

**THE EXTENT OF THE BANKS' DUTY IN PROCESSING DOCUMENTARY
CREDITS IN INTERNATIONAL TRADE**

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(KRMLAU003)

FOR

MASTERS IN COMMERCIAL LAW (LLM) DEGREE

PREPARED UNDER THE SUPERVISION OF

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Research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the Masters in Commercial Law (LLM) Degree in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of the Masters in Commercial Law (LLM) Degree dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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ACKNOWLEDGEMENTS

I wish to thank Professor Dick Christie, my supervisor. I found inspiration in your unwavering dedication to the study of the ever-evolving world of commercial law. Your guidance throughout the entire period that I worked on this dissertation is most appreciated. I am ever so grateful for your continued assistance while I was working from home. I know that computers are not your favourite of toys, but regardless you left no email unanswered. The knowledge I gained from this relationship is invaluable. May you continue going strong. Thank you for being the best supervisor I could hope for.

I also wish to thank Nyaradzo Chari, Mrs Taisekwa Duru (Mainini) and Tainie Mundondo (Mother), for their useful comments and suggestions, and their constructive criticism, all of which helped me to produce a paper of this quality.

To Farai Noble, Lydia Namateefu, Rita Zaramba, and Kudzai Munjeri (Cousin), thank you for being there when I was down and out and needed a helping hand in getting to the next level with my work. I could have never come this far without all you guys in my corner. I wish you all the best in all that you do.

Last but not least, I thank Tinashe 'Shane' Chidakwa, for being there all the way with words of encouragements.

DEDICATION

I dedicate this paper a woman that beat all the odds in raising her two babies, a woman that is my pillar of strength, and my source of wisdom and inspiration, my mother. Thank you for raising me to become the best I can be. This one is for you mum!

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CHAPTER 1

1. INTRODUCTION

Documentary credits, also called letters of credit or banker's commercial credits, are the most common system of payment in international trade and have been described as 'the life blood of international commerce'.¹

The question underlying this presentation is, to what extent is there a positive duty on the part of the participating banks to process documentary credits? That is, by issuing, confirming or advising credit, or paying or reimbursing under a credit. To this end, the relationships between the banks and the applicant and the beneficiary are important as the foundation of the banks' duties under documentary credit and will be discussed in length.

Before delving into the relationships characterizing documentary credits and the resultant duties, it is necessary to explore the basic aspects and concepts underlying documentary credits. In this regard, the point of departure will be defining documentary credits and exploring their scope of application, the need for their existence, and outlining how they work. There is also need to define the parties involved in documentary credits. The seller (exporter) is the applicant for a credit and the buyer (importer) is the beneficiary of the credit. No need arises for these to be defined any further. The major participating banks will however be defined and their general functions will be discussed briefly.

An important component in the documentary credit system is The Uniform Customs and Practices for Documentary Credits (UCP)², published by the International Chamber of Commerce (ICC). Their role in the whole scheme of

¹ Per Kerr L.J. in *R.D Harbottle (Mercantile) Ltd. v National Westminster Bank Ltd* [1978] Q.B. 146, 155.

² The Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No. 500 (UCP 500)

documentary credits will be briefly considered, with emphasis on their place in South African law.

There are two main general duties that befall all banks in the processing of documentary credits that will be discussed. The first of these duties being a duty to strictly comply with the terms of a credit, and the second being the banks' duty to act with reasonable care when dealing with documents tendered under a credit. Outside these two, the banks' other obligations are based on the nature of the relationships between the issuing bank, confirming bank, advising bank, and corresponding banks and the applicant, beneficiary and the banks amongst themselves.

Although to a large extent the duty of processing documentary credits is borne by the banks, it is not an absolute duty and the banks do not shoulder the entire burden of processing documentary credits. The applicant and the beneficiary also have a part to play in the successful completion of the credit transaction. Such duties arise mainly in the event that documents tendered under the credit are rejected for non-compliance. These duties will be highlighted in the course of the discussion.

