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EVIDENTIAL IMPLICATIONS OF THE USE OF ELECTRONIC LETTERS OF CREDIT IN INTERNATIONAL TRADE

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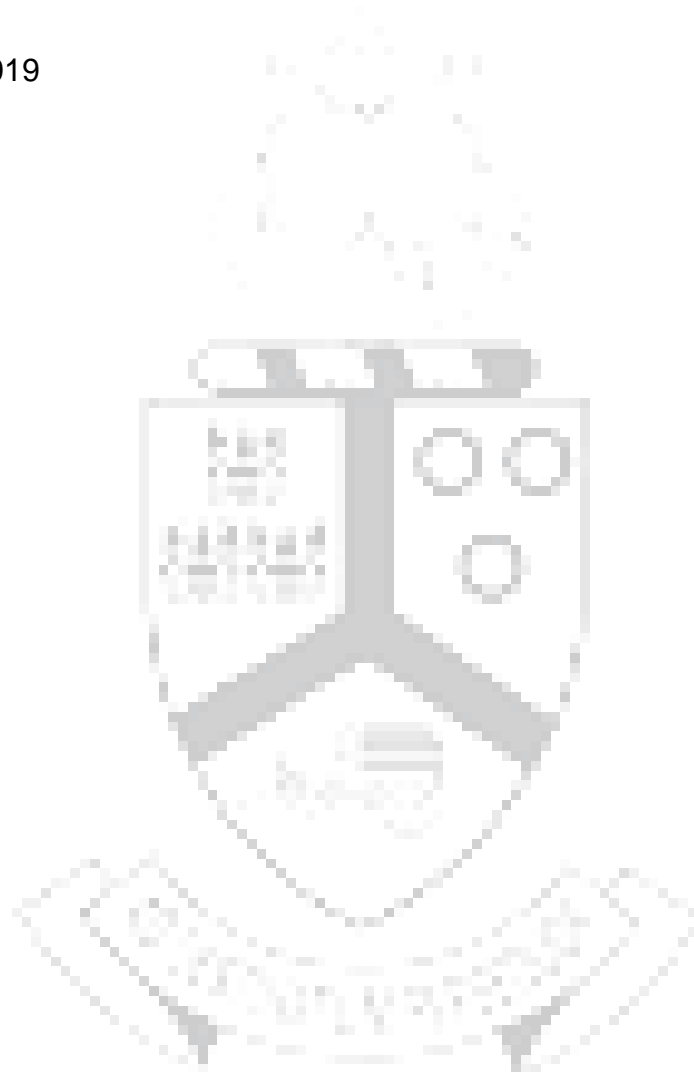
30 September 2019

DECLARATION

I declare that 'EVIDENTIAL IMPLICATIONS OF THE USE OF ELECTRONIC LETTERS OF CREDIT IN INTERNATIONAL TRADE' has not been submitted for any degree or examination in any university, and that all sources I have used or quoted have been indicated and acknowledged by complete references.

Isaac Marara:

30 September 2019



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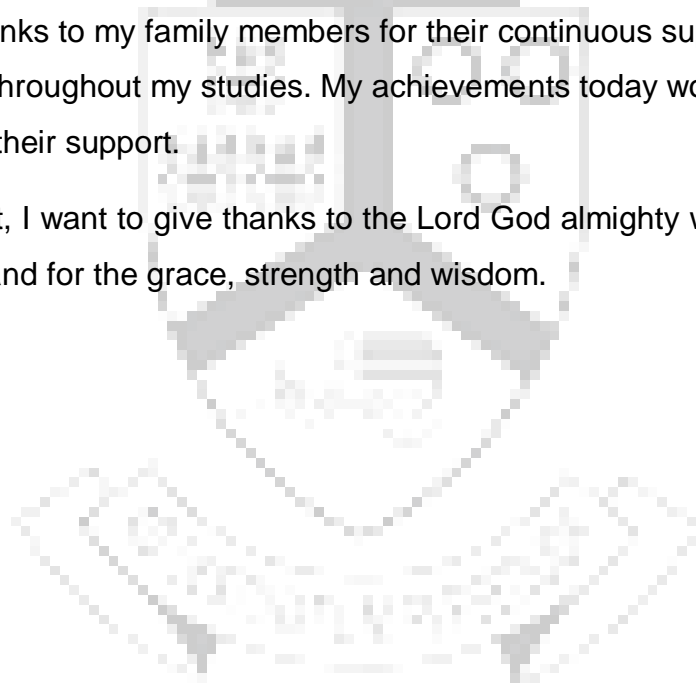


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- Electronic Communications Act No. 25 of 2002 (South Africa).

- Uniform Electronic Evidence Act 1998 (Canada).
- Uniform Customs and Practice for documentary credits UCP (600 and 500)
- UNCITRAL Model law on Electronic Commerce
- UNCITRAL Model Law on Electronic Signatures
- Supplement to the Uniform Customs and Practice for Documentary Credits (eUCP) 2007
- Supplement to the Uniform Rules for Collection (eURC) 2019.

LIST OF ABBREVIATIONS

e-UCP	Supplement to the Uniform Customs and Practice for Documentary Credit
e-URC	Supplement to the Uniform Rules for Collection
ICC	International Chamber of Commerce
UCP	Uniform Customs and Practice for Documentary Credit
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
URCG	ICC Uniform Rules for Contract Guarantees

ABSTRACT

The law is influenced by the changing circumstances of society; hence it is never static. Likewise, the laws regarding international payment methods have been influenced by the changing circumstances and practices of merchants. However, the introduction of technology through electronic means of communication and payment has faced resistance from the courts as the law remained static. This research explores how the law has been a stumbling block to the development of electronic commerce in international trade.

The payment methods in international trade have been predominantly based on traditional (paper-document) letters of credit and physical cash transfer. In many jurisdictions, paper-based letters of credit have been afforded statutory recognition for instance in areas of negotiability, but the same cannot be argued for electronic data intended to represent a letter of credit. This resulted in lack of trust in electronic transfers and fear of the risks that might come with electronic letters of credit. The main legal obstacles to full acknowledgment of electronic letters of credit are; authentication of electronic documents; lack of legal recognition by the courts due to their nature (that is, data messages) and lack of recognition in the laws of contracts (digital signatures, digital contracts), just to mention a few.

This research will critically analyse the evidential implications of the use of electronic letters of credit in international trade and illustrate the functional equivalence of electronic letters of credit as to those of traditional letters of credit. This research supports the notion that if courts around the world were to embrace the advancement of technology and benefits that come with it, trade procedures will be simplified and harmonised. Ultimately, this research intends to encourage full use of electronic letters of credit, which are more efficient, accurate and saves time.

KEYWORDS

- International trade;
- International transactions of sale
- Letters of credit/Electronic letters of credit;
- Electronic communications

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

In international sales transactions, there is often a conflict of interest between the buyer/importer and seller/exporter.¹ The conflict is often stirred up by the fact that the parties are in different jurisdictions across borders or even oceans where performance and payment in terms of the contract of sale cannot be conducted simultaneously.² This results in a high risk of non-performance on the party who performs first, therefore in instances of non-performance it creates a burden to enforce performance or sue the other party in a foreign jurisdiction.³ On the one hand, the seller runs the risk of non-payment if the goods are shipped or delivered to the buyer before payment is made.⁴ While on the other hand, the buyer runs the risk of non-performance if payment is made before the goods are shipped or delivered.⁵ Therefore, as a result of such high risks associated with international sales transactions, there is a need for a common ground for both parties.

To curb the above-mentioned problem, letters of credit have been widely used in international trade as a method of payment which provides measures of certainty as to the intention of the parties to perform their obligations in terms of the contract.⁶ However, letters of credit are not the only method of payment in international trade but rather the most commonly used and this study will be restricted to letters of credit.⁷ Letters of credit have developed over many centuries with the aim to eliminate the risk associated with trade, especially where parties are in different countries without precise information regarding the financial status or creditworthiness of each other.⁸ Such developments have resulted in reduction of risk through shifting the payment obligation from the buyer/importer to a third-party bank or financial institution which guarantees

¹ JP van Niekerk & WG Schulze *The South African Law of International Trade: Selected Topics* (2016) 4th ed SAGA Legal Publications CC 235.

² Niekerk & Schulze (n 1) 235.

³ Niekerk & Schulze (n 1) 235.

⁴ RLF García, 'The Autonomy Principle of Letters of Credit.' (2010) 3 *Mexican Law Review* 1: 69.

⁵ García (n 4) 1: 69.

⁶ AN Oelofse 'The Law of Documentary Letters of Credit in Comparative Perspective' (1997) 3 - 6

⁷ See Niekerk & Schulze (n 1) 236.

⁸ H Alavi 'Documentary letters of credit, legal nature and sources of law' (2016)) *Journal of legal studies* 106.

payment to the seller/beneficiary upon presentation of complying documents in terms of the letter of credit.⁹ Letters of credit as an instrument for financing international trade have been considered as “Life Blood of Commerce”.¹⁰

Although, paper-based letters of credit are the standard form of payment in international trade, electronic-based letters of credit emerged in practice and are widely used.¹¹ However, full implementation of electronic letters of credit faces stumbling blocks through standard procedures, for instance, in order for a buyer to take possession of the goods or to satisfy government requirements necessary to import goods, the complying documents must be in a paper document or original form.¹² There is a need for a move towards realigning commercial law with electronic commerce (e-commerce) with the aim to simplify and harmonize international trade procedures.¹³ Due to the advancement of technology through electrification of information and communications via the internet, one can find it reasonable that letters of credit should also be in-line with modern technology and replace paper-based letters of credit with paperless letters of credit.¹⁴

Moreover, the authentication of a paper-based letter of credit is provided by a manuscript signature as opposed to an electronic signature in electronic letters of credit. Despite electronic signatures being widely accepted as having the same legal effect with a manuscript signature, proving an electronic signature before a court of law would require expert evidence as opposed to the authenticity of a hand-signed document. The technicality associated with electronic signatures goes beyond the expertise of the courts and this creates evidential implications on the use of electronic letters of credit.

1.2 RESEARCH PROBLEM

Inevitably, technology is evolving daily but the law seems to have not been able to catch up. Despite most of the international commercial transactions being conducted electronically, electronic letters of credit have not been widely accepted in many

⁹ Alavi (n 8) above 106.

¹⁰ *Harbottle v National Westminster Bank* [1977]2 All ER 870.

¹¹ L Sarna ‘Letters of Credit: Electronic Credits and Discrepancies’ (1990) 4 *Banking and Finance Law Review* 149, 154.

¹² JG Barnes & JE Byrne ‘E-commerce & Letter of credit law and Practice’ (2001) 25.

¹³ Barnes & Byrne (n 12) 23.

¹⁴ VR Mathew ‘The bank payment obligation: A vehicle for the electrification of commercial letters of credit’ (2015).

courts.¹⁵ Arguments have been raised against the uncertainty of electronic signatures, the evidential weight of data messages, authenticity, the legal validity and enforcement of electronic letters of credit.¹⁶ These are some of the factors that are detrimental to acceptance and legal recognition of electronic letters of credit. However, practice has shown that the benefits of electronic letters of credit outweigh those of paper-based letters of credit.

In addition, the resistance against electronic letters of credit is largely influenced by the misperception that electronic signatures are more prone to forgery or any alteration in contrast to manuscript signatures. This misconception is associated with technophobia (fear of technology) and a lack of knowledge.

In most jurisdictions, the rules of evidence fail to take notice of the fact that, the world is changing and admissibility requirements of paper-based evidence in its original form is incompatible with e-commerce. If such requirement is applied rigidly across all forms of Data, then how does one present an electronic letter of credit before the court as evidence?

1.3 AIMS AND OBJECTIVES OF THE RESEARCH

The main aim of this research is to explore legal challenges associated with the use of electronic letters of credit, focusing more on the evidential implications. The research also attempts to investigate the functions of signatures and critically analyse how electronic signatures can provide functions equivalent to those of manuscript signatures. If the latter is true, any doubts about electronic signatures are eliminated, therefore full integration between commercial law and e-commerce.

Moreover, at the end of the day, this research seeks to clarify the differences between electronic letters of credit and the paper-based modes, the difference between electronic signatures and manuscript signatures as well as the applicability of electronic signatures in letters of credit. It also seeks to highlight the importance of aligning evidential rules to be in-line with e-commerce in order to accommodate modern forms of evidence.

¹⁵ R Bergami 'e-UCP: A revolution in international Trade?' (2004) https://www.academia.edu/eUCP_a_revolution_in_international_trade.

¹⁶ Bergami (n 15) above.

Ultimately, this research intends to encourage full use of electronic letters of credit, which are more efficient, accurate and saves time, just to mention a few.

1.4 RESEARCH QUESTIONS

The central research question in this study is: What are the underlying legal challenges that are facing acceptability and recognition of electronic letters of credit?

Focusing more on the central research questions, this study will also scrutinize the following sub-questions:

- i. What is the legal nature and acceptability of electronic letters of credit by courts in international sale of goods?
- ii. What is the nature and purpose of an electronic signature in letters of credit?
- iii. Is there any legal difference between an electronic signature and manuscript signature?
- iv. What is the role of letters of credit in international trade and finance?
- v. Are electronic letters of credit more efficient and secure as compared to paper-based letters of credit?
- vi. Do courts legally accept and recognise electronic letters of credit as a method of payment in international trade?

1.5 SIGNIFICANCE OF THE STUDY

The law is never static but rather constantly changing and evolving, influenced by the changes in the society. For many years electronic advancement has been used in international sales of goods, but the law has been standing on its way. The importance of this study is to illustrate how the law needs to keep up with electronic advancements in order to accommodate changing circumstances in international trade. One can argue without a doubt that electronic technology is the future and if the courts are not to accept it today, then when will they accept? It is time for the legal world to fully embrace technological advancement and shun away from rigid paper-based requirements that requires manuscript signatures.

Furthermore, the success of this study will a shade light to technical processes involved in the creation of an electronic signature which gives validity to an electronic letter of credit. This study will attempt to propose ways to accommodate modern electronic evidence in international trade. The introduction of electronic letters of credit

was aimed at the efficiency and accuracy of documents in international sale transactions. If one is to fully understand the benefits which come with electronic letters of credit as opposed to paper-based, then one would understand the push behind full electrification of international sales transactions.

1.6 LITERATURE REVIEW

Historically payment methods have been developed by merchants in an attempt to balance conflicting economic interests between parties and such methods are given force by the law.¹⁷ The law has always been following the practice of merchants, hence *lex mercatoria*.¹⁸ The world of commerce is constantly in pursuit of efficiency as well as maximizing profit from its operations. Robert Bergami argues that in order to achieve greater efficiency and maximum profit, there is a need to invent solutions that will reduce errors, minimize and improve processing times and automate repetitive functions.¹⁹ Such innovative solutions need to form part of a single system in international trade.²⁰ Letters of credit were designed to be part of a single system of international payment methods. The end goal was to achieve greater efficiency and maximum profit as well as to alleviate the risks associated with creditworthiness of a party to an international transaction. Due to evolution of technology, electronic letters of credit were introduced into the system of international payment methods. However, with regard to electronic letters of credit, the law has failed to keep up with the practice of merchants.

The payment methods in international trade have been predominantly paper-based and physical cash transfer.²¹ In many jurisdictions, paper-based documents have been afforded statutory recognition for instance in areas of negotiability, but the same cannot be argued for electronic data intended to represent a document.²² This resulted in lack of trust in electronic transfers and fear of the risks that might come with electronic documents. Much has not been written about electronic payment methods from a legal perspective since electronic letters of credit are not legally recognised

¹⁷ Dr A Davidson 'Electronic Records in Letters of Credit' UNCITRAL paper 2011 (*unpublished*).

¹⁸ Davidson (n 17) above.

¹⁹ Bergami (n 15) above.

²⁰ Bergami (n 15) above.

²¹ UNCITRAL Report of the Working Group on International Payments on the work of its Twenty-Fourth Session, A/CN.9/360 (17 February 1992).

²² See Bergami (n 15) above.

despite being used in practice. According to Allan Davidson,²³ “the management of international business is nothing more or less than the management of international risk”. If parties to an international trade transaction make use of a hardcopy printout of an electronic document, they run the risk of inadmissibility of such a document before court.

