) beneficiary of the credit. The seller acquires the goods from its South African supplier and wishes to conceal this fact. Consequently, it, relying on the first credit issued, requests a South African bank to issue a second credit in favour of the supplier (second beneficiary). The second beneficiary presents conforming documents to the South African bank. The documents, however,

[135] The subsequent holder may satisfy the requirements of a holder in due course. See s 27(1) of the Bill of Exchange Act 34 of 1964. See also Hugo (n 122) 411.

disclose a sanctioned individual or entity in terms of South African law. Since the second beneficiary will not be paid the documents will not be forwarded to the original beneficiary. This means that the original beneficiary will not be able to tender documents to the issuing bank. Hence the original beneficiary will never receive the goods and will simply be in breach of the contract of sale.

(ii) A South African buyer enters into a contract of sale with an English seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a South African bank in favour of the seller – the (original) beneficiary of the credit. The seller, relying on the first credit, requests an English bank to issue a second credit in favour of the supplier (second beneficiary). The second beneficiary presents conforming documents to the English bank. The documents, however, disclose a sanctioned individual or entity in terms of South African law. Should the English bank pay the second beneficiary, the original beneficiary will need to reimburse the English bank to gain possession of the documents. The question whether the South African bank will pay the original beneficiary upon presentation of its documents depends on whether those documents disclose the sanctioned individual or entity.

5.2.6 Interference with payment under demand guarantees

As in the case of letters of credit, a reference to a sanctioned individual or entity in the presented documents may impact upon payment under demand guarantees. Unlike in the case of letters of credit, few banks may become involved in demand-guarantee transactions. Consequently, fewer scenarios are conceivable.

5.2.6.1 Transactions involving only a guarantor

Two scenarios relating to the guarantor and the manifestation of a sanctioned individual or entity in the documents are considered below.

(i) A South African employer enters into a construction contract with a South African contractor. A performance guarantee is issued by a South Africa bank (guarantor) in favour of the employer. The contractor's performance is defective and amounts to breach of contract. Consequently, the employer tenders conforming documents. The documents, however, disclose a sanctioned individual or entity in terms of South African law. The guarantor is legally barred from processing the transaction.

UNIVERSITY OF JOHANNESBURG

(ii) A South African employer enters into a construction contract with an English contractor in terms of which payment is to be secured by way of a payment guarantee. The employer procures the issuing of the guarantee from a South African bank in favour of the contractor. Following a dispute between the parties the contractor tenders conforming documents to the guarantor. The documents, however, disclose a sanctioned individual or entity in terms of South African law. The beneficiary will accordingly not be able to enforce payment against the issuing bank.

5.2.6.2 Transactions involving counter-guarantors

Two permutations relating to the counter-guarantor and the manifestation of a sanctioned individual or entity in the documents are appraised below.

(i) A South African employer enters into a construction contract with an English contractor. An English bank (guarantor) issues a guarantee in favour of the contractor (beneficiary) against a counter-guarantee by the employer's South African bank (counter-guarantor). During the course of the transaction, a dispute arises between the employer and contractor, triggering the submission of conforming documents by the beneficiary. The documents, however, disclose a sanctioned individual or entity in terms of South African law. If the English guarantor pays it will not be reimbursed by the counter-guarantor since the latter is legally unable to process the transaction. The beneficiary will not be able to enforce payment against the guarantor if it refuses to pay since South African law is the proper law of the transaction.

(ii) An English employer enters into a construction contract with a South African contractor. A South African bank (guarantor) issues a guarantee in favour of the contractor (beneficiary) against a counter-guarantee by the employer's English bank (counter guarantor). A dispute arises between the employer and contractor, triggering the submission of conforming documents. The documents, however, disclose a sanctioned individual or entity in terms of South African law. Since the issuing bank will not process payment, there is no reason for it to call up the counter-guarantee.

UNIVERSITY
OF
JOHANNESBURG

5.2.7 Conclusions

The above analysis has shown that banks involved in demand-guarantee and especially letter-of-credit transactions in various capacities may find themselves in a dubious position should the documents be indicative of a sanctioned individual or entity in terms of South African law. A South African bank that refuses to pay or reimburse due to the documents disclosing a sanctioned individual or entity may rely on the fact that it would be unlawful for it to pay or reimburse. This defence of unlawfulness evidently gains impetus from the notion of legal impossibility of performance, which originates from South African contract law. In accordance with this notion, the letter of credit or demand guarantee is regarded as invalid and consequently does not create any valid and enforceable obligations.

In the case of non-South African banks, however, reliance cannot be placed on such a defence. Where non-South African banks discharge their payment obligations in instances where the documents disclose a sanctioned individual or entity, they will not be reimbursed. On the flip side, if the non-South African bank does not pay, the beneficiary will not be able to enforce payment against it because South African law is the proper law of the transaction.

Despite the implications for trade finance, compliance with domestic targeted financial sanctions serves the important function of combating financial crime and, in so doing, preserving the "integrity of the international financial system".[136] Sanctions practice, however, suggests that compliance with domestic sanctions alone is inadequate for the purposes of detecting and preventing financial crime. To this end, the practice of complying with foreign targeted financial sanctions has gained much ground. This issue, and its particular challenges for South African parties involved in letter-of-credit and demand-guarantee transactions, is considered immediately below.

5.3 Compliance with foreign targeted financial sanctions

5.3.1 Introduction

The aim of this section is to investigate the effect of compliance by South African banks with foreign targeted financial sanctions on letters of credit and demand guarantees. The focus falls on interferences with payment and reimbursement. But before conducting the investigation the following issues are explored: (i) the relevant international sanctions; (ii) the impact of blocking statutes and other similar measures; and (iii) business and reputational considerations

[136] Wolfsberg Group, ICC and BAFT (n 2) 8.

as the basis for compliance with foreign sanctions. These issues serve as necessary background to the investigation.

5.3.2 International sanctions

Elsewhere in this study[137] it was stated that the sanctions regimes of the United Kingdom (UK), United States of America (US) and the European Union (EU) are the most progressive and sophisticated in the world. It stands to reason that these sanctions regimes are particularly relevant in the context of compliance with foreign targeted financial sanctions.

In the UK the Office of Financial Sanctions Implementation (OFSI), on behalf of HM Treasury, is responsible for implementing financial sanctions. In carrying out this responsibility, the OFSI maintains on its open website two lists of those subject to financial sanctions.[138] The first is the "Consolidated List", which contains a list of designated persons subject to asset freezes for the purposes of UK financial sanctions legislation and UN sanctions. The list is intended to ensure compliance by businesses and individuals with UK financial sanctions. The second list maintained by the OFSI relates to those entities subject to specific capital market restrictions and which are not included on the Consolidated List. In the US the Office of Foreign Assets Control (OFAC) is vested with the primary responsibility of implementing sanctions. To this end, the OFAC maintains on its official website a list of Specially Designated Nationals and blocked persons (SDNs) that are targeted.[139] These SDNs include a large number of natural persons and juristic entities (including import and export companies, shipping companies and banks) as well as a large number of vessels (ships and aircraft). Due to the status of the EU in relation to its member states, member states are under an obligation to implement and enforce EU sanctions. Regulations giving effect to EU sanctions are immediately applicable in the domestic legal order of EU member states and directly binding upon all individuals and entities within member states.

While compliance with UK and EU financial sanctions is generally restricted to persons and entities within the UK and EU as well as those entities established in terms of the laws of the UK and EU member states, OFAC sanctions invariably carry extraterritorial effect.[140] In

[137] See par 3.1 above.

[138] OFSI *UK Financial Sanctions General guidance for financial sanctions under the Sanctions and Anti-Money Laundering Act 2018* (2020) 11.

[139] https://www.treasury.gov/ofac/downloads/sdnlist.pdf (accessed on 21 June 2020). Concerning the imposition and relaxation of OFAC sanctions, see the overview by Boscariol *et al* "Export controls and economic sanctions" in *The Year in Review An Annual Publication of the ABA/Section of International Law* (Spring 2016) 27 34–39.

[140] See in this regard the comparative analysis in par 3.7 above.

general terms, extraterritorial application of laws refers to the implementation of one country's policies and laws in relation to persons and entities of another.[141] In the context of the "unintended consequences of increased and stricter compliance rules" Marxen explains the effect of the extraterritorial application of laws and regulations as follows:

> "The compliance matrix is … expanded by extraterritorial application of laws and regulations by some countries, most notably the United States of America (also referred to as long-reach or long-arm approach or legislation) in matters of, inter alia, sanctions. By treating transactions that are nominated in US-Dollars, in some cases irrespective of where contract formation takes place, where goods or services are exchanged or delivered, and where parties are domiciled, to be subject to US-American law, the United States of America, effectively, imposes its own compliance expectations onto the global financial network and international banking and trade."[142]

Within the context of this thesis, this means that foreign (non-US) banking institutions are expected to comply with US sanctions. This is done by screening client and transactional information against the OFAC sanctions lists. Although EU and UK sanctions do not carry extraterritorial application, non-EU and UK banks may be inclined also to incorporate into their compliance system, and comply with, the OFSI and EU sanctions lists. A positive match in this regard may lead the foreign bank to report the transaction concerned to the relevant authority and to refuse to process or facilitate it.[143]

Theoretically, the question whether banks should comply with foreign extraterritorial law and regulation is a straightforward one – since they are not legally bound by such law and regulation, banks need not comply therewith.[144] Banking practice, however, indicates that the matter is not as simple as that. Non-compliance with extraterritorial US sanctions in particular may give rise to a host of significant commercial consequences for foreign persons and institutions.[145] Any non-US bank that disregards such laws and regulations may have to contend with grave business-related sanctions and penalties. Moreover, the non-US bank is

[141] Clark "Dealing with U.S. extraterritorial sanctions and foreign countermeasures" 2004 *University of Pennsylvania Journal of International Economic Law* 455 456.

[142] (n 30) 177–178 (footnotes omitted). Extraterritorial application of laws and regulations does not, however, relate only to institutional compliance. It may also, for instance, raise complex questions concerning conflict of laws. See generally Dodge "Extraterritoriality and conflict-of-laws theory: an argument for judicial unilateralism" 1998 *Harvard International Law Journal* 101 *et seq*.

[143] See in this regard par 3.3.2 above on EU sanctions; par 3.4.2 above on OFAC sanctions; and par 3.5.3 above on UK sanctions.

[144] However, in cases where parties contractually agree to be bound by specific foreign law, this will give rise to a legal obligation to comply with such law. Such instances are not dealt with in this chapter as they fall beyond the scope of this study.

[145] See Kittrie "New sanctions for a new century: treasury's innovative use of financial sanctions" 2014 *Journal of International Law* 789 815; and, generally, Amariles and Winkler "U.S. economic sanctions and the corporate compliance of foreign banks" 2018 *The International Lawyer* 497.

likely to experience reputational damage due to allegations of compliance contraventions and its association with financial crime. To mitigate these risks, non-US banks increasingly resort to complying with such foreign law and regulations. It stands to reason that a South African bank that complies with foreign sanctions does not do so by way of a legally binding obligation, but on the basis of strong business and reputational considerations. These business and reputational considerations are discussed in more detail below.[146]

5.3.3 Impact of blocking statutes and other similar measures

As discussed above,[147] the EU has enacted a regulatory mechanism[148] aimed at prohibiting and restricting compliance with certain US sanctions that carry extraterritorial effect, typically referred to as the "blocking statute".[149] In anticipation of the UK's withdrawal from the EU, it adopted blocking regulations[150] substantively similar to the EU blocking statute. The US legislation or regulations to be disregarded in this regard are contained in an annex to the EU blocking statute and UK regulations, respectively.[151]

In the context of this thesis, the EU blocking statute and UK regulations place EU and UK banks in a precarious position. On the one hand, if they comply with US sanctions by, for instance, terminating contractual relations with certain sanctioned individuals or entities, such an act may be treated as being unlawful under EU or UK law, which may render the bank liable to a monetary fine or some other serious penalty.[152] This implies that a refusal to process or facilitate a contract in order to comply with certain US sanctions "should be regarded as invalid and ineffective, with the consequence that national courts are obliged to treat the contractual

UNIVERSITY OF JOHANNESBURG

[146] See par 5.3.4 below.

[147] See par 3.3.4 above.

[148] Council Regulation (EC) 2271/1996 of 22 November 1996; and Commission Delegated Regulation (EU) 2018/1100 of 6 June 2018.

[149] On the use of this term see Ventura "Contemporary blocking statutes and regulations in the face of unilateral and extraterritorial sanctions" in Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 221 *et seq*; and Szabados *Economic Sanctions in EU Private International Law* (2020), especially at Chapter 7 entitled "Blocking statutes".

[150] The Protecting against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations 2020. On these regulations see par 3.5.6 above.

[151] Currently, the annexes contain only international sanctions enacted by the US against Cuba and Iran. Relevant statutes in this regard include the Cuban Liberty and Democratic Solidarity Act of 1996, the Iran Sanctions Act of 1996, and the Iran Freedom and Counter-Proliferation Act of 2012.

[152] In this regard, the EU blocking statute and UK regulations permit EU and UK persons to recover damages from other EU and UK persons who have complied with the relevant US sanctions legislation in contravention of the blocking statute and UK regulations, and nullify the effect in the EU and UK of any foreign court rulings relating to the US sanctions.

relationship as having continued on the same commercial terms as those previously existing".[153] On the other hand, where an EU or UK bank complies with the blocking statute or regulations by continuing to engage a certain sanctioned individual or entity, this will constitute non-compliance with US sanctions, which consequently may lead to the imposition of strong business and reputational-related penalties and sanctions by US authorities.[154]

Transposed to the letter-of-credit situation, this means that an EU or UK bank acting as issuing bank or confirming bank that observes a reference to a US-sanctioned individual or entity in the documents must decide whether it will authorise payment (and comply with the blocking statute or regulations) or decline to process payment (and comply with US sanctions). If the bank pays it will be in violation of applicable US sanctions laws and regulations. However, if it refuses to pay, not only will this amount to unlawful conduct in terms of EU and UK law, but it will also constitute a breach of its obligations in terms of the letter of credit, in which case the beneficiary may be able to institute legal proceedings against the bank to enforce payment. This position also applies *mutatis mutandis* in relation to demand-guarantee transactions.

5.3.4 Business and reputational considerations

Ultimately, the penalties and sanctions associated with foreign sanctions violations are intended to impact upon the business operations of violating banks. Such penalties and sanctions may take several forms. The question as to which penalty or sanction must be imposed as well as the extent of such penalty or sanction is generally determined with reference to the prescribed sanction in the contravened legislation and the nature and severity of the violation.

Monetary fines are commonly imposed penalties. Often settled by way of, or coupled with an order of, forfeiture, monetary fines may be substantial. In 2012, for example, ING bank agreed to forfeit $619 million to settle US criminal charges alleging that ING bank violated US sanctions laws against Cuba and Iran.[155] This was believed to be the largest US sanctions-related penalty imposed at the time. In 2015, however, a US district court far exceeded that

[153] Opinion of Advocate General Hogan https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62020CC0124 (accessed on 4 October 2021) par 111. Although this opinion was formulated with reference to the EU blocking statute, the remarks are relevant to the UK regulations as well.

[154] which could include fines, freezing of assets and even imprisonment, to name a few. On these penalties and sanctions, see par 5.3.4 immediately below.

[155] "ING bank to pay US$619 million for alleged violations" (July/August 2012) *Documentary Credit World* 3.

benchmark by ordering BNP Paribas SA to forfeit a staggering $8.83 billion and pay a fine of $140 million for conspiring to violate a US statute.[156] It was alleged that BNP Paribas had contravened US sanctions against Sudan, Cuba, and Iran in part by omitting certain information from wire transfers to enable them to pass through the US financial system without attracting attention from US authorities.[157] BNP Paribas pleaded guilty to the charges as part of a negotiated plea agreement with the US government. More recently, in 2019, Standard Chartered Bank agreed to forfeit $657 million to the OFAC "to resolve [sanction] violations primarily related to Iran, with other violations involving current or former sanctions on Cuba, Sudan, Burma, Syria, and Zimbabwe".[158] One last example will suffice: in 2021 the French bank Union de Banques Arabes et Françaises agreed to a settlement of approximately $8.5 million with the OFAC regarding 127 apparent violations of Syria-related sanctions.[159] Most of the violations involved the bank's processing of internal transfers on behalf of Syrian entities and the subsequent corresponding funds transfers through a US bank. It is worth stating that thirteen of the violations concerned transactions involving either back-to-back credits or other similar trade finance instruments.

Monetary fines are not, however, the only imposed penalties. Others have emerged in practice. The most notable of these are the freezing of assets, suspension of banking licences,[160] revocation or rejection of insurance cover for export transactions or ocean voyages,[161] enhanced regulatory oversight, and disconnection from the SWIFT communication network.[162] In recent times, moreover, senior banking personnel have also been the target of a host of punitive measures, including personal arrests, suspension or termination of employment,

UNIVERSITY
OF
JOHANNESBURG

[156] http://www.reuters.com/article/us-bnp-paribas-settlement-setnencing-idUSKBN0NM41K20150501 (accessed on 28 June 2021).

[157] n (155) above.

[158] "Standard Chartered agrees to settlement in US, fine in UK" (May 2019) *Documentary Credit World* 4.

[159] "French bank agrees to settlement with OFAC for apparent Syria-related sanctions violations" (January 2021) *Documentary Credit World* (n 6) 3–4. The statutory maximum civil monetary penalty in this matter totalled more than $4.1 billion; however, the OFAC determined that the bank's apparent violations were "non-egregious" and "voluntarily self-disclosed". For this reason, a significantly lesser settlement amount of $8,527,500 was imposed.

[160] See, for instance, Habib Bank which, due to money laundering violations, surrendered its banking licence for New York State and agreed to permanently close its branch in New York City. See (April 2018) *Documentary Credit World* 30.

[161] Heimann and Pieth *Confronting Corruption* (2018) 213. As pointed out by Marxen, (n 30) 175 ft 80, "[t]his makes international shipments, and thus a significant aspect of international trade, virtually impossible, and has been applied in the past, for example, against Iranian entities.".

[162] therefore potentially restraining international trade even further.

imposition of substantial monetary fines, industry-wide employment bars and travel bans.[163] These restrictions, and more so a combination of them, may be incredibly burdensome for the violating bank, particularly in relation to its business operations.

Apart from business-related penalties and sanctions, foreign sanctions violations may also attract reputational damage. In its 2019 study guide, the Association of Anti-Money Laundering Specialists explains generally the grave nature of reputational risk as follows:

> "The potential that adverse publicity regarding an organization's business practices and associations [such as a violation of foreign sanctions], whether accurate or not, will cause a loss of public confidence in the integrity of the organization. As an example, reputational risk for a bank represents the potential that borrowers, depositors and investors might stop doing business with the bank because of a money laundering scandal. […] The loss of high-quality borrowers reduces profitable loans and increases the risk of the overall loan portfolio. Depositors may withdraw their funds. Moreover, funds placed on deposit with a bank may not be a reliable [source] of funding once depositors learn that the bank may not be stable. Depositors may be more willing to incur large penalties rather than leaving their funds in a questionable bank, resulting in unanticipated withdrawals, causing potential liquidity problems."[164]

These remarks can be accepted as equally valid in the realm of trade finance, where reliability is a key factor to consider when a bank is approached for issuance of an instrument of payment or security.

Reputational damage may also take the form of reduced or restricted access to international banking networks, products and services, and facilities (such as correspondent accounts) or having to pay more to have access thereto. Moreover, a violating bank may be deemed an institution not fully committed to the fight against financial crime which could, particularly where other banks in the region are similarly classified, lead to it being "de-risked". De-risking entails the termination of, or implementation of commercial restrictions relating to, business relationships by banks with entities or individuals in high-risk jurisdictions or regions.[165] De-risking can include refusing access to particular commercial products and services (such as trade finance instruments), termination of existing customer or correspondent-

UNIVERSITY
OF
JOHANNESBURG

---

[163] Marxen (n 30) 175. For a case in which most of these measures were applied, see the investigation relating to MoneyGram's former Chief Compliance Officer, Mr Haider, by the US's Financial Crimes Enforcement Network, better known as "FinCEN". In this matter it was determined that Mr Haider, *inter alia*, "failed to implement an appropriate [anti-money laundering program] and conduct effective audits or terminate known high-risk agents. As a result of the investigation, Mr. Haider was removed from his employment at MoneyGram and was individually assessed a $1 million civil money penalty in 2014. FinCEN also sought to bar Mr. Haider from working in the financial services industry". See https://www.steptoeinternationalcomplianceblog.com/2017/05/former-moneygram-cco-settles-with-fincen-and-u-s-attorneys-office/ (accessed on 19 August 2021).

[164] ACAMS (n 40) 8.

[165] http://www.fatf-gafi.org/topics/fatfrecommendations/documents/rba-and-de-risking.html (accessed on 28 June 2021) and "'De-friending' correspondents" (May 2015) *Documentary Credit World* 4.

banking relationships, or even simply refusing to open an account for a prospective customer. All of this will lead to increased costs and complex application procedures for the parties in de-risked jurisdictions or regions. Thus, the broader outcome of de-risking is "almost complete isolation from the international financial system, with obviously dire consequences in terms of trade, economic growth and financial inclusion".[166]

For the emerging economies of Africa in particular, this may have disastrous, long-term consequences because African countries, generally, place significant importance on trade for their development and access to basic supplies. Wass captured this issue appropriately as follows:

> "De-risking has had unintentional and costly consequences, especially in Africa, Central and Eastern Europe, and Asia Pacific. Among the biggest losers are small businesses that can't access working capital or trade finance. As correspondents depart, they've left holes in the funding space, cutting credit lines and withdrawing finance."[167]

In *Bredenkamp v Standard Bank of South Africa Ltd,*[168] the South African Supreme Court of Appeal, against the background of Standard Bank's unilateral closure of Bredenkamp and the other appellants' bank accounts due to their listing as SDNs in terms of the sanctions emanating from the OFAC, confirmed business and reputational considerations as the basis of foreign sanctions compliance as follows:

> "The Bank was also apprehensive of the possibility that any continued relationship with the appellants would create material business risks. Although the Bank itself is not bound to comply with the listing, many financial institutions with which it conducts business internationally are. These financial institutions impose stringent obligations in respect of the correspondent accounts they offer to banks such as the respondent. Any misstep by the Bank concerning a client who is an SDN could lead to the seizure of funds transferred in bulk on behalf of a number of clients, to a closure of accounts or to an adverse report to OFAC. It follows that it was not only the Bank's reputation that it felt was at risk but that there were also material business risks."[169]

UNIVERSITY OF JOHANNESBURG

[166] Spruyt (n 3) 11. See further Global Centre on Cooperative Security, Oxfam and World Bank *Brief: De-risking in the Financial Sector* (2017); and Financial Stability Board *Action Plan to Assess and Address the Decline in Correspondent Banking* (2018).

[167] Wass "Could regtech bridge the trade finance gap in emerging economies?" 2018 *Global Trade Review* https://www.gtreview.com/news/fintech/could-regtech-bridge-the-trade-finance-gap-in-emerging-economies/ (accessed on 29 June 2021). See also the following remarks by the ICC *2018 Global Trade – Securing Future Growth* (2018) 97: "Coupled with the continued retreat of many global banks from the continent due to business, regulatory and KYC compliance considerations, many local banks in Africa suffered from inadequate correspondent banking lines and insufficient foreign currency liquidity to finance trade."

[168] 2010 4 SA 468 (SCA). For a discussion concerning the *Bredenkamp* case, see Schulze "The bank's right to cancel the contract between it and its customers unilaterally" 2011 *Obiter* 211–223. See further Norje "Unfair contractual terms – effect of constitution: Bredenkamp v Standard Bank of South Africa Ltd 2009 SA 304 (GSJ) and 2009 6 SA 277 (GSJ)" 2010 *THRHR* 517–529.

[169] *Bredenkamp* (n 168) par 18.

Although the issue of foreign sanctions compliance was incidental to this case,[170] the judgment is important in this regard for two reasons. Firstly, it evidences the extensive reach of US extraterritorial sanctions. Secondly, the judgment, it is suggested, can be seen as giving impetus to the view that a violation of foreign sanctions should not be taken lightly and consequently should be avoided as far as reasonably possible.

In the wake of the *Bredenkamp* case, other South African banks clamped down on OFAC-listed persons and entities. This is especially true of First National Bank, one of South Africa's largest and oldest commercial banks. In 2013 it announced the closure of all bank accounts held by individuals or entities listed on the SDN list. The decision was reached after it came to the bank's attention that Al Aqsa Foundation of South Africa, one of its customers, was a listed entity. First National Bank's Commercial Banking CEO at the time, Vacy-Lyle, stated the following:

> "It has come to the bank's attention that the foundation is expressly listed by the US Department of Treasury, [OFAC] and other international sanctions lists. The listing of the foundation has been verified with reference, inter alia, to the addresses contained in the listings documents. […] The international financial community impose stringent obligations in respect of the maintenance of banking relationships with entities listed by OFAC, and the decision by FNB to terminate its relationship with the foundation is a consequence of this fact alone. […] FNB would have and will take the same decision with regards to any [Office of Foreign Assets Control] OFAC listed entity."[171]

Not only are such decisions commercially and reputationally justifiable, but they are also practical given that, in the words of the Supreme Court of Appeal, "[a]ny misstep by the [b]ank concerning a client who is an SDN could lead to the seizure of funds transferred in bulk on behalf of a number of clients, to a closure of accounts or to an adverse report to OFAC".[172] This is, of course, particularly relevant in the context of international trade transactions involving letters of credit where transactions are frequently nominated in US dollars and payment is typically remitted through US-linked financial networks.[173] It can hardly be doubted that such practicalities also make it enormously difficult for banks not to comply with foreign sanctions.

UNIVERSITY OF JOHANNESBURG

---

[170] Essentially, the question the court had to consider was whether, in light of the business and reputational considerations of the OFAC listing that led to the closure of the accounts, any constitutional values were "offended". The bank argued, *inter alia*, that it had the right in terms of an express term of the contract to close the accounts with reasonable notice. In finding that no constitutional values were offended, the term or clause was held to be enforceable. See *Bredenkamp* (n 168) pars 22–24 and 64.

[171] "FNB to close OFAC-listed accounts" https://www.bizcommunity.com/Article/196/163/88123.html (accessed on 6 April 2021).

[172] See *Bredenkamp* (n 168) above.

[173] See the discussion in par 5.3.5 below.

It would seem then, in conclusion, that the factors informing compliance with foreign, and particularly OFAC, targeted financial sanctions are compelling: on the one hand, the imposition of business and reputational-related penalties and sanctions may have devastating consequences for the business operations of a violating bank. On the other hand, and specifically in cases concerning trade finance transactions, compliance with foreign sanctions may be the more practical decision in that it may avoid difficult situations where, for instance, funds are tied up abroad or bank accounts are closed unilaterally. These interconnected factors also demonstrate the extensive reach of extraterritorial laws and regulations, which – especially in the sanctions context – enable governments to "regulate and restrict the actions of financial institutions beyond its borders."[174]

5.3.5 Interference with payment under letters of credit

Financial institutions are instructed to reject any funds transfer referencing an OFAC-listed individual, entity or vessel. For US banks involved in letter-of-credit transactions, non-compliance with this instruction is unlawful. Therefore, it is expected that no US bank, whether involved as issuing bank, nominated bank, confirming bank, transferring bank, reimbursing bank, collecting bank or correspondent bank, will process payment under a letter of credit should any of the many documents presented in terms of letters of credit contain a reference to a sanctioned individual, entity or vessel. Although South African banks involved in such transactions with US banks are without any legal obligation to comply with the instruction, the business and reputational risks that typically accompany US sanctions violations may persuade South African banks to comply with the instruction. Without any legal basis, however, South African banks that comply will not be afforded protection under South African law and may consequently attract litigation where contractual obligations are not fulfilled.[175] This is especially true for the bank's payment obligations.