CHAPTER 2

2.0 AN OVERVIEW OF DOCUMENTARY CREDITS

This chapter gives a brief overview of the scheme of things under documentary credits, setting the foundation for a more detailed examination of the major focus of the presentation. It defines documentary credits, and briefly discusses the need for their existence and how they work. It also looks at the role played by the UCP under South African law, and defines the participating banks.

2.1 Definition of Documentary Credits

Documentary credits cannot easily be defined in any specific terms because there are many different varieties currently in use. Davis notes that to attempt to define documentary credits 'would serve no good purpose, for a commercial letter of credit as such, unlike, for example, a bill of exchange, is not clothed with particular attributes, the absence of any one of which would destroy its legal validity.'³ McCurdy adds, 'to attempt to define a commercial letter of credit would be more than futile. That the use of a definition as a starting point serves to obscure analysis and is a source of legal error is nowhere more evident than in the subject of letters of credit. The variations of documentary credits are almost infinite.'⁴

This difficulty in defining documentary credits has not prevented the formulation of numerous definitions. Such definitions have however described documentary credits only in general terms. According to Goode, 'A documentary credit is in essence a banker's assurance of payment against presentation of specified documents'⁵ An attempt at a detailed definition is contained in the UCP 500. Article 2 provides that:

³ Davis, A. G. *The Law Relating to Commercial Letters of Credit* 3 ed (1963) Pitman & Sons Ltd London 12.

⁴ McCurdy, W. E. "Commercial Letters of Credit" (1921-1922) 35 *Harvard Law Review* 539 542.

⁵ Goode, R. *Commercial Law* 2 ed (1995) Penguin Harmondsworth 964.

For the purpose of these Articles, the expressions “Documentary Credit(s)” and “Standby Letter(s) of Credit” (hereinafter referred to as “Credit(s)”), mean any arrangement, however named or described, whereby a bank (the “Issuing Bank”) acting at the request and on the instructions of a customer (the “Applicant”) or on its own behalf,

- (i) is to make a payment to or to order of a third party (the “Beneficiary”), or is to accept and pay bills of exchange (Draft(s)) drawn by the Beneficiary,
or
- (ii) authorises another bank to effect such payment, or to accept and pay such bills of exchange (Draft(s)),
or
- (iii) authorises another bank to negotiate,
against stipulated document(s), provided that the terms and conditions of the Credit are complied with.

What is important in this and such other attempts at defining documentary credits, is not necessarily the definitions themselves but more importantly the vital characteristics or elements that form documentary credits. The principal element is the opening of a credit pursuant to the existence of a contract between the buyer and the seller. The bank is in no way concerned with, or bound by, such contracts.⁶ This is an agreement separate and independent from the main contract according to which the bank undertakes to satisfy the seller’s claim on condition that the seller or his agent presents certain documents stipulated in the credit. Thus the bank deals in documents and not with the goods, services or performance to which the documents relate.⁷

2.2 The Need for Documentary Credits

Documentary credits have been described as ‘the life blood of international commerce’.⁸ They fulfill more a practical commercial need than a legal one. This need arises out of the very nature of international trade where parties in different countries and very often unknown to each other, trade with each other on a daily basis. It is impossible for payment and delivery to be effected simultaneously as often

⁶ Cranston, R. *Principles Of Banking Law* 2nd ed (2002) Oxford University Press 387.

⁷ Article 4 UCP 500.

⁸ *R.D Harbottle* case (n1 above).

occurs in domestic trade, and neither party is willing to take the risk of being the first to perform its obligations under the sale agreement.

It is in this regard that banks fulfill a critical role in enabling the parties to successfully give effect to the transaction. In executing their role as the neutral third party who can protect the interests of both parties, the banks make use of documentary credits.⁹ It is for this role that '[b]anks are the pivot on which international transactions turn'¹⁰

As Hugo¹¹ notes, documentary credit therefore serve a threefold role in international commerce. They serve a security, a payment and a credit function, all of which are vital to the smooth flow of international trade.

2.3 How Documentary Credits Work

The parties to an international sale transaction may agree that the purchase price shall be paid by means of a banker's documentary credit. The buyer (applicant), who is also the importer, will request his bank (the issuing bank) to issue a documentary credit to the seller (beneficiary), who is also the exporter. The buyer's application for credit will state the documents that the seller must tender and the way in which the goods must be described in these documents.