The use of documentary credits requires documents issued or presented to remain in their initial form, paper documents or electronic, for evidential purposes in courts, in order to be admissible.²⁴ The law of evidence has been the immediate obstacle to the use of electronic communications in trade. Although, electronic communications may be admitted as evidence in most jurisdictions, the evidential weight attached to it varies contrary to weight attached to any paper document.²⁵ Scholars like Ch'ng Huck Yong argues that, courts should take judicial notice of the commercial benefits that comes with using electronic communications over physical delivery of documents and the fact that electronic communications are the new order of the day accepted by merchants and banks.²⁶

Moreover, due to large amounts involved in financial transactions through electronic communications, authentication of electronic documents has become crucial to lawyers, traders and banks mostly for evidential purposes. The laws of evidence in most jurisdictions do not address all the aspects regarding transmission of electronic communications.²⁷ For instance, the authentication of electronic signatures goes beyond the expertise of both the legislature and courts. This creates problems when such technical issues are brought before courts which deals with un-updated laws of evidence. However, as stated earlier on that the laws have been following the practice of merchants, the laws of evidence must be in-line with the current e-commerce and afford electronic documents the same evidential weight to those of paper documents.

The International Chamber of Commerce (ICC) in 2002 launched a set of rules to supplement the Uniform Customs and Practice for Documentary credits (UCP), that

²³ See Davidson (n 17) above.

²⁴ See Davidson (n 17) above.

²⁵ See Bergami (n 15) above.

²⁶ C Huck Yong ‘International Trends in Documentary Transactions’, (1993) 14 *Sing Law Review* 171, 213-4.

²⁷ The UNCITRAL Model Law of Electronic Commerce and the many international Electronic Transactions Acts partly resolves some of these issues.

is, electronic supplements to the UCP (eUCP).²⁸ The eUCP rules do not work in isolation to the UCP rules but rather supplement the UCP rules with an option for lodgement of electronic documents.²⁹ Article e1(a) of the eUCP provides that the supplement to UCP 600 intends to accommodate presentation of either electronic records alone or a combination of electronic records and paper documents.

Furthermore, the United Nations Commission on International Trade Law (UNCITRAL) recognised that the legal requirements of use of paper-based documentation has been a stumbling block to the development of e-commerce and as a result the Model law on Electronic Commerce was issued.³⁰ The Model law is based on the approach of functional equivalence.³¹ This approach compares the purposes and functions of the traditional paper-based documents against those of electronic commerce techniques. The major functions of a traditional document are to allow for the authentication of data through a signature, to provide legibility and to prove originality, just to mention a few. The aim of the UNCITRAL is to illustrate that electronic records can provide the same level of security if not more to those of paper-based documents. Electronic documents have a higher degree of reliability and speed with regards to the identification of the source as well as content of the data. Signatures can also be used in electronic documents and such signatures are so sophisticated to an extent that alteration cannot be possible.

This research agrees that the functions provided by the traditional paper-based payments methods can be achieved more effectively and efficiently with electronic payment methods. If both these methods can achieve the same purpose in international trade, then both must be afforded the same legal status. Arguments to exclude electronic documents based on fact that they are intangible will not hold water.

1.7 RESEARCH METHODOLOGY

This research will review mainly secondary sources which includes draft laws, journals articles, textbooks, statutes and other relevant sources on electronic letters of credit and e-commerce in general. The research will explore, recognize, evaluate and

²⁸ International Chamber of Commerce, supplements to the UCP 600 for electronic presentation eUCP (2006) Edition Publication number 600E.

²⁹ See eUCP (n28).

³⁰ See www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf.

³¹ See Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce paragraphs 15-19, www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf.

analyse the issues associated with evidential implications of use of electronic letters of credit in relation to draft laws and statutes applicable. A comparative approach on case law from different jurisdiction will be made in order to understand and illustrate the practical aspect of how electronic letters of credit are received in international trade. The Supplement to the Uniform Customs and Practice for Documentary Credits for Electronic Presentation (eUCP), the UNCITRAL Model laws as well as the United Nations Conference on Trade and Development (UNCTAD) will be afforded special focus.

1.8 OVERVIEW OF CHAPTERS

This research will be structure in the following manner:

Chapter 1

This chapter introduces the topic of the research starting with a brief history and legal problems associated with electronic letters of credit. Research questions will be formulated as well as illustration of the significance and aims of the study. The main argument of the research will be presented together with the research methodology.

Chapter 2

The legal nature of a letter of credit as a method of payment in international trade and its evolution to electronic letter of credit will be explored in this chapter.

Chapter 3

This chapter gives an overview of the sources applicable to both traditional letters of credit and the emerging electronic letters of credit. These sources will establish legal recognition of electronic letters of credit in international trade.

Chapter 4

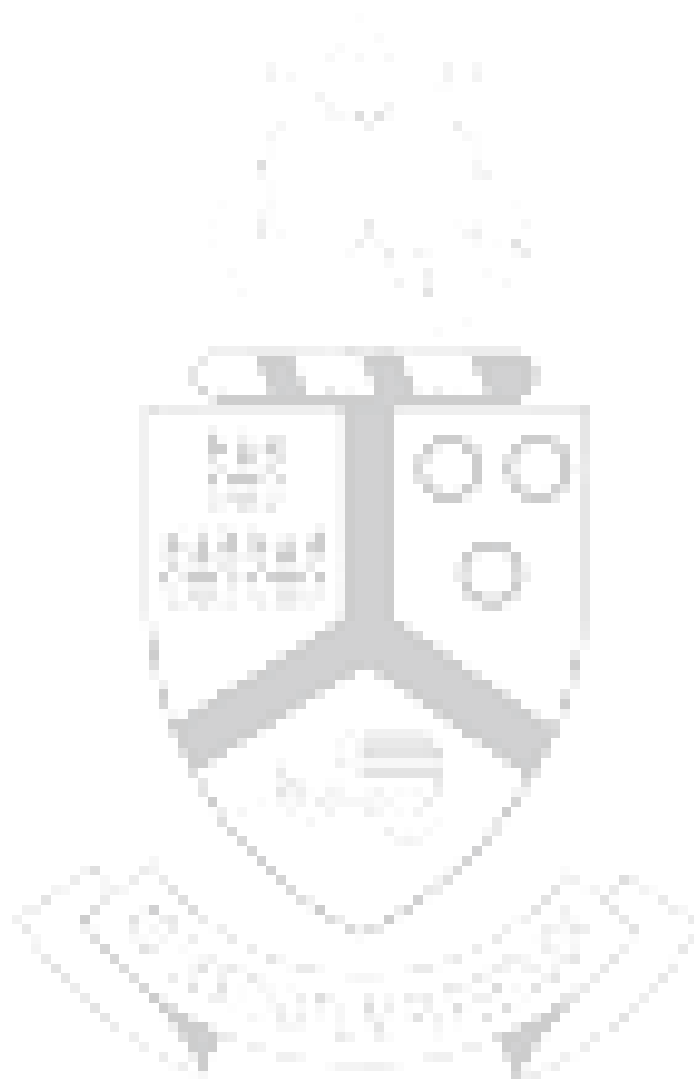
In this chapter, a comparative approach will be made to analyse the efficiency and reliability of traditional paper-based methods of payment against electronic methods of payment. The technical nature of electronic signature will be fully illustrated in this chapter.

Chapter 5

Current laws of evidence will be criticised in this chapter and how the current legal regimes fail to recognise letters of credit signed electronically.

Chapter 6

This chapter will conclude the research and will attempt to provide recommendations to problems associated with electronic letters of credit.



CHAPTER 2

LEGAL NATURE AND EVOLUTION OF LETTERS OF CREDIT AS A METHOD OF PAYMENT IN INTERNATIONAL TRADE

2.1 OVERVIEW

International trade by nature is risky and such risk can be in the form of customer risk, financial risk, transportation risk or country risk, to mention just a few. Documentary letters of credit were devised to mitigate trade risk through shifting the payment obligation from the buyer to a third-party bank which guarantee payment upon presentation of complying documents by the seller.

According to W McCurdy, an attempt to come up with a perfect definition for a documentary letter of credit would be more than futile.³² Based on the same line of thought, A Davis,³³ argues that it would be safe to comprehend the meaning of the letter of credit instead of trying to define it. Nevertheless, various scholars have attempted to define the letter of credit. For instance, JP van Niekerk and WG Schulze described a letter of credit as a conditional promise by the issuing bank to pay the purchase price to the seller on behalf of the buyer, the condition being that complying documents are presented at the correct place and within a specific time.³⁴ According to Roy Goode, a letter of credit can be described as a promise which is independent from the underlying transaction which gave birth to the promise and the promise is considered binding.³⁵ Moreover, according to Kudriachov, letters of credit can be described as “*one-way abstract transaction, in which the emitting bank cannot reject the execution of its obligation by referring to non-execution of obligations by other parties to the transaction*”³⁶

³² WE McCurdy ‘Commercial Letter of Credit’ (2011) 35 *Harvard Law Review* 539 <http://heinonline.org/HOL>.

³³ See AG Davis ‘The Law Relating to Commercial Letters of Credit’ *The Cambridge Law Journal* Cambridge University Press (3rd ed, Isaac Pitman & Sons Ltd 1963) 19.

³⁴ Niekerk & Schulze (n 1) above 242.

³⁵ R Goode ‘Abstract Payment Undertakings’ (1991) in Peter Cane and Jane Stapleton (eds), *Essays for Patrick Atiyah* (OUP).

³⁶ Koudriachov (n40) 37-43.

2.2 HISTORY AND BACKGROUND OF LETTERS OF CREDIT

The actual genesis of the letter of credit cannot be easily ascertained, but one thing for sure is its eminent and long antiquity that can be traced all the way back to 13th century commercial dealings of Kings and Queens.³⁷ Rufus Trimble made reference to clay promissory note of Babylon which dates back to 3000 B.C which was a payment method with interest rate on a specified date.³⁸ However, Holdsworth warned scholars from comparing a letter of credit with such analogous devices.³⁹

The documentary letter of credit can be regarded as one of the oldest and well-established payment methods for international trade. In fact, due to its long history, it was considered as “Life Blood of Commerce”.⁴⁰ The roots of the wording letter of credits can be traced from the French word ‘Accreditif’ which means the power for doing something.⁴¹ The French word ‘Accreditif’ in turn can be traced from a Latin word ‘Accrediwus’ which means trust.⁴²

Documentary letters of credit have gained the trust of merchants and banks as a result of its historical use and this has casted any doubt of use of letters of credit in international trade.⁴³ This long historical use can be found in the banking system old Egypt, Babylon and Greece, etcetera.⁴⁴ Archaeological evidence from ancient Greece provides letter of credits drawn by banks to their correspondents.⁴⁵ With reference to De Rover, Medici bank in Bruges and Italy during 1300s made use of letters of credit.⁴⁶

During middle ages trade faced two particular problems, that is, (a) merchants lacked security during carriage of gold and other precious items in their business trips and (b) merchants had no common trade currency for their cash needs abroad.⁴⁷ Letters of

³⁷ See RJ Trimble ‘The Law Merchant and the Letter of Credit’ (1948) 61 *Harvard Law Review*. 981; A Davidson ‘The Evolution of the Letter of Credit Transaction’ *Journal of International Banking and Financial*; FR Sanborn ‘Origins of the Early English Maritime and Commercial Law’ (1995) 347 *Law New York Volume* 10 128.

³⁸ RJ Trimble ‘The Law Merchant and the Letter of Credit’ (1948) 61 *Harvard Law Review* 982-86.

³⁹ WS Holdsworth, ‘The Origin and Early History of Negotiable Instrument II’ (1915) 31 *LQR* 173.

⁴⁰ *Harbottle v National Westminster Bank* [1977]2 *All ER* 870.

⁴¹ SA Koudriachov ‘The Application of the Letter of Credit Form of Payment in International Business Transactions’ (2001) 10 *Currents International Trade Law Journal* 37.

⁴² Koudriachov (n40) 37.

⁴³ See Alavi (n 8) above.

⁴⁴ See Alavi (n 8) above.

⁴⁵ See Alavi (n 8) above.

⁴⁶ R De Roover ‘Money, Banking and Credit in Medieval Bruges’ (1942) 2 *Journal of Economic History* (Suppl. Issue) 52.

⁴⁷ See Alavi (n 8) above.

credit were used to combat these problems as merchants find it less risk to exchange cash with a letter of credit at a bank with a guarantee of being cashed out at another bank of destination, contrary to carrying cash in hand.⁴⁸

The growth of international trade as well as the British banking system resulted in London being the financial centre hence acceptance of Pound Sterling as the currency for international trade.⁴⁹ On a later stage, letters of credit entered the United States of America due to raise of competition among financial institutions together with acceptance of drafts against shipment.⁵⁰ In the present day, letters of credit are the most commonly used methods of financing international trade.

Legal scholars like Davidson A refer to an English case of *Pillans v Van Miero* held in 1763 as the first lawsuit involving a letter of credit.⁵¹ From a legal historical perspective, *Rose v Von Mierop & Hopkins* is considered to be one of the first lawsuits and landmark cases on letters of credit in the English case law.⁵²

2.3 LEGAL NATURE OF LETTERS OF CREDIT

The documentary letter of credit transaction involves two sides: the buyer's side (importer) and the seller's side (exporter).⁵³ Each of these sides ordinarily have a bank, therefore a total of at least four parties are involved in this transaction.⁵⁴ The buyer approaches its bank with instructions to issue a letter of credit on behalf of the seller⁵⁵ Upon acceptance of instructions from the buyer, the bank issues the letter of credit in terms of which the bank guarantees to pay the purchase price upon presentation of specific documents by the seller.⁵⁶ The buyer is typically described as the applicant and the bank that accepts the buyer's instructions, is known as the issuing bank or the issuer of the letter of credit.⁵⁷

⁴⁸ See Alavi (n 8) above.

⁴⁹ See Alavi (n 8) above.

⁵⁰ See Alavi (n 8) above.

⁵¹ See R J Trimble 'The Law Merchant and the Letter of Credit' (1948) 61 Harvard Law Review 981; Alan Davidson, "The Evolution of the Letter of Credit Transaction Journal of International Banking and Financial; F R Sanborn, Origins of the Early English Maritime and Commercial Law, New York, 1930, 347 Law (1995) Volume 10 128;

⁵² *Pillans and Rose vs Van Mierop and Hopkins* (1756) 97, English. Rep. 1035 (BURR 1666).

⁵³ See Niekerk & Schulze (n 1) above 242.

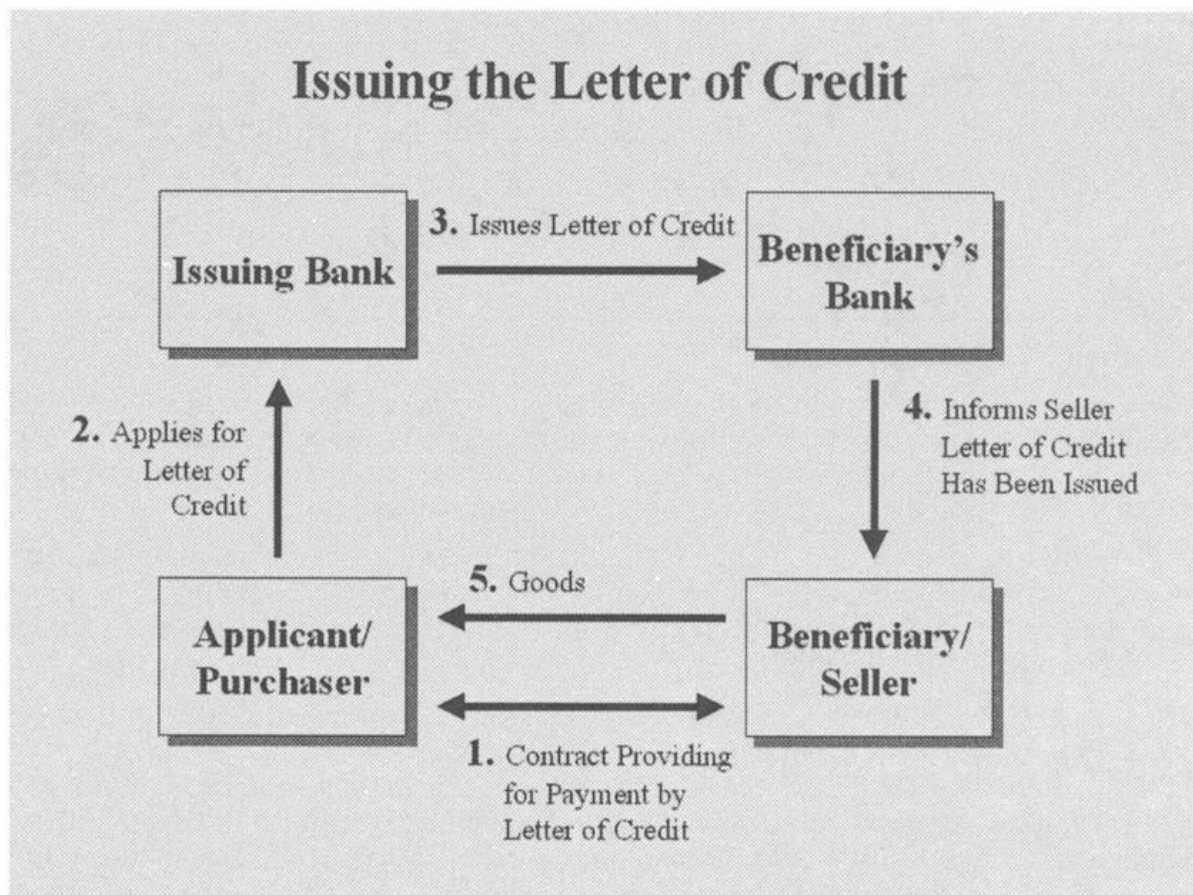
⁵⁴ RJ Mann 'The Role of Letters of Credit in Payment Transactions' (2000) 98 *Michigan Law Review* 2497-2500 <https://www.jstor.org/stable/1290352> Accessed: 30-07-2019

⁵⁵ See Mann (n55) above 2497-2500.