Given that a letter of credit may involve several banks all serving different functions in the transaction, the permutations are many. The scenarios most likely to emerge in letter-of-credit practice are examined below. It must be remembered that, for the purposes of this thesis, the proper law applicable to the contractual relationships in these scenarios is South African law.

---

[174] Newcomb "Non-U.S. banks are target of recent economic actions" 2008 *Banking Law Journal* 468 469.

[175] See par 5.4 below.

5.3.5.1 Excursus: payment in foreign currency

Payment in international commercial transactions may be nominated in a currency foreign to the paying bank. This is particularly true for international trade finance transactions. To facilitate such transactions, funds are usually transferred using correspondent banking relationships.[176] Where the foreign bank and local bank have an existing relationship, the funds can be transferred across their own books. In other words, funds are transferred directly. This is achieved using so-called "nostro" and "vostro" accounts.[177]

The terms "nostro" and "vostro" refer to accounts one bank holds with another, essentially looking at the same accounts separately from the perspective of each bank. More specifically, a nostro[178] account can be described as a current account held by a local bank with a foreign bank.[179] The banks normally have business relations or are counterparties or correspondent banks. A nostro account is sometimes known by the local bank as its "correspondent account". By contrast, a vostro[180] account can be described as an account a local bank holds on behalf of a foreign bank.[181] Vostro accounts are always held in local currency.[182]

This may be illustrated using an example of a letter-of-credit transaction. A letter of credit is issued by a South African bank on behalf of a South African buyer in favour of a Nigerian seller – the beneficiary of the credit. The letter of credit, however, is payable in US dollars, and requires the services of a US correspondent bank. The South African bank may have a nostro account with the US bank (a vostro account from the US bank's perspective). The US bank may have a nostro account with the South African bank (a vostro account from the South African bank's perspective). In fact, both correspondent accounts may exist. If at least one of the banks has a correspondent account with the other, the funds transfer can happen across the books of the bank hosting the account. This means that in order to effect the transfer of funds from the South African Bank to the US bank the South African bank would need to credit the US bank's nostro account at the South African bank with the appropriate amount.

[176] Correspondent banking can also be used to facilitate transactions other than international funds transfers, including cheque clearing, cash management, and payable-through accounts, to name a few. See FATF *Correspondent Banking Services* (2016) 7.

[177] Mugasha (n 130) 214.

[178] which means in English "our" account with another institution.

[179] Baker and Brandel *The Law of Electronic Fund Transfer Systems* (2001) par 30.01.

[180] which means in English "your" account with us.

[181] (n 179) above.

[182] Mugasha (n 130) 214 ft 96.

This would have the effect of putting the US bank in funds so that it would be in a position to pay the Nigerian beneficiary.

If neither of the correspondent accounts existed, the banks would need to consider using one or more correspondent banks. Correspondent banking entails the transfer of funds between two banks in different jurisdictions facilitated by the involvement of intermediary banks.[183] So, where neither bank has an account with each other, if the South African bank has an account with another US bank, then the funds transfer can occur through an applicable US inter-bank payment system such as Fedwire. As a real-time gross settlement system owned and controlled by the US Federal Reserve Banks, Fedwire facilitates the settlement of, *inter alia*, high-value domestic payment transactions.[184] "Each transaction is processed individually and settled upon receipt via a highly secure electronic network. Settlement of funds is immediate, final and irrevocable."[185] Most countries have a functionally similar inter-bank payment or settlement system.[186]

Nostro and vostro accounts, however, are used only where the banks in question have a direct relationship. Where a direct relationship does not exist, correspondent banking arrangements can become complex.[187] This can be illustrated by the earlier example of a South African issuing bank and a US correspondent bank in a documentary-credit transaction. Assume that the banks have no correspondent accounts with each other (thus, no direct relationship) and that both banks have a (different) Zimbabwean correspondent bank. Although this construction is unlikely since issuing banks typically instruct local banks with which they have a direct relationship (unless of course the issuing bank has no correspondent relationships in the particular jurisdiction),[188] it is not inconceivable.

UNIVERSITY
OF
JOHANNESBURG

[183] FATF (n 176) describes "correspondent banking" as "the provision of banking services by one bank (the 'correspondent bank') to another bank (the 'respondent bank'). Large international banks typically act as correspondents for thousands of other banks around the world. Respondent banks may be provided with a wide range of services, including cash management (e.g. interest-bearing accounts in a variety of currencies), international wire transfers, cheque clearing, payable-through accounts and foreign exchange services (footnote omitted)."

[184] See https://www.frbservices.org/financial-services/wires (accessed on 24 May 2022).

[185] See https://www.frbservices.org/financial-services/wires (accessed on 24 May 2022).

[186] Tompkins and Olivares *Clearing and Settlement Systems from Around the World: A Qualitative Analysis - Bank of Canada Staff Discussion Paper, No. 2016-14* (2016) 6.

[187] Bollen *The Law and Regulation of Payment Services – A Comparative Study* (2012) 66; and Schweizerische National Bank *The Continuous Linked Settlement Foreign Exchange Settlement System* (2009) 2.

[188] Foreign banks typically establish correspondent relationships with local banks if doing so makes sense from a business perspective.

They establish that the most efficient way to settle the transaction is via their Zimbabwean correspondent banks. The South African issuing bank will itself transfer funds to its Zimbabwean correspondent bank using nostro/vostro accounts. The issuing bank's Zimbabwean correspondent bank will transfer funds to the US bank's Zimbabwean correspondent bank using the inter-bank payment system used in Zimbabwe.[189] The Zimbabwean correspondent bank in receipt of the funds will then transfer funds to the US bank, probably using nostro/vostro accounts. Consequently, the US bank will have obtained the funds to pay the Nigerian beneficiary on presentation of conforming documents.

In this example, each bank acts directly or indirectly in relation to the letter-of-credit transaction. There is at least one foreign currency exchange involved – rands to US dollars. There are also different languages, time zones, and legal systems involved. A significant commercial risk of using correspondent relationships is known as the Herstatt risk, which in the context of international trade has been described as "the risk of a buyer not receiving currency which has been bought after already paying away the currency sold."[190] Herstatt risk is essentially a timing issue, since one bank has to release funds before the other.

As an alternative to correspondent banking, the Continuous Linked Settlement (CLS) Bank was established in 2002. The US dollar has been included in the CLS system.[191] CLS is "an international simultaneous bilateral system primarily designed to reduce [foreign exchange settlement] risk".[192] CLS bank has a settlement account with each central bank in whose currency it trades and is supervised by the US Federal reserve. Each settlement member holds

UNIVERSITY
OF
JOHANNESBURG

[189] The Real-Time Gross Settlement (RTGS) system applicable in Southern Africa may be used in this regard. The SARB explains this system as follows: "This system is used to enable the exchange of value (payments) by members of the public, merchants, and corporate and government entities through accounts held by their banks at the SARB. The domestic payment settlement system has been in operation since 1998, while the regional payment settlement system was implemented by the SARB as a delegated operator, in collaboration with Southern African Development Community (SADC) central banks in 2013. *The regional payment settlement system facilitates cross-border payments within the SADC region*" (my emphasis). See https://www.resbank.co.za/en/home/what-we-do/payments-and-settlements/Real-time_Gross_Settlement_System_Renewal_Programme (accessed on 16 May 2022).

[190] Tan "Continuous Linked Settlement: a new era in foreign exchange settlement" 2002 *Journal of Banking and Finance Law and Practice* 312 313.

[191] The other currencies traded are the Mexican Peso, Canadian Dollar, Pound Sterling, Israeli Shekel, Japanese Yen, Korean Won, Danish Krone, Euro, South African Rand, Hong Kong Dollar, Hungarian Forint, Singapore Dollar, Norwegian Krone, Australian Dollar, New Zealand Dollar, Swedish Krona, and the Swiss Franc.

[192] https://www.cls-group.com/about/ (accessed on 16 May 2022).

an account with the CLS bank and settlement is across the books of the CLS. Associates can make arrangements to settle through an agent who is a settlement member.[193]

CLS offers a real-time simultaneous gross settlement system for international funds transfers between internationally active banks arising from foreign exchange transactions. It is essentially a high-value clearing system for banks and other large juristic institutions.[194] Although payment in international transactions is still primarily facilitated through correspondent banking arrangements, the CLS system is gaining momentum at a rapid pace in this regard.[195]

In the era of targeted financial sanctions, US dollar-denominated documentary-credit transactions may present challenges for non-US paying banks. Expanding on the example of the documentary credit above, if the beneficiary presents conforming documents which nevertheless disclose an OFAC-listed individual, entity or vessel, payment will not be processed due to the necessity of involving a US correspondent bank. Provided US law does not govern the transaction, the non-US beneficiary may in principle be able to enforce payment against the South African issuing bank. Practically, however, this may be difficult because the South African issuing bank may not be in a position to effect payment in US dollars if the funds were not transferred to the South African bank by the US correspondent bank – thus the manifestation of the Herstatt risk. This issue is addressed in the scenarios below, where applicable.

UNIVERSITY OF JOHANNESBURG

5.3.5.2 Transactions involving only an issuing bank

One scenario relating to the issuing bank and the manifestation of an OFAC-listed individual, entity or vessel in the documents is considered below.

A South African buyer enters into a contract of sale with a South African seller in terms of which payment is to be effected by means of a letter of credit. The buyer (applicant) procures the issuance of the letter of credit from a South African bank. Payment is, naturally, denominated in South African rands. The seller (beneficiary) presents conforming documents to the issuing bank. The documents, however, disclose an OFAC-listed individual, entity or

[193] Tan (n 190) 314: "To eliminate foreign exchange settlement risk, banks participating in the CLS system settle both legs of each foreign exchange transaction across the CLS Bank's books on a payment-versus-payment (PVP) basis."

[194] Bollen (n 187) 69.

[195] In this regard, many of the largest financial institutions in the world make use of the CLS system. See https://www.cls-group.com/communities/banks/ (accessed on 16 May 2022).

vessel. If the issuing bank pays, it should be reimbursed for the transaction since the applicant cannot legally justify a decision not to reimburse. If the issuing bank does not pay it will be in breach of its contractual obligations towards the beneficiary. Consequently, the beneficiary may be able to enforce payment against the issuing bank.

5.3.5.3 Transactions involving confirming banks

Two scenarios relating to the confirming bank[196] and the manifestation of an OFAC-listed individual, entity or vessel in the documents are considered below.

(i) A US buyer enters into a contract of sale with a South African seller. The buyer procures the issuance of a letter of credit from a US bank in favour of the seller – the beneficiary of the credit. On instruction from the issuing bank, the letter of credit is confirmed by a South African bank. The beneficiary presents conforming documents to the South African bank. The documents, however, disclose an OFAC-listed individual, entity or vessel. Since the US bank is legally unable to process the transaction, the South African bank will not be reimbursed should it pay the beneficiary. However, if it does not pay the beneficiary it will be in breach of its contractual obligations towards the beneficiary in terms of its confirmation of the letter of credit. Although in principle it should be possible for the beneficiary to enforce payment against the South African confirming bank, practically it may be difficult for the South African confirming bank to make payment if payment is nominated in US dollars and the funds were not transferred to the South African bank. If the South African bank has sufficient US dollars, however, it may use these funds to satisfy its payment obligations.

In relation to cases involving silent confirmations, if the South African confirming bank pays the beneficiary it will not be able to enforce reimbursement against the issuing bank or any other party. If the confirming bank does not make payment, the beneficiary may, depending on the terms of the silent confirmation, be able to enforce payment against it.

(ii) A South African buyer enters into a contract of sale with a US seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a South African bank in favour of the seller – the beneficiary of the credit. On instruction from

[196] For background on confirming banks, see par 2.2.3.1 above.

UNIVERSITY OF JOHANNESBURG

the issuing bank, the letter of credit is confirmed by a US bank. The beneficiary presents conforming documents to the US bank. The documents, however, disclose an OFAC-listed individual, entity or vessel. As the US bank is legally prohibited from paying, the beneficiary will not be able to enforce payment against it. Even though the beneficiary, in accordance with the UCP 600, acquires a right against both the confirming bank and the issuing bank,[197] it will not be able to enforce payment against the South African issuing bank either, as this would constitute a contravention of US law on the part of the beneficiary.

In relation to cases involving silent confirmations, a similar outcome is expected, namely, that the US beneficiary is legally barred from enforcing payment against either of the banks involved.

5.3.5.4 Transactions involving nominated banks

Two scenarios relating to the nominated bank[198] and the manifestation of an OFAC-listed individual, entity or vessel in the documents are assessed below.

(i) A US buyer enters into a contract of sale with a South African seller. The buyer procures the issuance of a letter of credit from a US bank in favour of the seller – the beneficiary of the credit. A South African bank is nominated to pay. The beneficiary presents conforming documents to the South African bank. The documents, however, disclose an OFAC-listed individual, entity or vessel. The US issuing bank is barred from processing the transaction; therefore, if the South African bank pays the beneficiary it will not be reimbursed. There is nevertheless no reason why the South African nominated bank should pay as it has made no payment undertaking towards the beneficiary.

(ii) A South African buyer enters into a contract of sale with a US seller. The buyer procures the issuance of a letter of credit from a South African bank in favour of the seller – the beneficiary of the credit. A US bank is nominated to pay. The beneficiary presents conforming documents to the US bank. The documents, however, disclose an OFAC-listed individual, entity or vessel. The beneficiary will not be able to enforce payment

[197] See art 8(*a*) of the UCP 600 (n 5).

[198] Acting as mandatary of the issuing bank, the nominated bank simply discharges the issuing bank's payment obligation and, therefore, does not itself make any payment undertaking towards the beneficiary. On nominated banks, see par 2.2.3.1 above.

against the US nominated bank since the bank is legally barred from doing so.[199] It also cannot enforce payment against the South African issuing bank because doing so would constitute a breach of US law.

5.3.5.5 Transactions involving transferring banks

Two scenarios relating to the transferring bank[200] and the manifestation of an OFAC-listed individual, entity or vessel in the documents are analysed below.

(i) A South African buyer enters into a contract of sale with a US seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a South African bank in favour of the seller – the (original) beneficiary of the credit. The seller, however, does not produce the goods itself but acquires it from its US supplier. Consequently, the issuing bank mandates a US transferring bank to make the same credit available in whole to the US supplier (the second beneficiary).[201] The second beneficiary presents conforming documents to the transferring bank. The documents, however, disclose an OFAC-listed individual, entity or vessel, which prohibits the transferring bank from processing the transaction. As the second beneficiary will not receive payment the documents will not be forwarded to the original beneficiary. The original beneficiary will in turn not be able to tender documents to the issuing bank.

(ii) A US buyer enters into a contract of sale with a South African seller. A letter of credit is issued by a US bank in favour of the seller – the (original) beneficiary of the credit. The issuing bank mandates a South African transferring bank to make the same credit available in whole to the supplier (the second beneficiary). The second beneficiary presents conforming documents to the transferring bank. The documents, however, disclose a sanctioned individual, entity or vessel in terms of US law. If the South African bank pays the second beneficiary, the original beneficiary will need to reimburse the South African bank to gain possession of the documents. Whether the US bank will pay

[199] It has, in any event, made no payment undertaking towards the beneficiary.

[200] In the case of transferable credits, the credit confers upon the beneficiary the right to request the *transferring bank* to make the whole or part of the credit available to a second beneficiary (usually the manufacturer or supplier of the goods). Thus, a new credit from the same issuing bank emerges. The two credits are independent of each other. On transferable credits in general, see par 2.2.4 above.

[201] resulting in a completely new and independent credit.

the original beneficiary upon presentation of its conforming documents depends on whether those documents reflect the sanctioned individual, entity or vessel.

5.3.5.6 Transactions involving reimbursing and claiming banks

Three scenarios relating to the reimbursing bank[202] and the claiming bank, and the disclosure of an OFAC-listed individual, entity or vessel in the documents are surveyed below.

(i) A US buyer enters into a contract of sale with a South African seller (beneficiary). There is a US issuing bank and a South African nominated bank. The credit further provides for bank-to-bank reimbursement and, as such, a South African reimbursing bank is mandated. The beneficiary presents conforming documents to the nominated bank. The documents, however, disclose an OFAC-listed individual, entity or vessel. The US issuing bank is legally unable to process the transaction. If the South African nominated bank pays the beneficiary it may still be reimbursed by the South African reimbursing bank since the reimbursement bank will not be afforded an opportunity to examine the documents for itself,[203] and, in any event, is not bound by US law. However, if the reimbursing bank pays the nominated bank it will not be able to recover moneys paid from the US issuing bank. There is, however, no reason why the South African nominated bank should pay the beneficiary as it has made no payment undertaking towards the beneficiary. Thus, the beneficiary will not be able to enforce payment against any of the banks involved. It may sue the applicant of the credit (buyer) on the basis of unjustified enrichment law to reclaim the goods.

(ii) A US buyer enters into a contract of sale with a South African seller. There is a US issuing bank and a South African confirming bank, the latter so instructed by the issuing bank. In accordance with the credit, a South African reimbursing bank is mandated. The beneficiary presents conforming documents to the South African confirming bank. The documents, however, disclose an OFAC-listed individual, entity or vessel. The US issuing bank is precluded from facilitating the transaction. If the South African confirming bank pays the beneficiary it will probably be reimbursed by the reimbursing

[202] A reimbursement bank, as mandatary of the issuing bank, reimburses the nominated or confirming bank (in this context, the claiming bank) once it has paid the beneficiary against conforming documents. See par 2.2.3.1 above.

[203] See in this regard Hugo (n 122) 407.

bank – as the reimbursing bank will be unaware of the listing and is not bound by US law. Yet, if the reimbursing bank pays it will not be reimbursed by the US issuing bank. Conversely, if the South African confirming bank does not pay it will be in breach of its contractual obligations towards the beneficiary in terms of its confirmation of the credit. In this case it should in principle be possible for the beneficiary to enforce payment against the South African confirming bank. Again, in practice the enforcement of payment against the confirming bank may be problematic if payment is nominated in US dollars and the funds have not been transferred to the South African bank.

(iii) In cases where the reimbursing bank is a US bank, it will not process reimbursement on account of the legal prohibition to do so. However, the nominated or confirming bank in such cases will in any event probably be US and thus also legally prohibited from processing the transaction. Hence, a claim for reimbursement will not be made. Moreover, the beneficiary in these circumstances will not be able to enforce payment against the South African issuing bank, as the beneficiary will most probably be a US person or entity and therefore bound by US law.

5.3.5.7 Transactions involving collecting banks

Two permutations relating to the collecting bank (agent of the beneficiary) and the manifestation of an OFAC-listed individual, entity or vessel in the credit transaction are examined below.

UNIVERSITY OF JOHANNESBURG

(i) A US buyer enters into a contract of sale with a South African seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a US bank in favour of the seller – the beneficiary of the credit. The beneficiary requests its own bank to tender the documents and receive payment on its behalf (the South African collecting bank). After the seller relinquishes control of the goods, the collecting bank presents conforming documents to the US issuing bank. The documents, however, disclose the involvement of an OFAC-listed individual, entity or vessel. The US issuing bank is legally barred from processing the transaction. The collecting bank accordingly cannot enforce payment against the issuing bank, but it may seek reimbursement from the beneficiary in so far as it delivered the documents to the issuing bank.

(ii) A South African buyer enters into a contract of sale with a US seller. A South African bank issues a letter of credit in favour of the seller – the beneficiary of the credit. The beneficiary requests its own bank to tender the documents and receive payment on its behalf (the US collecting bank). The documents disclose an OFAC-listed individual or entity. The beneficiary will not be able to enforce payment against the South African issuing bank as it will be legally impossible for it to do so.

5.3.5.8 Acceptance credit transactions

Two scenarios relating to the manifestation of a US sanctioned individual, entity or vessel in the documents tendered under an acceptance credit[204] are dealt with below.

(i) A US buyer enters into a contract of sale with a South African seller. The buyer procures the issuance of an acceptance letter of credit from a US bank in favour of the seller – the beneficiary of the credit. A South African bank is nominated to receive the documents and, if they are in order, to accept the bill of exchange and pay it on maturity. The beneficiary presents conforming documents to the South African bank together with the bill of exchange drawn on the South African bank payable 90 days after acceptance. The documents, however, disclose an OFAC-listed individual, entity or vessel, which leads the US bank to refuse to process or facilitate the transaction. If the South African bank pays the beneficiary or any subsequent holder (who may have purchased it in a discounting transaction)[205] on maturity of the bill of exchange it will not be reimbursed by the US bank. The nominated bank is under no obligation to accept the bill of exchange and, in light of the fact that it will not be reimbursed for any payment, would be wise to dishonour the bill by refusing to accept it. However, once it has accepted the bill it is bound to pay it on maturity to the beneficiary or any holder who has purchased it in a discounting transaction. If it has accepted the bill and payment is denominated in US dollars the South African nominated bank may find itself in a predicament.

(ii) A South African buyer enters into a contract of sale with a US seller. A South African issuing bank and US nominated bank are involved. The beneficiary presents conforming

[204] While operating on a similar footing to sight payment credits, these credits differ in so far as they involve the use of a bill of exchange (banker's acceptance) which is often discounted. See par 2.2.3.1 above.

[205] The subsequent holder may satisfy the requirements of a holder in due course. See s 27(1) of the Bill of Exchange Act (n 135). See also Hugo (n 122) 411.

UNIVERSITY OF JOHANNESBURG

documents to the US bank together with the bill of exchange drawn on the US bank payable 90 days after acceptance. The documents, however, disclose an OFAC-listed individual, entity or vessel. The US bank is legally circumvented from processing the transaction. If the South African bank pays the beneficiary in terms of the bill of exchange or a subsequent holder in terms of the banker's acceptance, it will forgo reimbursement. The US beneficiary will not be able to enforce payment against the South African bank since it (the beneficiary) is bound by US law. The same applies to a subsequent holder of the bill that is a US person or entity. A subsequent holder of the bill that is not a US person or entity, on the other hand, will, on maturity of the bill of exchange, in principle be able to enforce payment against the South African bank because the letter of credit, despite the involvement of the US nominated bank, is also available with the issuing bank.[206] As has been emphasised in many of the scenarios above, in practice this may be difficult if payment has been denominated in US dollars.

5.3.5.9 Back-to-back credit transactions

Two scenarios relating to a reference to an OFAC-listed individual, entity or vessel in the documents of a back-to-back credit[207] are evaluated below.

(i) A South African buyer enters into a contract of sale with a US seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a South African bank in favour of the seller – the (original) beneficiary of the credit. The seller acquires the goods from its US supplier and wishes to conceal this fact. Consequently, it, relying on the first credit issued, requests a US bank to issue a second credit in favour of the supplier (second beneficiary). The second beneficiary presents conforming documents to the US bank. The documents, however, disclose an OFAC-listed individual, entity or vessel, which leads the US bank to refuse to process or facilitate the transaction. Since the second beneficiary is not paid the documents will not be forwarded to the original beneficiary. Hence the original beneficiary will not be able to tender documents to the issuing bank. The implication is that the original beneficiary will never receive the goods and will be in breach of the contract of sale.

[206] See art 7(*a*)(iv) of the UCP 600 (n 5).

[207] Back-to-back credits, akin to transferable credits, involve the use of two consecutive letters of credit. Back-to-back credits, however, are issued by two different banks, resulting in two entirely distinct credits. On these credits, see par 2.2.4 above: "Back-to-back credits".

(ii) A US buyer enters into a contract of sale with a South African seller. As required under the contract of sale, the buyer procures the issuance of a letter of credit from a US bank in favour of the seller – the (original) beneficiary of the credit. The seller, relying on the first credit, requests a South African bank to issue a second credit in favour of the supplier (second beneficiary). The second beneficiary presents conforming documents to the South African bank. The documents, however, disclose an OFAC-listed individual, entity or vessel. Should the South African bank pay the second beneficiary, the original beneficiary will need to reimburse the South African bank to gain possession of the documents. The question whether the US bank will pay the original beneficiary upon presentation of its documents depends on whether those documents reflect the sanctioned individual, entity or vessel.

5.3.6 Interference with payment under demand guarantees

5.3.6.1 Transactions involving only a guarantor

Two scenarios relating to the guarantor and a reference to an OFAC-listed individual, entity or vessel in the documents are considered below.

(i) A South African employer enters into a construction contract with a South African contractor. A performance guarantee is issued by a South African bank (guarantor) in favour of the employer. Naturally, the nominated currency is South African rands. The contractor's performance is defective and amounts to breach of contract. Consequently, the employer tenders conforming documents to the guarantor. The documents, however, disclose an OFAC-listed individual or entity. If the guarantor pays it should be reimbursed for the transaction since the contractor (applicant of the guarantee) cannot legally justify a decision not to reimburse. If the guarantor refuses to pay, the employer should be able to enforce payment against it because (i) it has made a payment undertaking towards the employer and (ii) it is not legally barred from processing the transaction.

(ii) A US employer enters into a construction contract with a South African contractor in terms of which payment is to be secured by way of a payment guarantee. The employer procures the issuance of the guarantee from a US bank in favour of the contractor (beneficiary). Following a dispute between the parties the beneficiary tenders

conforming documents to the guarantor. The documents, however, disclose an OFAC-listed individual or entity, which leads the guarantor to refuse to process payment. The beneficiary will accordingly not be able to enforce payment against the issuing bank.

5.3.6.2 Transactions involving counter-guarantors

Two permutations relating to the counter-guarantor and the manifestation of an OFAC-listed individual or entity are appraised below.

(i) A US employer enters into a construction contract with a South African contractor. A South African bank (guarantor) issues a guarantee in favour of the contractor (beneficiary) against a counter-guarantee by the employer's US bank (counter-guarantor). During the course of the transaction, a dispute arises between the parties triggering the submission of conforming documents by the beneficiary. The documents, however, disclose an OFAC-listed individual or entity. If the South African guarantor pays it will not be reimbursed by the counter-guarantor since the latter is legally unable to process the transaction. If the guarantor refuses to pay, the beneficiary will in principle be able to enforce payment against it. However, if payment is nominated in US dollars, this may be problematic.

(ii) A South African employer enters into a construction contract with a US contractor. A US bank (guarantor) issues a guarantee in favour of the contractor (beneficiary) against a counter-guarantee by the employer's South African bank (counter-guarantor). A dispute arises between the employer and the contractor triggering the submission of conforming documents. The documents, however, disclose an OFAC-listed individual or entity, which prohibits the US guarantor from processing the transaction. Since the issuing bank will not process payment, there is no reason for it to call up the counter-guarantee.

5.3.7 Summary and analysis

As is apparent from the above discussion, a reference to an OFAC-listed individual, entity or vessel in the letter-of-credit or demand-guarantee documents may impact upon the bank's ability to process payment. Unlike the position of US banks, non-US banks and especially South African banks that refuse to process payment due to an OFAC-listing cannot invoke unlawfulness as a defence. This is because South African banks are not legally obliged to comply with OFAC sanctions. In the case of UK and EU financial institutions, however, they

may rely on the fact that to comply with certain US sanctions is unlawful. They nevertheless remain exposed to the serious business and reputational risks that typically accompany non-compliance with US sanctions.