Once the credit has been issued the issuing bank notifies the beneficiary that a documentary credit has been opened in the beneficiary's favour. This is usually done through a bank in the beneficiary's country. The bank can merely advise (the advising bank) the beneficiary that a documentary credit has been opened or it may confirm

⁹ Booyesen, H. *Principles of International Trade as a Monistic System* (2003) Interlegal, Pretoria, 739.

¹⁰ Booyesen, H. *International Transactions and the International Law Merchant* (1995) Interlegal, Pretoria, 233.

¹¹ Hugo, C. F. *The Law Relating To Documentary Credits from a South African Perspective with Special Reference to the Legal Position Of the Issuing and Confirming Banks* (1996) University of Stellenbosch, 17.

(the confirming bank) the credit. In the latter case the confirming bank undertakes joint and several liability with the issuing bank towards the beneficiary.¹²

Once the beneficiary receives notification of the documentary credit and is satisfied that it meets the terms of the contract of sale and that he can meet the terms and conditions of the credit, the beneficiary will effect shipment and obtain the necessary documentation. The most important document is the bill of lading, which is a document of title. Other documents may include a commercial invoice, an insurance certificate, a certificate of origin, and an inspection certificate. The beneficiary presents all these documents to the advising or confirming bank, and if they are in strict conformity with the documentary credit, the beneficiary is then entitled to payment.

The bank which takes up the documents sends them to the issuing bank. The issuing bank examines the documents and if they satisfy the documentary credit requirements it will reimburse, in the pre-agreed manner, the advising, confirming, or any other nominated bank that has paid, accepted or negotiated under the documentary credit. The conforming documents are then released to the buyer who reimburses the issuing bank. Using the documents, the buyer may then take delivery of the goods successfully completing the sale transaction.

2.4 The Role of The Uniform Customs and Practice for Documentary Credits (UCP)

Documentary credits are classically governed by the UCP which are published by the ICC. The UCP is principally concerned with banking practice, and the focus of its attention is on the bank's duties and liabilities.¹³ These rules are incorporated in general conditions of banking associations and have been adopted by banks in more

¹² Booyesen (n9 above) 739.

¹³ Wilde, K. C. D. M. (ed) *International Transactions: Trade and Investment, Law and Finance* The law Book Company, 80

than 160 countries.¹⁴ As a result of their almost universal adoption, the UCP have brought about a high degree of uniformity to the law.

Article 1 of the UCP states that:

The Uniform Customs and Practices for Documentary Credits ... shall apply to all documentary credits ... where they are incorporated into the text of the Credit. They are binding on all parties thereto, unless otherwise expressly stipulated in the Credit.

Although Wilde¹⁵ notes that '[i]n practice there are very few disputes over the legal nature of the UCP, because the UCP is most often explicitly incorporated in the contract and the letter of credit'¹⁶, it also is true that the legal nature of the UCP has been the subject of much controversy and legal debate. The controversy and debate stems from the fact that the ICC which formulates the UCP is a private organization with no formal legislative power.¹⁷

The legal force of the UCP in South Africa has been explained in the literature and case law. As Booysen¹⁸ explains, the UCP are normally not regarded as having objective legal force, but as having customary legal status. The regular and constant revision of the UCP however is a factor against their classification as customary law. They are considered as trade usages applied in practice by banks the world over. This presupposes that every rule must be tested against the requirements of a trade usage, and it is doubtful whether every rule in the UCP satisfies this criterion. The rules are viewed as attaining legal force by incorporation into the contract in the manner contemplated in Article 2 as noted above. It may be accepted that the rules are so widely known that the parties ought to have contemplated their application. "The legal force of the UCP rules lies in all probability in a combination of the above

¹⁴ Van Houtte, H. *The Law of International Trade* 2nd ed, (2002) Sweet & Maxwell, London, 271

¹⁵ Wilde (n13 above).

¹⁶ Van Houtte (n14 above) 273.

¹⁷ Booysen (n9 above) 741.