⁵⁶ See Mann (n55) above 2497-2500.

⁵⁷ See Mann (n55) above 2497-2500.

Figure 1 below illustrates the typical transaction.



In addition, the letter of credit comprises of at least three clearly distinguishable contracts (refer to figure 1 diagram).⁵⁸ These three contracts are autonomous, and they create a separate set of legal relationships between the parties involved.⁵⁹ The first one being the underlying contract, for instance, a contract of sale under which the buyer agrees to purchase goods from the seller while the seller agrees to sell the goods to the buyer.⁶⁰ The letter of credit is applicable to a different type of commercial contracts, but this discussion is restricted to the contract of international sale. Secondly, the contract of mandate under which the issuing bank (the mandator) undertakes to perform a mandate for the applicant (mandator) in terms of the latter's instructions.⁶¹ The principal mandate being payment of the purchase price to the beneficiary (seller). The issuing bank is entitled to remuneration by the applicant only after performance of its mandate. This contract creates a separate relationship

⁵⁸ See Mann (n55) above 2497-2500.

⁵⁹ See Niekerk & Schulze (n 1) above 268.

⁶⁰ See Article 4 UCP 600.

⁶¹ See Niekerk & Schulze (n 1) above 271

between the applicant and the issuing bank.⁶² Thirdly, the contract that creates the relationship between the issuing bank and the beneficiary under which the issuing bank agrees to honour the beneficiary's draft upon presentation of required documents.⁶³ This relationship originates from the underlying contract of sale between the buyer and the seller. The issuing bank is instructed to pay the purchase price in terms of the contract of sale to the beneficiary and upon accepting the mandate the bank agrees to pay the beneficiary therefore creation of the third contract between the issuing bank and the seller.

2.4 TYPES OF LETTERS OF CREDIT

There are various payment and finance instruments in international trade and most of them share certain characteristics that are governed by the same principles. Three main types of letters of credit are generally used in practice, that is, (a) documentary letter of credit; (b) standby letter of credit; and (c) the acceptance.⁶⁴ This research is paying more attention on documentary letter of credit. The expressions 'documentary letter of credit', 'letter of credit', 'credit' and 'commercial letter of credit' is used interchangeably in practice.⁶⁵

The modern letters of credit can be categorised into two basic forms, that is, the commercial letter of credit, commonly used in international sale as payment mechanism and the standby letter of credit, mostly used in domestic transactions as a guarantee for non-performance.⁶⁶ Other types of letters of credit are derived from these basic forms of letter of credit. Although these letters of credit share the same legal nature, there are fundamental differences between the two with regards to their commercial purpose, the way the credit is honoured, and the risk involved.⁶⁷ Due to digitalisation of information electronic letters have been derived from the commercial letter of credit.

⁶² See Niekerk & Schulze (n 1) above 271

⁶³ See Article 7 UCP 600.

⁶⁴ See Niekerk & Schulze (n 1) above 242.

⁶⁵ The terms 'letter of credit', 'credit', 'commercial letter of credit' and 'documentary credit' are used interchangeably.

⁶⁶ RP Buckley 'Potential Pitfalls with Letters of Credit' (1990) 70 *Australian Law Journal* 227; see also JF Dolan 'The Law of Letters of Credit – Commercial and Standby Credits' 4 ed (2007) ch 1.04 and 1.05.

⁶⁷ M Kelly-Louw M 'Selective Legal Aspects of Bank Demand Guarantees' (2008) University of South Africa *Unpublished* 81.

Letters of credit have been compared to automobiles since both have been in use for long and their functions continue to expand through adapting to changing circumstances of the society. Different types of letters of credit are derived from the above-mentioned basic forms of letters of credit.

2.4.1 DOCUMENTARY LETTERS OF CREDIT

Documentary letters of credit are the traditional form of letters of credit which was designed by merchants for international commercial transactions.⁶⁸ This is a commitment made by the bank to pay a specified amount to the seller on behalf of the buyer if the seller meets the prescribed conditions and submit required documents including a title document.⁶⁹ Letter of credit transaction involves at least three parties: the buyer (applicant), the seller (beneficiary) and the issuing bank. The first stage is the conclusion of a contract of sale between the buyer and the seller as the underlying transaction under which payment of the purchase price is agreed to be made through a letter of credit.⁷⁰ The applicant approaches a third-party bank to issue a letter of credit in favour of the beneficiary.⁷¹ Upon acceptance of the application by the bank, a letter of credit is issued in favour of the beneficiary and the bank will have an obligation to pay the beneficiary upon presentation of conforming documents.⁷² The presentation of conforming documents to the issuing bank before payment is made will provide assurance to the applicant that the goods were shipped.⁷³ At the same time, the letter of credit will provide assurance to the beneficiary that payment will be made once the goods are shipped.

The documentary letter of credit provides almost equal security and risk to both parties.⁷⁴ Both parties are provided with high degree protection hence the letter of credit being the most common method of payment in international trade.⁷⁵ Although the documentary letter of credit is a result of the contract of sale between parties, the

⁶⁸ G Xiang & RP Buckley 'The Unique Jurisprudence of Letters of Credit: Its Origin and Sources' (2003) 4 *San Diego International Law Journal* 94-102 <https://digital.sandiego.edu/ilj/vol4/iss1/6>.

⁶⁹ EG Hinkelman *A Short Course in International Payments: How to use Letter of Credit, D/P and D/A terms, Prepayments, Credit and Cyberpayments in International Transactions* 11.

⁷⁰ K Kazmierczyk 'Letter of Credit as a Security Device in International Trade. What will change under the Uniform Customs and Practice 600?' (2006) LLM Thesis, Central European University Hungary.

⁷¹ See Kazmierczyk (n70) above 11.

⁷² See Kazmierczyk (n70) above 12.

⁷³ See Kazmierczyk (n70) above 12.

⁷⁴ See Hinkelman (n69) above 11.

⁷⁵ See Hinkelman (n69) above 13.

bank will specifically deal with the documents regarding goods but not the goods themselves.⁷⁶ The major document to be presented by the seller is the bill of lading or title document which authorize the holder of documents to take possession of the goods shipped.⁷⁷

Moreover, upon application for the documentary credit, the buyer and the issuing bank may issue the documentary credit as revocable or irrevocable.⁷⁸ The two have different advantages and disadvantages to both parties. With the revocable documentary credit, the buyer and/or issuing bank have the discretion to amend or cancel the credit at any time without the approval of the seller.⁷⁹ This would be advantageous to the buyer but of great disadvantage to the seller as the credit can be cancelled even if the goods are in transit. As for the irrevocable credit, the credit forms a binding contractual obligation on the issuing bank that must be honoured if the seller complied with the terms and such credit cannot be amended or cancelled without the express approval of the seller.⁸⁰ This creates an advantage to the seller since the seller only needs to comply with the terms of the credit and does not run the risk of credit cancellation or amendment. In addition, within the irrevocable credits, the buyer and the seller may further agree on either irrevocable unconfirmed credit or irrevocable confirmed credit.⁸¹ With regards to unconfirmed documentary credit, the issuing bank has the sole responsibility to make payment to the seller.⁸² Under the confirmed documentary credit, both the issuing bank and the advising bank undertakes to pay the seller.⁸³ The advising bank is usually located in the seller's country and its commitment to pay is independent of that of the issuing bank.⁸⁴ Although confirmed documentary credits are expensive as compared to unconfirmed documentary credits, they provide great advantage to the seller since two banks are committed to make payment.⁸⁵

⁷⁶ See Hinkelman (n69) above 13.

⁷⁷ RM Goode *Commercial Law* (1995) 899.

⁷⁸ R Bergami 'UCP 600 rules – changing letter of credit business for international traders?' (2009) *International Journal of Economics and Business Research* 200.

⁷⁹ See Bergami (n78) above.

⁸⁰ See Bergami (n78) above.

⁸¹ P Ellinger & D Neo *The Law and Practice of Documentary Letters of Credit* (2010) 195.

⁸² See Ellinger & Neo (n81) above.

⁸³ See Ellinger & Neo (n81) above.

⁸⁴ See Ellinger & Neo (n81) above.

⁸⁵ See Ellinger & Neo(n81) above.

The issuing bank is paid a certain fee by the applicant for its services.⁸⁶ In order for the bank to mitigate the risk associated with extending credit to the buyer until reimbursement, the bank often take security over the documents tendered.⁸⁷

2.4.2 STANDBY LETTERS OF CREDIT

Similar to the documentary letter of credit, standby letters of credit involve three parties, that is, the applicant, the issuing bank and the beneficiary, and their transaction operate under the same legal framework.⁸⁸ Moreover, the transactions between the parties involves the underlying contract, the contract of mandate and the letter of credit itself.⁸⁹ However, contrary to commercial letter of credit which is a mechanism for payment and financing international sales of goods, standby letter of credit can be used for a number of different transactions. This can be illustrated by the Canadian case of *Rosen v Pullen*,⁹⁰ in which the standby letter of credit was used to guarantee performance of a marriage promise. Unlike the commercial letter of credit, standby letter of credit can be used in different transactions like: (a) construction industry as protection against malperformance or non-performance by a contractor, (b) financial industry to support corporate issues of commercial paper, and (c) international sale transactions as a guarantee for proper functioning of purchased equipment.⁹¹

Despite the standby letter of credit and documentary letter of credit being of the same legal nature, major differences can be spotted. Firstly, there is a difference between their commercial purpose. The commercial letter of credit is designed as a payment mechanism which provide the beneficiary with security against non-payment while on the other hand, the standby letter of credit is designed as a default instrument which provide the beneficiary with security against the applicant's defective or non-performance.⁹² The issuer of a commercial letter of credit expect to pay as the underlying contract is expected to be complied with whereas the issuer of standby letter of credit does not expect to pay.⁹³ Secondly, there is a difference between

⁸⁶ See Xiang & Buckley (n68) above 94-102

⁸⁷ See Xiang & Buckley (n68) above 94-102.

⁸⁸ See Hinkelman (n69) above 87.

⁸⁹ See Hinkelman (n69) above 87.

⁹⁰ *Rossen v Pullen* [1981] 126 D.L.R.3d 62.

⁹¹ See Xiang & Buckley (n68) above 94-102.

⁹² See Xiang & Buckley (n68) above 94-102.

⁹³ See Xiang & Buckley (n69) above 94-102.

documents to be presented under commercial letter of credit and those under the standby letter of credit. The terms of the commercial letter of credit require the beneficiary to present complying documents which usually include the bill of lading, commercial invoice and insurance certificate which indicates compliance with the underlying contract.⁹⁴ Under the standby letter of credit payment is only triggered upon presentation of documents attesting the applicant's failure to perform in terms of the underlying contract.⁹⁵ The major difference between the two is that under the commercial letter of credit the beneficiary seeks to prove compliance with the underlying contract for the credit to be honoured, while under the standby letter of credit the beneficiary seeks to prove non-performance by the applicant for the credit to be honoured.⁹⁶ Thirdly, the level of risk involved between the two is different. The standby letter of credit is riskier than a commercial letter of credit. Under the standby letter of credit, the statement by the beneficiary is required to trigger payment as opposed to the commercial letter of credit which requires documents from parties that confer title as well as evidence of shipment of goods, hence proving high level of security.⁹⁷ Although standby letters of credit might require documents from third parties like certificate of an engineer, the fact that the beneficiary's statement is still applicable makes it riskier than where only documents from independent third parties are required.⁹⁸ In other words, there is more chances of fraud in standby letters of credit as compared to commercial letters of credit.

2.4.3 ELECTRONIC LETTERS OF CREDIT

The emergence of electronic letters of credit is due to the technological advancement on trade. The world of commerce is constantly on pursuit for efficiency as well as maximizing profit from its operations.⁹⁹ In this digital age, merchants and banks had to come up with solutions of financing trade that will reduce errors, minimize and improve processing times and automate repetitive functions.¹⁰⁰ Such innovative solutions need to form part of a single system in international trade hence the introduction of electronic

⁹⁴ See Xiang & Buckley (n69) above 94-102.

⁹⁵ See Xiang & Buckley (n69) above 94-102.

⁹⁶ See Xiang & Buckley (n69) above 94-102.

⁹⁷ See Xiang & Buckley (n69) above 94-102.

⁹⁸ See Xiang & Buckley (n69) above 94-102.

⁹⁹ See Bergami (n15) above.

¹⁰⁰ See Bergami (n15) above.

letters of credit in practice.¹⁰¹ This was a major development in the world of trade in order to cope up with e-commerce demands.

Letters of credit were designed to be part of a single system of international payment methods.¹⁰² Electronic letters of credit are derived from a commercial letter of credit and can be described as a letter of credit transaction that is carried out through electronic communications and governed by internationally accepted rules, for example the eUCP. All the transactions and parties involved in a commercial letter of credit are also applicable to an electronic letter of credit, that is, the contract of sale between a buyer and a seller, contract of mandate between the buyer as an applicant the bank, the issuance of a letter of credit by the bank in favour of the seller as the beneficiary and the involvement of the advising bank usually in the seller's jurisdiction. This is a resemblance of a traditional letter of credit but in an electronic format.

The end goal of relying on electronic communications is to achieve greater efficient and maximum profit as well as to alleviate the risks associated with creditworthy of a party to an international transaction.¹⁰³ The benefits of shifting to electronic letters of credit outweighs those of traditional paper-based letters of credit. Electronic letters of credit are in-line with the end goal of merchants and banks, that is, maximizing profit and cost reduction through operational efficiency. In international trade, time is of the essence and electronic transactions are completed faster than those of paper based. The required documents are obtained from different institutions and therefore with paper-based documents it takes time to gather all the documents and it cost more as opposed to transfer of documents via electronic communications, for example, Electronic Data Interchange (EDI). Earlier submission of documents via electronic communications would save time and money on merchants. Traditional letters of credit incur additional costs of transferring documents via international courier. In addition, Allan Davidson underscored that the management of international business is nothing more but mitigating and management of international risk.¹⁰⁴ Electronic letters of credit mitigate the risk of fraud and they are also easy to correct in the event of rejection by the issuing bank for non-compliance. With paper-based documents, traders run the

¹⁰¹ See Bergami (n15) above.

¹⁰² See Bergami (n15) above.

¹⁰³ See Bergami (n 15) above.

¹⁰⁴ See Davidson (n 15) above.

risk of unnecessary costs if the documents are rejected considering the high level of documents rejected by issuing banks in practice.