It is submitted that because of their significant nature, these business and reputational considerations are likely to bring about an increased risk of non-payment of demand guarantees and letters of credit in South Africa. In other words, South African banks are likely to gravitate towards complying with OFAC sanctions in lieu of performing in terms of letters of credit and demand guarantees.

Whether this will also be the case regarding UK and EU banks is not clear. Case law in EU countries do not provide clarity either since there have been judgments both in favour of and against a far-reaching application of the blocking statute. A recent case brought before Landgericht Hamburg, Germany, is of particular interest in this regard.[208] The case concerned an Iranian bank, Bank Melli, and Deutsche Telekom (Telekom), the largest telecommunications provider in Europe and the bank's telecommunication service provider. Among Telekom's affiliates and subsidiaries are, *inter alia*, T-Mobile US, as well as T-Systems North America, through which Telekom maintains a considerable US presence. In 2018 the US government declared its withdrawal from the Joint Comprehensive Plan of Action (also referred to as the Iran Nuclear Deal) in terms of which sanctions against Iran and Iranian entities had been suspended temporarily.[209] This was followed by the revival of US sanctions against Iran and Iranian entities. Consequently, the SWIFT network suspended the bank's membership and cut off the branch from its network servers.

To comply with the US sanctions, Telekom gave notice of its decision to terminate the telecommunications services contracts with Bank Melli's branch in Hamburg with immediate effect. Bank Melli in turn sought an interim injunction, either restraining Telekom from terminating the telecommunications services, or ordering it to reinstate telecommunications services. The injunction was granted on a temporary basis by Landgericht Hamburg. Telekom appealed the decision.

The appellate court (Oberlandesgericht Hamburg), firstly, issued a judicial notice (so-called Hinweisbeschluss) to the parties and indicated a position in favour of Bank Melli. The court, *inter alia*, clarified that a termination of the contracts with the bank by Telekom due to

[208] LG Hamburg, 28.11.2018, ref.: 319 O 265/18. The summary and interpretation of this case is based on Marxen "Europe's blocking statute and its impact on international commercial transactions" (July/August 2021) *Documentary Credit World* 39 41–43.

[209] See https://2009-2017.state.gov/documents/organization/245317.pdf (accessed on 14 May 2022).

pressure from US enforcement agencies would constitute a contravention of the EU blocking statute. It, secondly, requested a preliminary ruling from the Court of Justice of the EU in Luxembourg on the interpretation and application of the first paragraph of article 5 of the EU blocking statute. Before the preliminary ruling could be published, however, Telekom decided to withdraw its appeal and therefore made the injunction by Landgericht Hamburg, the court of first instance, legally binding. While the approach by Oberlandesgericht Hamburg postulates support for a far-reaching application of the EU blocking statute, other German courts have, in similar cases, reached diametrically opposing conclusions.[210]

Compliance by South African banks with OFAC sanctions is expected where letter-of-credit or demand-guarantee transactions involve a US bank or are nominated in US dollars. While this statement as it stands is correct, it would be wrong to conclude that compliance with OFAC sanctions is dependent upon the involvement of a US bank or the US dollar. Hugo and Strydom explain that

> "even where no American bank is involved, non-compliance with OFAC sanctions holds enormous reputational risks for the banks involved which can even lead to a prohibition of maintaining correspondent accounts within U.S. financial institutions, thereby cutting off access to US dollar payment systems and business in the United States generally."[211]

This means that even where no US bank is involved in a letter-of-credit or demand-guarantee transaction, or where the transaction is nominated in a currency other than US dollars, a South African bank would still be inclined to comply with OFAC sanctions and reject the beneficiary's demand for payment upon a reference to an OFAC-listed individual, entity or vessel in the documents.

UNIVERSITY
OF
JOHANNESBURG

Irrespective of whether or not the transaction involves a US bank or the US dollar, however, the South African bank's decision to comply with US sanctions means that the beneficiary will not receive payment. Though placed in a vexing situation, the (South African)[212] beneficiary is not without recourse. It could conceivably institute legal proceedings

[210] See OLG Cologne, 07.02.2020, ref: I-19 U 118/19, 19 U 118/19 where the court favoured the telecommunications provider and allowed termination of its services with parties that have ties to US- sanctioned Iranian entities.

[211] (n 28) 130, footnote omitted. See also Carter and Farha "Overview and operation of the evolving US financial sanctions, including the example of Iran" *Proceedings of the Annual Meeting (American Society of International Law)* (2013) 315 319; Stanton "North Korea: the myth of maxed-out sanctions" *Fletcher Sec Rev* (2015) 20 24; and *Bredenkamp* (n 168).

[212] As explained above, the US beneficiary will be in breach of US law if it tries to enforce payment under the credit or guarantee.

against the South African bank on the basis that the bank's refusal to pay amounts to breach of contract. This possibility is explored immediately below.

5.3.8 The beneficiary's legal recourse

The question scrutinised in this section is whether compliance by a South African paying bank with foreign targeted financial sanctions (which manifests as a refusal to process payment despite the presentation of conforming documents) may constitute breach of contract under South African law. A positive answer to this question may entitle the South African beneficiary, as the creditor/innocent party, to legal remedies which can be enforced through an action, or in some instances an application, in a South African court.[213]

A breach in terms of South African law, broadly put, occurs when performance of contractual obligations is late or defective, or where there is no performance at all.[214] Where the envisaged outcome is not achieved due to legally unjustified conduct by one of the parties, that party commits breach of contract.[215] On a practical level a breach can be identified where an obligation has not been fulfilled.[216] The terms of the contract and conduct of the parties are central to the determination of a breach.[217]

South African law does not embrace a unitary concept of breach.[218] Five distinct types of breach can instead be identified. These are: (i) *mora debitoris*, (ii) *mora creditoris*, (iii) positive malperformance, (iv) repudiation, and (v) prevention of performance. In the event of breach, a determination as to which breach the particular circumstances fit into is required before the question as to which relief should be sought can be answered.[219]

The aforementioned question (that is, whether a South African bank's refusal to process payment of a letter of credit or demand guarantee on the basis of compliance with foreign targeted financial sanctions may constitute breach of contract) is examined below against the

[213] See par 5.3.8.2 below.

[214] Christie and Bradfield *Christies Law of Contract in South Africa* (2016) 586.

[215] Schulze *et al General Principles of Commercial Law* (2019) 123.

[216] (n 214) above.

[217] Special mention must be made of breach provisions which determine the instances of breach and regulate what will happen in the event of a breach.

[218] See, however, Clive and Hutchison "Breach of contract" in Zimmermann, Visser and Reid (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) 176.

[219] Cockrell "Breach of contract" in Zimmermann and Visser (eds) *Southern Cross Civil Law and Common Law in South Africa* (1996) 303 333.

background of each type of breach. This is followed by an assessment of the remedies at the beneficiary's disposal.

5.3.8.1 Breach of contract

5.3.8.1.1 *Mora debitoris*

Where a contracting party does not perform at the agreed time and the delay is without legal justification, that party is said to be in *mora*.[220] When this failure to perform is caused by the debtor it is known as *mora debitoris. Mora debitoris* can occur when the debtor has not tendered performance at the agreed time although it has fallen due, or where the debtor has performed but performance is late.

Mora debitoris encompasses two requirements. The first is that performance must still be possible to perform at a later stage and therefore it is merely delayed.[221] Hence if performance has been rendered impossible due to the fault of the debtor, the breach will not constitute *mora debitoris* but potentially prevention of performance (which is discussed below). Secondly, the performance must already be claimable or due.[222] This is an obvious requirement since a performance can only be delayed or late if it is already due and enforceable.[223] If the contract fixes a date for performance, then a failure to perform by this date constitutes *mora* and will result in performance being claimable. *Mora* that arises in this manner is referred to as *mora ex re*.[224] Where, on the other hand, the contract does not stipulate a date for performance, the creditor may place the debtor in *mora* by serving the debtor with a demand or notice[225] requiring the debtor to perform by a certain stipulated date. This date must be reasonable and determined with reference to the specific circumstances of the matter. If the debtor does not perform by the stipulated date, this constitutes *mora ex persona.*[226]

The general rule is that supervening impossibility of performance discharges contractual obligations, releasing the parties and specifically the debtor from the duty to perform. The exception to the rule is where performance becomes impossible after the debtor

---

[220] Christie and Bradfield (n 214) 591.

[221] Schulze *et al* (n 215) 124.

[222] Zimmermann *The Law of Obligations: Roman Foundations of a Civilian Tradition* (1990) 791; and Schulze *et al* (n 215) 124.

[223] Christie and Bradfield (n 214) 591–592; and Schulze *et al* (n 215) 124.

[224] Christie and Bradfield (n 214) 591–592.

[225] which may take the form of a letter, summons or any other method of communication, either orally or in writing.

[226] Christie and Bradfield (n 214) 596; and Schulze (n 215) 124.

has fallen in *mora*. In such instances the supervening impossibility will not invalidate the contractual obligations of the debtor and it will accordingly remain liable for performance.[227]

The South African bank's refusal to make payment on the basis of a reference to an OFAC-listed individual, entity or vessel in the presented documents satisfies the above requirements: firstly, the refusal is without legal justification and is not also objectively impossible; the implication is that payment is still capable of being processed. Secondly, because no legal justification to the contrary exists, the beneficiary's claim for payment, augmented by the presentation of conforming documents, remains valid. This means that the bank's refusal in no way extinguishes the beneficiary's claim which remains due and enforceable. It follows that the bank's refusal to pay may constitute *mora debitoris*.

The circumstances contemplated in a letter-of-credit and demand-guarantee transaction are such that a date for payment is not fixed in the contract; rather, payment is triggered upon the presentation of conforming documents. A demand or notice by the beneficiary containing a reasonable date for payment to be made should be instituted against the bank to place it in *mora*. If the bank fails to pay on this date, this will constitute *mora ex persona*.

5.3.8.1.2 *Mora creditoris*

The creditor is typically the party that receives performance and not the party from whom performance is expected. In many instances, however, the cooperation of the creditor is necessary to enable the debtor to perform. In such instances, the creditor's failure to cooperate timeously with the debtor may cause the debtor's performance to be delayed. This breach is referred to as *mora creditoris*.[228] *Mora creditoris* encompasses three requirements. The first is that the debtor's performance must be physically and legally capable of being discharged. In other words, the obligation from which performance arises must be valid. The second is that the debtor must tender proper performance to the creditor. The third is that the creditor must fail to give his cooperation and thereby delay the debtor's performance.[229]

The consequences of *mora creditoris* are as follows: the debtor's duty of care is diminished; a discharge of the debtor's obligation to perform due to a supervening impossibility (thus without the fault of the debtor) while the creditor is in *mora* will provide

---

[227] Schulze *et al* (n 215) 126.

[228] Unfortunately, South African courts tend to confuse *mora creditoris* with *mora debitoris* by treating conduct that amounts to the former as constituting the latter. See Hutchison and Pretorius (eds) *The Law of Contract in South Africa* (2017) 301.

[229] 303.

the debtor with a valid basis not to perform; and if the debtor is in *mora*, it is removed by the subsequent *mora* of the creditor.[230]

Mora creditoris is not applicable to the circumstances under consideration. The bank's refusal to pay does not require cooperation from the beneficiary at all. The beneficiary is also not involved in the compliance processes undertaken by the bank in which the reference to the listed individual, entity or vessel is identified – it would merely, in the ordinary course of banking practice, be notified of the bank's decision not to pay.

5.3.8.1.3 Positive malperformance

Positive malperformance entails an act by the debtor which is contrary to the terms of the contract.[231] It concerns the content or quality of the performance rendered and can occur in two situations. The first is where the debtor tenders defective or improper performance and the second is where the debtor performs an act which is contrary to the terms of the contract.[232] Cockrell[233] states that this type of breach serves "a residual purpose" since it regulates circumstances of breach which fall outside the scope of the other types of breach. It is unclear whether fault is a requirement under positive malperformance.[234]

A South African bank's refusal to process payment does not fit into the mould of the first type of positive malperformance since the bank has not performed at all. Moreover, the bank's refusal to authorise payment constitutes an omission rather than an act, which means that the second form of malperformance is also not applicable.

UNIVERSITY
OF
JOHANNESBURG

5.3.8.1.4 Repudiation

Repudiation occurs when the behaviour[235] of a contracting party suggests that it does not, without lawful justification, intend to honour its obligations.[236] Repudiation is accordingly a form of anticipatory breach.[237] The examples of repudiation are widely divergent, but one can

---

[230] Schulze *et al* (n 215) 127.

[231] Hutchison and Pretorius (n 228) 306.

[232] Schulze *et al* (n 215) 128.

[233] Cockrell (n 219) 312.

[234] Hutchison and Pretorius (n 228) 307. The authors further remark that by their silence on the point, most cases and writers create the impression that fault is not required.

[235] words or conduct.

[236] *Datacolor International (Pty) Ltd Intamarket (Pty) Ltd* [2001] I All SA 581 (A). See further Hutchison and Pretorius (n 228) 310 who describe repudiation as an "unjustified attempt to cancel the contract".

[237] Hutchison and Pretorius (n 228) 310.

identify refusal to render or accept performance, and notification of an inability to perform as most prevalent. To determine whether particular conduct constitutes repudiation, an objective test is employed: the question is "whether the person alleged to have repudiated has behaved in a way that would lead a reasonable person to conclude that the repudiating party does not intend to fulfil his or her part of the contract."[238]

Once repudiation is established, the innocent party may elect to either reject the repudiation and hold the repudiating party to its obligations or accept the repudiation and avail itself of the remedies available for breach of contract.[239]

The bank's refusal to pay may amount to repudiation. Firstly, in the normal course of events, the beneficiary will be notified of the bank's intention not to process payment. Such a notice may be dispatched before the beneficiary tenders conforming documents. Secondly, by not processing payment "within five business days following the day of presentation"[240] of the documents, and without an otherwise legitimate defence to payment,[241] the bank's conduct may be viewed as repudiation. It is submitted that such a notice referred to above or the refusal to process payment after the expiry of the stated period is likely to satisfy the objective test in that it would lead a reasonable person to conclude that the bank does not intend to honour its payment obligations and therefore not be bound by the letter-of-credit or demand-guarantee contract.

5.3.8.1.5 Prevention of performance

Prevention of performance occurs when the debtor culpably renders its own performance impossible or where the creditor culpably renders the debtor's performance impossible.[242] In the case of the prevention of performance by the debtor, the debtor is not excused from performing its obligation.[243] Since performance is impossible and therefore cannot be rendered,

---

[238] Schulze *et al* (n 215) 128.

[239] Schulze *et al* (n 215) 128.

[240] art 14(b) of the UCP (n 5) and art 20(a) of the URDG 758 (n 5) both provide that the paying bank has five business days within which to examine the demand.

[241] In this regard, beneficiaries often submit abusive (for example, fraudulent) demands. In such instances the fraudulent conduct can form the basis of an interdict (injunctive relief) against the beneficiary preventing payment of the letter of credit or demand guarantee. Often considered in the context of exceptions to the so-called independence principle, this issue has received significant attention in South African law, particularly in relation to demand guarantees. For a thorough analysis in this respect, see Hugo "Bank guarantees" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 437 445–455 as regards demand guarantees and Hugo (n 122) 422–430 concerning letters of credit. See further pars 2.4.2.4 and 2.4.2.5 above respectively.

[242] Hutchison and Pretorius (n 228) 315–316.

[243] Schulze *et al* (n 215) 129.

the debtor will be required to pay damages. In the case of prevention of performance by the creditor, conversely, the debtor is considered to have discharged its obligation and is therefore entitled to performance by the creditor.[244]

As mentioned above, fault is a requirement of prevention of performance.[245] There is a presumption in favour of fault on the part of the party in breach. The implication is that the party in breach bears the onus of proving a lack of fault. Fault is the distinguishing factor between prevention of performance and the doctrine of supervening impossibility of performance.[246]

The South African bank's refusal to authorise payment due to the OFAC listing in no way compromises its ability to effect payment. In other words, performance has not been rendered impossible and is still physically and legally capable of being processed. It follows that the bank's refusal to pay does not constitute prevention of performance.

5.3.8.2 Contractual remedies

5.3.8.2.1 Introduction

Enforcement of performance, cancellation of the contract and damages are the main remedies available for breach of contract in South African law. Ultimately, the choice as to which remedy, or remedies, should be claimed lies with the innocent party.[247] Enforcement of performance and cancellation of the contract are "mutually exclusive";[248] thus the innocent party has a choice between one or the other, it cannot choose both.[249] Damages, on the other hand, may be claimed together with any one of these remedies, or, in the alternative, provided the remedies are not inconsistent and the innocent party is not overcompensated.[250]

All of this means that the South African beneficiary of a letter of credit or demand guarantee which is refused payment by a South African bank on the basis of a reference to an OFAC-listed individual, entity or vessel in the documents, and which refusal amounts to breach of contract, potentially has three remedies at its disposal. It could: (i) enforce payment, (ii) cancel the contract, and (iii) claim damages. These remedies are considered below.

UNIVERSITY OF JOHANNESBURG

[244] Schulze *et al* (n 215) 129. See also Van Huyssteen *et al* (n 57) 416.

[245] Schulze *et al* (n 215) 129; and Hutchison and Pretorius (n 228) 316.

[246] For this distinction see Schulze *et al* (n 215) 150.

[247] The terms of the contract may be of relevance to the beneficiary in this regard.

[248] Schulze *et al* (n 215) 131.

[249] Where the two remedies are claimed in the alternative, enforcement of the one will exclude the other.

[250] Christie and Bradfield (n 214) 616.

5.3.8.2.2 Enforcement of performance

The "primary" remedy for an innocent party which has suffered a breach of contract is enforcement of performance.[251] Because this remedy gives effect to the parties' original intentions and the maxim *pacta servanda sunt*,[252] it is said to be the "obvious"[253] remedy for breach. An innocent party in principle has the right to claim performance whenever the other party commits a breach, irrespective of the type of breach committed. Enforcement of performance can entail any of the following orders:

(a) an order for specific performance;
(b) an order for reduced performance;
(c) a prohibitory interdict.

Orders for specific performance

This is a court order in which a contracting party is compelled to do what it has promised in the contract. Such orders are subject to judicial discretion[254] and can be refused on grounds of public policy.[255] Moreover, specific performance is not available in instances where performance has been rendered impossible or where the party in breach is insolvent.[256] In such instances the innocent party can claim damages.[257]

In *Farmers Co-operative Society (Reg) v Berry*[258] the court held that for a claim for specific performance to succeed (i) the innocent party must have already performed or be in a position to perform its obligations, and (ii) it must be possible for the party in breach to perform – in other words its performance must be possible. Hutchison and Pretorius[259] add that the notion that the order of specific performance must not be contrary to public policy should constitute a third requirement.

UNIVERSITY
OF
JOHANNESBURG

---

[251] *Benson v SA Mutual Life Assurance Society* 1986 (1) SA 776 (A) 782.

[252] which translates to "the strict enforcement of obligations".

[253] Schulze *et al* (n 215) 131.

[254] *Santos Professional Football Club (Pty) Ltd v Igesund & Another* [2002] JOL 10021 (C) 7.

[255] *Haynes v Kingwilliamstown Municipality* 1951 (2) SA 371 (A).

[256] Hutchison and Pretorius (n 228) 334.

[257] Concerning claims for damages, see par 5.3.9.2.4 below.

[258] 1912 AD 343 350–351.

[259] Hutchison and Pretorius (n 228) 334.

It is noteworthy that claims for specific performance often take the form of claims for payment of a sum of money.[260] Hence an order for specific performance may be appealing to the beneficiary of a letter of credit or guarantee which has had its demand for payment resisted by the bank due to the documents disclosing an OFAC-listed individual, entity or vessel.

Orders for reduced performance

An order for specific performance may not always be appropriate or acceptable.[261] This is especially true of cases where the other (innocent) party has performed, but its performance is not proper. In such cases an order for reduced performance may be more suitable.

Orders for reduced performance are especially applicable in relation to reciprocal contracts where the parties must perform simultaneously or where the performance of the innocent party precedes the performance of the other party.[262] The relevant principle in this regard is the principle of reciprocity. In terms of this principle the innocent party must perform properly or tender proper performance before it can demand counter-performance.[263] Consequently, the party in breach is entitled to withhold its performance until the innocent party has performed.[264] This defence is known as the *exceptio non adimpleti contractus*.

The practical effect of the application of the *exceptio non adimpleti contractus* is that a court will not order specific performance in favour of an innocent party where such party has not yet performed or has rendered defective performance.[265] Thus, the principle of reciprocity and the *exceptio non adimpleti contractus* effectively constitute "an absolute bar to the remedy of specific performance for as long as [the innocent party] fails to render or tender his or her own performance."[266]

Reliance on the *exceptio non adimpleti contractus* by the party in breach may in some instances prove to be unfair. Therefore, South African courts may, where fairness so requires, refuse to allow a party to rely thereon and order it to render a reduced counter-performance (as

UNIVERSITY
OF
JOHANNESBURG

[260] Hutchison and Pretorius (n 228) 334.

[261] Schulze *et al* (n 215) 132.

[262] Van Huyssteen *et al* (n 57) 436.

[263] Van Huyssteen *et al* (n 57) 436 and 443.

[264] BK *Tooling (Edms) Bpk v Scope Precision Engineering (Edms) Bpk* 1979 1 SA 391 (A) 415–416.

[265] Schulze *et al* (n 215) 133.

[266] Schulze *et al* (n 215) 133.

opposed to full performance).[267] In this way the contract is enforced, regardless of the fact that the innocent party has rendered or tendered incomplete or defective performance.

South African courts will generally grant the innocent party an order for reduced performance only if the following is proved:

(a) that the party in breach is using the defective performance;
(b) that the circumstances equitably justify that the court exercise its discretion in favour of granting such an order; and
(c) what the reduced contract price (or performance) should be.[268]

Prohibitory interdicts

In the event a party performs, or threatens to perform an act, contrary to the contract, a prohibitory interdict[269] may be used to end or prevent such conduct. The party who seeks an interdict to prohibit such conduct is in reality attempting to enforce the contract, since it is requesting specific performance in the negative sense. Because of the urgency involved, prohibitory interdicts are usually sought by way of application rather than action and, consequently, conflicts of fact on the affidavits frequently arise.[270]

South African law distinguishes between two types of prohibitory interdicts: that is, final interdicts and interim, also known as interlocutory, interdicts.[271] A final interdict, as the name suggests, enjoins something from happening permanently.[272] "As a final interdict is a drastic measure that resolves the matter between the parties"[273] the applicant must establish the

UNIVERSITY OF JOHANNESBURG

[267] BK *Tooling* (n 264) 435. Prior to this case, courts generally approached the *exceptio non adimpleti contractus* mechanically in that the *exceptio* was applied without consideration for principles of fairness and equity. The appellate division in *BK Tooling*, however, held that courts have a discretionary power in relation to the *exceptio*. This means that courts are now permitted to relax the *exceptio non adimpleti contractus* and grant the innocent party a claim for a reduced performance where fairness so requires.

[268] BK *Tooling* (n 264) 435.

[269] Christie and Bradfield (n 214) 629 correctly point out that the principles governing the issue of an interdict to enforce a promise not to do something and the issue of an interdict to protect any other right are fundamentally different. Hence the former, which is most relevant to this study, should not be referred to as a mere interdict, but rather a "prohibitory interdict".

[270] For guidance on the handling of such conflicts, see *Planscon-Evans Paints Ltd v Van Riebeeck Paints (Pty) Ltd* [1984] 2 All SA 366.

[271] An extensive treatment of the South African law relating to prohibitory interdicts falls beyond the scope of this study; however, reference must be made to final and interim interdicts in order to present a complete overview of prohibitory interdictory relief.

[272] Loggerenberg *Erasmus: Superior Court Practice Volume II* (2016) par D6–3 a.

[273] *Du Plessis v Labuschagne and Others* (3799/2016) [2017] *ZAFSHC* 24 (16 February 2017) par 2.

following in order to succeed with its application: (i) that it has a clear right, (ii) that an injury or damage is actually committed or that there is a reasonable apprehension of an injury or harm, and (iii) that no other satisfactory remedy is available to it.[274]

An interim interdict, on the other hand, provisionally bars something from happening until such time as the temporary order is made final.[275] The court will grant an applicant interim relief if the applicant can prove that: (i) it has a *prima facie* right, (ii) it has a well-grounded apprehension of irreparable harm if the interim relief is not granted, (iii) the balance of convenience favours the granting of an interim interdict, and (iv) no other satisfactory or adequate remedy in the circumstances exists.[276] These requirements are well established and have been cited in several judicial decisions.[277]

5.3.8.2.3 Cancellation of the contract

Cancellation of the contract is an extraordinary remedy.[278] It is available to the innocent party in two instances. The first is where the contract contains a cancellation clause.[279] A cancellation clause confers upon the parties the right to cancel the agreement.[280] Such clauses may be drafted in wide terms so as to confer upon the innocent party a right to cancel for any breach of contract, or it could be drafted in a narrow fashion in order to restrict cancellation to certain types of breach. A cancellation of the contract would need to be in accordance with this clause. Where the contract does not provide for a cancellation clause, secondly, the innocent party will acquire a right to cancel the contract if the breach is sufficiently serious, or material.[281] Therefore if the breach is not of a serious or material nature, the cancellation remedy will not be available.

UNIVERSITY OF JOHANNESBURG

[274] Loggerenberg (n 272) D6-12; and Harms *Civil Procedure in the Superior Courts* (2003) 27 par A5.2.

[275] Harms (n 274) 26 par A5.1 and 28 par A5.6.

[276] Kelly-Louw *Selective Legal Aspects of Bank Demand Guarantees* (2009 thesis UNISA) 315; Loggerenberg (n 272) D6-17; and Harms (n 274) 29 par A5.7.

[277] See, for example, *Mattress House (Pty) Ltd t/a Mia Bella Interiors v Investec Property Fund Ltd* 2017/36270 [2017] ZAGPHC 298 (13 October 2017) par 20; *Bombardier Africa Alliance Consortium v Lombard Insurance Company Limited and Another* (A222/2019) [2020] ZAGPPHC 554 (7 October 2020) par 11; *Du Plessis v Labuschagne* (n 273 above); and *Setlogelo v Setlogelo* 1914 AD 221.

[278] Hutchison and Pretorius (n 228).

[279] also known as a *lex commissoria.*

[280] In this regard, the cancellation clause may prescribe a procedure for cancellation and stipulate who is entitled to rely on the clause.

[281] Hutchison and Pretorius (n 228) 336; Schulze *et al* (n 226) 134; and Harker "The nature and scope of rescission as a remedy for breach of contract in American and South African law" 1980 *Acta Juridica* 61 77.

The cancellation remedy is available in relation to each type of breach. In the case of *mora debitoris* the creditor will have a right to cancel in three instances: firstly, when there is no cancellation clause and a date for performance is fixed in the contract, if the debtor's failure to perform (thus *mora ex re*) constitutes a material breach the creditor will be entitled to cancel the contract. In other words, the debtor has failed to perform on a date that is "of the essence to the contract".[282] Schulze *et al* state, however, that the "mere fact that a contract specifies an exact date for performance does not mean that time is of the essence to the contract."[283] The question should always be whether the debtor's failure to perform on the fixed date is material to the contract. Secondly, where the debtor is in *mora* with a significant part of its obligations and no date for performance has been fixed in the contract (thus *mora ex persona*), the creditor can acquire a right of cancellation by sending the debtor a "notice of intention to cancel the contract". Such a notice must provide the debtor with a reasonable time to perform and must also be clear that the creditor will cancel the contract if the debtor does not perform by the stipulated date. In this way, the creditor fixes a date for performance and further acquires a right of cancellation.[284] Finally, in the case of a cancellation clause that entitles the creditor to cancel the contract on the basis of the debtor's breach, the exercise of this right of cancellation is not dependent on whether or not the breach is material or sufficiently serious.