¹⁸ As above.

mentioned explanations ... Because of their wide acceptance by the international business community, their status as general principles seems to be unchallenged.”¹⁹

2.5 Participating Banks in Documentary Credits

2.5.1 The Issuing Bank

The issuing bank is “a bank ... acting at the request and on the instructions of a customer (the “Applicant”) or on its own behalf ...”²⁰ that undertakes to pay the beneficiary on presentation of specified documents. In terms of Article 9(a) of the UCP 500, the issuing bank gives a definite undertaking, provided that the stipulated documents are presented to the nominated bank or to itself and that the terms and conditions of the credit are complied with, to perform in one of four ways²¹, depending on whether the credit is available by sight payment, by deferred payment, by acceptance or by negotiation.²²

2.5.2 The Advising Bank

The advising bank is one that advises a credit to the beneficiary without engagement on its part. According to the UCP 500:

A credit may be advised to the Beneficiary through another bank (the “Advising Bank”) without engagement on the part of the Advising Bank, but

¹⁹ Booyesen (n9 above) 742.

²⁰ Article 2 UCP 500

²¹ The four forms of performance are:

- (i) if the credit provides for sight payment, to pay by sight;
- (ii) if the credit provides for deferred payment, to pay on the maturity date determinable in accordance with the stipulations of the credit;
- (iii) if the credit provides for acceptance by the issuing bank itself, to accept draft(s) drawn by the beneficiary and to pay them at maturity, or, if the credit provides for acceptance by another drawee bank, to accept and to pay at maturity draft(s) drawn by the beneficiary on itself in the event the drawee bank stipulated in the credit does not accept draft(s) drawn on I, or to pay draft(s) accepted but not paid by such drawee bank at maturity;
- (iv) if the credit provides for negotiation to pay without recourse to drawers and/or bona fide holders draft(s) drawn by the beneficiary and/or documents presented under the credit.

²² Hapgold, M. *Paget's Law of Banking* 12th ed, (2002) Butterworths LexisNexis, 746-7.

that bank, if it elects to advise the Credit, shall take reasonable care to check the apparent authenticity of the Credit which it advises.²³

When advising a credit therefore, the advising bank must ascertain with reasonable care the apparent authenticity of the credit. If the advising bank cannot establish such apparent authenticity it must so inform the bank from which the instructions appear to have been received without delay, and in the event that it elects nonetheless to advise the credit it must inform the beneficiary that it has not been able to establish the authenticity of the credit.²⁴ If it suspects fraud in the documentary credit, the advising bank must ask the issuing bank to confirm its authenticity.²⁵

The advising bank will often be a branch or subsidiary of the issuing bank in the beneficiary's country, or a local bank with which the issuing bank regularly engages in business with.

2.5.3 The Confirming Bank

'A confirming bank is one which upon the authorization of a request of the issuing bank adds its confirmation to a credit.²⁶ As Hugo²⁷ notes, the confirmation of a credit by the confirming bank is necessitated by the beneficiary's dissatisfaction with the undertaking of only the issuing bank, which is often a foreign bank. This will typically arise where the beneficiary finds the creditworthiness of the issuing bank suspect, and hence requires confirmation of the credit by a local bank. A confirming bank assumes like obligations to the beneficiary²⁸ and a like reimbursement obligation to other nominated banks²⁹ as the issuing bank. The confirming bank's

²³ Article 7(a) UCP 500.

²⁴ Article 7(b) UCP 500.

²⁵ Van Houtte (n14 above) 267.

²⁶ Hapgold (n22 above) 747.

²⁷ Hugo (n11 above) 13.

²⁸ Article 9 (b) UCP 500.

²⁹ Article 14 (a) UCP 500.

undertaking amounts to a primary liability³⁰ and is independent of any of the other relationships surrounding the documentary credit.

The confirming bank is often, but not necessarily, the same bank as the advising bank.