Letters of credit are governed by international rules that are binding between parties who have elected to be bound. However, with regards to electronic letters of credit, domestic laws have failed to keep up with the practice of merchants and international rules. The law has always been following the practice of merchants, hence *lex mercatoria* but in the case of electronic letters of credit it has been a stumbling block.¹⁰⁵ There is lack of legal recognition of electronic letters of credit by courts in some jurisdictions despite merchants using electronic communications daily. The domestic laws of evidence do not accommodate data messages as evidence or less weight is afforded to data messages. Moreover, some domestic laws of contract do not legally recognise digital signatures and digital contracts. This is mostly due to misperception of the functions and purposes of electronic letters of credit, lack of technology and resources to accommodate new developments, lack of experts in the field of international payment methods to assist law makers and technophobia, to mention just a few.¹⁰⁶

The United Nations together with other international trade organisations took the initiative to harmonise international trade laws through the UNCITRAL Model Laws on Electronic Commerce and Electronic Signatures. The ICC went further to establish a supplement for the Uniform Customs and Practice for Documentary Credits (eUCP). These institutions aim to provide States with a template for legislative drafting, emancipating all the jurisdictions of the functional equivalence of electronic letters of credit, to facilitate adaptation to the digital age, etcetera. The researcher agrees with the initiatives to harmonise international trade laws and a move from paper-based letters of credit to paperless letters of credit. The importance of harmonisation of trade laws and e-commerce will be explained in the following chapters.

2.5 PRINCIPLES UNDERLYING DOCUMENTARY LETTERS OF CREDIT

Since the establishment of the letter of credit by merchants to effect payment and financing their transactions, various practices and customary usages have been developed among banks that deals with letters of credit. Most of the practices and

¹⁰⁵ See Davidson (n 17) above.

¹⁰⁶ DK Basimanyane 'Electronic Letter of Credit as a Cross Border Trade Payment Mechanism: Botswana as Case Study' LLM Thesis, University of Pretoria (2016) 18.

usages forms the basis of the UCP 600, for instance, article 34 of UCP which exempt banks from any liability associated with the form, sufficiency, accuracy and authenticity of documents submitted by the beneficiary. Furthermore, article 37 of UCP exempt banks from any liability associated with conduct of third parties. Over the past decades two practices and usages have gained the status of fundamental doctrines underlying letters of credit, that is, the doctrine of autonomy and the doctrine of strict compliance. Article 4 and 5 of UCP has incorporated these doctrines.

2.5.1 THE DOCTRINE OF AUTONOMY

The doctrine of autonomy entails that the letter of credit as a payment method in international trade is independent from the underlying transaction.¹⁰⁷ This principle is based on the notion that the three contractual relations between parties to an international commercial transaction, that is, the underlying contract of sale between the importer and the exporter, the contract of mandate between the applicant and the issuing bank, and the letter of credit contract between the issuing bank and the beneficiary, are independent and separate from each other.¹⁰⁸ In simple terms, transactions like the contract of international sale which is being financed or using a letter of credit as a payment method has no influence on the operation of the letter of credit.

This doctrine is entrenched in article 4 of UCP 600 which provides that, letters of credit by their nature are separate transactions which are independent from any other contract, for example, contract of sale on which they are based.¹⁰⁹ Article 4 further exempt banks from the operations of the underlying contract although the letter of credit refers to the underlying contract.¹¹⁰ Goes hand-in-hand with article 5.

The doctrine of autonomy entrenches the letter of credit in international trade as a separate and independent transaction under which the bank has an obligation to pay the beneficiary.¹¹¹ This would exclude the issuing bank from concerning itself with any matter or disputes arising from the underlying transaction.¹¹² Therefore, the issuing bank is only bound by the terms of the letter of credit in relation to its obligation towards

¹⁰⁷ See Niekerk & Schulze (n 1) above 278.

¹⁰⁸ R Sakar *Transnational Business Law: A Development Prospective* (2003) 1st ed Kluwer Law International 32.

¹⁰⁹ Article 4 of UCP 600.

¹¹⁰ Article 4 of UCP 600.

¹¹¹ See *Phillips & Another v Standard Bank of South Africa Ltd & Others* 1985 (3) SA 301 (W); *Ex parte Sapan Trading (Pty) Ltd* 1995 (1) SA 218 (W).

¹¹² See Niekerk & Schulze (n102) 279.

the beneficiary.¹¹³ Its duty is to examine whether the documents tendered are correct and correspond with the terms and conditions of the letter of credit. This creates an obligation on the issuing bank to honour the letter of credit in favour of the beneficiary upon presentation of complying documents. At the same time, the bank may not unilaterally change the terms of the letter of credit after it has been issued.¹¹⁴ The obligation to comply with the letter of credit bound both the bank and the beneficiary.¹¹⁵ If the tender documents that correspond with the underlying contract but contrary to the letter of credit, the issuing bank cannot pay the beneficiary.¹¹⁶ In cases where the advising bank is involved, it will be only liable to the issuing bank, the beneficiary and the applicant has no privity against the advising bank based on the letter of credit.¹¹⁷

The principle serves as a deterrent against interfering with the issuing bank's obligation to pay the beneficiary in instances of litigation by the applicant against the beneficiary for breach of contract.¹¹⁸ In *Ex Parte Sapan Trading (Pty) Ltd*,¹¹⁹ the court rejected an interdict application by the buyer to stop the issuing bank from paying the beneficiary due to breach of contract. The court emphasised that the letter of credit by its nature is independent from the underlying contract. It was further held that, such an interdict can only be accepted in exceptional circumstances, for instance fraud.

In the event of wrongful honouring of the letter of credit, the applicant has a recourse against the issuing bank based on breach of contract of mandate. Then in turn, the issuing bank may institute a legal action against the advising bank in terms of the letter of credit.¹²⁰

However, the principle of autonomy is not without an exception. The only applicable exception to this doctrine is the fraud rule, under which the bank can reject to honour the letter of credit to the beneficiary if satisfied that the documents tendered are fraudulent and the beneficiary is part of the fraud.¹²¹

¹¹³ See Niekerk & Schulze (n102) 279.

¹¹⁴ See Niekerk & Schulze (n102) 279.

¹¹⁵ See Niekerk & Schulze (n102) 280.

¹¹⁶ See Niekerk & Schulze (n102) 280.

¹¹⁷ See Sarkar (n105) 32 above.

¹¹⁸ FH Chan 'Documentary compliance under UCP: A Fault-Finding Mission or a Mere Guessing Exercise' (2008) 5 *Trade Journal* 76.

¹¹⁹ *Ex Parte Sapan Trading (Pty) Ltd* 1995(1) SA 218 (W).

¹²⁰ Basimanye (n103) 19.

¹²¹ Basimanye (n103) 19.

2.5.2 THE DOCTRINE OF STRICT COMPLIANCE

The doctrine of strict compliance entails that documentary letters of credit deals specifically with documents and the bank is entitled to reject documents that does not strictly conform to the terms of the credit.¹²² The doctrine has two parts to it; (a) letter of credit specifically deals with documents, and the second part, (b) the documents tendered by the beneficiary must strictly comply with the requirements of the letter of credit.¹²³ The first part of the doctrine is fundamental to international payment methods as it provide guarantee to users of letters of credit against any extrinsic factors.¹²⁴ The second part of the doctrine does not allow room for documents that are almost the same with the required documents.¹²⁵ This legal principle imposes an obligation on the issuing bank to ensure that the documents presented by the beneficiary strictly comply with the terms and conditions of the letter of credit. If the issuing bank pays the beneficiary on non-conforming documents, such bank has breached its mandate and may not recover the amount paid to the beneficiary from the applicant.¹²⁶

This doctrine is also entrenched in article 4 of UCP which provides that the parties to a letter of credit transaction deals purely with documents and not with goods or any other services related to documents.¹²⁷ In *Phillips & Another v Standard Bank of South Africa Ltd & Others*,¹²⁸ the court rejected an interdict aimed at preventing Standard Bank from paying an Italian manufacturer after a South African applicant had discovered defects on imported shoes. The court held that the bank is restricted to deal with documents and not with goods, and such a breach had no effect on the terms and conditions of the letter of credit. Moreover, not only does the tendered documents need to conform with terms and conditions of the letter of credit but also the documents must appear on face value to be in strict conformity.¹²⁹

In determining compliance of documents submitted by the beneficiary, the bank relies solely on the face value of documents.¹³⁰ Payment can only be done when the

¹²² C Murray & others *Schimitthoff: The Law and Practice of International Trade* (2012) 12th ed Sweet & Maxwell 196.

¹²³ Niekerk & Schulze (n102) 273.

¹²⁴ Niekerk & Schulze (n102) 273.

¹²⁵ *Equitable Trust Company of New York v Dawson Partners Ltd* [1927] 27 L.I.R. 49.

¹²⁶ See Niekerk & Schulze (n102) 274.

¹²⁷ Article 4 of UCP 600.

¹²⁸ *Phillips & Another v Standard Bank of South Africa Ltd & Others* 1985 (3) SA 301(W).

¹²⁹ R Mehta 'Does UCP 600 Soften or End the Doctrine of Strict Compliance?' (2007) 101 *Newsletter* 78.

¹³⁰ Article 14(a) UCP 600.

documents comply with the terms and conditions of the letter of credit. Furthermore, emphasis should be given to the fact that compliance of the documents submitted by the beneficiary to the bank does not relate to quality or quantity of goods that were shipped.¹³¹ This would also mean that the bank does not take into account whether the goods delivered to the applicant comply with the description in the commercial invoice or even whether the goods were delivered to the applicant.¹³² Article 14(b) of UCP provides issuing banks a reasonable period of five days to examine the documents presented.¹³³

However, two exceptions to this rule have evolved from the English case law namely, the doctrine of substantial compliance and the doctrine of qualified compliance.¹³⁴ The former doctrine provides that, if an attempt to perform obligations to a contract is made in good faith and the essential purpose is achieved despite the attempt not explicitly complying with the contract, such attempt is deemed complete.¹³⁵ The latter doctrine provides that, a minor deviation which is immaterial is permissible in honouring the draft.¹³⁶ These doctrines provide banks with the discretion to honour or reject non-conforming documents to the terms and conditions of the letter of credit. However, these doctrines are not codified hence they carry less weight in international commercial practices. Moreover, these doctrines faced massive criticism from different scholars due to their inconsistency with the doctrine of strict compliance. Scholars like Tier J argues that, such doctrines undermine the function and financing purpose of the letter of credit therefore destabilizing the value and certainty fundamental of the letter of credit.¹³⁷ In support of this argument, Sakar is of the opinion that the aforementioned doctrines contradict the doctrine of strict compliance as the compliance rule stipulates that the letter of credit can only be honoured when all the discrepancies are cured.¹³⁸

¹³¹ See Niekerk & Schulze (n102) above 287.

¹³² See Niekerk & Schulze (n102) above 287.

¹³³ Article 14(b) of UCP 600.

¹³⁴ See Article 23 of the UCP 500; Article 20 UCP 600.

¹³⁵ *First Nat'l Bank v Wynne* 256 S E 2d 383 GA APP 1979.

¹³⁶ Article 21 of the UCP 600.

¹³⁷ J Tier 'Letters of Credit: A Solution to the Problem of Documentary Compliance' (1982) 4 *Fordham Law Review* 855.

¹³⁸ See Murray (n119) 325.

Same as the doctrine of autonomy, under the doctrine of strict compliance issuing banks cannot honour fraudulent documents even though on face value they are in conformity with the terms and conditions of the letter of credit.

2.6 EXCEPTIONS TO DOCTRINES UNDERLYING DOCUMENTARY CREDITS

The underlying doctrines of letters of credit are without exceptions, a controversial issue relates to when the beneficiary renders a defective performance in terms of the underlying contract but presents documents that complies with the letter of credit.¹³⁹ The question is whether the bank should honour the credit and neglect the fact that the beneficiary rendered a defective performance. In order to determine solutions to this scenario, two conflicting and competing principles must be considered;¹⁴⁰ One should consider the established doctrine of autonomy on the one hand, which provides that the letter of credit constitutes an independent and separate transaction which cannot be affected by the defects of the underlying contract. As a result, the issuing bank is obliged to honour the draft upon presentation of complying documents without considering compliance with the underlying contract. On the other hand, the principles of reasonableness and fairness dictates that a beneficiary cannot benefit out of fraudulent conduct or from malperformance. One would not find it reasonable for a seller to be paid after rendering a defective performance and submit complying documents. To sort out this unsatisfactory situation, a few exceptions have been acknowledged and accepted in practice.

2.6.1 CONTRACTS CONTRARY TO LAW, GOOD MORALS OR PUBLIC POLICY

It is common cause that contracts that are contrary to law, good moral or public policy are illegal and therefore void. The maxim *ex turpi causa non oritur actio*, dictates that no action may arise from illegal contract and as a result courts must not give effect to illegal contracts.¹⁴¹ Based on the same principle, banks may not give effect to illegal contracts through financing them. However, based on the doctrine of autonomy and independence of the letter of credit, the illegal contract is separate and independent from the letter of credit. Therefore, this would mean that the bank should pay out without enquiring into the credibility of the underlying contract. One can argue that in

¹³⁹ See Niekerk & Schulze (n102) above 290.

¹⁴⁰ See Niekerk & Schulze (n102) above 290.

¹⁴¹ See Niekerk & Schulze (n102) above 291.

so doing the issuing will be aiding an illegal contract. The question to be answered is whether the independence and autonomy of the letter of credit is absolute.

In such circumstances, scholars are of the opinion that the independence and autonomy of the letter of credit is limited with the aim to avoid condoning and aiding of illegal contracts¹⁴². At the same time, one should not expect or assume a burden on banks to investigate the legality of underlying contracts as that would frustrate the autonomy of the letter of credit.¹⁴³ Scholars like JP van Niekerk and WG Schulze proposed that banks may not be burdened with duties to investigate the legality of the underlying contract but in circumstances where the bank is aware of such illegality, the bank must not honour the credit.¹⁴⁴ They further argued that, although there is no general duty on banks to investigate underlying transactions, knowledge of the legality of transactions may be achieved through exercising reasonable care. In the event that a credit is honoured based on illegal underlying contract without the knowledge of the bank, such payment cannot be faulted.¹⁴⁵

2.6.2 FRAUD

This is an exception to both the doctrine of the autonomy of the letter of credit and the doctrine of strict conformity.¹⁴⁶ Fraud is commonly done through forging and deliberately falsifying documents to comply with the terms and conditions of the letter of credit.¹⁴⁷ It is common cause that the beneficiary cannot benefit out of forged documents and therefore the bank must not honour the credit upon discarding falsified documents. The fraud exception is based on the notion that a fraudulent beneficiary cannot rely on the autonomy of the letter of credit to financially benefit based on forged or falsified documents. The UCP 600 made no reference to fraud or forgery of documents. However, this can be dealt with in terms of the ICC Uniform Rules for Contract Guarantees (URCG) under article 9(a) and (b) which oblige banks to pay the beneficiary upon presentation of complying documents and must refuse to pay under certain circumstances, for example fraud.¹⁴⁸

¹⁴² See Niekerk & Schulze (n102) above 291.

¹⁴³ See Niekerk & Schulze (n102) above 291.

¹⁴⁴ See Niekerk & Schulze (n102) above 291.

¹⁴⁵ See Niekerk & Schulze (n102) 291.

¹⁴⁶ JF Dolan 'Tethering the Fraud Inquiry in Letters of Credit Law' (2006) 21 *Banking and Finance Law Review* 479, 480 and 485.

¹⁴⁷ See Niekerk & Schulze (n102) 291.

¹⁴⁸ M Kelly-Louw 'International Measures to Prohibit Fraudulent Calls on Demand Guarantees and Standby

In terms of principle *fraus omnia corrumpit*, a beneficiary who intends to deceive the issuing bank with falsified documents for financial gains is not entitled to payment under the instrument.¹⁴⁹ The bank with an obligation to pay the beneficiary need to prove that the beneficiary acted in bad faith and such beneficiary had knowledge of the material misrepresentation for fraud exception to be applicable.¹⁵⁰ Fraud cannot be claimed in instances where the beneficiary had no knowledge of the misrepresentation in the documents or where fraud in documents is the conduct of a third party, for example, loading agent who entered incorrect information on the bill of lading.¹⁵¹ The fraud excepting rule must not be misunderstood with errors and oversight. In the case of *Discount Records Ltd v Barclays Bank Ltd and Another*,¹⁵² the English court held that courts should be cautious about interfering with bankers, documentary credits and the international banking system at large, unless exceptional circumstances with grave cause exist, as frequent interference might impair the trust placed on documentary credits.