The above applies *mutatis mutandis* in relation to *mora creditoris*. Where the fixed date for performance has lapsed and time is of the essence, the cooperation of the creditor is necessary to enable the debtor to perform on time. Where the contract does not fix a date for performance, the debtor must notify the creditor that if it does not provide the necessary cooperation it will cancel the contract. Where the parties have agreed to a cancellation clause which affords the debtor a right of cancellation in the event of a breach by the creditor, the exercise of this right of cancellation is not dependent on whether or not the breach is material or sufficiently serious.

The remedy of cancellation will be available to the creditor following malperformance, more specifically defective performance, by the debtor in one of two manners. Firstly, where, owing to the seriousness of the defect, it would be unreasonable to expect the creditor to adhere

[282] Christie and Bradfield (n 214) 636. See further Wessels JA's remarks in *Greenfield Manufacturers (Temba) (Pty) Ltd v Royton Electrical Engineering (Pty) Ltd* 1976 (2) SA 565 (A) 569, which effectively resolve that the creditor's entitlement to cancel the contract in these circumstances amounts to a tacit term.

[283] Schulze *et al* (n 215) 135.

[284] Schulze *et al* (n 215) 135.

to the contract.[285] Secondly, where the parties agreed on a cancellation clause. The creditor may cancel the contract in accordance with the clause. In the latter regard, the defect need not be of a material or serious nature.

As regards repudiation, cancellation is available to the innocent party where the repudiation relates to a materially salient obligation of the contract.[286] Should the parties have agreed on a cancellation clause, cancellation of the contract must be in accordance with that clause. In this regard, the repudiation does not need to relate to a materially salient obligation.

In the case of prevention of performance by the debtor the creditor has an automatic right of cancellation, since performance has been rendered impossible.[287] In instances where the creditor prevented the performance of the debtor, the debtor can claim performance or cancellation.

Where the innocent party has a right of cancellation, it must decide whether to cancel or enforce the contract.[288] The innocent party is afforded a reasonable period to make the decision.[289] It must nevertheless elect wisely because whatever remedy is chosen is final and irrevocable.[290]

While the act of cancellation typically takes the form of a notice to that effect, an election might also be apparent from the innocent party's conduct. For example, if the innocent party accepts and uses the defective performance, it will be regarded as having elected to enforce the contract. It is wise for such a party to make clear that its right of cancellation is reserved. Cancellation becomes effective only once the other party is made aware of the grounds of cancellation.[291] If the innocent party has not been made aware of such grounds, the cancellation may not take effect. For this reason, it is best practice that an act of cancellation be communicated in writing and not verbally, since in the case of the latter, one runs the risk of omitting important information. A written notice may also cover any other associated aspects, including the date and time of cancellation, leaving no room for ambiguity and

UNIVERSITY
OF
JOHANNESBURG

[285] Harker (n 281) 70.

[286] See *Stewart Wrightson (Pty) Ltd* v *Thorpe* 1977 (2) SA 943 (A).

[287] Van Huyssteen *et al* (n 57) 453.

[288] This is the case since, as referred to above, enforcement and cancellation are inconsistent with one another or mutually exclusive.

[289] A failure to cancel the contract within a reasonable time may, however, pave the way for the assumption to be made that the remedy has been waived. See in this regard *Segal v Mazzur* 1920 CPD 634 644-645 (as per Watermeyer AJ).

[290] *Thomas v Henry* 1985 (3) SA 889 (A) 896.

[291] Hutchison and Pretorius (n 228) 338.

assumption. If the contract prescribes that a cancellation must be put in writing, such requirements must be adhered to.

A major consequence of cancellation is the termination of the obligations. This means that the parties are relieved from their obligations to the extent that performance has not been rendered. Where performance has been rendered, the performance must be returned to the party which performed. In this sense cancellation not only extinguishes contractual obligations, but places on both parties the duty to return performance received by the other party (restitution).[292] Restitution, however, may be dispensed with if a court deems it equitable to do so or if performance was rendered impossible due to *vis maior* or the acts of an autonomous third party.[293] It may also be the case that the parties agreed to a penalty clause which provides that a breach will entitle the innocent party to cancel the contract and keep whatever has been performed.[294]

5.3.8.2.4 Damages

As mentioned above,[295] the innocent party may, in addition to a claim for enforcement or cancellation of the contract, claim damages as compensation for any patrimonial loss suffered as a result of the breach.[296] Payment of damages, therefore, aims to put the innocent party in the position it would have been in had the contract not been breached but carried out as planned.[297]

The law of damages and especially the assessment of claims for damages is complicated. Fortunately, a set of general principles have been developed in South African law over the years to assist in the assessment of such claims.[298] Any party seeking to institute a claim for damages must acknowledge and comprehend these principles in order to succeed with its claim. These principles are considered briefly below.

UNIVERSITY OF JOHANNESBURG

[292] Restitution is accordingly aimed at placing the parties in the position they were in prior to the contract being concluded.

[293] Hutchison and Pretorius (n 228) 340.

[294] Schulze *et al* (n 215) 137.

[295] par 5.3.9.2.1 above.

[296] It must be noted that no damages may be claimed unless a breach of contract has been proved. So, it is misleading to say that damages may be awarded in the event of a delay of performance or even non-performance. They may be awarded only when such delay or non-performance constitutes *mora*.

[297] *Probert v Baker* 1983 (3) SA 229 (D) 223.

[298] Christie and Bradfield (n 214) 643.

The commission of a breach of contract does not necessarily mean that the innocent party has suffered a loss – a loss must be of a patrimonial nature and must adversely impact upon the innocent party's patrimony (estate).[299] Hence where compensation is sought for a non-patrimonial loss, such as for pain and suffering, the law of contract generally does not offer any assistance. A claim for compensation in this regard may be based on the law of delict, instead.[300]

To measure damages South African courts rely on the so-called "difference"[301] or "differential" principle.[302] The principle entails a comparison between the innocent party's patrimonial position subsequent to the breach and its patrimonial position had the breach not been committed.[303] The difference represents the loss suffered and is referred to as the "interesse" of the innocent party.[304] In this context the interesse is positive since the innocent party is being put in the position it would have been in had the breach not occurred.[305] Negative interesse, on the other hand, applies when the innocent party is put in the position it would have been in had the agreement never been concluded.[306]

Another important principle is that there must be a direct causal link between the damages and the breach of contract.[307] Where such a link is not established, a claim for damages may not be granted. Though logical and simple in theory, in practice this principle is fraught with difficulties and inconsistencies, especially in cases where claims for damages are also based on factors outside of the breach.[308]

The importance of the establishment of causation becomes evident in cases where claims for damages are so far removed from the party in breach (defendant) that it ought not to be held liable for the damages. Put differently, a defendant may in certain instances be able to

UNIVERSITY OF JOHANNESBURG

---

[299] Schulze *et al* (n 215) 138.

[300] Schulze *et al* (n 215) 138. Thus evidencing potential overlap between the law of contract and the law of delict.

[301] Schulze *et al* (n 215) 138; and Van Huyssteen *et al* (n 57) 468.

[302] Hutchison "Back to basics: reliance damages for breach of contract revisited" 2004 *SALJ* 51 52.

[303] *Swart v Van der Vyver* 1970 (1) SA 633 (A) 643.

[304] Van Huyssteen *et al* (n 57) 467.

[305] Schulze *et al* (n 215) 138.

[306] Van Huyssteen *et al* (n 57) 468. It must be noted, however, that negative interesse is traditionally used in cases assessing damages in delict, not contract.

[307] This entails a two-stage enquiry: that is, factual causation and legal causation. See Christie and Bradfield (n 214) 642.

[308] For example, the negligent conduct of the innocent party which contributed to the loss it suffered. In such instances the Apportionment of Damages Act 34 of 1956 may find application. See Christie and Bradfield (n 214) 659–660.

escape liability for the patrimonial loss suffered by the innocent party (plaintiff). South African law in this regard distinguishes between "general" damages and "special" damages.[309] The former concerns those damages which are considered to have been foreseen or contemplated by the parties.[310] The latter, conversely, refers to those damages which could not have been foreseen or contemplated by the parties as a probable consequence of the breach since they do not flow "naturally and generally" from the breach.[311] The defendant's liability is therefore limited to general damages and does not extend to special damages.[312] In *Steenkamp v Du Toit*[313] the test for establishing liability for general damages was laid down as follows:

> "In cases not complicated by the existence of fraud or other exceptional features, a person who has rendered himself liable for damages, is responsible for the *natural and probable consequences* of his act, these consequences being ascertained with reference to the defendant's knowledge at the time. A man, therefore, who has failed to carry out his contractual obligation, is liable for such damages as he must *reasonably* have known would *naturally and probably* result from the breach: such damages in other words, as given his knowledge of the circumstances, might naturally be expected to follow the breach" (my emphasis).

In addition to assessing the merits of a claim for damages, quantifying the damages is also necessary. Because the damages suffered at breach of contract consist principally of a monetary value representing the performance the innocent party has had to forgo,[314] this monetary value of the performance is usually accepted to be the market value or market price of the lost performance.[315] Damages are thus frequently assessed in relation to this yardstick.[316] The market value is usually calculated with reference to the time and place at which the performance would have taken place, and appears to be available in relation to most forms of breach.[317]

In conclusion, the complexities and difficulties innocent parties may experience in proving and quantifying damages has given rise to the inclusion of penalty clauses. Such clauses make provision for the payment of a fixed sum of money in the event of breach. In this way, payment of the penalty serves as a substitute for a claim for damages.

UNIVERSITY
OF
JOHANNESBURG

309 *Shatz investments (Pty) Ltd v Kalovyrnas* 1976 (2) SA 545 (A).

310 Schulze *et al* (n 215) 139.

311 Van Huyssteen *et al* (n 57) 475–476. The question whether damages are general or special in nature is dealt with on a case-by-case basis.

312 Christie and Bradfield (n 214) 653.

313 1910 TS 171 175.

314 Van Huyssteen *et al* (n 57) 478.

315 *Novick v Benjamin* 1972 (2) SA 842 (A) 860.

316 Schulze *et al* (n 215) 140.

317 See Van Huyssteen *et al* (n 57) 479–483.

5.3.8.2.5 The beneficiary's election: enforce payment or cancel the contract?

The South African beneficiary under a letter of credit or demand guarantee whose demand for payment is refused by a South African bank due to an OFAC listing in the documents, and which refusal constitutes breach of contract – more specifically *mora debitoris* or repudiation,[318] is faced with an election: that is, to enforce payment or cancel the contract.[319] Either way, the beneficiary may claim damages.

Although several factors may conceivably influence the election process, including, for example, the practical or commercial significance of the delay caused by non-payment, the operational and reputational risk of continuing to engage an OFAC-listed individual, entity or vessel, and the potentially exorbitant litigious and other costs and expenses involved in enforcing or cancelling the letter-of-credit contract, the nature of the underlying transaction will most certainly be a decisive factor. After all, letters of credit and demand guarantees are designed and sought to support underlying transactions, particularly in so far as payment is concerned in relation to letters of credit.[320]

Where the underlying transaction is significantly high in value or part of a complex series of transactions, achieving the originally intended result of the contract will most likely be prioritised. This will also be the case where the beneficiary, or the buyer in this context, has no other means of acquiring the same or similar goods. Letters of credit and demand guarantees securing such transactions are likely to be enforced. To this end, an order for specific performance may be sought.[321] The denomination of payment in a currency other than South African rands (for example, US dollars) may, however, present challenges for the South African bank in relation to effecting payment. This will especially be the case where the US bank has not put the South African bank in the funds to pay the beneficiary by the time the OFAC listing becomes apparent.

UNIVERSITY
OF
JOHANNESBURG

---

[318] See pars 5.3.9.1.1 and 5.3.9.1.4 above respectively. With reference to repudiation, the statement in the text operates on the premise that the beneficiary accepts the bank's repudiation, thereby entitling it to the remedies.

[319] These remedies, as previously stated, are mutually exclusive.

[320] Horowitz (n 5) 2 par 1.05-1.06; Hugo "Protecting the lifeblood of international commerce: a critical assessment of recent judgments of the South African supreme court of appeal relating to demand guarantees" 2014 *TSAR* 661 661; and *Phillips v Standard Bank of South Africa Ltd* 1985 3 SA 301 (W) 301 par G-H.

[321] As the beneficiary has not performed in a defective or incomplete manner, reduced performance may not be an appropriate order in this respect. Likewise, a prohibitory interdict may not be suitable since the bank's refusal cannot be prohibited; rather, the obligation to pay should be enforced (hence the suggested order for specific performance).

Where the originally intended result does not justify enforcement, the cancellation remedy is available. If the letter-of-credit or demand-guarantee contract does not contain a cancellation clause, the beneficiary may rely on the fact that payment is a material obligation under the contract and that non-payment constitutes sufficient grounds for cancellation. In the ordinary course of events, the beneficiary will, whether relying on a cancellation clause or otherwise, send a notice to the bank informing the bank of its decision to cancel the credit. Where a claim for cancellation is subsequently granted by the court, the order will also require, in accordance with the concomitant principle of restitution, that all inter-bank payments and reimbursements made, if any, be returned to sender.

Against this background it is suggested, where appropriate, that both remedies (namely, enforcement of performance and cancellation of the contract) should be sought, with the less-desired one being claimed in the alternative. This will increase the beneficiary's prospects of obtaining relief for the breach of contract.

As indicated above, either of these remedies may be combined with a claim for damages. The beneficiary in these circumstances may claim damages for any patrimonial loss suffered, provided such loss flows naturally and generally from the bank's refusal to pay.

5.3.9 Conclusions

This section of the study investigated the impact of compliance with foreign targeted financial sanctions – and the OFAC sanctions in particular – on letters of credit and demand guarantees. Because such compliance is premised on strong business and reputational considerations and is without legal basis, a South African bank that complies therewith will not be afforded protection under South African law. This section has shown that, accordingly, a South African bank's refusal to authorise payment under a letter of credit on account of a reference to an OFAC listing in the documents may constitute breach of contract. More specifically, it has been shown that the bank's refusal could take the form of *mora debitoris* or repudiation. Where the refusal is proven to constitute breach of contract, the beneficiary will be entitled to contractual relief in the form of legal remedies such as enforcement of performance, cancellation of the contract and damages. Should the beneficiary elect to enforce payment, a successfully sought order for specific performance will require of the bank to process payment. Alternatively, if it chooses to cancel the contract, the court will order restitution.[322] Either of these remedies may be coupled with a claim for damages.

[322] On restitution in relation to cancellation see 5.3.8.2.3 above.

UNIVERSITY OF JOHANNESBURG

It is therefore clear that "the once highly secure letter-of-credit business has become significantly riskier in these times of targeted financial sanctions."[323] Since payment under demand guarantees may also be compromised by these sanctions, it is submitted that the same can be said in relation to these instruments. For beneficiaries of letters of credits and demand guarantees this means that the risk of non-payment for sanctions-related reasons has become a stark reality.

To manage their sanctions risk exposure, finally, banks have in recent times adopted problematic documentary practices. In the following section these documentary practices are explored in greater detail.

5.4 Documentary issues

5.4.1 Introduction

The research presented in the previous sections of this chapter[324] investigated the effect that a bank's compliance with targeted financial sanctions may have on payment under letters of credit and demand guarantees. The research in this section explores the problematic documentary practices that banks have adopted or conceivably may adopt to manage their sanctions risk exposure. The practices explored in this regard are the inclusion of so-called sanctions clauses and other sanctions-related non-documentary conditions in letters of credit and demand guarantees. The issue of unjustified amendments by the beneficiary for the purposes of sanctions evasion is also considered.

UNIVERSITY
OF
JOHANNESBURG

5.4.2 Sanctions clauses

The practice of including sanctions clauses in letters of credit and demand guarantees has emerged strongly in recent years. With the sharp increase in sanctions compliance requirements and expectations over the last decade,[325] banks have sought various ways to mitigate the legal risk of engaging sanctioned individuals and entities. Sanctions clauses are one such method. They have accordingly been described as "one of the unintended consequences"[326] of increased and stricter compliance obligations and expectations. Although this "legal risk" is generally contemplated in relation to a single sanctions regime, banks involved in international

[323] Hugo and Strydom (n 28) 130.

[324] pars 5.2 and 5.3 above.

[325] For a discussion of the role and contribution of the most important international organisations in this regard, see Chapter Four above.

[326] Hugo and Strydom (n 28) 126.

transactions are frequently subject to risks relating to multiple sanctions regimes.[327] This holds particularly true for international documentary-credit transactions where the sanctions regimes applicable to the issuing bank, the confirming or nominated bank, the currency or place of payment, and the law stipulated in the choice of law clause may all potentially apply.[328] To alleviate potential conflict between regulatory requirements and expectations in this regard, banks usually implement internal sanctions policies[329] which, as will be seen below, may be referred to in sanctions clauses. Sanctions clauses are mostly included at the behest of the issuing bank.[330]

Although indicative of the issuing bank's commitment to complying with sanctions laws and regulations, sanctions clauses are not beyond criticism. The main problem is that they have the effect of restricting performance under letters of credit and demand guarantees. More specifically, they afford the issuing bank an opportunity to determine whether or not it must pay the beneficiary or reimburse the nominated or confirming bank with reference to factors outside of the stipulated documents.[331] This is especially the case when a reference is made in the sanctions clause to internal policies or a discretion of the issuing bank. This discussion is focused on these type of sanctions clauses.

UNIVERSITY
OF
JOHANNESBURG

[327] When sanctions laws are determined to be applicable to a particular transaction, they will generally be regarded as being mandatory. The issue of overriding mandatory rules has enjoyed significant attention in private international law and is beyond the scope of this thesis. For further reading on South African private international law relating to overriding mandatory rules, see Forsyth (n 101) 343–349.

[328] ICC "Addendum to the ICC guidance paper on the use of sanctions clauses (2014)" https://iccwbo.org/content/uploads/sites/3/2020/05/20200504-addendum-to-sanction-clauses-paper.pdf (2020) 2 (accessed on 15 May 2022); and Barnes "Sanctions Mention in LC Text – 2008 Letter" in *New York Events Conference Materials (Institute of International Banking Law and Practice)* (2019) 58 60. See further in this regard Fredericks and Neels (n 106) 63–73; and Fredericks and Neels (n 117) 227.

[329] ICC "Guidance paper on the use of sanctions clauses in trade finance-related instruments subject to ICC rules" https://iccwbo.org/publication/guidance-paper-on-the-use-of-sanctions-clauses-2014/ (2014) 2 (accessed on 15 May 2022).

[330] In this section the term "issuing bank" will also mean "guarantor" unless the context indicates otherwise.

[331] (n 329) 2 par 1.3.

5.4.2.1 Types of sanctions clauses

While sanctions clauses may vary significantly in scope,[332] three types of sanctions clauses have become increasingly popular within the trade-finance industry. An example of each type is quoted by the ICC[333] in its 2014 guidance paper:[334]

> (a) "Presentation of document(s) that are not in compliance with the applicable anti-boycott, anti-money laundering, anti-terrorism, anti-drug trafficking and economic sanctions laws and regulations is not acceptable. Applicable laws vary depending on the transaction and may include United Nations, United States and/or local laws."[335]
>
> (b) "[Bank] complies with the international sanction laws and regulations issued by the United States of America, the European Union and the United Nations (as well as local laws and regulations applicable to the issuing branch) and in furtherance of those laws and regulations, *[Bank] has adopted policies which in some cases go beyond the requirement of applicable laws and regulations*. Therefore [Bank] undertakes no obligation to make any payment under, or otherwise to implement, this letter of credit (including but not limited to processing documents or advising the letter of credit), if there is involvement by any person (natural, corporate or governmental) listed in the USA, EU, UN or local sanctions lists, or any involvement by or nexus with Cuba, Sudan, Iran or Myanmar, or any of their governmental agencies."[336]
>
> (c) "Trade and economic sanctions ('sanctions') imposed by governments, government agencies or departments, regulators, central banks and/or transnational organizations (including the United Nations and European Union) impact upon transactions involving countries, or persons resident within countries currently including [long list of countries follows] … . Issuing bank and all of its related bodies corporate might be subject to and affected by, sanctions, with which it will comply. Please contact issuing bank for clarification before presenting documents to issuing bank … or undertaking any dealings regarding this credit involving countries or persons affected by sanctions. Issuing bank is not and will not be liable for any loss or damage whatsoever associated directly or indirectly with the application of sanctions to a transaction or financial service involving issuing bank. *Issuing bank is not required to perform any obligation under this credit which it determines in its discretion will, or would be likely to, contravene or breach any sanction. This clause applies notwithstanding any inconsistency with the current edition of the … [UCP].*"[337]

The first clause, clause (a), simply states that the issuing bank is bound by the laws to which it is subject. Such laws find automatic application and, in the event of a conflict, will trump the

---

[332] as they address the specific needs of banks. The imaginative and innovative nature of contractual drafting also plays a role in this regard.

[333] For background on the ICC see par 4.3 above.

[334] ICC (n 329) 4 par 3.1. These three types of clauses are also considered in ReedSmith "Sanctions clauses – safeguarding payment under letters of credit" (11 January 2012) https://www.reedsmith.com/en/perspectives/2012/01/sanctions-clauses--safeguarding-payment-under-lett (accessed 5 October 2021).

[335] par 3.1 (a).

[336] par 3.1 (b) (my emphasis).

[337] par 3.1 (c) (my emphasis).

provisions of the UCP 600.[338] These types of sanctions clauses are unproblematic since they merely draw attention to the existence of sanctions laws and regulations.

Two variations of clause (a) are noteworthy. The first, formulated by the ICC, reads as follows:

> "[notwithstanding anything to the contrary in the applicable ICC Rules or in this undertaking,] *We disclaim liability for delay, non-return of documents, non-payment, or other action or inaction compelled by restrictive measures, counter-measures or sanctions laws or regulations mandatorily applicable to us or to [our correspondent banks in] the relevant transaction.*"[339]

The second, prepared by the Institute of International Banking Law and Practice (IIBLP),[340] reads as follows:

> "We disclaim liability for delay, non-return of documents, non-payment, or other action or inaction compelled by a judicial order or government regulation applicable to us [or our service providers]."[341]

Although substantively similar, clause (a) and the variations differ in one important respect: the variations refer to the sanctions laws and regulations applicable to the issuing bank *and* to those applicable to the correspondent banks involved in the transaction. Clause (a) does not indicate which national sanctions laws are applicable.

The second clause quoted above, clause (b), however, is problematic. The clause stipulates that the bank has adopted internal policies relating to sanctions which may extend beyond the applicable laws and regulations. A logical interpretation of this clause suggests that, in addition to the manifestation of the involvement of a sanctioned party, the bank may refuse to authorise payment or process the transaction if doing so would violate its own internal policies irrespective of the law.[342] The problem with this position is that none of the other parties involved would have knowledge of these internal policies. In other words, they would not be privy to the circumstances, as contemplated by the policies, that would trigger a rejection of a complying presentation or refusal to otherwise process the transaction. It follows that the beneficiary is unaware of the strength of the issuing bank's undertaking. And the nominated

UNIVERSITY OF JOHANNESBURG

---

[338] In this regard, it must be kept in mind that ICC rules have no higher status than contractually incorporated terms of a contract and cannot override mandatory law.

[339] ICC (n 328) above.

[340] For background on the IIBLP, see par 4.6 above.

[341] See "IIBLP Sanctions clause" in *2019 New York Events Conference Materials (Institute of International Banking Law and Practice)* (2019) 57.

[342] Hugo and Strydom (n 28) 127.

and/or confirming banks are uncertain as to whether they will be reimbursed should they pay a complying presentation.

The third clause quoted above, clause (c), is equally problematic. This clause effectively permits the issuing bank to decline to pay or process payment on the basis of a determination "in its discretion" that such payment would contravene or would be likely to contravene sanctions. The beneficiary and the nominated and/or confirming banks are, similarly, without any certainty in so far as the performance of the issuing bank's contractual obligations towards them are concerned.

Although these clauses feature prominently in trade finance practice, they are not, as alluded to above, the only sanctions clauses encountered. In this regard, banking practice indicates that sanctions clauses sometimes include vague and generalised terms which may have the same effect as clauses (b) and (c).[343] For instance, in a recent official ICC opinion[344] the ICC responded to a query relating to a sanctions clause indicating that the bank would not "handle or deal with any documents, shipments, goods, payments and/or transactions that may relate, directly or *indirectly*, to any sanctioned countries/regions, persons or parties."[345] The ICC stated that it is uncertain as to what the term "indirectly" means. One interpretation is that the bank will refuse to pay or process the transaction if it comes to its attention that one of the parties to the transaction has dealings with or is otherwise related to a sanctioned country/region, individual or entity for the purposes of not only domestic sanctions laws but also foreign sanctions laws. On this interpretation, the manifestation of such a fact may require of the bank to conduct enhanced due diligence and implement other compliance procedures. Whatever its meaning, the term may give rise to confusion and uncertainty.[346]

5.4.2.2 Issues relating to the non-documentary nature of sanctions clauses

As indicated above, sanctions clauses are most problematic when a reference is made to the issuing bank's internal policies or discretion. Such clauses effectively enable the issuing bank to embark on an investigation into facts, and therefore not the documents, when determining whether it must pay. Hence these type of sanctions clauses are said to be non-documentary in

[343] On the issues emanating from clauses (b) and (c), see par 5.4.2.2 immediately below. See also par 5.4.2.3 below.

[344] ICC Banking Commission Document 470/TA920rev (October 2021) 1.

[345] my emphasis.

[346] ICC (n 344) 4.

UNIVERSITY OF JOHANNESBURG

nature[347] and accordingly constitute non-documentary conditions. A non-documentary condition can be described as a condition in a letter of credit or demand guarantee that does not indicate a document to comply with the credit or guarantee. Non-documentary conditions are in principle unacceptable as they give rise to issues relating to the operation and fundamental characteristics of these instruments. The UCP 600 provides that "[i]f a credit contains a condition without stipulating the document to indicate compliance with the condition, banks will deem such condition as not stated and will disregard it."[348] The URDG 758 similarly states that if a guarantee contains a condition "other than a date or the lapse of a period without specifying a document to indicate compliance with that condition […] then the guarantor will deem such condition as not stated and will disregard it … ."[349]

Although non-documentary conditions in general seem to be included at the instance of the beneficiary,[350] sanctions clauses are mostly included on the request of the issuing bank. This is indicative of the peculiar nature of sanctions clauses. Against this background it is argued that sanctions clauses do not fit neatly into the mould of article 14(h) and article 7. The issuing bank is essentially required to disregard a clause which it requested. Bearing in mind the significance of the purpose for which sanctions clauses are used,[351] it is unlikely that the issuing bank will be willing to do so. It stands to reason that articles 14(h) and 7 may not be effective in cases of sanctions clauses. Moreover, as an express term of the documentary-credit or demand-guarantee contract, a sanctions clause may well override articles 14(h) and 7, which are merely incorporated by reference. There is support for the view that the principles of the interpretation of contracts favour an express term in the event of a conflict between an express term and a standard incorporated term (i.e. article 14(h) or article 7).[352] Commenting from an English perspective, Bridge explains that article 14(h) will be disregarded in the case of a non-

[347] ICC (n 329) 3.