2.5.4 The Nominated Bank

The definition of documentary credits in Article 2 (i) of the UCP 500 provides for a situation where the issuing bank authorises another bank to effect payment under the credit. Just as the issuing bank may not wish to communicate the credit directly to the beneficiary, it may also prefer not to pay the beneficiary directly and choose to authorize or “nominate” another bank to pay on its behalf.³¹ A nominated bank is thus a bank so authorised by the issuing bank to pay, to incur a deferred payment undertaking, to accept draft(s) or to negotiate.³² A confirming bank for instance is a nominated bank. In some instances there may be both a confirming bank and one or more other nominated banks, as where a credit is confirmed but is also negotiated by any bank in a named territory.³³ In terms of Article 10 (c) of the UCP 500 the nominated bank does not assume a payment undertaking, unless the nominated bank is the confirming bank.

2.6 Confirmed and Unconfirmed Documentary Credit

The discussion in this presentation will be restricted only to confirmed and unconfirmed documentary credits. The distinction between these two types of

³⁰ del Busto C *Documentary Credits-UCP 5000 & 400 Compared* 1993 ICC Publications 511 Paris 24.

³¹ Hugo (n11 above) 14.

³² Article 10 (b) (i) UCP 500.

³³ Hapgold (n22 above) 747.

documentary credits emerges in the UCP. 'This distinction relates to the role of the intermediary bank.'³⁴

A confirmed credit requires the intermediary bank's own undertaking to pay the seller on presentation of the requisite documents, in addition to that of the issuing bank. Hugo illustrates that the confirmation of documentary credits may take one of three forms. In the first instance the beneficiary may be promised cash upon delivery of the documents, or on a later specified date after delivery of the documents to confirming or nominated bank. Secondly, the beneficiary may be requested to draw a bill on the confirming bank which undertakes to accept the bill against delivery of the documents. Thirdly the confirming bank may undertake to negotiate the beneficiary's draft and/or other documents presented in terms of the credit.³⁵

The intermediary bank thus assumes an obligation towards the beneficiary of the credit. The obligation of the confirming bank is however separate and independent from that of the issuing bank and should not be regarded as a secondary obligation in the nature of a guarantee.³⁶ 'The commercial purpose of a confirmed credit is to the beneficiary a cause of action against a bank which is within the confirming bank's jurisdiction should the credit be dishonored.'³⁷

Where the documentary credit is unconfirmed, the intermediary bank may be requested merely to transmit or advise the undertaking of the issuing bank to the beneficiary. The advising bank is therefore not liable to the beneficiary. The bank's sole obligation in this case is to verify 'the apparent authenticity of the credit which it

³⁴ Hugo (n11 above) 37.

³⁵ Hugo (n11 above) 39.

³⁶ Brindle, M. & Cox, R. (ed) *Law of Bank Payments* 3rd ed, (2004) Sweet and Maxwell, London, 663.

³⁷ As above.

advises.³⁸ In practice however the credit will provide for payment to be made by the advising bank notwithstanding the fact that the bank has not confirmed the credit.

³⁸ Article 7(a) UCP 500.

CHAPTER 3

3.0 BANKS' GENERAL DUTIES

This chapter focuses on the duties that are applicable to all the banks in the processing of documentary credits. This precedes the discussion of the banks' obligations arising from different relationships that will be dealt with in subsequent chapters.

3.1 Doctrine of Strict Compliance

The doctrine of strict compliance provides that the documents presented under the documentary credit must comply strictly with the terms and conditions of the credit. Acceptance or rejection of the documents by the bank is dependent on whether the documents conform on their face to the terms of the credit. If on their face the documents are in strict conformity with the terms of the credit, the bank will accept the documents. If they are not, they will reject the documents.³⁹ The duty on the bank is therefore to comply strictly with the directions in the documentary credit,⁴⁰ and '[t]here is no room for documents which are almost the same, or which will do just as well.'⁴¹

The duty of the bank in this respect is inscribed in Article 14 (b) of the UCP 500 in the following terms:

Upon receiving all the documents the Issuing Bank and/or Confirming bank, if any, or a Nominated Bank acting on their behalf, must determine on the basis of the documents alone whether or not they appear on their face to be in compliance with the terms and conditions of the Credit. If the documents appear on their face not to be in compliance with the terms and conditions of the Credit, such banks may refuse to take up the documents.