There is a need to further distinguish between fraud made by the beneficiary that is discovered before payment by the bank is done and that discovered after the credit is honoured.¹⁵³ On the other hand, one should also distinguish between fraud made by a third party as opposed to that of the beneficiary.¹⁵⁴ Given the fact that fraud is discovered before payment is made, the applicant must apply for an interdict to stop the bank from paying out.¹⁵⁵ If forgery or falsification of documents appears on face value, the bank must refuse to honour the credit.¹⁵⁶ In the event that the bank makes a payment to a fraudulent beneficiary in good faith, such bank cannot be liable, and the applicant may not recover the amount paid from the bank.¹⁵⁷ If the applicant and the bank are under the loan for consumption (*mutuum*) and payment is made to a fraudulent beneficiary, the bank will still be entitled to reimbursement from the

Letters of credit' (2010) 1(1), Geo. Mason J, Int'l Comm. L., 74.

¹⁴⁹ RK Gutteridge and Megrah's *Law of Banker Commercial Credit* (2008) 56.

¹⁵⁰ Gutteridge & Megrah (2008) 54.

¹⁵¹ *Union Carriage & Wagon Co Ltd v Nedcor Bank Ltd* 1996 CLR 724 (W).

¹⁵² *Discount Records Ltd v Barclays Bank Ltd and another* 1975 (1) All ER 1071.

¹⁵³ See Niekerk & Schulze (n102) above 291.

¹⁵⁴ See Niekerk & Schulze (n102) above 291.

¹⁵⁵ See Niekerk & Schulze (n102) above 292.

¹⁵⁶ See Niekerk & Schulze (n102) above 292.

¹⁵⁷ See Niekerk & Schulze (n102) above 292.

applicant.¹⁵⁸ The applicant is left with an option of instituting a civil or criminal proceeding against the beneficiary.¹⁵⁹

2.7 CONCLUSION

Considering the fact that international commercial transactions deal with parties that are not within the same jurisdiction and sometimes unfamiliar with each other, the letter of credit mitigate some of the risk. Letter of credit provides equal level of security for non-performance to both parties. However, the paper-based letter of credit has discrepancies can be solved with electronic modes which are easy to use and efficient. In the following chapter the research will explore the legal sources that govern electronic letters of credit as a payment method in international trade.



¹⁵⁸ See Niekerk & Schulze (n102) above 292.

¹⁵⁹ See Niekerk & Schulze (n102) above 292.

CHAPTER 3

SOURCES OF ELECTRONIC LETTERS OF CREDIT AND ITS LEGAL RECOGNITION

3.1 INTRODUCTION

Although the letter of credit originated from the practice of merchants, the modern banking practice of letters of credit is standardised by the Uniform Customs and Practice for Documentary credits (UCP) and these set of rules were issued by the International Chamber of Commerce. The unification of these rules has been highly successful over the past decades and they now almost have universal effect.¹⁶⁰ One can argue that the UCP is the most successful international attempt to unify international trade laws. Periodic revisions of the UCP have been made and the latest version is the UCP 600 which took effect on 1st July 2007.¹⁶¹ The former Secretary General of the ICC, Jean-Charles Rouher stated that, "in a world of fast changing technology and rapidly improving communications, periodic review of ICC rules for trade facilitation is inevitable."¹⁶²

Due to increase use of electronic communications, the ICC promulgated the "eUCP"¹⁶³ as a supplement to the UCP and as a way to "accommodate presentation of electronic records alone or in combination with paper documents".¹⁶⁴ This is an attempt by international organisations to harmonise international trade law. These organisations are referred as formulating agencies and most of their measure to harmonise international trade are welcomed and applied by the international business community.¹⁶⁵ Among the formulating agencies is the United Nations which took a positive step in 1966 towards the harmonisation of the law of international trade through the United Nations Commission on International Trade Law (UNCITRAL).

3.2 SUPPLEMENT TO THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (e UCP)

Due to advancement of technology merchants and banks had to come up with a way to speed up their international payment process and reduce transaction costs. As a

¹⁶⁰ UCP 600 is the seventh version of the rules.

¹⁶¹ Letters of credit opened before July 1 (2007) will continue to be governed by UCP 500.

¹⁶² Forward to the UCP 500, 1993.

¹⁶³ eUCP Version 1.1 'Supplement to UCP 600 for Electronic Presentation (2007).

¹⁶⁴ Article e1(a) eUCP.

¹⁶⁵ Murray (n119) 191.

result, electronic formats began to be used to issue letters of credit and for presentation of complying documents.¹⁶⁶ This pushed the ICC to draft a supplement to the UCP which accommodates electronic formats or a combination of electronic and paper documents.¹⁶⁷ In an attempt to accommodate electronic presentation, the ICC promulgated the Electronic Uniform Customs and Practice for Documentary Credits (eUCP) as a supplement to the UCP.¹⁶⁸ These are uniform rules for presentation of electronic letters of credit that are fair and reflective of the modern e-commerce practices in international trade.¹⁶⁹ The drafters of the eUCP recognised the need to accommodate a dual approach since the transition from paper presentation to electronic presentation would not take place overnight, especially for situations where paper documents are not irreducible.¹⁷⁰ They drafted the articles to accommodate a mixture of formats, that is, paper and electronic presentation.¹⁷¹ However, the researcher is of the opinion that a fully electronic system would speed up the transition since it would increase efficiency and reduce transaction costs.

The ICC's first eUCP version 1.0 was enacted in 2002. By the time the first supplement eUCP version 1.0 was enacted, the UNCITRAL Model Law on Electronic Commerce and the Model law on Electronic Signatures had already established legal recognition of electronic signatures and documents. This was followed by the revised version 1.1 of 2007 which was structured into twelve Articles. The ICC intentionally enacted the eUCP in version numbers so that regular updates can be made to changing circumstances without impacting upon other existing ICC rules, which therefore reduce the period required to develop any potential identified revision.¹⁷² The current revised version 2.0 came into force as from 1 July 2019. New developments have been made with the eUCP version 2.0 which now constitutes fourteen Articles. The first two Articles providing the scope and its relationship to the UCP, while the third Article set out the definitions. The rest of the Articles stipulates the substantive rules that alter the underlying concepts of the UCP. Article 4 & 14 of Electronic Records and Paper Documents V. Goods, Services or Performance & Force Majeure respectively as new

¹⁶⁶ WP Cronican 'Buyer Beware: Electronic Letters of Credit and the Need for Default Rules' (2013) 45 *McGeorge Law Review* 385.

¹⁶⁷ See Cronican (n163) above 390.

¹⁶⁸ See Barnes & Byrne (n 12) above 26-29.

¹⁶⁹ See Barnes & Byrne (n 12) above 26-29.

¹⁷⁰ See Barnes & Byrne (n 12) above 26-29.

¹⁷¹ See Barnes & Byrne (n 12) above 26-29.

¹⁷² See UCP 2.0 accessed 03/09/2019.

addition. The eUCP version 2.0 is in-line with the ICC Banking Commission's aim to assist banks and merchants to accelerate adoption of electronic trade through focusing on the following three core aspects:

- (a) **eCompliance** – *evaluating ICC rules and guidelines in order to ensure “e” compliant as well as to enable the banks to accept data vs documents.*
- (b) **eLegal** – *for legal reviews of enforceability of digital against paper bills of lading, which are usually used as security for trade finance transactions by banks.*
- (c) **eStandards** – *setting up and developing minimum standards to enable digital connectivity, legality, liability, information security and technology.*¹⁷³

Under the UCP, the complying documents will be all presented once and examined by the bank, which is contrary to the electronic documents which cannot be presented all at once since some documents might come from different entities.¹⁷⁴ In contrast to the traditional presentation of documents under the UCP which require them to be presented at the same time, Article e5 of the eUCP allow electronic records to be presented separately and the place for presentation must be stated.¹⁷⁵ Therefore, there is a need to align the e-laws.¹⁷⁶

The requirement for documents to be in strict compliance with the letter of credit can be quite complex, and this can be magnified where parties elect to make use of electronic presentation.¹⁷⁷ This is because the security and trust provided by the letter of credit is embedded in the doctrine of strict compliance and by including electronic format, this would further complicate the equation.¹⁷⁸

Some scholars view the supplement as inadequate to the full recognition of electronic letters of credit, for instance, e4, e5, e11, etc.¹⁷⁹ They argue that the current eUCP has loopholes which are a major contribution to its failure to be fully integrated.¹⁸⁰ For instance the wording of article e5 does not provide a specific format to be used but

¹⁷³ ICC releases revised eUCP (Version 2.0) & first-ever eURC (Version 1.0) <https://www.essdocs.com/blog/icc-releases-revised-eucp-version-20-first-ever-eurc-version-10> accessed 03/09/2019.

¹⁷⁴ See Barnes & Byrne (n 12) above 26-29.

¹⁷⁵ See Cronican (n163) above 392.

¹⁷⁶ See Barnes & Byrne (n 12) above 26-29.

¹⁷⁷ See Cronican (n163) above 385.

¹⁷⁸ See Cronican (n163) above 385.

¹⁷⁹ See Cronican (n163) above 390.

¹⁸⁰ See Kelly-Louw (n145) above.

rather it is drafted in a manner that gives the parties a wide discretion to choose any format.¹⁸¹ This article goes against the agenda of harmonisation of trade laws as it creates uncertainty. The aim is to create uniform rules for presentation of electronic records rather than to create uncertainty of presentation of electronic records. Moreover, the eUCP does not address the issue of fraud even though one of the major factors affecting its implementation is the mistrust that electronic letters of credit are susceptible to fraud. There is a belief that electronic records can be easily manipulated and altered in a fraudulent manner. Given the fact that the UCP 600 which is being supplemented by the eUCP has provisions dealing with fraud, the absence of such provisions in the eUCP is a huge setback. One would agree with Davidson A that, this builds up to further legal uncertainty of electronic letters of credit.¹⁸²

According to Davidson A, the major stumbling block to full legal recognition of electronic letters of credit is the dilemma of having to prove the validity of electronic documents in the event of litigation and run the risk of documents being rejection by courts or electronic documents being given less evidential weight. In addition, he further disagreed with scholars like Kelly-Low M and Cronican WP and argued that the ICC had adequately drafted the model law, which is sufficient to regulate e-trade.¹⁸³

In support of the above argument, the current e-commerce laws, model laws, conventions and national legislations are sufficient to regulate the use of electronic letters of credit in international trade. All that needs to be done is implementation of the laws available. Merchants and banks have already paved the way for the use of electronic letters of credit. The duty is now on courts across all jurisdictions to give effect to the practice of merchants and accept the technological changes of the society. The courts now need to create a safety net for traders in cases of litigation and allow electronic documents for their relevance rather than to deny them based on their nature. Although lack of an accommodating legal regime cannot stop technological advancement, legal uncertainty would negatively impact harmonisation of trade laws.

Considering the speed at which electronic letters of credit are being used in practice and the diminishing use of traditional letters of credit, there is a need to establish a

¹⁸¹ See Cronican (n163) above 390.

¹⁸² See Davidson (n17) above.

¹⁸³ See Davidson (n17) above.

global legal regime that is binding to parties in order to create certainty and predictability. This would also eliminate the evidential risk of the need to prove the validity of a letter of credit before a court and therefore building trust on e-trading. Positively, many countries have welcomed the initiatives of the ICC and the United Nations on the UCP, eUCP, model laws and conventions as they provide a uniform template which is being incorporated into national statutes. This secures confidence on the global use of electronic modes. Example of statutes that are in-line with the above laws includes, SA, Canada, UK and USA.

3.3 SUPPLEMENT TO THE UNIFORM RULES FOR COLLECTION (eURC)

The ICC Banking Commission working group issued the first eURC version 1.0 together with the current updated eUCP version 2.0 in 2019 with the agenda to digitalise trade finance.¹⁸⁴ The ICC working group aims to evaluate existing rule for accommodation of new practices and technologies that are introduced by the e-commerce revolution. The end goal is to guide old rules to be e-compatible and e-compliant with e-trade and therefore enabling the banks and financial institutions to accept data over documents. The eURC is a supplement to the ICC Uniform Rules for Collections URC 522 (1995 revision) which deals with documentary collections. This is another international payment method that facilitate trade and contrary to the letter of credit, no payment guarantee is made to the seller by the bank. The development eURC falls outside the scope of eUCP despite both having the aim to harmonise international trade laws.

3.4 UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW (UNCITRAL)

The United Nations General Assembly created the UNCITRAL with the intention to accelerate harmonisation and unification of the law of international trade and also taking into account the interests of all people, especially from developing countries, for the development of international trade.¹⁸⁵ The UNCITRAL intended to deal with statutory obstacles which do not afford electronic records equal status as opposed to paper-based methods.¹⁸⁶ One would agree that affording electronic records equal status with paper-based methods is essential for enabling e-commerce and therefore

¹⁸⁴ D Meynell 'ICC Commentary on eUCP 2.0 and eURC 1.0: Article-by-Article Analysis' <https://cdn.iccwbo.org/content/uploads/sites/3/2019/07/>

¹⁸⁵ UNCITRAL Model Law on Electronic Commerce

¹⁸⁶ See (n82) above.

promoting efficiency in international trade. Considering the fact that international trade is carried out mostly by electronic data interchange and electronic commerce as opposed to paper-based methods of communication and information storage.¹⁸⁷ The UNCITRAL enacted Model Laws to deal with electronic commerce and electronic signatures. These models will be fully discussed below.

3.4.1 THE UNCITRAL MODEL LAW ON ELECTRONIC COMMERCE

The UNCITRAL issued a Model Law on Electronic Commerce (Model Law) in 1996¹⁸⁸ with the intention to provide a guide to national legislatures. The Model Law constitute two parts; the first one deals with e-commerce in general while the second one deals with e-commerce in specific areas. This is aimed at aligning old laws and concepts to be compatible with the electronic business environment.¹⁸⁹ It further aims to eliminate legal obstacles to e-commerce and increase legal predictability. The legal requirements prescribing the use of traditional paper-based documents is a stumbling block to the development of modern electronic means of communication.¹⁹⁰

The Model Law is applicable to any information in the form of data message used in relation to commercial transactions.¹⁹¹ Article 2 of the Model Law define data message as, *“information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy.”*¹⁹² Electronic data interchange is further defined as, *“the electronic transfer from computer to computer of information using an agreed standard to structure the information.”* The underpinning principle of this Model Law is illustrated in Article 5 which provides that, *“Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is in the form of a data message.”* As a result, the Model Law is based on the approach of functional equivalence which entails that, the purposes and functions of the traditional paper-based requirements can be equally achieved through electronic-based techniques. For instance, the following are among functions that are achieved by a paper document;

¹⁸⁷ See (n82) above.

¹⁸⁸ See www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf.

¹⁸⁹ Davidson A UNCITRAL 2011

¹⁹⁰ See Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce paragraphs 15-19, www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf.

¹⁹¹ See Article 1 of UNCITRAL model law on e-commerce.

¹⁹² See Article 2(a) of UNCITRAL model law on e-commerce.

- legibility of the document
- unalterable document
- ability to be reproduced into copies of the same data
- allow authentication of data by means of a signature; and
- acceptability by public authorities and courts.¹⁹³

The drafters of the Model Law argue that, electronic records cannot only achieve the functions of a paper document mentioned above but can also provide a much higher degree of reliability and speed, especially with regards to identification of the source and content of the data.¹⁹⁴ The following are examples of functionals that can be equally achieved by electronic records;

- **Legibility**

The legality of a document concerns its clearness and capability to be read. Paper-documents are written by ink which can easily fade away or be erased. Contrary to this, electronic documents do not fade ink over time and the font size of the text be easily adjusted to a preferred one. There electronic documents are more legible that a handwritten of paper document.

- **Inalterability**

The presentation of documents for purposes of letters of credit requires documents to strictly comply with the terms of the credit and such documents must not be in a format that can be easily altered or manipulated. Inalterability of a document provides security to the buyer and the bank against fraud by the seller or third parties. Both paper-based document and electronic can be altered but when comparing the level of security one notice that a paper document can be easily erased and altered while an electronic document can be locked with allowing any alteration. In order to alter a locked electronic document, one needs to print it first and after printing it cannot be argued to be an electronic document. Clearly an electronic document offers more security than a paper-based document.