[348] UCP 600 (n 5) art 14(h).

[349] URDG 758 (n 5) art 7.

[350] See, for instance, *Gian Singh & Co Ltd v Banque de l'Indochine* [1974] 2 Lloyd's Rep 1; *Banque de l'Indochine et de Suez SA v JH Rayner (Mincing Lane) Ltd* [1983] Q.B. 711; and *Chailease Finance Corp v Credit Agricole Indosuez* 2000 1 All ER (Comm) 399. For cases concerning demand guarantees see *Tecnicas Reunidas Saudia v Korea Development Bank* 2020 (EWHC) 968 (TCC) par 8; *Leonardo SpA v Doha Bank Assurance Company LLC* 2020 QIC (A) pars 33–35; and *Lukoil Mid-East Ltd v Barclays Bank Plc* 2016 (EWHC) 166 (TCC) par 6.

[351] That is, to mitigate the legal sanctions risks to which it is exposed.

[352] Christie and Bradfield (n 214) 240–255; Van Huyssteen *et al* (n 57) 357 ("effect will preferably be given to the 'immediate' words of the parties"); and *Ashcor Secunda (Pty) Ltd v Sasol Synthetic Fuels (Pty) Ltd* (624/10) 2011 (ZASCA) 158. See also Chivizhe and Hugo "Non-documentary conditions in letters of credit and demand guarantees" in Hugo (ed) *Annual Banking Law Update* (2021) 1 4; and the Singaporean case of *Kumagai-Zenecon Construction Pte Ltd v Arab bank Plc* 1997 2 SLR 805 par 25.

documentary condition because no provision in the UCP 600 accords it dominant status over any inconsistent provisions.[353] These remarks are equally applicable in relation to sanctions clauses.

The main characteristic of non-documentary conditions, as indicated above, is that they require of banks to investigate and verify facts (and not documents). These extraneous investigations typically give rise to an increase in expenses and require the implementation of protracted procedures and processes. Within the sanctions-clause context, this could mean that the issuing bank would have to determine whether payment will contravene or is likely to contravene sanctions by evaluating transactional information[354] against applicable sanctions lists as well as, if so stipulated, the bank's internal policies. For the nominated or confirming bank which is uncertain as to whether it will be reimbursed if it pays a complying demand, it may need to update its transactional risk assessment, which may also consequently have an impact on the beneficiary. The ICC puts it thus:

> "[A] nominated [or confirming] bank's risk assessment is likely not only to include the issuing bank and the country risk, but also the assessment of the likelihood of a prohibited reimbursement due to sanctions regulations or an internal, sanctions-related policy. This may result in increased costs, delays and potential disputes."[355]

The factual investigations necessitated by sanctions clauses may in turn have a negative effect upon the time frame within which the beneficiary receives payment or a notice of rejection,[356] thus paving the way for disputes between the parties and consequently the institution of legal proceedings by the beneficiary against the issuing bank and/or the nominated and confirming banks.

Extraneous investigations may also result in a violation of the independence principle of letters of credit and demand guarantees. The issuing bank's internal policies or discretion may draw it into the underlying contract. This means that the bank will determine whether to honour a complying presentation with reference to the documents *and* the underlying contract. The absence of an appreciation for the independence principle blurs the distinction between accessory guarantees[357] and letters of credit and guarantees. Hence in past times the bank's

[353] Bridge (n 132) 2090–2091. See also Chivizhe and Hugo (n 352) 4–5.

[354] most notably a description of the parties, vessels and goods involved, as well as the shipping routes.

[355] ICC (n 329) 3.

[356] See in this regard UCP 600 (n 5) art 16(c) and URDG 758 (n 5) art 20(a).

[357] On this instrument see par 2.3.7.2 above.

UNIVERSITY OF JOHANNESBURG

undertaking was sometimes treated as being accessory, to enable compliance with the non-documentary condition.[358]

Finally, the fact that a sanctions clause may confer upon the issuing bank the right to reject a complying presentation necessarily brings into question the irrevocable nature of credits and guarantees. It is trite that the bank's promise to pay is intended to be absolute, final and irreversible, subject only to the presentation of conforming documents.[359] Refusing to honour a complying presentation due to internal sanctions policies or a discretion, therefore, defeats the irrevocable nature and utility of these instruments. The consequent trend[360] of returning (conforming) documents to the beneficiary further undermines conventional letter-of-credit and demand-guarantee law in terms of which documents can be returned only if they are *not* in conformity with the requirements of the instrument concerned.[361]

5.4.2.3 Contractual validity of the mandate given by the issuing bank to the nominated bank relating to a letter of credit containing a sanctions clause

Another critical issue to consider is whether the contractual validity of the mandate given by the issuing bank to the nominated bank is brought into question by virtue of the credit containing a sanctions clause referencing the issuing bank's internal sanctions policies or a discretion.

The contractual situation of the nominated bank is unlike that of the confirming bank. When the nominated bank pays the beneficiary, it pays as mandatary of the issuing bank and makes no undertaking towards the beneficiary.[362] The nominated bank accordingly has a contractual relationship with the issuing bank and not the beneficiary. By contrast, the confirming bank by confirming the credit is regarded as having bound itself to the

UNIVERSITY OF JOHANNESBURG

[358] See, for instance, *Wichita Eagle and Beacon Publishing Co Inc v Pacific National Bank of San Francisco* 493 F 2d 1285 (9th Cir 1974), where a documentary credit was held to be an accessory guarantee by virtue of a non-documentary condition.

[359] In this regard, letters of credit and demand guarantees are defined in relation to their irrevocable nature. For instance, see UCP 600 (n 5) art 2 and 3 as well as § 5–102(a)(10) of the Uniform Commercial Code (UCC) in relation to letters of credit, and URDG 758 (n 5) art 1 in relation to demand guarantees.

[360] See ICC Banking Commission Document 470/1280 (9 August 2018) 2.

[361] See art 15 of the UCP 600 (n 5) read with aa 7, 14 and 16; and art 24(d) and (f) of the URDG 758 (n 5). See also Hugo and Strydom (n 28) 129.

[362] Hugo (n 122) 405.

beneficiary[363] and the issuing bank.[364] Put differently, the confirming bank acts in two capacities: principal and mandatary.

The mandate given by the issuing bank to the nominated bank may potentially on account of the use of a sanctions clause referencing internal policies or a discretion fail to meet the requirements of a valid contract. A confirming bank, however, will be required to confirm the credit irrespective whether or not the mandate given by the issuing bank meets the requirements of a valid contract. This is ascribed to the confirming bank's (independent) obligation to the beneficiary. It is for this reason that this research is restricted to the nominated bank. In order to assess the abovementioned question, regard must be had to the requirements of a valid contract in South African law. These requirements are considered immediately below.

5.4.2.3.1 Requirements of a valid contract

South African law recognises six requirements for a contract[365] to be valid and enforceable. These requirements can be summarised as follows:[366]

(i) Consensus: the parties who wish to enter into an agreement must intend seriously to create rights and duties and to be legally bound thereto. The parties must make this intention known to one another.

(ii) Contractual capacity: the parties must have the capacity to conclude a contract.

(iii) Formalities: any formalities whether prescribed by the law or by the parties themselves must be observed.

(iv) Legality: the contract must be lawful and not prohibited by legislation.

UNIVERSITY
OF
JOHANNESBURG

---

363 Malek and Quest *Jack: Documentary Credits* (2009) 145 par 6.24; and Oelofse (n 99) 55–56.

364 See Hugo (n 122) 406.

365 A precise definition of the term "contract" under South African law is elusive. Hutchison and Pretorius (n 228) 6, for example, define a contract as an agreement entered into between two or more persons with the purpose to create one or more legal obligations from this agreement that is enforceable in law. Nagel *Commercial Law* (2019) 42, moreover, describes a contract as an agreement that is reached with the intention for legal obligations to be created between the parties who have entered into this agreement that give rise to rights and duties. Huyssteen *et al* (n 57) 9, finally, describe a contract as an obligatory agreement, which implies that it is an agreement that creates legal obligations, that the parties intended for there to be obligations created and should all the requirements for a valid contract be met, a contract will be created. Despite the absence of a precise definition, a common theme is apparent from these definitions: namely, that a contract is an agreement that creates enforceable obligations between two or more persons.

366 Hutchison and Pretorius (n 228) 6.

(v) Possibility: the obligations the parties wish to create must be capable of being met when the contract is entered into.

(vi) Certainty: the obligations contained in the contract must be clear and determinable so that the parties to the contract know exactly what the obligations are.

For a contract to be valid under South African law all these requirements must be met. Each requirement is examined in more detail below.

Consensus

Consensus (also known as true agreement) is the very basis of a valid contract. It refers to the common intention of the parties to be bound by the terms and conditions of the contract. As a general rule, a contract is regarded as having been concluded at the time and place when consensus has been reached.[367] The reaching of consensus requires that the parties must exchange declarations which express their respective intentions to create enforceable rights and obligations. Typically, this is achieved through offer and acceptance.[368] In order to ascertain whether true consensus has been reached, it is necessary to establish whether a valid offer and acceptance was made: one party must have made an offer (the "offeror") and the other party must have accepted the offer (the "offeree").

To constitute a valid contract the offer must, in the first place, be made by the offeror with the intention to be bound by the offeree's acceptance of the offer. This intention, which may be an express or implied term, is what sets a true offer apart from an "offer" made in jest.[369] Secondly, the offer must be complete, clear and certain.[370] Not only must the offer contain all the provisions the parties wish to comply with and be bound by, but it must also be clear and unconditional to ensure that the rights and duties are determinable. As a consequence, "[n]o contract can arise if the offer is vague or ambiguous, since one of the requirements for a contract is that the performance must be certain or ascertainable."[371] So, too, must the offeree's

[367] Van Huyssteen *et al* (n 57) 62.

[368] See Van Huyssteen *et al* (n 57) 60 who state: "In its simplest form, a contract consists of an invitation to consent to the creation of obligations between two or more parties (called an 'offer'), and an affirmative response (called an 'acceptance')."

[369] Schulze *et al* (n 215) 55.

[370] Hutchison and Pretorius (n 228) 50.

[371] Schulze *et al* (n 215) 56. See also Van Huyssteen *et al* (n 57) 262–263.

acceptance be complete, clear and certain. Finally, the offer and acceptance can be completed only once they have been communicated to the respective party.[372]

Contractual capacity

Contractual capacity is the ability to enter into valid contracts, participate in legal dealings and create duties and receive rights.[373] Although every legal subject (whether a natural or juristic person) is presumed to have the legal capacity to enter into a contract, certain attributes or circumstances of a contracting party may restrict its ability to create duties and to receive rights. Marital status,[374] age[375] and mental instability[376] are all attributes that can affect a natural person's ability to act in accordance with his/her will and to appreciate the consequences of such an act. Insolvency is a circumstance that may impede a juristic person's ability to create duties and receive rights.[377] Against this background three categories of contractual capacity have developed: namely, full contractual capacity, limited contractual capacity and no contractual capacity.

As juristic persons are physically incapable of performing juristic acts, natural persons may act on their behalf. In concluding a contract, the representative of the contracting juristic person must have the necessary authority to bind the juristic person to the terms and conditions of the contract.[378] If the representative does not have the necessary authority, the contract will generally not be valid and enforceable.

UNIVERSITY
OF
JOHANNESBURG

Formalities

The question whether a valid contract has come into existence must also be determined with reference to whether there is compliance with the prescribed formalities, if any. Formalities are "those requirements relating to the outward, visible form in which the agreement must be cast to create a valid contract".[379] They may be prescribed by law[380] or the parties themselves. The

---

[372] Schulze *et al* (n 215) 57.

[373] Hutchison and Pretorius (n 228) 154.

[374] Christie and Bradfield (n 214) 268.

[375] Christie and Bradfield (n 214) 271.

[376] Christie and Bradfield (n 214) 287.

[377] Christie and Bradfield (n 214) 291.

[378] Hutchison and Pretorius (n 228) 160.

[379] Schulze *et al* (n 215) 99.

[380] Formalities laid down by statute are necessitated by public policy. As to the effect and purpose of such formalities, Van Huyssteen *et al* (n 57) 166 ft 3 state: "Formalities contribute to legal certainty, prevent

most common formalities are that the contract must be reduced to writing and signed by the parties.[381]

Where the law requires the observance of certain formalities, a failure to comply with such formalities prevents a contract from being created. Likewise, no contract comes into existence if a formality by the parties themselves is not observed. In the event, however, that no express provision to the effect that certain formalities must be complied with exists, a contract will have come into existence provided all the other requirements of a valid contract have been met.[382]

Legality

A contract can be valid only if it is legal and capable of being enforced.[383] Unlawful agreements will not accordingly be valid and can either be void or unenforceable, depending on the gravity of the illegally and the extent to which the unlawfulness impacts the contract.[384] The notion that legality is a requirement of a valid contract gives effect to the maxim *pacta servanda sunt*, which requires that the provisions of a freely concluded agreement must be enforced.[385] This principle must, however, be balanced against constitutional values, good faith, and public policy. The Supreme Court of Appeal in *Brisley v Drotsky*[386] put it thus:

> "The Constitution requires that its values be employed to achieve a careful balance between an unacceptable excess of contractual 'freedom' and securing a framework within which the ability to contract enhances rather than diminishes our self respect and dignity."

UNIVERSITY
OF
JOHANNESBURG

The practical implication of this balance is that the question as to whether a court may refuse to enforce valid contractual terms if a contracting party avers that the enforcement of these terms would be unreasonable and unfair, must be considered in light of the constitutional values and not only the provisions of the contract. As to the precise role of these values in contractual

---

malpractices and serve as a cautionary and protective function by drawing the line between negotiations and liability, and may be utilised to afford protection to those in danger of exploitation and to assist in the identification of the type of contract entered into by the parties."

[381] It should be noted that a contract reduced to writing does not necessarily imply a formality. Parties who resort to writing may do so for evidential reasons. See Van Huyssteen *et al* (n 57) 167.

[382] Schulze *et al* (n 215) 99.

[383] Hutchison and Pretorius (n 228) 181.

[384] *Sasfin (Pty) Ltd v Beukes* [1989] 1 All SA 347 (A) 8.

[385] Van Huyssteen *et al* (n 57) 210; and Hutchison and Pretorius (n 228) 518.

[386] 2002 (4) SA 1 (SCA) 95.

dealings, the Constitutional Court in *Beadica 231 CC and others v Trustees for the Time Being of the Oregon Trust and others*[387] held:

> "Our law has always, to a greater or lesser extent, recognised the role of equity (encompassing the notions of good faith, fairness and reasonableness) as a factor in assessing the terms and the enforcement of contracts. Indeed, it is clear that these values play a profound role in our law of contract under our new constitutional dispensation. However, a court may not refuse to enforce contractual terms on the basis that the enforcement would, in its subjective view, be unfair, unreasonable or unduly harsh. These abstract values have not been accorded autonomous, self-standing status as contractual requirements. Their application is mediated through the rules of contract law; including the rule that a court may not enforce contractual terms where the term or its enforcement would be contrary to public policy. *It is only where a contractual term, or its enforcement, is so unfair, unreasonable or unjust that it is contrary to public policy that a court may refuse to enforce it*."[388]

This was confirmed in the earlier often-cited Constitutional Court judgment of *Barkhuizen v Napier*.[389] It is noteworthy that this judgment emphasised the importance of the maxim *pacta servanda sunt*, particularly in relation to the fact that it "gives effect to the central constitutional values of freedom and dignity".[390]

The requirement of legality is therefore important not only to determine whether a contract is lawful, but also to determine the extent of the court's power in making such a determination.[391] In the latter regard, the South African judiciary has proceeded cautiously when ascertaining whether contracts are contrary to public policy. In *Sasfin (Pty) Ltd v Beukes*, the court held:

> "The power to declare contracts contrary to public policy should … be exercised sparingly and only in the clearest of cases, lest uncertainty as to the validity of contracts result from an arbitrary and indiscriminate use of the power. One must be careful not to conclude that a contract is contrary to public policy merely because its terms (or some of them) offend one's individual sense of propriety and fairness."[392]

UNIVERSITY
JOHANNESBURG

This approach safeguards the principle of freedom to contract as well as considerations of certainty, all of which are fundamentally important to the effective operation of contracts. Moreover, it implies that South African courts favour valid contracts and will give effect to the intentions of the parties as far as possible.[393]

---

[387] [2020] JOL 47440 (CC).

[388] par 80.

[389] *Barkhuizen v Napier* 2007 5 SA 323 (CC) pars 56 and 69 (my emphasis).

[390] par 57.

[391] Van Eeden *Commercial Law in South Africa* (2017) 79.

[392] *Sasfin (Pty) Ltd v Beukes* (n 384) 9.

[393] Hutchison and Pretorius (n 228) 185; and Van Huyssteen *et al* (n 57) 210.

Possibility

This requirement entails that the obligation created by the contract must be possible for the other party to fulfil.[394] Where it is not possible for a party to perform, no obligation is created.[395] An obligation will be impossible to perform if the impossibility is so serious that no one can perform the obligation – in other words, there must be absolute or objective impossibility.[396] In the case of a contract struck by an event of objective impossibility, the contractual obligations may be extinguished upon the happening of such event.

Certainty

Despite its close connection to the requirement of possibility,[397] certainty of performance is a distinct requirement of a valid contract. The test for certainty is objective.[398] This means that in determining whether there is certainty of performance, the conduct or belief of the parties in relation to the conclusion of the contract or fulfilment of any of their obligations is irrelevant. The question, rather, is whether the meaning of the contract is clear and ascertainable from the wording of the contract. The process of ascertaining the meaning of the contract is facilitated through processes of interpretation, guided by admissible evidence and canons of construction.[399] The certainty requirement enables a court to nullify an agreement where the parties have failed to express clearly the performances undertaken by them or where they have failed to set out material aspects relating to the operation of the obligations.[400] Ultimately, a court cannot enforce uncertain terms.[401]

Uncertainty in a contract can take various forms, including ambiguity, inconsistent usage of words, vagueness, and the discretion of a party to the contract.[402] There is support for the view that a discretion in relation to the performance of the other party may be acceptable and enforceable where such discretion must be exercised against some or other standard or

UNIVERSITY OF JOHANNESBURG

[394] Hutchison and Pretorius (n 228) 213.

[395] Hutchison and Pretorius (n 228) 213–214.

[396] *Unibank Savings and Loans Ltd (formerly) Community Bank v ABSA Bank* 2000 (4) SA 191 (W) 198–C.

[397] Hence Schulze *et al* (n 215) 87 *et seq* discuss certainty in relation to possibility.

[398] Van Huyssteen *et al* (n 57) 260.

[399] For a treatise on the rules of contractual interpretation in South African law, see Cornelius *Principles of the Interpretation of Contracts in South Africa* (2016).

[400] Van Huyssteen *et al* (n 57) 260.

[401] Hutchison and Pretorius (n 228) 218.

[402] Adams *A Manual of Style for Contract Drafting* (2008) 127. See further Hutchison and Pretorius (n 228) 221–224.

criterion, provided a level of objectivity is maintained and the discretion is exercised reasonably.[403] A discretion exercised by an independent third party may also be acceptable and enforceable as long as the third party is identifiable and exercises the discretion in an objective manner.[404] However, a discretion to determine one's own performance or when one wishes to perform is unacceptable and invalid.[405]

5.4.2.3.2 Application

Consensus: It is questionable whether a true meeting of the minds occurs when the nominated bank accepts the mandate of the issuing bank. A fundamental element of the consensus requirement is that the offer, or the mandate in this case, must be complete, clear and certain. A nominated bank is not privy to the internal sanctions policies of the issuing bank and for this reason is not entirely certain that it will be reimbursed upon payment of a complying presentation. Indeed, the extent of the issuing bank's reimbursement obligations towards the nominated bank are rendered uncertain by the internal policies. This is also the case in respect of a sanctions clause affording the issuing bank a discretion relating to payment. Against this background it is submitted that the mandate of the issuing bank given to the nominated bank fails to meet this requirement.

Contractual capacity: The issue of the sanctions clause does not affect this requirement. This requirement therefore remains intact for the purposes of this analysis.

Formalities: Sanctions clauses are also unlikely to have an impact on this requirement.

Legality: While the sanctions clause is not illegal in that it does not contravene the common law or any legislation, it does open the door for the nominated bank to institute legal proceedings against the issuing bank on the basis that it, or its enforcement, is so unfair or unreasonable that it contradicts public policy. As the court in *Sasfin* stated, a term may be contrary to public policy if it is the result of "an arbitrary and indiscriminate use of the power". Furthermore, the fact that the nominated bank would have already performed in terms of the letter of credit (i.e., paid the complying presentation) and is merely seeking reimbursement in respect of its performance should play a role in the court's assessment of the unfairness or unreasonableness of the sanctions clause.

---

[403] Hutchison and Pretorius (n 228) 223.

[404] *Letaba Sawmills (Edms) Bpk v Majovi Bpk* 1993 SA 768 (A); and *Southernport Developments v Transnet* [2005] 2 All SA 16 (SCA).

[405] *Withok Small Farms (Pty) Ltd v Amber Sunrise Properties 5 (Pty) Ltd* 2009 (2) SA 504 (SCA); and *Murray and Murray and Another NO* [1959] 2 All SA 291 (W). See also *Williams and Taylor v Hitchcock* 1915 WLD 51.

Possibility: Reimbursement by the issuing bank is possible. The issuing bank's internal policies or discretion does not *physically* or *legally* prevent it from reimbursing the nominated bank. Hence, for the purposes of this analysis, this requirement will generally be fulfilled.

Certainty: A sanctions clause drawing attention to internal sanctions policies or a discretion will undoubtedly introduce uncertainty to the documentary-credit transaction. It is a well-established principle of South African contract law that a court will not enforce uncertain terms. The discretion of the issuing bank constitutes one which relates to the performance of its own obligations. In accordance with South African law such discretions give rise to uncertainty, and may conceivably be regarded as invalid and unenforceable. Furthermore, in some ways the issuing bank's obligation could be seen as subject to a potestative condition ("I will perform if I want to"),[406] in which case the requirement of certainty, and to an extent consensus, will not be satisfied. It is appropriate to quote the court in *Shell SA (Pty) Ltd v Corbitt and Another*:[407] "[no] contract is legally enforceable if it is made to depend solely upon the will of one of the parties what part he should perform".[408]

Against this background it is clear that the mandate given by the issuing bank to the nominated bank may, on account of a sanctions clause, fail to satisfy the requirements of a valid contract under South African law, in which case the mandate cannot be enforced against the nominated bank.

5.4.2.3.3 Severability

The conclusion reached immediately above is that sanctions clauses may render the mandate given by the issuing bank to the nominated bank invalid, since by virtue of its inclusion the mandate may fail to meet the requirements of a valid contract. Nevertheless, if the sanctions clause is severable from the remainder of the contract, the other terms and conditions could remain in force. The mandate is then only partially invalid. Although the issue of severability has arisen mostly in connection with restraint of trade and illegal clauses,[409] it can and has been considered in relation to other types of clauses, including those which are void for vagueness,[410]

[406] Van Huyssteen *et al* (n 57) 335 state that a condition is potestative "if its fulfillment depends on the will and corresponding act of one contractant who, upon fulfillment, becomes an unconditional debtor …".

[407] 1986 (4) SA 523 (C).

[408] 525.

[409] See Christie and Bradfield (n 214) 448 and 451.

[410] *Kriel v Hochstetter House (Edms) Bpk* 1988 (1) SA 220 (T).

those which become impossible,[411] as well those which do not comply with statutory formalities.[412] Nothing, therefore, prevents a South African court from considering severance in respect of a sanctions clause.

Whether a term is severable from the agreement depends on "the probable intention of the parties as it appears in, or can be inferred from, the terms of the contract as a whole."[413] In ascertaining the intention of the parties, the court must consider three questions:[414]

(i) Is the term in question grammatically or notionally distinct from the remainder of the agreement? In other words, is the term an independent clause in the contract that can be removed without reformulating the contract?
(ii) If the term in question is removed, will the substantial character of the contract remain unchanged? Severance should not affect the nature of the contract.
(iii) Would the parties have concluded the contract without the term in question? Courts treat this question as vital.

A court will only find in favour of severability if the answers to all three questions are in the affirmative.

While sanctions clauses are sometimes incorporated into force majeure clauses,[415] they are mostly separate clauses in letters of credit. Hence most sanctions clauses will meet the first leg of this severability test. But even where sanctions clauses form part of other clauses, they may be grammatically autonomous from the remainder of the clause in which case this first question will also be satisfied.

Secondly, the nominated bank is mandated to take delivery of the documents from the seller and, provided they are in conformance with the terms of the credit, pay the seller as mandatary of the issuing bank. Sanctions clauses in no way assist the nominated bank in carrying out its mandate; conversely, the nominated bank can perform its undertaking without a sanctions clause. This is to say that the operation of the contract is not dependent on the

---

[411] *Bob's Shoe Centre v Heneways Freight Services (Pty)* Ltd 1995 (2) SA 421 (A) 430.

[412] *Du Plooy v Sasol Bedryf (Edms) Bpk* 1988 (1) SA 438 (A).

[413] *Sasfin (Pty) Ltd v Beukes* (n 384) 16. See further *Collen v Rietfontein Engineering Works* [1948] 1 All SA 414; and *Interland Durban (Pty) Ltd v Walters* [1993] 3 All SA 437.

[414] *Sasfin (Pty) Ltd v Beukes* (n 384) 16-17; and *Benlou Properties (Pty) Ltd v Vector Graphics (Pty) Ltd* 1993 (1) SA 179 (A) 180–190.

[415] ReedSmith (n 334).

sanctions clause and so the contract can be fulfilled even if the sanctions clause is eliminated. Thus, the second question is satisfied.

Finally, as the nominated bank's mandate does not hinge on the existence of the sanctions clause, it stands to reason that the parties can enter into the contract without the sanctions clause. Sanctions clauses are a recent trend. Two decades ago, these clauses were unheard of in the letter-of-credit industry. Moreover, despite their increasing use, not all letters of credit are issued subject to sanctions clauses. This denotes that these instruments can and do operate successfully without sanctions clauses. Therefore, this question is also satisfied.

It follows that sanctions clauses may conceivably be severed from letters of credit. A nominated bank that does not wish to deal with the consequences of an invalid contract may request the court to sever the sanctions clause from the contract. If the court orders severance, the issuing bank may not raise its internal policies or discretion as a defence to reimbursement and must accordingly reimburse the nominated bank that has paid a complying presentation. The beneficiary of the letter of credit may also seek such an order for the purposes of payment under the letter of credit.

5.4.2.3.4 Conclusions

It is fair to say that sanctions clauses run counter to legal certainty and predictability, both of which are vitally important to the success of letters of credit and demand guarantees.[416] For beneficiaries, nominated banks and confirming banks, sanctions clauses imply a disproportionate risk of non-compliance by issuing banks. Underscored by some of the issues discussed above, the ICC has discouraged the practice of including sanctions clauses in trade finance instruments:

> "It is recommended that banks refrain from issuing or accepting trade finance instruments that include Sanctions clauses that purport to impose restrictions beyond those applicable to the performance of the obligation under the trade finance instruments as a matter of law. Broader sanctions clauses defeat the independence principle in letters of credit and demand guarantees, the exclusively documentary nature of the instrument, and create uncertainty."[417]

It is suggested that this view be given strong consideration when the use of sanctions clauses is contemplated.

---

[416] Johns and Blodgett "Fairness at the expense of commercial certainty: the international emergence of unconscionability and illegality as exceptions to the independence principle of letters of credit and demand guarantees" 2001 *Northern Illinois University Law Review* 297 297; and Marxen *Demand Guarantees in the Construction Industry: A Comparative Legal Study of Their Use and Abuse from a South African, English and German Perspective* (2017 thesis UJ) 73.

[417] ICC (n 329) 1–2.

5.4.3 Other non-documentary conditions

As the use of sanctions clauses continue to gain ground, so, too, may the use of other non-documentary conditions become an attractive sanctions risk-mitigation tool to issuing banks. Non-documentary conditions used in the sanctions context may conceptually relate to any stage of the transaction. For example, the issuing bank may request that the seller ship the goods on a "non-sanctioned vessel", without calling for documentary proof to that effect.[418] Or, that the duly authorised representative of the seller be required to personally present the documents so as to authenticate his/her identity against applicable sanctions lists and for the purposes of other sanctions compliance mechanisms.[419]

A discussion of the issues and challenges posed by non-documentary conditions was provided above in the context of sanctions clauses.[420] They will therefore not be revisited here. It suffices to say that non-documentary conditions run counter to traditional letter-of-credit and demand-guarantee practice. By undermining the documentary nature of these instruments, non-documentary conditions have the effect of eroding the certainty and predictability that the trade finance industry has come to know.

5.4.4 Unjustified amendments

Letters of credit and demand guarantees may be amended. An amendment can be described as an alteration to the terms of the instrument after it has been authorised. Amendments require the agreement of all the parties involved. Article 10(a) of the UCP 600 puts it thus: "Except as otherwise provided by article 38, a credit can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank, if any, and the beneficiary." Similarly, article 11(b) of the URDG 758 provides:

> "An amendment made without the beneficiary's agreement is not binding on the beneficiary. Nevertheless the guarantor is irrevocably bound by an amendment from the time it issues the amendment, unless and until the beneficiary rejects that amendment."

---

[418] This example is based on the set of facts in *Banque de l'Indochine et de Suez SA v JH Rayner (Mincing Lane)* (n 350). In this case the letter of credit contained a non-documentary condition which read as follows: "Shipment to be effected on vessel belonging to shipping company, member of an International Shipping Conference".

[419] This example is based on the set of facts in *Gian Singh* (n 350). In this case the non-documentary condition stipulated that the documents must be presented with the presenter's passport so that the bank could determine whether the signature on the passport corresponded with that on the documents.

[420] See par 5.4.2 above.

Amendments by beneficiaries are generally sought to remedy errors or inaccuracies that may otherwise lead to a rejection of the presentation. An example of such an error is where the quantity of the goods to be shipped as reflected on the instrument is incorrect. Or, that the guaranteed amount as reflected on the instrument is wrong. Amendments have the effect of fulfilling the transaction as originally intended.

Amendments are, however, also susceptible to financial-crime abuse. In its 2019 study guide, the Association of Anti-Money Laundering Specialists provides a comprehensive list of trade financing activities that typically indicate money laundering and terrorist financing, one of which is the significant amendment of letters of credit without any apparent justification.[421] Unjustified amendments have also been cited by several international organisations as risk indicators or red flags for the purposes of financial crime compliance.[422]

In the context of sanctions evasion, the aim of the unscrupulous beneficiary that seeks an amendment is to obscure or delete certain information that may otherwise trigger the imposition of targeted financial sanctions and ultimately a refusal to process payment. Such information could include, for instance, the identity of a sanctioned individual or entity, the fact that the ship on which the goods were carried voyaged through the waters of a sanctioned jurisdiction, or that the ship itself is a sanctioned vessel. Obviously, this information will not be communicated to any of the banks involved. Instead, the beneficiary will advance some spurious reason relating to the transaction in support of its request for the amendment.

It would be prudent to emphasise that a single amendment will not constitute a red flag for the purposes of financial crime compliance and, more particularly, sanctions compliance. It is only when multiple amendments with no apparent justification have been requested or effected that the transaction may be flagged as unusual and suspicious.

5.4.5 Conclusions

This section of the study dealt with the problematic documentary practices that banks have adopted or conceivably may adopt to manage their sanctions risk exposure. In this respect, regard was had to sanctions clauses and other sanctions-related non-documentary conditions. The issue of unjustified amendments by the beneficiary for the purposes of sanctions evasion was also explored.

UNIVERSITY OF JOHANNESBURG

[421] ACAMS (n 40) 190.

[422] Wolfsberg Group, ICC and BAFT (n 2) 45; and Hong Kong Association of Banks "Guidance paper on combating trade-based money laundering" (1 February 2016) 1 25.

5.5 General concluding remarks and analysis

As the focal point of this study, Chapter Five has comprehensively examined the impact of targeted financial sanctions on letters of credit and demand guarantees. The first part explored compliance with domestic targeted financial sanctions, while the second part explored compliance with foreign targeted financial sanctions. The research in both parts indicates that targeted financial sanctions may serve as a basis[423] upon which a bank may refuse to honour a (complying) presentation. The third part of the study explored the unorthodox documentary practices that banks have subscribed to or conceivably may adopt to manage their sanctions risk exposure. The issue of beneficiaries seeking unjustified amendments for the purposes of evading sanctions was also considered in part three. By interfering with payment and reimbursement, sanctions diminish the integrity and utility of letters of credit and demand guarantees.[424] The following remarks by Hugo and Strydom accurately summarise the general theme of this chapter:

> "… the once highly secure letter-of-credit business has become significantly more risky in these times of targeted financial sanctions. Beneficiaries are less certain of being paid and banks who have paid or have committed themselves to pay, may not be able to recover the money paid".[425]

Although these remarks refer only to letters of credit, they are equally fitting to the case of demand guarantees as well.

Uncertainty of payment runs counter to the commercial purpose of letters of credit and demand guarantees, which is to provide the beneficiary with the assurance of payment upon delivery of conforming documents.[426] And if credits and guarantees do not fulfil their commercial purpose, it is difficult to see why they would continue to be used in international trade and commercial transactions. In fact, trade finance practice has in recent years witnessed an increase in clean payment (that is, non-documentary) trading terms, which, ironically, may be counterproductive in so far as sanctions compliance is concerned. Marxen explains:

> "Changing and expanding financial crime legislation makes it increasingly difficult and cumbersome for banks and other parties involved in international trade and international trade finance to comply with applicable laws… In many cases, banks have responded by limiting

[423] While banks are under a legal obligation to comply with domestic sanctions, compliance with foreign sanctions is premised on strong business and reputational considerations. See in this regard pars 5.2.2 and 5.3.4 above respectively.

[424] See pars 5.2, 5.3 and 5.4 above.

[425] Hugo and Strydom (n 28) 130.

[426] On this commercial purpose, see *Phillips* (n 320) par G-H; and *United City Merchants (Investments) Ltd v Royal Bank of Canada (The American Accord)* [1983] 1 AC 168 183 (per Lord Diplock).

> their risk exposure … Significant de-risking decisions have been reported in international banking and trade finance which, in turn, have contributed to the emergence of clean payment trading terms in international contracts. Clean payment transactions, regrettably, deprive banks of transactional oversight and therefore limit their capabilities of identifying and reporting financial crime. The unintended consequences of de-risking and clean payment terms run counter to the initial aim of increasing customer and transactional monitoring and insight to scrutinise data for signs of financial crime."[427]

It stands to reason that an increase in the use of clean payment transactions[428] may have a negative effect on letter-of-credit and demand-guarantee usage.

Parties who, despite the above, seek to use the letter of credit or demand guarantee will also have to contend with the rising costs of banking and trade financing due to the onerous financial crime and sanctions compliance obligations and expectations imposed on banks.[429] Additionally, there is a growing expectation that banks involved in trade transactions should go even further (with further cost implications) by embarking on "vessel tracking" before processing payment.[430]

In conclusion, targeted financial sanctions seriously hinder the functionality of, and consequently the need for, letters of credit and demand guarantees. Left unaddressed, this issue may, in my view, raise doubt concerning whether these instruments remain "the lifeblood of international commerce".[431]

[427] Marxen (n 30) 183.

[428] International trade has seen a particularly strong increase in the use of advance payment and open account payment arrangements in recent years. For general background on these methods of payment, see pars 2.2.5.2 and 2.2.5.3 above respectively.

[429] See FATF (n 176) 4.

[430] See Updates "Tracking vessel voyages" (Jan 2018) *Documentary Credit World* 4.

[431] *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* (n 64). The phrase was repeated in *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976 (CA) 983; and *Intraco Ltd v Notis Shipping Corporation* (*the* Bhoja Trader) [1981] 2 Lloyd's Rep 256 (CA) 257. South African courts have also cited the phrase in *Ex parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W) 224H; and *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812 (A) 817E–F.

CHAPTER SIX: RECOMMENDATIONS AND INITIATIVES TOWARDS MITIGATING THE IMPACT OF TARGETED FINANCIAL SANCTIONS ON LETTERS OF CREDIT AND DEMAND GUARANTEES

6.1 Introduction

As was indicated in Chapter One,[1] the primary purpose of this study was to investigate fully the impact of targeted financial sanctions on letters of credit and demand guarantees from a South African perspective. This investigation was set out in Chapter Five. As background to the investigation, Chapter Two introduced letters of credit and demand guarantees and Chapter Three provided an overview of targeted financial sanctions with a particular focus on the legal and regulatory frameworks within which they operate. Chapter Four evaluated the role and contribution of the key international organisations that deal with targeted financial sanctions.

It is clear from the investigation that banks are expected not to process payment or facilitate the letter-of-credit or demand-guarantee transaction if the documents disclose a sanctioned individual or entity.[2] A South African bank that refuses payment on the basis of compliance with domestic sanctions may raise the defence of legal impossibility of performance, which emerges from the South African law of contract. This defence, however, is not available to a South African bank that refuses payment to comply with foreign sanctions. Consequently, a South African bank that complies with foreign sanctions is not afforded legal protection and may attract litigation from the beneficiary in respect of payment. Compliance with foreign sanctions is motivated by strong business and reputational considerations.

It is also clear from the investigation that banks involved in letter-of-credit and demand-guarantee transactions have adopted or conceivably may adopt problematic documentary practices to limit their sanctions risk exposure.[3] Such practices may take the form of so-called sanctions clauses and other sanctions-related non-documentary conditions. The practice of beneficiaries seeking unjustified amendments for the purposes of evading sanctions is also a problematic issue in this regard. Ultimately, the investigation has found that targeted financial

[1] par 1.2 above.

[2] pars 5.2–5.3 above.

[3] par 5.4 above.

sanctions render letters of credit and demand guarantees risky, which means that payment and reimbursement are less secure.[4]

Against this background, the following general initiatives have been identified to mitigate the sanctions problems and risks identified in relation to letters of credit and demand guarantees, and will receive further attention below: (i) an understanding of the sanctions risks, (ii) conducting a proper sanctions risk assessment, (iii) best practice on the use and formulation of sanctions clauses, and (iv) inter-bank communication. Save for (iv), these initiatives suggest that the mitigation of sanctions risks and problems is best approached in terms of prevention. In other words, parties to letter-of-credit and demand-guarantee transactions are more likely to be spared the impact of targeted financial sanctions if mitigation initiatives are implemented properly *prior* to the issuance of credits and guarantees.

But before dealing with these four initiatives, it is necessary to comment on the approach of current compliance measures aimed at combating financial crime in relation to letters of credit and demand guarantees – which may or may not be regulatory efforts but nevertheless translate into expectations for banks. While this issue does not directly concern the impact of sanctions on these instruments, it is nevertheless relevant and worthy of consideration. Today, almost all anti-financial crime frameworks consist of the same or similar mechanisms and tools for combating financial crime. Most noteworthy in this regard are due diligence investigations, risk assessments, risk indicators, sanctions screening and transaction monitoring.[5] The frequency and manner in which these measures are applied may vary from transaction to transaction. For instance, the level of due diligence and scrutiny that is appropriate for advance payment arrangements is typically low or regular, while due diligence in respect of letter-of-credit transactions is mostly heightened.[6] This variation in the application of compliance mechanisms is a consequence of the varying levels of risk associated with the particular transaction. Hence compliance measures in respect of letters of credit are heightened because they are perceived to be "high-risk".[7]

UNIVERSITY
OF
JOHANNESBURG

---

[4] par 5.5 above.

[5] See Wolfsberg Group, ICC and BAFT *Trade Finance Principles* (2019) 18–22. Also see generally Chapter Three.

[6] Marxen "Traditional trade finance instruments a high risk? a critical view of current international initiatives and regulatory measures to curb financial crime" in Hugo (ed) *Annual Banking Law Update* (2018) 161 172.

[7] Chatain *et al Preventing Money Laundering and Terrorist Financing – A Practical Guide for Bank Supervisors* (2009) 223; and Wolfsberg Group, ICC and BAFT (n 5) 8.

This, it is submitted, is nothing more than a perception, as no evidence of this high-risk nature has been provided.[8] In fact, in a recent joint report of the FATF and Egmont Group, the complete opposite was reported:

> "… [P]aying methods like letters of credit or documentary collection, which require customers to provide the [financial institution] with more documentation than open-account trade, are often seen by the private sector as less vulnerable to [trade-based money laundering]. Thus, money launderers may see open account trade as more attractive because the [financial institution] has more limited oversight of the transaction."[9]

Although these remarks concern specifically trade-based money laundering, they can be taken to apply to financial crime in general. Moreover, it has been argued (convincingly in my view) that the current focus of compliance on documentary payment methods and especially letters of credit "is probably ill-placed and does not represent the most efficient way of channeling and applying compliance resources."[10] It is therefore doubtful whether claims made regarding the high-risk nature of letters of credit and (by implication) demand guarantees are justified. They should probably be reconsidered.

Against this background, it is recommended that current compliance requirements and expectations should be re-adjusted in so far as strong emphasis is placed on documentary trade finance products.[11] Of course this does not mean that these trade finance products should not be made subject to compliance exercises. Rather, it means that the approach to compliance exercises in respect of letters of credit and demand guarantees in particular should not be different to those in respect of any other commercial transaction. Although such reform is likely to assist in reducing the impact of sanctions on letters of credit and demand guarantees, it is probably not the most appropriate and feasible solution in this regard. Processes of reform are generally lengthy and complex, with amendments and regulatory changes typically materialising several years after the initiation of the reformatory process.[12] Thus, to address the immediate sanctions concerns of the letter-of-credit and demand-guarantee communities, it is

---

[8] Sindberg "Combating trade based money laundering: rethinking the approach" www.lcviews.com/index/php?page_id=599 (accessed on 1 April 2021).

[9] FATF and Egmont Group *Trade-Based Money Laundering Trends and Developments* (2020) 42.

[10] Marxen (n 6) 182.

[11] See, in this regard, Hugo and Strydom "Sanctions, ships, international sales and security of payment" in Vrancken and Hugo (eds) *African Perspectives on Selected Marine, Maritime and International Trade Law Topics* (2020) 109 133.

[12] For instance, FATF mutual evaluation reports, which have a direct impact on whether member jurisdictions should under-go regulatory changes, are published roughly every 8–11 years. This is in addition to the country's own reformatory processes. See the "frequently asked questions" relating to mutual evaluations on the FATF's website https://www.fatf-gafi.org/faq/mutualevaluations/ (accessed on 2 December 2021).

suggested that the four initiatives referred to above should be considered carefully, at least in addition to the recommended reform.

6.2 Understanding the risks

It is imperative that parties to underlying commercial transactions are aware of the potential sanctions risks when opting to use letters of credit and demand guarantees. The risk of non-performance, and especially non-payment by the paying bank, is very real: not only will the manifestation of a sanctioned individual or entity trigger a refusal to authorise payment, but a mere suspicion by the bank of a sanctions contravention (which will be informed by the presence of several risk indicators) may well also interfere with payment.[13] Even in cases where the presence of a sanctioned party or suspicious activity is absent, sellers (in this context – beneficiaries) run the risk of not receiving payment expeditiously. The extremely broad scope of sanctions compliance expectations and reporting obligations on banks translate into an extremely onerous area for them,[14] which may result in transactional delays and setbacks. Additionally, the parties must be mindful of the risks posed by sanctions clauses, which are increasingly encountered in letters of credit and demand guarantees. Particular attention must be directed to those sanctions clauses that make reference to the bank's internal sanctions policies or discretion in relation to honouring the credit or guarantee.[15]

It is accordingly wise for sellers to be cognisant of, and sufficiently knowledgeable on, sanctions risks. In doing so, sellers are better placed to assess the advantages and disadvantages in the underlying transaction and ultimately whether the transaction will be best facilitated and realised by the credit or guarantee.

UNIVERSITY
OF
JOHANNESBURG

6.3 Sanctions risk assessment

The most effective way, it is suggested, to deal with sanctions risks, particularly those in relation to sanctioned individuals or entities, is to detect and prevent them early. Undoubtedly, the party in the best position to do so is the issuing bank. In a typical letter-of-credit scenario

---

[13] See, for instance, sec 4 of the Protection of Constitutional Democracy against Terrorist and Related Activities Act (POCDATARA) 38 of 2001 and sec 26B of the Financial Intelligence Centre Act (FICA) 33 of 2004, which require the imposition of targeted financial sanctions where a bank has actual knowledge of the existence of a sanctioned party and where a reasonable suspicion of a sanctioned party exists. The factors that may inform such a suspicion include irregular trade structures, nonsensical non-standard clauses and partial and multiple presentations, to name a few. See par 5.2.2 above.

[14] Spruyt "A legal analysis of the duty on banks to comply with targeted financial sanctions" 2020 *TSAR* 1 24.

[15] See the recommendations on sanctions clauses in par 6.4 below.

the applicant is required to fill out an application form which will include all the main particulars of the credit, including the parties' names, registration or identity numbers, the expiration date of the credit, the origin and intended destination of the goods, shipping terms and the documents required to trigger payment.[16] From a compliance perspective, however, this information is not sufficient. Thus, banks are increasingly required to go further by concerning themselves with the underlying transaction as well.[17] With this wealth of information now at its disposal, the issuing bank can conduct a thorough sanctions risk assessment of the prospective transaction.[18] This study has already considered sanctions risk assessments in some detail.[19] The purpose of a sanctions risk assessment is to determine whether a particular business relationship or transaction involves any sanctioned individuals or entities.[20]

A sanctions risk assessment, if conducted properly, will enable the bank to make an informed decision as to whether it should or should not issue the credit. The bank that picks up a reference in the documents or in the underlying transaction to a sanctioned individual or entity will, by refusing to issue the credit, avoid entirely the need to conduct subsequent and on-going sanctions compliance tasks and investigations. This applies also to the bank that strongly suspects the involvement of a sanctioned person or entity. At the risk of stating the obvious, the bank's refusal in this regard means that the beneficiary will not also be affected by sanctions. Issuing banks and guarantors will accordingly do well not to underestimate the importance of conducting a (proper) sanctions risk assessment, especially prior to the issuance of the letter of credit or guarantee.

UNIVERSITY
OF
JOHANNESBURG

[16] Adodo *Letters of Credit: The Law and Practice of Compliance* (2014) 29 par 2.03; and Bridge *Benjamin's Sale of Goods* (2014) 2012 par 23–004.

[17] Marxen (n 6) 165. See also Byrne and Berger *Trade Based Financial Crime Compliance* (2017) 174.

[18] In South Africa, the obligation of the bank to scrutinise the client relationship is contained in sec 28A(3) of the Financial Intelligence Centre Amendment Act 1 of 2017. The sec requires of the bank, as a so-called "accountable institution", to "scrutinise its information concerning clients with whom the accountable institution has business relationships in order to determine whether any such client is a person or entity mentioned in the proclamation by the President or the notice by the Director."

[19] See generally Chapter Three.

[20] The Financial Intelligence Centre (FIC) puts it thus: "Accountable institutions must therefore determine the likelihood that their client base and intended target market may include sanctioned persons or entities. This should assist the accountable institution in determining the amount of effort and resources it requires in order to determine whether they have sanctioned persons or entities as a clients [sic] or whether prospective clients are sanctioned persons or entities. Accountable institutions that have business relationships with foreign persons and entities are more vulnerable to dealing with sanctioned persons and entities." See FIC *Guidance Note 7: On the Implementation of Various Aspects of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* (2017) par 199.

The risk indicators that inform these assessments merit comment. The general approach is that, in accordance with the risk-based approach,[21] the presence of multiple risk indicators (as opposed to a single risk indicator) will raise suspicion[22] and in turn may trigger the imposition of targeted financial sanctions or, in the context of the present discussion, a refusal to issue the letter of credit or demand guarantee. However, this should not be taken to mean that the presence of a single risk indicator cannot be significant enough to justify a refusal. For example, an international contract of sale that does not call for salient, standard documentation, such as a transport document, may – and probably should – by itself constitute a strong suspicion. At the very least it should serve as motivation to enquire from the applicant about the missing document.

Sanctions screening exercises are also a key feature of sanctions risk assessments. By matching data against sanctions lists, these exercises have the ability to determine whether any of the parties involved are sanctioned for the purposes of United Nations sanctions as well as unilateral sanctions imposed by particular jurisdictions. It is submitted that sanctions screening performed at the time of contemplating the issuance of the credit or guarantee is the most effective tool in identifying sanctioned persons and entities. The effectiveness and strength of a screening exercise, however, are dependent on the accuracy of the transactional information available to the bank. Correct information will assist in identifying true positive hits (i.e., sanctions violations) and reducing the occurrence of so-called false hits or false positives. These terms have been described as follows:

> "A false hit is where a partial or unconfirmed match occurs between bank data and the data in the relevant list. A partial match will occur where target names have similar or common elements with non-targets. An unconfirmed match, [or false positive], would occur if the names match, but investigation confirms that the underlying identities are not the same."[23]

Therefore, it is essential for banks to ensure that the information provided on the credit or guarantee application is legible (in the case of paper-based applications), certain and complete.

---

[21] On the risk-based approach in South Africa, see Hugo and Spruyt "Money laundering, terrorist financing and financial sanctions: South Africa's response by means of the Financial Intelligence Centre Amendment Act 1 of 2017" 2018 *TSAR* 227 236 *et seq*; and Spruyt "The Financial Intelligence Centre Amendment Act and the application of a risk-based approach" in Hugo and du Toit (eds) *Annual Banking Law Update* (2017) 19 21 *et seq.* See further par 3.6.4 above.

[22] Financial Intelligence Centre *Guidance Note 4B: On Reporting of Suspicious and Unusual Transactions and Activities to the Financial Intelligence Centre in Terms of Section 29 of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* par 23; and FATF "Trade-based money laundering: risk indicators" (March 2021) https://www.fatf-gafi.org/media/fatf/content/Trade-Based-Money-Laundering-Trends-and-Developments.pdf 2 (accessed on 10 June 2022).

[23] Wolfsberg Group, ICC and BAFT (n 5) 19.

6.4 Sanctions clauses: their use and formulation

The increasing use of sanctions clauses in letters of credit and demand guarantees can be attributed to the dramatic increase in compliance laws and regulations and expectations in recent years. This study has provided a comprehensive analysis of the use of sanctions clauses.[24] As noted above,[25] sanctions clauses referencing the issuing bank's internal policies or a discretion in relation to honouring the credit or guarantee imply a disproportionate risk of non-compliance by issuing banks. Bearing in mind the extent to which the issues associated with such clauses impact upon the operation and fundamental character of letters of credit and demand guarantees,[26] the ineluctable conclusion to be drawn is that this practice is untenable and must be discontinued. This conclusion is consistent with the position of the ICC:

> "It is recommended that banks refrain from issuing or accepting trade finance instruments that include Sanctions clauses that purport to impose restrictions beyond those applicable to the performance of the obligation under the trade finance instruments as a matter of law. Broader sanctions clauses defeat the independence principle in letters of credit and demand guarantees, the exclusively documentary nature of the instrument, and create uncertainty."[27]

Certain circumstances may conceivably, however, justify the inclusion of a sanctions clause. In such instances it is suggested that references to internal policies or a discretion must be avoided at all costs and that the recommended sanctions clauses of the ICC and IIBLP must be taken into consideration when formulating the clause. The ICC's sanctions clause reads as follows:

> "[notwithstanding anything to the contrary in the applicable ICC Rules or in this undertaking,] We disclaim liability for delay, non-return of documents, non-payment, or other action or inaction compelled by restrictive measures, counter-measures or sanctions laws or regulations mandatorily applicable to us or to [our correspondent banks in] the relevant transaction."[28]

[24] See par 5.4.2 above.

[25] par 5.4.2.3.4 above.

[26] The issues in this regard primarily stem from the non-documentary nature of such sanctions clauses. See par 5.4.2.2 above in this respect.

[27] ICC "Addendum to the ICC guidance paper on the use of sanctions clauses (2014)" https://iccwbo.org/content/uploads/sites/3/2014/08/Guidance-Paper-on-The-Use-Of-Sanctions-Clauses-In-Trade-Finance-Related-Instruments-Subject-To-ICC-Rules.pdf 5 par 4.1 (accessed on 11 June 2022).

[28] ICC "Guidance paper on the use of sanctions clauses in trade finance-related instruments subject to ICC rules" https://iccwbo.org/content/uploads/sites/3/2020/05/20200504-addendum-to-sanction-clauses-paper.pdf 2 (accessed on 11 June 2022).

The IIBLP's sanctions clause reads as follows:

> "We disclaim liability for delay, non-return of documents, non-payment, or other action or inaction compelled by a judicial order or government regulation applicable to us [or our service providers]."[29]

Both clauses draw attention only to applicable sanctions laws and regulations and therefore do not include a reference to internal policies or a discretion. Moreover, they do not include vague and generalised terms which increase the danger of incoherence.[30] Accordingly, if the inclusion of a sanctions clause is deemed necessary, it is suggested that these or similar clauses should be used, since they do not give rise to the issues and difficulties that have been identified in this thesis.

6.5 Inter-bank communication

In a typical letter-of-credit scenario, the issuing bank and the additional bank (which may, for instance, be a nominated or confirming bank, or both) will normally communicate, by means of SWIFT,[31] at only two stages of the transaction. Firstly, the issuing bank will request the additional bank to perform a function in the transaction. This communication occurs prior to, or at the time of, the issuance of the credit. Secondly, upon the presentation of documents by the beneficiary to the additional bank and the subsequent payment of the credit by it, the additional bank will call on the issuing bank to effect reimbursement. This communication between the issuing bank and the additional bank usually concludes the letter-of-credit transaction.

It is submitted that periodic communication between banks for the purposes of drawing attention to sanctions violations, sanctioned parties or other sanctions-related issues may prove useful. The issuing bank can, for example, provide the additional bank with a summary of its transactional sanctions risk assessment at the time the services of the additional bank are requested. This will provide the additional bank with more context and will enable it to better determine whether it should or should not accept the request. Should any of the parties make

---

[29] IIBLP "IIBLP Sanctions clause" *2019 New York Events Conference Materials (Institute of International Banking Law and Practice)* (2019) 57 57.

[30] It is nevertheless conceivable that the phrase "applicable to us" quoted in both clauses may be susceptible to different interpretations. The question whether the phrase refers only to domestic sanctions or also to foreign sanctions may in practice emerge as a source of contention. See, for instance, ICC Banking Commission Document 470/TA920rev (October 2021) 4, with reference to the term "indirectly".