- **Reproduction**

¹⁹³ See Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce paragraphs 15-19, www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf.

¹⁹⁴ See the guide on the model law of e-commerce.

This refers to the ability to make copies identical to the original document. Both paper-based documents and electronic documents can be reproduced into many copies. However, paper-based documents can be physical damaged which makes it difficult and that is why in practice people are now scanning paper-based documents and keep them in electronic format. An electronic document is more secure with better storage and the ability to be reproduced into highly identical copies due to modern printers.

- **Authentication**

The authenticity or genuineness of a document can be established through a signature and the ability to identify the signatory. Manuscript signatures are susceptible to alteration and forging, and identification of the signatory is subjective. On the other hand, electronic signatures are inalterable, and an electronically signed document can only be accessed by a recipient with a key from the signatory. Therefore, identifying the signatory in electronically signed documents is much easier as compared to manuscript signatures.

- **Acceptability**

According to the best evidence rule, courts will accept documents that are in their original form, paper form, physically signed and must be capable of being presented in their original forms. This requirement has been a stumbling block to the acceptability of electronic documents. This research aims to illustrate that electronic documents can still be presented to public authorities and courts in their original form without the need to print a hard copy and this can be achieved through electronic filling. Banks and merchants have already accepted and continue to benefit from electronic documents, and now the burden is on lawmakers and courts to give force to acceptability of electronic documents.

Article 6 to 8 of the Model Law provides the functional-equivalent approach with regards to the concepts of “writing”, “signature” and “original”. Under Article 6, Model Law aims to afford electronic documents legal recognition in terms of the legal requirement of being in writing subject to the condition that the document is accessible to be usable for subsequent reference. In Article 7, the Model Law established functions of a manual signature that can be equally performed by a digital signature. The authentication of a digital signature is established if the signatory can be identified

and the signatory intended the signature to be associated with the content of the document. The controversial issue of retaining documents in their original form is addressed by Article 8. Article 8 entails that for the reliability of an electronic document to be established, one needs to prove that the document information as a whole is unalterable, except in circumstances where changes are accompanied by endorsements.

3.4.2 THE UNCITRAL MODEL LAW ON ELECTRONIC SIGNATURES

A signature is an essential requirement for the authentication of a document, and this has been one of the obstacles to the legal recognition of electronic documents. According to Prof Chris Reed, there are three primary functions of a signature accepted in practice, that is, to identify the signatory, the signatory intend the mark or data to be his/her signature and the signatory approves the text or writing associated with the signature.¹⁹⁵ Manuscript signatures have been traditionally used in commercial practice and the introduction electronic signatures faced legal resistance due mistrust, lack of knowledge and misperception about its security, just to mention a few despite being used in practice. Just like the Model Law on Electronic Commerce, the UNCITRAL Model Law on Electronic Signatures (Model Law) is based on the principles of functional equivalence. The UNCITRAL argues that the same functions and purposes of a manuscript signature can be achieved by an electronic signature and in terms of security, an electronic signature might be more efficient.

The Model Law is founded on the principles underlying article 7 of the UNCITRAL Model Law on Electronic Commerce in relation to the function of electronic signatures in the electronic environment. It aims to provide electronic signatures with a legal force through encouraging reliability and trust on the use of electronic authentication techniques, demonstrating functional equivalence and efficiency of electronic signatures, providing legal certainty to the use of electronic signatures in international trade and assisting States in their statutory drafting dealing with modern authentication techniques.¹⁹⁶ Article 2 of the Model Law define an electronic signature as *“data in electronic form in, affixed to or logically associated with, a data message, which may*

¹⁹⁵ C Reed ‘What is a signature’ (2000) 3 *Journal of Information Law & Technology*.

¹⁹⁶ UNCITRAL Model Law on Electronic Signature

be used to identify the signatory in relation to the data message and to indicate the signatory's approval of the information contained in the data message."¹⁹⁷

The principle of functional equivalence is emphasised in Article 3 of the Model Law which provides for equal treatment of signature technologies. One would agree that equal recognition and treatment of signature technologies is essential for the development of economy and efficiency in international trade.¹⁹⁸ The Model Law is not automatically binding between the parties unless they have elected to be bound by it.¹⁹⁹ How the fact that the Model Law is meant to assist States with their statutory drafting, this would mean harmonisation of national statutory from different jurisdiction with regards to electronic authentication techniques and therefore creating legal certainty at a global level. Once electronic signatures are equally treated with handwritten signatures then one would not have legal problems with authentication of electronic letters of credit.

3.5 BILL OF LADING ELECTRONIC REGISTRY ORGANISATION (BOLERO)

The terms of most letters of credit requires that the credit will be honoured upon presentation of complying documents. These documents must strictly comply with the terms and the most important documents are the bill of lading, commercial invoices and insurance documents.²⁰⁰ For purpose of this research, attention is payed to the bill of lading. The bill of lading can be described as a document that evidence a contract of carriage of goods issued by the carrier acknowledging that they have received the goods for transportation.²⁰¹ This is a document of title; the holder of the document is entitled to possession of the cargo and the right to ownership of the goods.²⁰² The traditional bill of lading can be distinguished between a straight (non-transferable/non-negotiable) bill and transferable/negotiable bill.²⁰³ In this digital age, the introduction of an electronic bill of lading to support the electronic letter of credit was inevitable. According to Caslav P, an e-bill can be described as "*data inserted in*

¹⁹⁷ Article 2 UNCITRAL Model Law on Electronic Signature

¹⁹⁸ Guide to Enactment of the UNCITRAL Model Law on Electronic Signatures (2001)

¹⁹⁹ Article 5 UNCITRAL Model Law on Electronic Signatures

²⁰⁰ ME Civelek & Others 'eUCP and Electronic Commerce Investments: e-Signatures and Paperless Foreign Trade' (2015) <http://dx.doi.org/10.17740/eas.econ.2015-V3-05>.

²⁰¹ See Civelek (n197) above 64.

²⁰² See Civelek (n197) above 64.

²⁰³ See Civelek (n197) above 64.

*a computer that is transmitted electronically, using electronic messages, so that an e-Bill consists of the series of electronic messages sent and received among a carrier, shipper, and consignee.*²⁰⁴

In practice, several e-Bills systems have been developed to facilitate issuing and transfer of electronic bills of lading, which include Bolero, essDOCS (2010) and e-title TM (2015).²⁰⁵ The Bolero is the most commonly used e-bill system and this research will be restricted to it. This was initiated by the ICC together with Through Transport Club (TTC) and the Society for Worldwide Interbank Financial Telecommunication (SWIFT).²⁰⁶ In order to understand e-bill process, reference must be made to Electronic Data Interchange (EDI). EDI is a platform that allows transmission of electronic data between interconnected multi-users, including carriers, shippers, banks, forwarders, etc, under agreed standards, directly between different computer systems in conjunction with telecommunication interfaces.²⁰⁷ This platform requires parties to use the same software and computer systems to transmit data among parties under the agreed format.²⁰⁸ Therefore an e-bill is issued then transferred via EDI from the carrier to the shipper, and the shipper is provided with a private key which ensures authentication and integrity of the transmission.²⁰⁹

The parties under the Bolero system are bound by the Bolero “Rulebook” which regulate the electronic central registry for bills of lading. The e-bill issued is authenticated by a digital signature which encourage a move from traditional paper-based bills of lading to electronic bills of lading, therefore supplementing electronic letters of credit process. The Bolero e-bill process have been recognised by international commercial community although it is binding between Bolero members.

3.6 CONCLUSION

In a nutshell, the initiatives of the UN, ICC and other trading organisations through Model Laws has been a crucial instrument towards global recognition of electronic

²⁰⁴ P Caslav ‘Documents of Title in Carriage of Goods by Sea under English Law: Legal Nature and Possible Future Directions’ 158 Ppp *published* 16/0612004 43-83.

²⁰⁵ See Caslav (n205) above 43-83.

²⁰⁶ See Caslav (n205) above 43-83.

²⁰⁷ S Eiselen ‘The electronic data interchange agreement’ (1995) 7 South Africa Mercantile L.J. 1,

²⁰⁸ TMA Doan ‘Switching paper to electronic bills of lading: legal perspective and reform options for Vietnam’ Msc Dissertation, World Maritime University.

²⁰⁹ J Senekal ‘The electronic bill of lading: A legal perspective’ (2010) LLM Thesis <https://dspace.nwu.ac.za/bitstream/handle/10394/4995/senekal>.

letters of credit. Complete implementation of electronic communications in international trade is a matter of time and the Model Laws have already paved a legal path for countries to follow. One can safely argue that the current Model Laws are sufficient to regulate the operations of electronic letters of credit in trade, but it is a matter of domestic laws which are failing to adapt to the digital age and give effect to international customs and practices of merchants and banks. Full implementation of electronic communications will have a positive effect towards increased efficiency and increased trade through less costly and faster transactions. The following chapter will critically analyse the benefits of electronic communications in international trade transactions against those of traditional paper-based communications.



CHAPTER 4

FUNCTIONAL EQUIVALENCE, EFFICIENCY & RELIABILITY OF ELECTRONIC LETTERS OF CREDIT

4.1 INTRODUCTION

The conceptual frame-work of this chapter is derived from the principle of functional equivalence, efficiency and reliability of an electronic letters of credit. This chapter will utilise a comparative approach to analyse the efficiency and reliability of traditional paper-based methods of payment against electronic methods of payment. The technical nature of an electronic signature will be examined as well as the level of security offered by electronic signatures as compared to manuscript signatures.

This research argues that electronic letters of credit must be recognised as functionally equivalent to documentary letters of credit. It further argues that electronic letters of credit provide a higher level of security, reliability and efficiency as compared to paper-based letters of credit. The research maintains that, the benefits of using electronic letters of credit outweighs those offered by paper-based documentary letters of credit.

4.2 THE FUNCTIONS OF ELECTRONIC LETTERS OF CREDIT IN TRADE

The electronic letters of credit as modern international payment method, aims to replicate the functions of the traditional paper-based documentary letter of credit. The researcher is of the opinion that the electronic letters of credit have provided more than just a replication of paper-based letters of credit and its benefits will be discussed in the following chapter. Considering the fact that electronic letters of credit provide the same functions as paper-based letter of credit, they must not be discriminated against in practice as of less important or of less evidential weight.

The principle of functional equivalence entails that where the law or practice requires a handwritten signature for authentication of a letter of credit, such requirement can also be met by the use of an electronic signature to authenticate a letter of credit. An electronic signature is equated to a handwritten signature on the basis that both forms of signatures perform the same function, therefore they must be afforded the same legal status. Similar to a handwritten signature which must be signed in the presence

of a witness, an electronic signature must be verified by an independent party by way of a digital certificate issued by a Certificate Authority.²¹⁰

4.3 THE BENEFITS OF ELECTRONIC LETTERS OF CREDIT IN TRADE

Considering the rate at which the digital era is progressing, the use of paper documents will be completely abandoned. The use of electronic documents has spread in both domestic and international jurisdictions and in some instances it is compulsory or no paper document is allowed.²¹¹ However, the extent to which electronic formats are being used in trade is not to the satisfactory level of the eUCP, paper documents are still prevailing.²¹² This has negative impact on trade since paper documents cannot be scanned and converted into image file then send through the internet as that would cause the documents to lose legal validity.²¹³ As a result, such documents are supposed to be delivered by couriers in their original form and that is a long and costly process. Despite the fact that paper documents are still widely used, the use of electronic documents is spreading quickly in international business community.²¹⁴ The preparation for introduction of electronic documents goes way back to the initiatives of the UNCITRAL, ICC and other international organisation although local statutes keep on standing in the way of e-trade.²¹⁵

The world of commerce is constantly in pursuit of efficiency as well as maximizing profit from its operations. Merchants and banks took advantage of the internet and introduce electronic letters of credit which are more efficient and cost effective through fast transmission of documents via the internet. Electronic letters of credit provide higher levels of authenticity and integrity as compared to traditional documentary letters of credit. This creates an environment of trust and confidence which is conducive for international business transactions. The transmission of complying documents required in terms of a letter of credit via the internet results in fast processing of goods at the border and ports, therefore maximizing profit through reduced cost. This would also cause increase in the world trade volume and products will become less expensive as it shortens business processes.

²¹⁰ S Mason 'Electronic Signatures in Practice' (2006) 148 Journal of High Technology at 151.

²¹¹ ME Civelek and others 'eUCP and Electronic Commerce Investment: e-Signature and Paperless Foreign Trade' (2015) Vol 3 Online Publication <http://busecon.eurasianacademy.org> 60-70.

²¹² Civelek (n211) 60-70.

²¹³ Civelek (n211) 60-70.

²¹⁴ Civelek (n211) 60-70.

²¹⁵ Civelek (n211) 60-70.

Contrary to paper-based letters of credit where complying documents can be easily forged by the beneficiary or any third party, the electronic letters of credit complying documents which are submitted electronically cannot be easily forged as they are examined by an electronic system. Moreover, a signing party to an electronic letter of credit has exclusive control over the electronic signature contrary to a handwritten signature which can easily be forged by a third party by just signing a similar signature.²¹⁶ This gives an electronic letter of credit more advantages as compared to paper-based letters of credit. In the ensuing paragraphs, a comparative approach on the benefits of electronic letter of credit will be explored.²¹⁷

a) Cost reduction

Paper-based letters of credit have paperwork cost due to repetitive data entries, postal and courier expenses, loss of documents and errors in documents. By using electronic equivalent letter of credit, costs relating to paperwork will be eliminated. A lot of business processes will be cut therefore increasing the efficiency of trade institutions.

b) Shorter transmission time

The traditional letter of credit and paper-based complying documents must be forwarded through post or courier and it takes days or even weeks in international trade transactions for the documents to be delivered. On the other hand, electronic documents can be received within two seconds after being sent. In the event that the complying documents are rejected for errors, electronic documents can be corrected on the internet without the need to send them back to the initial sender. Moreover, with paper documents banks need days to examine consistency with the letter of credit and this can be eliminated by electronic documents that can be examined rapidly by an electronic system. The UCP 600 provide banks with a period of five days to examine complying documents and such a long period can be eliminated by making use of electronic letters of credit.

c) Decreased effect of human factor

The electronic letters of credit are governed by common worldwide standards systematically, and this serves to eliminate human errors, bribery and favouritism.

²¹⁶ See Mason (n210) 151.

²¹⁷ Civelek (n211) 60-70.

Documentary letters of credit are executed and examined by humans who makes errors and might bypass some of the regulations.

d) Elimination of archive costs

Archiving of paper documents can be very costly, especially for large institutions like banks and trading companies. Documents are supposed to be stored in a secure place, safe from theft, fire and humidity for a long time. These documents need to be destroyed after the deadline and the process of destroying also involves costs, time consuming and it also take time to retrieve those documents. Electronic documents do not need physical space for storage, and neither are they prone to fire or humidity. To retrieve electronic documents is done automatically through the system and it takes seconds. Destroying of electronic documents would only require pressing of a delete button.

e) Recorded economy

Electronic documents will result in recorded economy and will eliminate irregular activities like tax evasion. This would benefit trade institutions and organisations like the UNCITRAL and the ICC gather trade statics and records. This would not be easy on paper documents and costly to capture all the information.

f) Prevention of fraud

In practice, conforming paper-based documents in terms of the letter of credit are susceptible to fraud through forgery by the beneficiary or third parties and electronic documents eliminate this risk.

g) Language differences stops being a problem

Electronic documents can be converted into desired language without the help of the sender contrary to paper documents which needs an interpreter.

4.4 THE RELIABILITY OF ELECTRONIC LETTERS OF CREDIT IN TRADE

The reliability of an electronic letter of credit refers to its quality of being trustworthy as an international payment method. The trustworthiness of an electronic letter of credit is mostly based on its nature, that is, electronic format and its authentication process. Electronic documents need to have an electronic signature in order to legally qualify

as a document.²¹⁸ Electronic documents can be described as a file created by a computer programme and the authenticity and the content of the signature must be confirmed to be original by a certificate authority.²¹⁹ Although many countries have enacted statutes recognising electronic signatures, one should not be too optimistic to think that electronic communications in international trade will automatically be accepted due to its cost benefits and that paper documents will completely disappear.²²⁰ Despite many countries enacting electronic signature laws, these laws are different from one jurisdiction to another.²²¹ UNCITRAL Model Laws have not successfully solve this dilemma since they are not binding, only if parties elect to be bound.