[31] The acronym stands for "Society for Worldwide Interbank Financial Telecommunications" and is described on its official website as "a global member-owned cooperative and the world's leading provider of secure financial messaging services". See https://www.swift.com/about-us/discover-swift (accessed on 6 December 2021).

their way onto a sanctions list during the course of the transaction, this information can also be communicated between the banks. Moreover, it is suggested that periodic communication can be used as a tool to iron out transactional suspicions or uncertainties that may otherwise trigger a refusal to authorise payment or process the transaction. In this way, inter-bank communication can be seen as a means of mitigating the impact of sanctions.

Although not standard trade finance practice, inter-bank communication relating to sanctions does not appear to be in conflict with any legal or practical aspect of the letter-of-credit or demand-guarantee transaction. It is also unlikely to infringe upon privacy laws and regulations since the additional bank, by virtue of a contract of mandate, is a party to the transaction and is thus entitled to information within the scope of the transaction. From a financial crime compliance perspective, furthermore, communication between the banks relating to sanctions will better place the banks to identify financial crime and to act accordingly. Such communication can be seen as consistent with anti-financial crime expectations and is likely to enhance the compliance experience.[32]

Having said that, inter-bank communication relating to sanctions is not without drawbacks. Not only does it constitute a time-consuming endeavour, it may also lead to increased costs and expenses which are likely to be borne by the issuing bank. These considerations must also be taken into account when the viability of this initiative is considered.

6.6 General conclusion

A letter of credit is an instrument of payment and a demand guarantee, an instrument of security. Both are regularly used in trade and commercial dealings. Their importance to international trade and commerce has led courts to describe them as the "lifeblood of international commerce".[33] Letters of credit and demand guarantees were introduced and discussed in Chapter Two.

As a key mechanism in combating financial crime, targeted financial sanctions have emerged prominently in recent years. Their use has been endorsed by leading international organisations such as, and especially, the United Nations and the Financial Action Task Force. This has prompted jurisdictions around the world to implement and enforce targeted financial

[32] Information sharing has long been identified as instrumental in fighting financial crime. See BAFT "Combatting trade based money laundering: rethinking the approach" https://www.amlc.nl/wp-content/uploads/2018/11/baft17_tmbl_paper.pdf 8–9 (accessed on 20 May 2022).

[33] *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* 1977 (2) All ER 862 (QB) 870b per Kerr J; *Ex parte Sapan Trading (Pty) Ltd* 1995 1 SA 218 (W) 224H; and *Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd* 1996 (1) SA 812 (A) 816E and I.

sanctions. This is particularly true of South Africa, where banks are legally obligated to comply with domestic targeted financial sanctions. An overview of targeted financial sanctions with specific reference to the legal and regulatory frameworks within which they operate was provided in Chapter Three. The role and contribution of the key international organisations that deal with targeted financial sanctions was provided in Chapter Four.

Targeted financial sanctions do not relate harmoniously with letters of credit and demand guarantees. The main problem is that these sanctions have the effect of interfering with payment (and reimbursement), particularly where reference is made in the documents to a sanctioned individual or entity. To mitigate sanctions risks, moreover, banks have adopted or conceivably may adopt (problematic) documentary practices, the most significant of which is the use of sanctions clauses. Chapter Five has comprehensively investigated this relationship.

Notwithstanding the seemingly risky nature of letters of credit and demand guarantees in times of targeted financial sanctions, these instruments still hold much commercial value. The letter of credit is the only payment instrument that balances the interests of all the parties to the underlying contract. And the demand guarantee is the only security instrument that offers almost immediate access to funds upon mere demand. Letters of credit and demand guarantees should therefore be retained as the "lifeblood of international commerce".

The thesis concludes by expressing the hope that this research will contribute towards a proper understanding of the relationship between targeted financial sanctions and letters of credit and demand guarantees, as well as of the mitigation of the impact of these sanctions on these instruments.

UNIVERSITY
OF
JOHANNESBURG

BIBLIOGRAPHY

1. Books and theses

Adams K *A Manual of Style for Contract Drafting* (2008)

Adodo E *Letters of Credit: The Law and Practice of Compliance* (2014)

Affaki G and Goode R *Guide to ICC Uniform Rules for Demand Guarantees (URDG 758)* (2011)

Amaefule C *The Exceptions to the Principle of Autonomy of Documentary Credits* (2011 thesis University of Birmingham)

Andrew G and Millett R *Law of Guarantees* (2011)

Bailey J *Construction Law Volume III* (2011)

Baker D and Brandel R *The Law of Electronic Fund Transfer Systems* (2001)

Beaucillon C (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021)

Bertrams R *Bank Guarantees in International Trade* (2013)

Bird J *Bird's Insurance Law in the United Kingdom* (2010)

Bridge M *Benjamin's Sale of Goods* (2014)

Bollen R *The Law and Regulation of Payment Services – A Comparative Study* (2012)

Boutros-Ghali B *Supplement to an Agenda for Peace* (1995)

Byrne J (ed) *LC Rules & Laws: Critical Texts for Independent Undertakings* (2018)

UNIVERSITY
OF
JOHANNESBURG

Byrne J and Berger J *Trade Based Financial Crime Compliance* (2017)

Carr I *International Trade Law* (2010)

Chatain P *et al Preventing Money Laundering and Terrorist Financing – A Practical Guide for Bank Supervisors* (2009)

Chesterman S, Franck T and Malone D *Law and Practice of the United Nations* (2008)

Chivizhe T *A Comparative Study of the Law and Practice Relating to the Compliance of Documents Calling for Payment under Letters of Credit and Demand Guarantees* (2021 thesis NWU)

Christie RH and Bradfield G *Christies Law of Contract in South Africa* (2016)

Chuah J *Law of International Trade: Cross-border Commercial Transactions* (2013)

Cornelius SJ *Principles of the Interpretation of Contracts in South Africa* (2016)

Cranston R *Principles of Banking Law* (2007)

Dugard J *International Law: A South African Perspective* (2012)

Ellinger P *Documentary Letters of Credit* (1970)

Ellinger P, Lomnicka E and Hare C *Ellinger's Modern Banking Law* (2011)

Ellinger P and Neo D *The Law and Practice of Documentary Letters of Credit* (2010)

Enonchong N *The Independence Principle of Letters of Credit and Demand Guarantees* (2011)

Finsen E *The Building Contract: A Commentary on the JBCC Agreements* (2018)

UNIVERSITY OF JOHANNESBURG

Forsyth CF and Pretorius JT *Caney's Law of Suretyship in South Africa* (2010)

Forsyth CF *Private International Law: the Modern Roman-Dutch Law Including the Jurisdiction of the High Courts* (2012)

Gao X *The Fraud Rule in the Law of Letters of Credit* (2002)

Giumelli F *Coercing, Constraining and Signalling: Explaining and Understanding International Sanctions after the End of the Cold War* (2011)

Hahlo H and Khan E *The South African Legal System and Its Background* (1968)

Hapgood M *Paget's Law of Banking* (2003)

Harms LTC *Civil Procedure in the Superior Courts* (2003)

Heimann F and Pieth M *Confronting Corruption* (2018)

Higgins R *The Development of International Law through the Political Organs of the United Nations* (1963)

Hoctor SV *Snyman's Criminal Law* (2021)

Horowitz D *Letters of Credit and Demand Guarantees: Defences to Payment* (2010)

Hosten WJ *et al Instruction to South African Law and Legal Theory* (1995)

Hufbauer G, Schott J, K Elliot and Oegg B *Economic Sanctions Reconsidered* (2009)

Hugo CF *The Law Relating to Documentary Credits from a South African Perspective with Special Reference to the Legal Position of the Issuing and Confirming Banks* (1996 thesis Stellenbosch University)

Hutchison D, Pretorius CJ and Du Plessis J *The Law of Contract in South Africa* (2012)

UNIVERSITY OF JOHANNESBURG

Hutchison D and Pretorius CJ (eds) *The Law of Contract in South Africa* (2017)

Kelley G *Construction Law* (2013)

Kelly-Louw M *Selective Legal Aspects of Bank Demand Guarantees* (2008 thesis UNISA)

Klee L *International Construction Contract Law* (2015)

Kolb R *An Introduction to the Law of the United Nations* (2010)

Kurkela M *Letters of Credit and Bank Guarantees under International Trade Law* (2008)

Loggerenberg DE *Erasmus: Superior Court Practice Volume II* (2016)

Malek A and Quest D *Jack: Documentary Credits* (2009)

Malan FR, Pretorius JT and Du Toit SF *Malan on Bills of Exchange, Cheques and Promissory Notes in South African Law* (2009)

Marxen K *Demand Guarantees in the Construction Industry: A Comparative Legal Study of Their Use and Abuse from a South African, English and German Perspective* (2017 thesis UJ)

Mckendrick E *Goode on Commercial Law* (2017)

Merkin R and Steele J *Insurance and the Law of Obligations* (2013)

Mugasha A *The Law of Letters of Credit and Bank Guarantees* (2003)

Oelofse AN *The Law of Documentary Letters of Credit in Comparative Perspective* (1997)

Reinecke FMB, Van Niekerk JP and Nienaber PM *South African Insurance Law* (2013)

Schulze W *et al General Principles of Commercial Law* (2019)

UNIVERSITY OF JOHANNESBURG

Sharrock R *Business Transactions Law* (2011)

Simma B (ed) *The Charter of the United Nations: A Commentary* (2002)

Sonnekus J *Unjustified Enrichment in South African Law* (2017)

South African Institution of Civil Engineering *Management Guide to the General Conditions of Contract* (2010)

Subedi S (ed) *Unliteral Sanctions in International Law* (2021)

Sykes E and Pryles M *Australian Private International Law* (1991)

Szabados T *Economic Sanctions in EU Private International Law* (2020)

Tams C *Enforcing Obligations Erga Omnes in International Law* (2005)

Van Eeden E *Commercial Law in South Africa* (2017)

Van der Puil J and Van Weele AJ *International Contracting* (2014)

Van der Merwe S *et al Contract: General Principles* (2003)

Van Huyssteen LF, Lubbe GF, Reineke MBF and Du Plessis JE *Contract: General Principles* (2020)

Van Jaarsveld IL *Aspects of Money Laundering in South African Law* (LLD thesis UNISA) (2011)

Van Niekerk J and Schulze W *The South African Law of International Trade: Selected Topics* (2016)

Visser D *Unjustified Enrichment* (2008)

UNIVERSITY OF JOHANNESBURG

Von der Goltz C *Deferred Payment Credits as Special Types* of *Documentary Credits* (1998 dissertation Stellenbosch University)

Wilmont-Smith R *Construction Contracts Law and Practice* (2010)

Wolff C *Law of Cross-Border Business Transactions Principles, Concepts, Skills* (2013)

Zarate J *Treasury's War: The Unleashing of a New Era of Financial Warfare* (2013)

Zimmermann R *The Law of Obligations: Roman Foundations of a Civilian Tradition* (1990)

2. Journal articles and book chapters

Afesorgbor SK "The impact of economic sanctions on international trade: how do threatened sanctions compare with imposed sanctions?" 2019 *European Journal of Political Economy* 11

Afriyie F and Jian J "An investigation of economic sanctions and its implications for Africa" 2018 *Journal of Politics and Law* 74

Aiolfi G and Bauer H-P "The Wolfsberg Group" in Pieth (ed) *Collective Action: Innovative Strategies to Prevent Corruption* (2012) 97

Ali M and Iqbal S "Sanctions and childhood mortality in Iraq" 2000 *The Lancet* 1851

Amariles D and Winkler M "U.S. economic sanctions and the corporate compliance of foreign banks" 2018 *The International Lawyer* 497

Barru D "How to guarantee contractor performance on international construction projects: comparing surety bonds with bank guarantees and standby letters of credit" 2005 *The George Washington International Law Review* 51

Beaucillon C "An introduction to unilateral and extraterritorial sanctions: definitions, state of practice and contemporary challenges" in Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 5

Bergsten E "A new regime for international independent guarantees and stand-by letters of credit: the UNCITRAL Draft Convention on Guaranty Letters" (1993) 27 *International Lawyer* 859

Biersteker TJ "Targeted sanctions and individual human rights" 2009 *Int'l J* 99

Borgers MJ "Confiscation of proceeds of crime: the European Union framework" in King and Walker (eds) *Dirty Assets: Emerging Issues in the Regulation of Criminal and Terrorist Assets* (2014) 27

Boscariol J *et al* "Export controls and economic sanctions" in *The Year in Review An Annual Publication of the ABA/Section of International Law* (Spring 2016) 27

Botosh H "Evaluation of the conditional-absolute payment issue in letters of credit: identifying which position provides maximum party autonomy, certainty, flexibility, fairness and good faith" 2016 *International Journal of Economics and Law* 9

Byrne J "The International Standby Practices (ISP98): new rules for standby letters of credit" (Fall 1999) 32 *Uniform Commercial Code Law Journal* 149

Cameron "UN targeted sanctions, legal safeguards and the European Convention on human rights 2003 *Nordic Journal of International Law* 159

Carter B and Farha R "Overview and operation of the evolving US financial sanctions, including the example of Iran" *Proceedings of the Annual Meeting (American Society of International Law)* (2013) 315

Caruso R "The impact of international economic sanctions on trade: empirical evidence over the period 1960-2000" 2005 *Rivista Internazionale Di Scienze Sociali* 41

UNIVERSITY
OF
JOHANNESBURG

Chivizhe T and Hugo C "Non-documentary conditions in letters of credit and demand guarantees" in Hugo (ed) *Annual Banking Law Update* (2021) 1

Clark HL "Dealing with U.S. extraterritorial sanctions and foreign countermeasures" 2004 *University of Pennsylvania Journal of International Economic Law* 455

Clive E and Hutchison D "Breach of contract" in Zimmermann, Visser and Reid (eds) *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004) 176

Cockrell A "Breach of contract" in Zimmermann and Visser (eds) *Southern Cross Civil Law and Common Law in South Africa* (1996) 303

Davis L and Engerman S "Sanctions: neither war nor peace" 2003 *Journal of Economic Perspectives* 187

Dawidowics M "Public law enforcement without public law safeguards? an analysis of state practice on third-party countermeasures and their relationship to the UN Security Council" 2007 *British Yrbk Int'l L* 333

De Koker L and Smit P "The combating of money laundering, financing of terrorism and proliferation financing" in de Koker (ed) *Money Laundering and Terror Financing Law and Compliance in South Africa* (2020) 1

De Koker L and Smit P "Key money laundering offences" in de Koker (ed) *Money Laundering and Terror Financing: Law and Compliance in South Africa* (2020) 31

De Koker L and Smit P "Key terror financing and international financial sanctions offences" in de Koker (ed) *Money Laundering and Terror Financing: Law and Compliance in South Africa* (2020) 75

De Ly F "The UN Convention on independent guarantees and stand-by letters of credit" 1999 *The International Lawyer* 831

Dinh VD and Wold MM "Extraterritorial application of US law" in Blair, Brent and Grant (eds) *Banks and Financial Crime: The International Law of Tainted Money* (2017) 485

Dodge WS "Extraterritoriality and conflict-of-laws theory: an argument for judicial unilateralism" 1998 *Harvard International Law Journal* 101

Dolan JF "The UN Convention on International Independent Undertakings: do states with mature letter-of-credit regimes need it?" (1998) *Banking and Finance Law Review* 1

Drezner DW "Targeted sanctions in a world of global finance" 2015 *International Interactions* 755

Du Plessis J "Comparative law and the study of mixed legal systems" in Reimann and Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2019) 474

Dunlap CJ "Lawfare today: a perspective" 2008 *Yale J Int'l Affairs* 146

Eckert SE "The evolution and effectiveness of UN targeted sanctions" in Van Den Herik (ed) *Research Handbook on UN Sanctions and International Law* (2017) 52

Eden "United nations targeted sanctions, human rights and the Office of the Ombudsperson" in Happold and Eden (eds) *Economic Sanctions and International Law* (2016) 135

Ellinger P "British business law: banking law" (November 2005) *Journal of Business Law* 704

Enonchong N "The autonomy principle of letters of credit: an illegality exception?" 2006 *LMCLQ* 404

Fredericks E and Neels J "The proper law of the documentary letter of credit (part 1)" 2003 *SA Merc LJ* 63

Fredericks E and Neels J "The proper law of a documentary letter of credit (part 2)" 2003 *SA Merc LJ* 207

UNIVERSITY OF JOHANNESBURG

Gao X and Buckley R “A comparative analysis of the standard of fraud required under the fraud rule in letter of credit law” 2003 *Duke Journal of Comparative and International Law* 293

Gao X “Presenters immune from the fraud rule in the law of letters of credit” 2002 *LMCLQ* 10

Giumelli F “Understanding United Nations targeted sanctions: an empirical analysis” 2015 *International Affairs* 1351

Goldman Z and Lindblom A “The US position and practice with regards to unilateral and extraterritorial sanctions: reimagining the US sanctions regime in a world of advanced technology” in Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 130

Harker JR "The nature and scope of rescission as a remedy for breach of contract in American and South African law" 1980 *Acta Juridica* 61

Hersey E "No universal target: distinguishing between terrorism and human rights violations in targeted sanctions regimes" 2013 *Brook J Int'l L* 1231

Hlavac M “Less than a state, more than an international organization: the sui generis nature of the European Union” 2010 *Georgetown Public Policy Institute* 1

Hofer “The proportionality of unilateral ‘targeted’ sanctions: whose interests should count?” 2020 *Nordic Journal of International Law* 399

Hufbauer G and Oegg B "Targeted sanctions: a policy alternative?" 2000 *Law and Policy in International Business* 11

Hugo C and Spruyt W "Money laundering, terrorist financing and financial sanctions: South Africa's response by means of the Financial Intelligence Centre Amendment Act 1 of 2017" 2018 *TSAR* 227

Hugo C "Bank guarantees" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 437

Hugo C "Conformity of demands submitted under independent guarantees" 2018 *TSAR* 680

Hugo C "Demand guarantees: insights from the People's Republic of China" in Hugo and Kelly-Louw (eds) *Jopie Jurist Mentor Supervisor and Friend* (2017) 129

Hugo C "Demand guarantees in the People's Republic of China and the Republic of South Africa" 2019 *BRICS LJ* 4

Hugo C "Discounting practices and documentary credits" 2002 *SALJ* 101

Hugo C and Lambertyn O "Documentary credits and independent guarantees" *Annual Banking Law Update* (2007) 183

Hugo C "The development of documentary letters of credit as reflected in the Uniform Customs and Practice of Documentary Credits" 1993 *SA Merc LJ* 44

Hugo C and Kobilski J "A critical evaluation of the law and practice of transferring independent guarantees" in Hugo and du Toit (eds) *Annual Banking Law Update* (2020) 23

Hugo C "Letters of credit and demand guarantees: a tale of two sets of rules of the International Chamber of Commerce" 2017 *TSAR* 1

Hugo C "Non-governmental initiatives towards the harmonisation of international trade law" 2003 *Journal of Juridical Science* 142

Hugo C "Payment in and financing of international sale transactions" in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 395

Hugo C "Protecting the lifeblood of international commerce: a critical assessment of recent judgments of the South African supreme court of appeal relating to demand guarantees" 2014 *TSAR* 661

UNIVERSITY OF JOHANNESBURG

Hugo C and Strydom H "Sanctions, ships, international sales and security of payment" in Vrancken and Hugo (eds) *African Perspectives on Selected Marine, Maritime and International Trade Law Topics* (2020) 109

Hutchison A "Back to basics: reliance damages for breach of contract revisited" 2004 *SALJ* 51

Hutchison T and Ducan N "Defining and describing what we do: doctrinal legal research" 2012 *Deakin Law Review* 83

Johns RJ and Blodgett MS "Fairness at the expense of commercial certainty: the international emergence of unconscionability and illegality as exceptions to the independence principle of letters of credit and demand guarantees" 2001 *Northern Illinois University Law Review* 297

Joyner C "International legal limits on the ability of states to lawfully impose international economic/financial sanctions" in Ronzitti (ed) *Coercive Diplomacy, Sanctions and International Law* (2016) 83

Joyner C "United Nations sanctions after Iraq: looking back to see ahead" 2003 *Chicago Journal of International Law* 329

Kelly-Louw M "Construction of demand guarantees gone awry" 2013 *SA Merc LJ* 404

Kelly-Louw M "Construing whether a guarantee is accessory or independent is key" in Hugo and Kelly-Louw (eds) *Jopie: Jurist, Mentor, Supervisor and Friend – Essays on the Law of Banking, Companies and Suretyship* (2017) 110

Kelly-Louw M and Marxen K "General update on the law of demand guarantees and letters of credit" in Hugo (ed) *Annual Banking Law Update* (2015) 276

Kelly-Louw M "Limiting exceptions to the autonomy principle of demand guarantees and letters of credit" in Visser and Pretorius (eds) *Essays in Honour of Frans Malan* (2014) 197

Kelly-Louw M “The documentary nature of demand guarantees and the doctrine of strict compliance” part 1 2009 *SA Merc LJ* 306

Kittrie OF “New sanctions for a new century: treasury’s innovative use of financial sanctions” 2014 *Journal of International Law* 789

Lawack V “The South African banking system” in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 63

Lupton C and Kelly-Louw M “Emergence of illegality in the underlying contract as an exception to the independence principle of demand guarantees” 2020 *Comparative and International Law Journal of Southern Africa* 1

Lupton C “Demand guarantees in the construction industry: recent developments in the law relating to the fraud exception to the independence principle” 2019 *SA Merc LJ* 399

Lurie J “On demand performance bonds: is fraud the only ground for restraining unfair calls” 2008 *International Construction Law Review* 443

Magnusson F "Targeted sanctions and accountability of the United Nations Security Council" 2008 *ARIEL* 35

Malan F “Forfaiting and the aval” 1993 *TSAR* 200

Mallard G, Sabet F and Sun J “The humanitarian gap in the global sanctions regime” 2020 *Global Governance* 121

Marxen K “Electronic bills of lading in international trade transactions – critical remarks on digitalisation and the blockchain technology” 2020 *Coventry Law Journal* 31

Marxen K and Hugo C “Exceptions to the independence of autonomous instruments of payment and security: the growing emergence of good faith” in Hugo and Möllers (eds) *Transnational Impacts on Law: Perspectives from South Africa and Germany* (2018) 131

UNIVERSITY
OF
JOHANNESBURG

Marxen K "Traditional trade finance instruments a high risk? a critical view of current international initiatives and regulatory measures to curb financial crime" in Hugo (ed) *Annual Banking Law Update* (2018) 161

Mohamad R "Unilateral sanctions in international law: a quest for legality" in Marossi and Bassett (eds) *Economic Sanctions under International Law: Unilateralism, Multilateralism, Legitimacy, and Consequences* (2015) 71

Moret "Unilateral and extraterritorial sanctions in crisis: implications of their rising use and misuse in contemporary world politics in Beaucillion (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 19

Mugasha A "Enjoining the beneficiary's claim on a letter of credit or bank guarantee" 2004 *The Journal of Business Law* 515

Nakanishi H "The construction of the sanctions regime against Iran: political dimensions of unilateralism" in Marossi and Bassett (eds) *Economic Sanctions under International Law: Unilateralism, Multilateralism, Legitimacy, and Consequences* (2015) 23

Newcomb D "Non-U.S. banks are target of recent economic actions" 2008 *Banking Law Journal* 468

Norje M "Unfair contractual terms – effect of constitution: Bredenkamp v Standard Bank of South Africa Ltd 2009 SA 304 (GSJ) and 2009 6 SA 277 (GSJ)" 2010 *THRHR* 517

Oelofse AN "Developments in the law of documentary letters of credit" 1996 *SA Merc LJ* 56

Orakhelashvili A "Sanctions and fundamental rights of states: the case of EU sanctions against Iran and Syria" in Happold and Eden (eds) *Economic Sanctions and International Law* (2016) 13

Özdamar Ö and Shahin E "Consequences of economic sanctions: the state of the art and paths forward" 2021 *International Studies Review* 1

UNIVERSITY
OF
JOHANNESBURG

Peročević K “European Union legal nature: EU as *sui generis* – a platypus-like society” 2017 *Journal for the International and European Law, Economics and Market Integrations* 101

Pieth M and Aiolfi G “The private sector becomes active: the Wolfsberg process” 2003 *Journal of Financial Crime* 359

Png C-A “International legal sources II – the United Nations Security Council resolutions” in Blair, Brent and Grant (eds) *Banks and Financial Crime The International Law of Tainted Money* (2017) 33

Powell C "Terrorism and the separation of powers at the national and international level" 2005 *SACJ* 151

Schmidt J “The legality of unilateral extraterritorial sanctions under international law” 2022 *Journal of Conflict and Security Law* 53

Schulze W “The nature of banking law and its sources” in Sharrock (ed) *The Law of Banking and Payment in South Africa* (2016) 23

Spruyt W “A legal analysis of the duty on banks to comply with targeted financial sanctions” 2020 *TSAR* 1

Spruyt W "The Financial Intelligence Centre Amendment Act and the application of a risk-based approach" in Hugo and du Toit (eds) *Annual Banking Law Update* (2017) 26

Stanton J “North Korea: the myth of maxed-out sanctions” *Fletcher Sec Rev* (2015) 20

Strydom H “South Africa’s position and practice with regard to unilateral and extraterritorial coercive sanctions” in Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 37

Symington J, Basson M and de Koker L “Risk and the risk-based approach to AML/CFT” in de Koker (ed) *Money Laundering and Terror Financing: Law and Compliance in South Africa* (2020) 201

UNIVERSITY OF JOHANNESBURG

Ramsden WA *Supervening Impossibility of Performance in the South African Law of Contract* (1985)

Reeves WH "The control of foreign funds by the United States Treasury" 1945 *Law and Contemporary Problems* 17

Tan "Continuous Linked Settlement: a new era in foreign exchange settlement" 2002 *Journal of Banking and Finance Law and Practice* 312

Tiefenbrun SW "Semiotic definition of lawfare" 2010 *Case Western Reserve J Int'l L* 29

Tzanakopoulos A "Sanctions imposed unilaterally by the European Union: implications for the European Union's responsibility" in Marossi and Bassett (eds) *Economic Sanctions and International Law* (2015) 145

Ventura D "Contemporary blocking statutes and regulations in the face of unilateral and extraterritorial sanctions" in Beaucillon (ed) *Research Handbook on Unilateral and Extraterritorial Sanctions* (2021) 221

Wadsley J and Penn G *The Law Relating to Domestic Banking* (2000)

Zhang R "Documentary letters of credit fraud exception rules: a comparative study of English and Chinese law" 2015 *Journal of International Banking Law and Regulation* 1

UNIVERSITY OF JOHANNESBURG

3. Miscellaneous

ACAMS *Study Guide CAMS Certification Exam* (2019)

Baird "NEC3 compared and contrasted with African procurement – South Africa" in Forward NEC3 Compared and Contrasted (2015) 115

Bank for International Settlements *Payment, Clearing and Settlement in South Africa* (2012)

DCW "Compliance concerns? contact OFAC" (April 2020) *Documentary Credit World* 7

DCW "'De-friending' correspondents" (May 2015) *Documentary Credit World* 4

DCW "French bank agrees to settlement with OFAC for apparent Syria-related sanctions violations" (January 2021) *Documentary Credit World* 3

DCW "ICC updates its sanctions clause guidance" (May 2020) *Documentary Credit World* 3

DCW "ING bank to pay US$619 million for alleged violations" (July/August 2012) *Documentary Credit World* 3

DCW "International updates" (April 2019) *Documentary Credit World* 8

DCW "International updates" (May 2015) *Documentary Credit World* 8

DCW "OFAC announces settlements for apparent US sanctions violations" (May 2019) *Documentary Credit World* 7