4.4.1 WHAT IS AN ELECTRONIC SIGNATURE

A document must be electronically signed by the sender in order to be authentic. Currently, there is no specific definition of electronic signatures that is agreed upon internationally.²²² However, many scholars have attempted to define an electronic signature. Mason S, defined an electronic signature as “*anything in electronic form that can be used to indicate that a signing entity intended their signature to have legal effect.*”²²³ Some scholars also defined it as “*any symbol, mark or method accomplished by electronic means, executed by a party with the present intent to be bound by a record and to authenticate a record.*”²²⁴ In simple terms, an electronic signature is nothing else but just a signature that is generated by a computer.²²⁵

Article 7 of the UNCITRAL Model Law on Electronic Commerce described an electronic signature as a method used to identify a signatory of a record and to indicate acknowledgement of the content of the document.²²⁶ The Model Law on Electronic Signatures further incorporated this article and the provisions relating to reliability of a signature.²²⁷ Scholars like Fitzgerald B and others, described an electronic signature

²¹⁸ Civelek (n211) 60-70.

²¹⁹ Civelek (n211) 60-70.

²²⁰ Civelek (n211) 60-70.

²²¹ Civelek (n211) 60-70.

²²² B Fitzgerald and others *Internet and E-commerce law; Technology, law and policy* (2007) at 542.

²²³ S Mason ‘Electronic signatures in Law’ 4th ed (2016) 17, 38 & 66.

²²⁴ SE Blythe ‘Digital Signature Law of the United Nations, European Union, United Kingdom and United States: Promotion of Growth in E-Commerce with Enhanced Security’ (2005) 11 *Richmond Journal of Law and Technology* 1 at 3.

²²⁵ Mason (n 223) 38 & 66.

²²⁶ UNCITRAL Model Law on Electronic Commerce at Art. 7.

²²⁷ UNCITRAL Model Law on Electronic Commerce at Art. 6.

as an electronic confirmation of the authenticity of electronic communications.²²⁸ In order to understand electronic signatures, there is a need to first examine the functions and purposes of manuscript signatures and what is it that gives them legal effect. For instance, in the Australian case of *Howley v Whipple*,²²⁹ the court made emphasis on the function of the signature rather than its form or how they are executed. It is a matter of the intention of the parties being expressed on the document.

In the leading English case of *Goodman v J Eban Ltd*,²³⁰ the court held that a rubber stamp was sufficient to authenticate a document and to provide evidence of the intention of parties. The major factor to consider is whether the signature provide evidence of authentication of a document as intended by the signatory.²³¹ In the English case of *Harrison v Harrison*,²³² the court accepted marking of a cross as a form of signature. A cross can be easily forged which is contrary to an electronic signature. Moreover, the use of fictitious names as a signature has been accepted,²³³ as well as the use of initials in *Phillimore v Barry*.²³⁴ These traditional forms of signature are still currently in use given the change of circumstances and one can question the reliability of these signature in the modern day.

The purpose of signing a document will continue to exist, but it is the manner in which traditional signatures are executed that is aimed at eliminating. For example, most banks and institutions are now using a biodynamic version of a manuscript signature, which is a special pen and pad measure that record the writing of the person as they sign.²³⁵ This is still a manuscript signature but in a digital form. Consequently, paper-based documents and the requirements of handwritten signature is being eliminated in practice due to technological advancements. In *re Reddings Goods* (1850) 14 Jur 1052

²²⁸ B Fitzgerald and others *Internet and E-commerce Law, Business and Policy* (20011) at 817.

²²⁹ *Howley v Whipple* 48 NH 487 (1869)

²³⁰ *Goodman v J Eban Ltd* [1954] 1 QB 550

²³¹ C Reed 'What is a Signature?' (2000) 3 *The Journal of Information Law and Technology* <http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2000>.

²³² *Harrison v Harrison* (1803) 8 Ves Jun 185; 32 ER 324.

²³³ *In re Reddings Goods* (1850) 14 Jur 1052.

²³⁴ *Phillimore v Barry* 1 Camp 512; 170 ER 1040.

²³⁵ See Mason (n210) 157.

4.4.2 FUNCTIONS OF ELECTRONIC SIGNATURES

Signatures ensure authentication and the integrity of the signed record.²³⁶ Mason underscored that authentication of a record provides two functions, that is, verifying the identity of the signer and verification of the originality of a record.²³⁷ In the event that a signature is accepted by a court of law, the signatory is not allowed to deny the authenticity of the document associated with the signature.²³⁸ A signature legally binds the signatory to the content of the document.²³⁹ This practice promotes trust and confidence between contracting parties.

In Common law jurisdictions, the signatory's intention determines the function and weight to be attached to a signature as evidence rather than the form of the signature.²⁴⁰ The same functions can be achieved by a manuscript signature can also be achieved by an electronic signature, that is, authentication of the parties, non-repudiation of transactions and integrity of communications.²⁴¹ Electronic signatures do not only provide evidence of authentication and intention of the signatory but also the identity of the signatory as illustrated in *Harding v Brisbane City Council*.²⁴²

Despite differences in nature and characteristics, an electronic signature is equated to a handwritten signature.²⁴³ The same function that is served by a handwritten signature can also be served by an electronic signature, that is, to authenticate, integrity and non-repudiation.²⁴⁴ Authentication means ensuring that the person or institution to a communication is who they are purported to be.²⁴⁵ The source of the communication must be clear and known. The integrity of an electronic communication refers to its ability not to be altered in the process of transmission. The recipient of a communication must be confident about the accuracy and completeness of the communication and be able to rely on it. The function to ensure non-repudiation refers

²³⁶ M Wang 'The Impact of Information Technology Development on Legal concept – A Particular Examination on the Legal concept of "Signature"' (2007) 15 Int'l JL & Info Tech 253 at 264.

²³⁷ S Mason & others 'England and Wales' in Stephen Mason (ed) *Electronic Evidence* 3ed (2012) 327 at 390.

²³⁸ Fitzgerald (n222) 542.

²³⁹ Fitzgerald (n228) 819.

²⁴⁰ See Mason (n210) 152.

²⁴¹ Fitzgerald (n228) 820.

²⁴² *Harding v Brisbane City Council* ([2008] QPEC 75).

²⁴³ CM Sjoberg & Anna Norden 'Managing Electronic Signatures: Current Challenges' 47 *Scandinavian Studies in Law* 79 at 83.

²⁴⁴ TJ Smedinghoff & RH Bro 'Moving with Change: Electronic Signature Legislation as a Vehicle for Advancing E-Commerce' (1999) 17 *John Marshall Journal of Computer & Information Technology Law* 723.

²⁴⁵ Fitzgerald (n222) 543.

to the fact that once a party has signed they cannot later dispute the contents of the communication. Therefore, this guarantees parties that once an agreement is reached, no party may ambush the other with changes even if they later change their minds.²⁴⁶

This is all centred around ensuring an environment of trust and confidence, for instance, witnessing of signatures, letterheads and paper with watermarks, to ensure that the signature and content associated with it is authentic, reliable and genuine. Although there is low level of trust on electronic signatures, in reality it offers high level security as compared to manuscript signatures, through methods like personal identity number (PIN), digital fingerprint and iris scan, to mention just a few.

4.4.3 TYPES OF ELECTRONIC SIGNATURE

Electronic signature is a broad term that encompasses a variety of signatures in different electronic forms. There are different types of electronic signature which are all designed to indicate the intention of a signing party to authenticate the document.²⁴⁷ The most commonly used and accepted type in practice is a digital signature.²⁴⁸ This research will briefly discuss types of electronic signatures used in practice but limited to those listed by the UNCITRAL in Promoting Confidence in Electronic Commerce, which are the following:

- a) Biometrics
- b) Digital signatures
- c) Passwords and Hybrid Methods; and
- d) Scanned and Typed signatures²⁴⁹

a) Biometrics

This is a technology that identifies a signatory through their unique biological features and characteristics like, fingerprints, iris scan, DNA, voice, hand or facial geometry, facial thermogram, typing patterns and handwriting. The biometric technology captures samples of these features in digital form and the information collected from the sample is used to create a reference sample. The identity of the person whose biometric sample matches is then confirmed as the signatory or their authenticity of the

²⁴⁶ Fitzgerald (n222) 543.

²⁴⁷ See Mason (n210) 157.

²⁴⁸ See Mason (n 210) 151

²⁴⁹ UNCITRAL, Promoting Confidence in Electronic Commerce: Legal Issues on International Use of Electronic Authentication and Signature Method (2009) 16 http://www.uncitral.org/pdf/english/texts/electcom/08-55698_Ebook.pdf.

communications is verified through matching their biometrical data with the ones on reference template.²⁵⁰

b) Digital signatures

These are electronic signatures that are designed to provide a high level of authentication and integrity. Digital signatures make use of encryption to provide the authenticity of electronic messages and to ensure integrity of the record. The technological application of the Asymmetric cryptography, which is a form of encryption, make use of algorithmic functions to create distinct but mathematically related pair of keys which comprise of a public key and a private key. The public key is unique but available to anyone who requires it freely. While the private key is unique but kept confidential by an individual. The digital signature is created by one of the keys and encrypt a hash or digest of a document, therefore making it unreadable, while the other key is used to verify the digital signature and convert the message to its original state.²⁵¹ An electronic communication is encoded by a public key and only the person with a private key can decode it. In many Civil law jurisdictions, a digital signature is afforded greater legal effect as compared to other forms of electronic signatures.²⁵²

c) Password and hybrid method

Codes and passwords are used as methods to get access to information or services as well as to sign electronic records. They are mostly used as authentication method for access control and identity verification in most transactions, for instance, internet banking and credit card transactions.²⁵³

d) Scanned signatures and typed names

Most day to day transactions do not make use of any specific authentication or signature technology but rather electronic communications are authenticated in the form of email messages that have name and address of parties. In some cases, a digital image of an original handwritten signature is created as a formal signature. The level of security and authentication is very low but they are mostly used on a daily

²⁵⁰ UNCITRAL (n 249) 27-29.

²⁵¹ UNCITRAL (n 249) 17-27.

²⁵² See Mason (n210) 151.

²⁵³ UNCITRAL (n 249) 29.

basis because of their cost-effectiveness and easy to verify the originator of the message.²⁵⁴

4.5 CONCLUSION

The failure to recognise and afford electronic letters of credit equal evidential weight compared to paper-based letters of credit in litigation due to their electronic nature has been stumbling blocks to the progression of e-trade. This has a negative impact to economic growth of both trading parties as parties are forced to relying on paper-based letters of credit which are less efficient. The principle of functional equivalence as discussed above, clearly illustrate how electronic letters of credit functions similar to paper-based letters of credit and both should be afforded the same legal status. One can safely argue that electronic letters of credit provides more advantages as a payment method compared to paper-based letters of credit and the law should give effect to this modern development.

Banks and merchants have trust and confidence in electronic letters of credit, it is the law that traders do not have trust in. The electronic nature of documents provides more security which means less risk for traders. International trade is nothing but management of risk. This chapter have shown that an electronic signature can fulfil the purpose of a handwritten signature. As a result, one can conclude that discriminatory laws against any type of electronic signature is not justified. In fact, this chapter reflects that the use of electronic signature to authenticate letters of credit is beneficial to traders through reliability, high level of security and efficiency. Hence courts and legislatures should move away from technophobia and start to embrace new technology which aims to eliminate the requirement of a handwritten signature for authentication. The researcher calls for domestic legislatures to review their electronic commerce statutes to be in line with the practice of traders. The question remain unanswered is the extent of legal implications of using electronic letters of credit in international trade. The follow chapter will address evidential legal implications of the use of electronic letters of credit.

²⁵⁴ UNCITRAL (n 249) 30.

CHAPTER 5

LEGAL IMPLICATIONS

5.1 INTRODUCTION

The current laws of evidence are as a result of the changing circumstances of the past. Due to the widespread of the Roman law in the twelfth and thirteen countries throughout Europe as common law, credibility began to be attributed to records.²⁵⁵ In order to meet the required standards, forgery of documents became the order of the day.²⁵⁶ As a result, rules had to be put in place to circumvent this problem, for example formality requirements for the creation of a record, originality of records and authentication of records by experts when required as proof of a fact at issue.²⁵⁷

The law had to keep up with the changing circumstances of the time and two basic rules of evidence were established, that is, the best evidence rule and the authentication rule. The best evidence rule requires that the original record must be submitted as evidence before court, while the authentication rule requires that records submitted as evidence of a fact at issue must be what it purports to be.²⁵⁸

The advancement of technology through electronic documentary letters of credit challenges the traditional rules of evidence and procedure, therefore a need for new laws. For instance, the applicability of the best evidence rule would be redundant to electronic records where it's difficult to determine the original electronic version. The authentication rule will not be applicable as well since authenticity of an electronic record cannot be established on face value of the document but rather through an investigation into unbroken lines of traces up to the legitimate sender.²⁵⁹ This is all because of the complexity around the digital environment which can no longer be accommodated by traditional laws of evidence and procedure. The digital environment is ever changing and the laws should also keep up with the changing circumstances and the law must be updated from time to time.

²⁵⁵ L Duranti & others 'Electronic Records and the Law of Evidence in Canada: The Uniform Electronic Evidence Act Twelve Years Later' (2010) *Archivaria* 70 *The Journal of the Association of Canadian Archivists* 96.

²⁵⁶ Duranti (n 255) 96.

²⁵⁷ Duranti (n 255) 96.

²⁵⁸ H MacNeil *Trusting Records: Legal, Historical, and Diplomatic Perspectives*

²⁵⁹ H MacNeil 'Providing Grounds for Trust: Developing Conceptual Requirements for the Long-term Preservation of Electronic Records' *Archivaria* 50 (2000) 52–78.

The common law evidentiary rules were designed to deal with the admissibility, relevance and evidential weight of paper-based documents. No anticipation to electronic risk of unreliability, forgery or fraud was made. There is a high risk of incorrect findings if courts continue to rely on ancient laws of evidence to modern pieces of evidence.²⁶⁰

Although some jurisdictions have enacted statutes to govern electronic transactions in line with the UNCITRAL Model Laws and the eUCP, for example the South African Electronic Communications Act²⁶¹ and the Canadian Uniform Electronic Evidence Act,²⁶² not all jurisdictions have followed suit and it is problematic since trade is a reciprocal international transaction. Authors argued that the problem relating to laws of evidence and procedure with regards to admissibility of electronic records in litigation cannot be resolved by a once of legislation but rather a continuous update of the legislation in line with technological changes.²⁶³ Important factors to consider when enacting electronic statutes would be reliable creation of electronic records that are trustworthy and inviolate over a long period of time.

Despite the law's failure to give effect to modern technology, some judges have expressed willingness to acknowledge and admit modern technological evidence to the extent that the evidence is reliable and does not conflict with the judicial process.²⁶⁴ On the other hand, some judges argue from a conservative point of view in support of the rule of law preferring the legislature to take a lead in updating the common law to meet technological changes.²⁶⁵ The Canadian Supreme Court stated that the courts' role should be limited to "incremental" updating of common law to suit the changing circumstances without encroaching into the legislature's sphere which is responsible for major reforms.²⁶⁶ This research agrees with the argument that reforming of ancient laws of evidence is the role of the legislature and it falls out of the court's jurisdiction

²⁶⁰ Duranti (n 255) 96.

²⁶¹ Electronic Communications Act No. 25 of 2002.

²⁶² Uniform Electronic Evidence Act (1998).

²⁶³ LB Moses 'Recurring Dilemmas: The Law's Race to Keep Up with Technological Change' UNSWLRS 21 (2007) <http://www.austlii.edu.au/cgi-bin/sinodisp/au/journals/UNSWLRS/2007/21.html> (accessed on 20/09/2019).

²⁶⁴ *R v Nikolovski* [1996] 3S.C.R. 1197, 141 D.L.R. (4th) 647.

²⁶⁵ *Myers v Director of Public Prosecutions* [1965] A.C. 1001 (H.L.), not followed in *Ares v Venner* [1970] S.C.R. 608, 14 D.L.R. (3d) 4.

²⁶⁶ *Grant v Torstar* [2009] 3 S.C.R. 640, 2009 SCC 61, para 46.

which are only responsible for adjudication of legal disputes through interpreting the law.

The Canadian courts have recognized the shortfalls of the old laws of evidence in relation to technological advances and acknowledged that the best evidence rule cannot be applied strictly to electronic records.²⁶⁷ Although some judges argue that the admissibility of electronic records should be based on compliance with the requirements of the current laws of evidence.²⁶⁸ One can argue that such a standpoint of view would undermine the initiatives made by the UNCITRAL, ICC and other trading institutions as well as newly enacted statutes on admissibility of electronic records.

5.2 APPLICABILITY OF THE LAW OF EVIDENCE

Electronic credit users need to be aware of the fact that the documents issued or presented must remain in their original form to avoid running the risk of inadmissibility of such documents if required as evidence in court.²⁶⁹ Electronic communications have been facing legal challenges to be fully incorporated and recognised in international trade transactions. Among the legal challenges is the applicability of the law of evidence on electronic records. The old laws of evidence were not designed to deal with modern electronic records and the law makers have failed to solve this lacuna by keeping up with the trade practices, customs and usage of merchants. As a result, the authentication of electronic messages is crucial to merchants, banks and lawyers, and not only for evidential purposes but also for content and financial consequences.²⁷⁰

Although the UNCITRAL Model Laws on Electronic Commerce and Signature provide for admissibility of electronic communications, this might not be applicable under domestic jurisdiction or between parties who have not elected to be bound by it.²⁷¹ The transmissions may not be admissible at law. In the event that electronic communications are admitted as evidence in court, the evidential weight attached to it varies with weight attached to paper-based documents.²⁷²

²⁶⁷ *Kamloops Square Management Ltd v Baron* [2006] BCCA 37, 51 B.C.L.R. (4th) 360 at para 14–16.

²⁶⁸ *R v Ganes* [2005] S.J. No. 832 (Prov. Ct.).

²⁶⁹ A Davidson 'Electronic Records in Letters of credit' (2011) <https://www.uncitral.org>>UNCITRAL-paper (accessed 13/09/2019).

²⁷⁰ Davidson (n 269) 8-16.

²⁷¹ UNCITRAL Model Laws on Electronic Commerce (1996) & Electronic Signatures (2001).

²⁷² Davidson (n 269) 8-16.

The application of the “best evidence” principle is also a contributing fact as courts are obliged to disregard otherwise relevant material. This principle comprises of two main exclusionary rules, that is, the rule against hearsay evidence and the rule against accepting secondary contents of a document if the original copy is available.²⁷³ The rule against hearsay evidence regard such evidence as untested and unreliable.²⁷⁴ The secondary evidence is the most detrimental in relation to electronic records and it is often referred as the “best evidence” rule.²⁷⁵ However, exceptions are applicable to these rules. This is an old rule which originates from an English case of *Omychund v Barker*,²⁷⁶ where Lord Harwicke held that no evidence was admissible unless it was “the best that the nature of the case will allow”. The general rule provides that secondary evidence will not be admissible if the primary material is available.

The hearsay rule is not without exceptions, the exception rules required the evidence submitted to be reliable and necessary.²⁷⁷ In practice, the litigant is required to produce external evidence to prove authenticity of the disputed record and in most cases a witness with personal knowledge of the document to acknowledge the record.²⁷⁸ Although this practice continues to be used to electronic records in local jurisdictions, this would not be practical in international trade due to the nature of long-distance transactions involved.

There are debates over which version of an electronic message is an original and the requirement that documents must remain in their original form might not be applicable to electronic messages. Some argue that at least eight copies of an electronic message are produced from the creation to receipt of the message²⁷⁹ There are no answers as to which copy is admissible as the original. However, the majority argue that the original electronic message is the one created by the sender and the recipient only receives a copy.²⁸⁰ On the other hand, a few argue that the original version is the one with the recipient, especially in instances where changes were made to the electronic message in the process of transmission through data fluctuations.²⁸¹ There

²⁷³ Davidson (n 269) 8-16.

²⁷⁴ Davidson (n 269) 8-16.

²⁷⁵ Davidson (n 269) 8-16.

²⁷⁶ *Omychund v Barker* (1745) 1 Atk 21, 49; 26 ER 15, 33.

²⁷⁷ Davidson (n 269) 8-16.

²⁷⁸ Davidson (n 269) 8-16.

²⁷⁹ Alan Davidson, "Retaining Electronic Mail for Evidentiary Purposes", (1999) 6 *Proctor* 30, 30.

²⁸⁰ Davidson (n 269) 8-16.

²⁸¹ Davidson (n 269) 8-16.

are no answers yet as to which of the copies is admissible as the original version. Due to the complexity around electronic messages, the requirement that documents must retain their original status to be legally admissible might not be applicable.

The application of the secondary evidence rule is based on physical evidence and when dealing with electronic letters of credit we are dealing with intangible evidence and this rule should not be applicable. This argument can be supported by the majority judgment of the Australian High Court in the case of *Butera v Director of Public Prosecutions for the State of Victoria*.²⁸² The court held that the best evidence rule should not apply to exclude copied audio tapes “*provided the provenance of the original tape, the accuracy of the copying process and the provenance of the copy tape are satisfactorily proved*” The same can be argued for admissibility of printed version of electronic letters of credit and also considering the fact that the best evidence rule is an ancient principle which goes back as early as the 16th century.²⁸³ In the above-mentioned case, the court adapted to changing circumstances and gave effect to technological advancement through giving its self a discretion to accept the evidence and consider the weight to be attributed to such evidence. Although one might argue that this goes against the principle of the rule of law, in such circumstances the court is justified for making a decision that is fair and equitable. The burden is now left to lawmakers to update the laws.

Some argue that all documents must be admissible whether paper-based, electronic or copies and the only difference there should be the weight attached to the document rather than admissibility of the document based on its nature. In *Butera* case, Dawson J, argue that “some modes of proof are better than others, but it is weight attached to it rather than admissibility.” The same can be argued that, not all admissible evidence is accepted by courts and all admissible evidence is not afforded the same weight. Ch’ng Huck Yong, argues that, courts should take judicial notice of the benefits that comes with the use and widespread of electronic communications.²⁸⁴

5.3 PROVING HARD COPIES OF ELECTRONIC RECORDS

One of the major problems facing banks and merchants in litigation is to prove hard copies of electronic records before courts and to have such evidence admitted. This

²⁸² *Butera v Director of Public Prosecutions for the State of Victoria* (1987) 164 CLR 180, 186.

²⁸³ See *Duranti* (n 255) 96.

²⁸⁴ CH Yong ‘International Trends in Documentary Transactions’ (1993) 14 *Sing L.R.* 171, 213-4.

has been the major stumbling block to implementation of the eUCP and use of electronic letters of credit. The laws of evidence do not equally protect electronic records as compared to paper-based records therefore relying on electronic records creates a higher risk to traders. In the United States case of *Armstrong v Executive of the President*,²⁸⁵ the court had to decide the status of a hard copy printout of an email. The court held that the printed version does not capture all the relevant information which is available on an electronic version. An electronic version presents the linkage between the messages sent, the date of transmission and the date of receipt, among other information which cannot be captured by a printout version.

Some jurisdictions have abolished the secondary evidence rule and, in such jurisdictions, electronic documents should be admissible and afforded equal weight upon considering all relevant factors.²⁸⁶ A legitimate question that the courts should enquire after admitting a hardcopy printout is why the original document is not present. The simple answer to this question is most courts and the laws of evidence do not provide a platform for presentation of electronic documents.

In *Armstrong* case, Richey J held that a printout version does not capture all the relevant information contained in the electronic version. One can argue that in applying the secondary evidence rule, relevant information is excluded and treated as less liable. Therefore, with regards to electronic records, this rule cannot be applicable since the original document cannot be easily determine between the one with the recipient or the one with the sender. One copy is created in the sender's RAM space, temporary space and permanent space and when the data message is sent, it is copied to the internet service provider and then finally another copy to the recipient's RAM space, temporary space and permanent space.²⁸⁷ From this process of transmission, which electronic message should be considered as the original version? One wonders if the best evidence rule should be applicable to electronic records.

There is still legal uncertainty with regards to the status of electronic records due to contradicting judgments by different jurisdictions. The English court of Appeal in *Glencore International v Bank of China*²⁸⁸, rejected an electronic document with a "wet"

²⁸⁵ *Armstrong v Executive of the President* (1993) 810 F Supp.

²⁸⁶ See Davidson (n 269) 8-16.

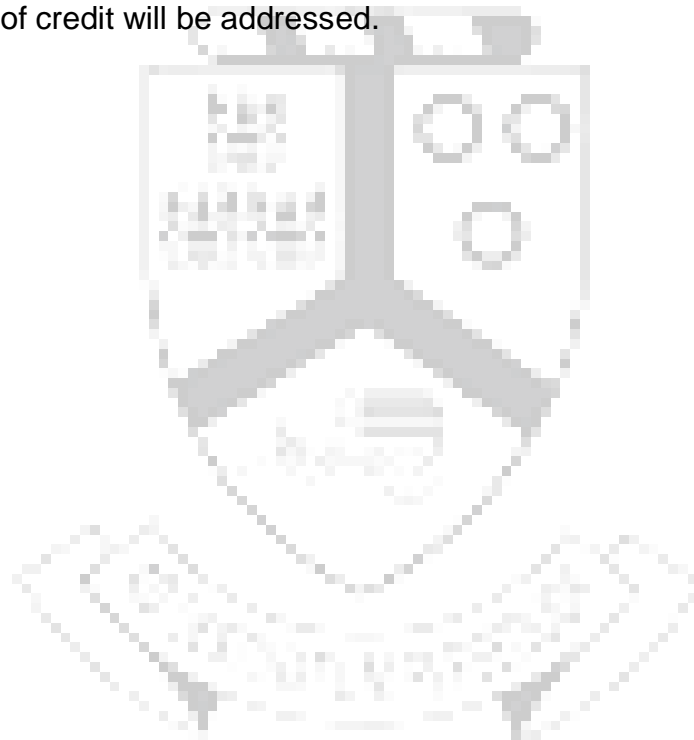
²⁸⁷ See Davidson (n 269) 8-16.

²⁸⁸ *Glencore International v Bank of China* [1996] 1 Lloyd's Rep 135.

signature as an original document on the basis that it appeared to be copied.²⁸⁹ All the aspects of electronic communications for instance emails are not fully addressed by the laws of evidence.²⁹⁰ There is a need to bring evidential laws in line with e-trade and to provide rules for proving authenticity of electronic transmission before courts.

5.4 CONCLUSION

If documents are to be tendered in their original form, there should be platforms to receive electronic records in courts and the modern laws of evidence should be structured to accommodate electronic records. Failure to enact legislation that accommodate electronic evidence will result to incorrect findings if the old laws are applied. The researcher agrees with the argument that the best evidence rule should not be strictly applied to electronic evidence. In the following chapter, recommendations to the current legal problems facing recognition and acceptability of electronic letters of credit will be addressed.



²⁸⁹ JE Byrne 'What's an Original?' (1998) *Documentary Credit World* 42.

²⁹⁰ UNCITRAL Model Law of Electronic Commerce (1996).

CHAPTER 6

RECOMMENDATIONS AND CONCLUSION

6.1 INTRODUCTION

The research revealed that despite most of international commercial transactions being conducted electronically, electronic letters of credit have been facing legal challenges which affect its acceptability in many courts. This is mostly due to ancient evidential principles which were not designed to accommodate modern electronic evidence as well as other factors like uncertainty of electronic signatures, evidential weight of data messages, authenticity, legal validity and enforcement of electronic letters of credit. This has a negative impact to acceptability, trust and legal recognition of electronic letters of credit. However, the chapters above have proven that the benefits of electronic letters of credit outweighs those of paper-based letters of credit.

Practice have shown that in most jurisdictions the principles of evidence have failed to take notice technological changes and still require a handwritten signature for authentication of documents. However, the research has reflected that such admissibility requirements are incompatible with e-commerce.

6.2 SUMMARY OF THE FINDINGS

Chapter 2 provided the historical background of letters of credit as an international payment method. The chapter further looked into the legal nature of a letter of credit and its evolution to electronic letter of credit. The two main underlying principles of the letter of credit were discussed, that is, the doctrine of autonomy and the doctrine of strict compliance. These underlying principles are not without exceptions, which are contracts contrary to law, good morals, or public morals and fraud. The findings reflected that the letter of credit as a payment method has gained the trust and confidence of merchants and banks as it balances the interests as well as reduce the risk of both trading parties. It has proven to be efficient and reliable to the extent of being referred as the life blood of international trade. This chapter has shown that with regards to international payment, letters of credit have proven to be the most effective.

Chapter 3 lay out the legal frame work that governs electronic letters of credit in international trade. The legal recognition of electronic letters of credit was further discussed in light of the UCP and eUCP, UNCITRAL Model Law n Electronic Commerce, Electronic Signature and the Bill of lading Electronic Registry Organisation

as the main sources. The research revealed that electronic letters of credit are internationally recognised as a payment method although there are legal challenges and risks associated with using them in practice.

Chapter 4 utilised a comparative approach to analyse the efficiency and reliability of traditional paper-based methods of payment against electronic methods of payment. The chapter further examined the technical nature of electronic signature as well as its importance to authentication of electronic letters of credit. The findings revealed that the use of electronic letters of credit is more beneficial than to rely on traditional paper-based letters of credit. Furthermore, electronic signatures have proved to be more reliable, efficient and can provide more security than a handwritten signature.

Chapter 5 was the core chapter which addressed the major challenges affecting widespread recognition of electronic letters of credit in international trade. The current laws of evidence were discussed and the finding revealed that modern domestic evidential rules have failed to accommodate electronic letters of credit despite being recognised internationally among traders. It was further revealed that the evidential principles like the best evidence rule are no longer applicable to some of modern electronic evidence.

6.3 RECOMMENDATIONS

Considering the modern technological advancement through electronic records, the researcher is of the opinion that the ancient laws of evidence are not applicable to the nature and characteristics of modern records. Therefore, there is a need for the legislature to enact new laws that are compatible with the modern records in collaboration with records professionals, lawyers, information technology professionals and law enforcement authorities. The new laws must take into account issues relating to admissibility, relevance and weight attached to electronic documentary evidence. Moreover, these laws must be in-line with international statutes of the UNCITRAL, ICC and other international trade organisations for harmonisation of e-trade laws. This will enable courts to come up with accurate findings of facts based on relevant electronic documentary evidence gathered from reliable sources where authentication can be proved. International legal uncertainty with regards to admissibility, relevance and weight attached to electronic documentary evidence in litigation will be eliminated as a result. In addition, this will further create trust among merchants and banks to rely on international statutes such as the

UNCITRAL Model Law on Electronic Commerce and Electronic Signatures due to certainty in legal precedent from different jurisdictions globally.

The laws of evidence must not be drafted in a too restrictive or prescriptive manner in order to accommodate future technological developments. These laws should also aim to recognise electronic evidence from international business transactions the same way electronic evidence from domestic business transactions is recognised without any discrimination. There is also a need for legislatures to move away from drafting of laws of evidence in a language that is biased towards paper documents or interpretation by courts that suggest that paper documents are superior than electronic documents. Moreover, domestic procedural laws should now provide options for e-filing and courts should provide a platform for presentation of electronic records as evidence without the need to printout electronic evidence. This can also be enforced through providing international statutes a legal force between trading parties, therefore domestic legislatures are forced to update their local statutes to be in line with international e-commerce. In addition, the question of reliability of electronic signatures can be solved through the use a digital certificate of internationally accepted certificate authorities.

6.4 CONCLUSION

In a nutshell, this study has revealed that despite wide spread use of electronic payments methods in international trade, there is still legal resistance to accept the changes more specifically of rules of evidence. The use of electronic letters of credit has proved to be the most effective and efficient payment method in trade which should be encouraged to promote economic growth. The promotion of the use of electronic payment methods like electronic letters of credit would solve a number of problems associated with paper-based payment methods, for instance, forgery of document, long processing period and human error, just to mention a few. The aim is to have non-discriminatory rules in local jurisdictions against international electronic transactions. Although there is a slow move towards incorporating international trade statutes into national legislation, countries like South Africa, Canada, UK and USA have taken the initiative to draft e-legislation that is in line with the UNCITRAL Model Laws and e-commerce.

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