DCW "Standard Chartered Agrees to settlement in US, fine in UK" (May 2019) *Documentary Credit World* 4

DCW "US treasury sanctions additional entities in Burma (Myanmar)" (March 2021) *Documentary Credit World* 11

Hong Kong Association of Banks "Guidance paper on combating trade-based money laundering" (1 February 2016) 1

HSBC *Global Report – Navigator Now, Next and How for Business* (2018)

Hufbauer G and Elliot K *US Economic Sanctions: Their Impact on Trade, Jobs and Wages* (April 1997) Working Paper Special

UNIVERSITY OF JOHANNESBURG

Lupton C "Investec Bank Ltd v Lombard Insurance Company Ltd and Another (case no. 69330/2018) [2019] ZAGPPHC 251 (26 June 2019) [South Africa]" (June 2020) Vol 24/(6) *Documentary Credit World* 21

Marxen K "Europe's blocking statute and its impact on international commercial transactions" (July/August 2021) *Documentary Credit World* 39

Meynell D *Commentary on eUCP version 2.0 and eURC version 1.0* (2019)

Opinion of Advocate General Hogan delivered on 12 May 2021 "Bank Melli Iran, Aktiengesellschaft nach iranischem Recht v Telekom Deutschland GmbH" (2021) Document 62020CC0124

Padinhere VE "What Covid-19 is showing us about the future of trade" (June 2020) *Documentary Credit World* 39

Schweizerische National Bank *The Continuous Linked Settlement Foreign Exchange Settlement System* (2009)

Tompkins M and Olivares A *Clearing and Settlement Systems from Around the World: A Qualitative Analysis - Bank of Canada Staff Discussion Paper, No. 2016-14* (2016)

UK Parliament *Brexit: Sanctions Policy*

UNIVERSITY OF JOHANNESBURG

4. Case law

Australia

Mendelson-Zeller Co Inc v T & C Providores Pty Ltd (1981) 1 NSWLR 366

England

Banque de l'Indochine et de Suez SA [1983] Q.B. 711

Banco Santander SA v Bayfern Ltd [1999] CLC 1321

Banque Saudi Fransi v Lear Siegler Services Inc [2006] EWCA Civ 1130

Bank Negara Indonesia 1946 v Larisa (Singapore) Pte Ltd [1988] 1 AC 583 (PC)

Banque de l'Indochine et de Suez SA v J H Rayner (Mincing Lane) Ltd [1983] 1 QB 711 (CA)

Chailease Finance Corp v Credit Agricole Indosuez 2000 1 All ER (Comm) 399

Edward Owen Engineering Ltd v Barclays Bank International Ltd [1978] 1 All ER 976 (CA)

Equitable Trust Company of New York v Dawson Partners Ltd [1926] 27 LI L Rep 49 (HL)

Frank Maas (UK) Ltd v Habib Bank AG Zurich [2001] Lloyd's Rep (banking)

Gian Singh & Co Ltd v Banque de l'Indochine [1974] 2 Lloyd's Rep 1

Intraco Ltd v Notis Shipping Corporation (the Bhoja Trader) [1981] 2 Lloyd's Rep 256 (CA)

Jackson v Royal Bank of Scotland (2005) *Lloyd's Rep* 366 (HL)

Lukoil Mid-East Ltd v Barclays Bank Plc 2016 (EWHC) 166 (TCC)

Mahonia Ltd v JP Morgan Chase Bank [2003] 2 *Lloyd's Rep* 911 (QB); [2004] EWHC 1938

Mannesman Handel AG v Kaunlaren Shipping Corporation [1993] 1 Lloyd's Rep

Maradive & Oil Services (SAE) v CAN Insurance Co Europe Ltd [2002] EWCA Civ 369

Midland Bank Ltd v Seymour [1955] 2 Lloyd's Rep (QB) 147

UNIVERSITY
OF
JOHANNESBURG

National Infrastructure Development Co Ltd v Banco Santander SA [2016] EWHC 2990 Comm

Paradine v Jane 1647 Aleyn

RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd 1977 (2) All ER 862 (QB)

Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran [1993] 1 Lloyd's Rep 236 (CA)

Tecnicas Reunidas Saudia v Korea Development Bank 2020 (EWHC) 968 (TCC)

United City Merchants (Investments) Ltd v Royal Bank of Canada (The American Accord) [1983] 1 AC 168

United Trading Corporation SA v Allied Arab Bank Ltd (1985) 2 Lloyd's Rep 554

Uzinterimpex JSC v *Standard Bank plc* [2007] 2 Lloyd's Rep 187

W J Alan & Co Ltd v El Nasr Export and Import Co [1972] 2 QB 189 (CA)

UNIVERSITY
OF
JOHANNESBURG

European Court of Justice

Costa v ENEL [1964] ECR 585

Kadi cases: Joined Cases C–402/05P and C–415/05P, Yassin Abdullah *Kadi and Al Barakaat International Foundation v Council of the European Union and Commission of the European Communities* [2008] ECR I–06351

Germany

LG Hamburg, 28.11.2018, ref.: 319 O 265/18

OLG Cologne, 07.02.2020, ref: I-19 U 118/19, 19 U 118/19

Singapore

Kumagai-Zenecon Construction Pte Ltd v Arab bank Plc 1997 2 SLR 805

South Africa

Ashcor Secunda (Pty) Ltd v Sasol Synthetic Fuels (Pty) Ltd (624/10) 2011 (ZASCA) 158

Barkhuizen v Napier 2007 5 SA 323 (CC)

Bayley v Harwood 1954 (3) SA 498 (A)

Beadica 231 CC and Others v Trustees, Oregon Trust and Others 2020 (9) BCLR 1098 (CC)

Benlou Properties (Pty) Ltd v Vector Graphics (Pty) Ltd 1993 (1) SA 179 (A)

Benson v SA Mutual Life Assurance Society 1986 (1) SA 776 (A)

BK *Tooling (Edms) Bpk v Scope Precision Engineering (Edms) Bpk* 19719 1 SA 391 (A)

Bob's Shoe Centre v Heneways Freight Services (Pty) Ltd 1995 (2) SA 421 (A)

Bombardier Africa Alliance Consortium v Lombard Insurance Company Limited and Another (A222/2019) [2020] ZAGPPHC 554 (7 October 2020)

Breedenkamp v Standard Bank of South Africa Ltd 2009 5 SA 304 (GSJ)

Breedenkamp v Standard Bank of South Africa Ltd 2009 6 SA 277 (GSH)

Bredenkamp v Standard Bank of South Africa Ltd 2010 4 SA 468 (SCA)

Brisley v Drotsky 2002 4 SA 1 (SCA)

UNIVERSITY
OF
JOHANNESBURG

Bryte Insurance Company Ltd v Raubex Construction (*Pty*) *Ltd* unreported, case no 13787/2015 (ZAGPJHC) 373 (8 December 2017)

Casey v Firstrand Bank Ltd 2014 (2) SA 374 (SCA)

Coface South Africa Insurance Co Ltd v East London Own Haven t/a Own Haven Housing Association 2014 2 SA 382 (SCA)

Collen v Rietfontein Engineering Works [1948] 1 All SA 414

Collisons (SW) Ltd v Kruger 1923 PH A 78 (SWA)

Compass Insurance Co Ltd v Hospitality Hotel Developments (Pty) Ltd 2012 (2) SA 537 (SCA)

Datacolor International (Pty) Ltd Intamarket (Pty) Ltd [2001] I All SA 581 (A)

Dormell Properties 282 CC v Renasa Insurance Co Ltd 2011 1 SA 70 (SCA)

Du Plessis v Labuschagne and Others (3799/2016) [2017] *ZAFSHC* 24 (16 February 2017)

Du Plooy v Sasol Bedryf (Edms) Bpk 1988 (1) SA 438 (A)

EBJ Mining Construction (Pty) Ltd v Hattingh (42/17) [2017] ZANWHC 91 (23 November 2017)

Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd 2012 1 SA 256 (CC)

Ex parte Sapan Trading (Pty) Ltd 1995 1 SA 218 (W)

Ex parte Spinazze 1985 (3) SA 650 (A)

Fast Track Contracting (Pty) Ltd v Constantia Insurance Company Ltd 2018 unreported case no. 22474/2018 (14 December 2018)

UNIVERSITY OF JOHANNESBURG

Farmers Co-operative Society (Reg) v Berry 1912 AD 343

First Rand Bank v Brera 2013 (5) SA 556 (SCA)

Frankel Pollak Vinderine Inc v Stanton NO 1996 2 All SA 582 (W)

Greenfield Manufacturers (Temba) (Pty) Ltd v Royton Electrical Engineering (Pty) Ltd 1976 (2) SA 565 (A)

Group Five Construction (Pty) Limited v Member of the Executive Council for Public Transport Roads and Works Gauteng [2015] ZAGPJHC 55 (13 February 2015)

Group Five Construction (Pty) Ltd v Transnet SOC Limited 2019 unreported case no 45879/2018 (ZAGPJHC) 328 (28 June 2019)

Group Five Power International (Pty) Ltd v Cenpower Generation Company Ltd 2018 unreported case no 41068/2008 (ZAGPJHC) 663 (16 November 2018)

Guardrisk Insurance Company Ltd v Kentz (Pty) Ltd 2014 1 All SA 307 (SCA)

Interland Durban (Pty) Ltd v Walters [1993] 3 All SA 437

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

Letaba Sawmills (Edms) Bpk v Majovi Bpk 1993 SA 768 (A)

Planscon-Evans Paints Ltd v Van Riebeeck Paints (Pty) Ltd [1984] 2 All SA

New Heriot Gold Mining Co Ltd v Union Government 1916 AD 415

Haynes v Kingwilliamstown Municipality 1951 (2) SA 371 (A)

Hersman v Shapiro 1926 TPD 375

UNIVERSITY
OF
JOHANNESBURG

Hyde Construction CC v Blue Cloud Investments 40 (Pty) Ltd [2012] JOL 28470 (WCC)

Investec Bank Ltd v Lombard Insurance Co Ltd 69330/2018 (ZAGPPHC) 251 (26 June 2019)

Improvair (Cape)(Pty) Ltd v Establissements Neu 1983 (2) SA 138 (C)

Kriel v Hochstetter House (Edms) Bpk 1988 (1) SA 220 (T)

Kristabel Developments (Pty) Ltd v Credit Guarantee Insurance Corporation of Africa Limited 2015 (ZAGPJHC) 264 (20 Oct 2015)

Kudu Granite Operations (Pty) Ltd v Caterna Ltd 2003 (5) SA 193 (SCA)

Laconian Maritime Enterprises Ltd v Agromar Lineas Ltd 1986 (3) SA 509 (D)

Lake v Reinsurance Corporation Ltd 1967 3 SA 124 (W)

Lombard Insurance Co Ltd v Landmark Holdings (Pty) Ltd 2010 2 SA 86 (SCA)

Lombard Insurance Co Ltd v Schoeman (2018 (1) SA 240 (GJ)

Loomcraft Fabrics CC v Landmark Holdings (Pty) Ltd 1996 (1) SA 812 (A)

Mattress House (Pty) Ltd t/a Mia Bella Interiors v Investec Property Fund Ltd 2017/36270 [2017] ZAGPHC 298 (13 October 2017)

McCarthy Retail Ltd v Shortdistance Carriers CC 2001 (3) SA 482 (SCA)

Minister of Transport and Public Works, Western Cape v Zanbuild Construction (Pty) Ltd 2011 5 SA 528 (SCA)

Mutual and Federal Insurance Co Ltd v KNS Construction (Pty) Ltd 208/2015 [2016] (ZASCA) 87 (31 May 2016)

UNIVERSITY
OF
JOHANNESBURG

Murray and Murray and Another NO [1959] 2 All SA 291 (W)

OK Bazaars (1929) Ltd v Standard Bank of South Africa Ltd 2002 (3) SA 688 (SCA)

Novick v Benjamin 1972 (2) SA 842 (A) 860

Peter, Flamman and Co v Kokstad Municipality 1919 AD 427

Phillips v Standard Bank of South Africa Ltd 1985 (3) SA 301 (W)

Phenix Construction Technology Ltd v Hollard Insurance Company Ltd 2017 unreported case no 10995/2015 (ZAGPJHC) 174 (4 May 2017)

Probert v Baker 1983 (3) SA 229 (D) 223

Pucjlowski v Jonnston's Executors 1946 WLD 1

Radon Projects (Pty) Ltd v N V Properties (Pty) Ltd 2013 (6) SA 345 (SCA)

Raubex Construction (Pty) Ltd v Bryte Insurance Company Ltd 2019 unreported case no 337/2018 (ZASCA) 14 (20 March 2019)

R v Myers 1948 (1) SA 375 (A)

R v Patz 1946 AD 845

SA National Roads Egency SOC Limited v Fountain Civil Engineering (Pty) Ltd (395/2020) 2021 ZASCA 118 (20 Sep 2021)

Santos Professional Football Club (Pty) Ltd v Igesund & Another [2002] JOL 10021 (C)

Sasfin (Pty) Ltd v Beukes [1989] 1 All SA 347 (A)

UNIVERSITY
OF
JOHANNESBURG

Savoi and Others v National Director of Public Prosecutions [2014] ZACC

Scatec Solar SA 163 (Pty) Ltd and Another v Terrafix Suedafrika (Pty) Ltd [2014] (ZAWCHC)

Schoeman v Lombard Insurance Co Ltd 2019 (1299/2017) (ZASCA) 66 (29 May 2019)

Shatz investments (Pty) Ltd v Kalovyrnas 1976 (2) SA 545 (A)

Shell SA (Pty) Ltd v Corbitt and Another 1986 (4) SA 523 (C)

Southernport Developments v Transnet [2005] 2 All SA 16 (SCA)

Standard Bank of SA Ltd v Efroiken and Newman 1924 AD 171

Stannic v SAMIB Underwriting Managers (Pty) Ltd [2003] 3 All SA 257 (SCA)

State Bank of India v Denel SOC Limited [2015] 2 All SA 152 (SCA)

Segal v Mazzur 1920 CPD 634

Steenkamp v Du Toit 1910 TS 171

Stewart Wrightson (Pty) Ltd v *Thorpe* 1977 (2) SA 943 (A)

Sulzer Pumps v Covec-Joint Venture 2014 ZAGPPHC (2 September 2014)

SVV Construction v Attorneys, Notaries and Conveyancers Fidelity Guarantee Fund 1993 (2) SA 577 (C)

Thomas v Henry 1985 (3) SA 889 (A) 896

Transnet SOC Limited v ABSA Insurance Company Ltd 2019 unreported case no. 08853/2016 (24 October 2019)

UNIVERSITY OF JOHANNESBURG

Transnet Ltd t/a National Ports Authority v Owner of MV Snow Crystal 2008 (4) SA 111 (SCA)

Unibank Savings and Loans Ltd (formerly) Community Bank v ABSA Bank 2000 (4) SA 191 (W)

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

University of the Western Cape v ABSA Insurance Company 2015 (ZAGPJHC) 303 (28 Oct 2015)

Venfin Investments v KZN Resins (642/2010) [2011] ZASCA 128 (15 September 2011)

Vereins- und Westbank AG v Veren Investments 2000 (4) SA 238 (W)

Williams and Taylor v Hitchcock 1915 WLD 51

Withok Small Farms (Pty) Ltd v Amber Sunrise Properties 5 (Pty) Ltd 2009 (2) SA 504 (SCA)

United States of America

Benz v Compania Naviera Hidalgo Sa 353 US 138 (1957)

Blackmer v United States 284 US (1932)

EEOC v Arabian American Oil Co 499 US (1991)

Foley Bros, Inc v Filardo 336 US (1949)

Hartford Fire Insurance Co v California 509 US (1993) 764

Sztejn v J Henry Schroder Banking Corporation (1941) 31 NYS 2 Ed

Wichita Eagle and Beacon Publishing Co Inc v Pacific National Bank of San Francisco 493 F 2d 1285 (9th Cir 1974)

5. Conventions, treaties and legislation

Australia

Trade Practices Act 51 of 1974

European Union

Convention on the Law Applicable to Contractual Obligations (1980)

Treaty on European Union (Consolidated version 2016)

Treaty Establishing the European Community (Consolidated version 2016)

Treaty on the Functioning of the European Union (Consolidated version 2016)

Treaty of Lisbon (2009)

South Africa

Apportionment of Damages Act 34 of 1956

Bills of Exchange Act 34 of 1964

Constitution of the Republic of South Africa, 1996

Financial Intelligence Centre Act 38 of 2001

Financial Intelligence Centre Amendment Act 1 of 2017

Prevention of Organised Crime Act 121 of 1998

UNIVERSITY OF JOHANNESBURG

Protection of Constitutional Democracy against Terrorist and Related Activities Act 33 of 2004

Miscellaneous

African Union Convention

United Kingdom

Anti-Terrorism, Crime and Security Act 2001

Counter Terrorism Act 2008

Counter-Terrorism and Security Act 2015

Criminal Justice Act 2003

Economic Crime (Transparency and Enforcement) Act 2022

Prevention of Terrorism Act 2005

Proceeds of Crime Act 2002

Sanctions and Anti-Money Laundering Act 2018

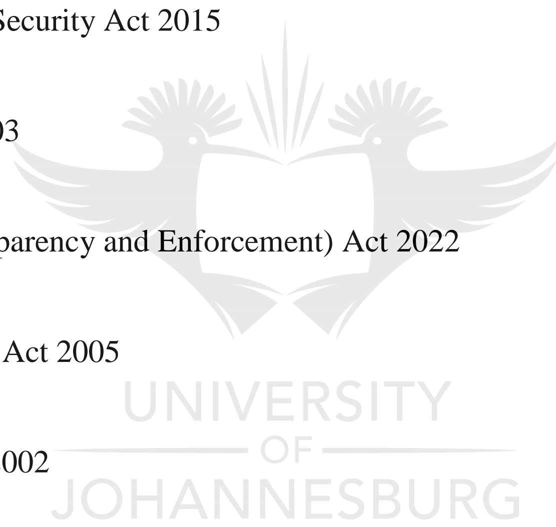
Terrorism Act 2000

Terrorism Act 2006

European Union (Withdrawal) Act 2018

United States of America

Antiterrorism and Effective Death Penalty Act of 1996



Bank Secrecy Act 12 USC §§ 1951-1959

International Emergency Economic Powers Act of 1977

Money Laundering Control Act of 1986, 31 USC § 5324

Trading with the Enemy Act of 1917

Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (Title III: International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001)

6. Internet sources

Bizcommunity "FNB to close OFAC-listed accounts" https://www.bizcommunity.com/Article/196/163/88123.html

Fassbender *Targeted Sanctions and Due Process: the Responsibility of the UN Security Council to Ensure that Fair and Clear Procedures are Made Available to Individuals and Entities Targeted With Sanctions Under Chapter VII of the UN Charter* (20 March 2006) www.un.org/law/counsel/Fassbender_study.pdf

More Than Shipping "Lloyd's and IMO numbers for shipping vessels" https://www.morethanshipping.com/lloyds-imo-number-vessels/

Norton Rose Fulbright (UK) "Economic Crime (Transparency and Enforcement) Act" https://www.nortonrosefulbright.com/en/knowledge/publications/19dd871c/economic-crime-transparency-and-enforcement-act-2022

Reuters "BNP Paribas sentenced in $8.9 billion accord over sanctions violations" http://www.reuters.com/article/us-bnp-paribas-settlement-setnencing-idUSKBN0NM41K20150501

UNIVERSITY OF JOHANNESBURG

Sindberg K "Combating trade based money laundering: rethinking the approach" www.lcviews.com/index/php?page_id=599

Steptoe "Former MoneyGram CCO settles with FinCEN and US Attorney's Office" https://www.steptoeinternationalcomplianceblog.com/2017/05/former-moneygram-cco-settles-with-fincen-and-u-s-attorneys-office/

Wass "Could regtech bridge the trade finance gap in emerging economies?" *https://www.gtreview.com/news/fintech/could-regtech-bridge-the-trade-finance-gap-in-emerging-economies/*

White House "Statement by the President on Cuba policy changes) https://obamawhitehouse.archives.gov/the-press-office/2014/12/17/statement-president-cuba-policy-changes

7. Regulatory guidance

European Union

UNIVERSITY OF JOHANNESBURG

European Union Commission *Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: The European Economic and Financial System: Fostering Openness, Strength and Resilience* (2021)

European Union Commission *Proposal for a Directive of the European Parliament and of the Council on the Mechanisms to be put in place by the Member States for the Prevention of the Use of the Financial System for the Purposes of Money Laundering or Terrorist Financing and Repealing Directive (EU) 2015/849* (2021)

European Union Council *EU Council Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community* (2019)

European Union Council *Guidelines on Implementation and Evaluation of Restrictive Measures (Sanctions) in the Framework of the EU Common Foreign and Security Policy* (15 June 2012)

Miscellaneous

Judicial Committee of the Supreme People's Court *Provisions of the Supreme People's Court of the People's Republic of China on Several Issues Concerning the Trial of Disputes over Independent Guarantees* (Chinese Independent Guarantee Rules)

Judicial Committee of the Supreme People's Court *Rules of the Supreme People's Court Concerning Several Issues in Hearing Letter of Credit Cases* (Chinese LC Rules)

Singapore

Monetary Authority of Singapore "Guidance on Anti-Money Laundering and Countering the Financing of Terrorism Controls in Trade Finance and Correspondent Banking" (October 2015)

UNIVERSITY
OF
JOHANNESBURG

South Africa

Financial Intelligence Centre *A New Approach to Combat Money Laundering and Terrorist Financing* (2017)

Financial Intelligence Centre *Guidance Note 4B: On Reporting of Suspicious and Unusual Transactions and Activities to the Financial Intelligence Centre in Terms of Section 29 of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)*

Financial Intelligence Centre *Guidance Note 6: On Terrorist Financing and Terrorist Property Reporting Obligations in Terms of Section 28A of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001*)

Financial Intelligence Centre *Guidance Note 7: On the Implementation of Various Aspects of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001)* (2017)

United Kingdom

OFSI *UK Financial Sanctions General Guidance for Financial Sanctions under the Sanctions and Anti-Money Laundering Act 2018* (2020)

The Counter-Terrorism (Sanctions) (EU Exit) Regulations 2019 Annual Review under section 30 of the Sanctions and Anti-Money Laundering Act 2018 (Annual Review of Counter-Terrorism Regulations)

United States of America

OFAC *Recent Action, Executive Order Amending Counter Terrorism Sanctions Authorities* (2019)

OFAC *Regulations for the Financial Community* (2012)

OFAC Terrorists Assets Report Calendar Year 2020 Twenty-ninth Annual Report to the Congress on Assets in the United States Relating to Terrorist Countries and Organizations Engaged in International Terrorism (2020)

OFAC "What you need to know about Treasury restrictions" (2012)

8. International standards, guidance and related documents

BAFT "Combatting trade based money laundering: rethinking the approach" (August 2017)

BAFT *Guidance for Identifying Potentially Suspicious Activity in Letters of Credit and Documentary Collections* (2015)

Basel *Core principles for effective banking supervision* (2012)

Basel *Prevention of criminal use of the banking system for the purpose of money-laundering* (December 1988)

Financial Stability Board *Action Plan to Assess and Address the Decline in Correspondent Banking* (2018)

FATF and Egmont Group *Trade-Based Money Laundering Trends and Developments* (2020)

FATF *Combating Proliferation Financing: A Status Report on Policy Development and Consultation* (2010)

FATF *Correspondent Banking Services* (2016)

FATF *FATF Guidance on Counter Proliferation Financing – The Implementation of Financial Provisions of United Nations Security Council to Counter Proliferation of Weapons of Mass Destruction* (2018)

FATF *Guidance Correspondent Banking Services* (2016)

FATF *Guidance for a Risk-Based Approach: The Banking Sector* (2014)

FATF *High-Level Principles and Objectives for FATF and FATF-style regional bodies* (as updated in February 2019)

FATF *International Best Practices: Targeted Financial Sanctions Related to Terrorism and Terrorist Financing (Recommendation 6)* (2013)

FATF *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation* (2012 as amended)

FATF *Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems* (as updated in October 2021)

FATF *Money Laundering & Terrorist Financing Through the Real Estate Sector* (2007)

UNIVERSITY OF JOHANNESBURG

FATF *Mutual Evaluation Report (South Africa)* (2009)

FATF *Mutual Evaluation Report (South Africa)* (2021)

FATF *Mutual Evaluation Report of (United Kingdom)* (2018)

FATF *Report on Money Launder/Terrorist Financing Risks and Vulnerabilities Associated with Gold* (2015)

FATF *Report on Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals* (2013)

FATF *Report on Risk of Terrorist Abuse in Non-Profit Organisations* (2014)

FATF *Trade-Based Money Laundering: Risk Indicators* (March 2021)

FINTRAC *Risk-Based Approach Guide* (June 2017)

Global Centre on Cooperative Security, Oxfam and World Bank *Brief: De-risking in the Financial Sector* (2017)

ICC *2018 Global Trade – Securing Future Growth* (2018)

ICC Banking Commission *Guidance Paper – The Use of Drafts (Bills of Exchange) Under Documentary Credits* (January 2019)

ICC *International Standby Practices* (ISP98)

ICC *Guide to Export/Import: Global Business Standards & Strategies* (2018)

ICC *Guidance Paper on the Use of Sanctions Clauses in Trade Finance-related Instruments subject to ICC Rules* Document 470/1238 (2014)

UNIVERSITY
OF
JOHANNESBURG

ICC *Addendum to Guidance Paper on the use of Sanctions Clauses (2014)* (2020)

ICC *Supplement to UCP 600 for Electronic Presentation* (e-UCP)

ICC Uniform Customs and Practice for Documentary Credits (UCP 500)

ICC Uniform Customs and Practice for Documentary Credits (UCP 600)

ICC *Uniform Rules for Collections* (e-URC)

ICC Uniform Rules for Demand Guarantees (URDG 658)

ICC Uniform Rules for Bank-to-bank Reimbursement (URR 2008)

IIBLP *"IIBLP Sanctions clause" in 2019 New York Events Conference Materials (Institute of International Banking Law and Practice)* (2019) 57

International Law Commission *Articles on the Responsibility of International Organisations* (ILC)

Report of the Special Rapporteur on the negative impact of unilateral coercive measures on the enjoyment of human rights, Alena Douhan UN Doc A/HRC/48/59 (8 July 2021)

UN *Arms Embargoes: Explanation of Terms* (2015)

UN *Letter Dated 3 May 2002 from the Deputy Permanent Representative of the United States of America to the United Nations Addressed to the President of the Security Council* UN Doc No S/2002/515

UN *Travel Bans: Explanation of Terms* (2015)

UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit

UNCITRAL *Recognizing and Preventing Commercial Fraud* (2013)

Wolfsberg Group *Wolfsberg Anti-Money Laundering Principles for Correspondent Banking* (2014)

Wolfsberg Group *Wolfsberg Anti-Money Laundering Principles for Private Banking* (2012)

Wolfsberg Group, ICC and BAFT *Trade Finance Principles* (2019)

Wolfsberg Group *Guidance on a Risk Based Approach for Managing Money Laundering Risks* (2006)

Wolfsberg Group *Guidance on SWIFT Relationship Management Application (RMA) Due Diligence* (2016)

Wolfsberg Group *Notification for Correspondent Bank Customers* (April 2007)

Wolfsberg Group *Statement on the Suppression of the Financing of Terrorism* (2002)

Wolfsberg Group *Wolfsberg Guidance on Sanctions Screening* (2019)