³⁹ Carr, I. *Principles of International Trade Law* (1999) Cavendish Publishing Limited London 275.

⁴⁰ Wilde (n13 above) 82.

⁴¹ Per Lord Sumner in *Equitable Trust Co. of New York v. Dawson Partners Ltd* (1926) 27 L.L. L.R. 49 at 52.

Wilde⁴² interprets this article as requiring the bank to consider whether the documents appear, 'on their face,' to comply. It also requires the bank to determine, 'on the basis of the documents alone,' whether to take up or refuse them. These provisions are based on the proposition that the banks are neither experts in the trade concerned, nor are they required to have knowledge of the sale terms. Banks are only expected to consider the accuracy of the documents presented.

The obligations of the bank under Article 14 (b) have a corresponding right in Article 14 (a). The latter provides that, as long as the bank effects payment against documents appearing on their face to be in accordance with the credit, then the bank entitled to reimbursement. Therefore whether banks are entitled to be reimbursed under Article 14 (a) or to take appropriate action under 16 (b) depends upon the application of the doctrine of strict compliance.⁴³

The doctrine of strict compliance precludes the application of the *de minimis* rule in documentary credits. This was decided and set out in *Moralice (London) Ltd v ED and F Man*⁴⁴ where the credit stipulated a bill of lading for 5 000 bags and the bank rejected the tendered bill of lading which reflected 4 997 bags. Brindle and Cox⁴⁵ however question whether there is any real justification for excluding the *de minimis* principle from all cases and whether either the buyer or the bank requires protection to this degree. The extreme strictness of the law has tended to distort commercial reality by encouraging buyers to rely on technicalities to justify the rejection often where the decision to reject is motivated by other factors such as adverse market movements. Where a discrepancy has no possible practical importance, it might be better to recognise that it should not invalidate a documentary

⁴² Wilde (n13 above) 82.

⁴³ As above.

⁴⁴ [1954] 2 Lloyd's Rep. 526.

⁴⁵ Brindle and Cox (n36 above) 661.

presentation. The English Court of Appeal in *Seaconsar Far East Ltd v. Bank Markazi Jomhoori Island Iran*⁴⁶ suggests that this may indeed be the law.

Articles 37 and 39 of the UCP 500 go a long way in easing the harshness of the doctrine of strict compliance.⁴⁷ Article 37 (c) requires that the description of the goods in the commercial invoice correspond with the credit and other documents may describe the goods in general terms not inconsistent with the description of the goods in the credit. Under Article 39 the UCP allows various tolerances in the credit amount, weight and value of the goods.

3.2 Duty of Reasonable Care

The duty to examine documents with reasonable care is expressed in Article 13 (a) of the UCP as follows:

Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit.

Under common law the bank is required to conduct a visual examination and exercise reasonable care. According to Lord Diplock⁴⁸:

... the duty of the issuing bank which it may perform either by itself, or by its agent, the notifying bank, is to examine documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit. The express position to this effect in...the Uniform Customs and Practices for Documentary Credits...does no more than re-state the duty of the bank at common law. In business transactions financed by documentary credits, banks must be able to act promptly on presentation of the documents. In the ordinary case, visual inspection of the actual documents presented is all that is called for.

The bank need not ascertain whether the contents of the documents truly reflect reality. Nor may the bank get involved with the legal enforceability of the

⁴⁶ [1993] Lloyd's Rep. 236 at 240; [1994] 1 A.C 438.

⁴⁷ Carr (n39 above) 276.

⁴⁸ *Gian Singh Ltd v. Banque de l'Indochine* [1974] 2 All ER 754; [1974] 1 WLR 1234.

presented documents for even when the documents are legally questionable they may be of some commercial value to the customer, and 'it is not for the bank to reason why.'⁴⁹ Banks require a clean bill of lading and unless otherwise instructed in the credit will refuse documents indicating the defective condition of the goods and/or the packaging.⁵⁰

If documents appear upon a reasonably careful examination to be in compliance with the terms and conditions of the credit, the examining bank and the applicant must accept them.⁵¹ The bank is excused for accepting *bona fide* fake or forged documents, if it could not notice something that ought to have alerted it of the forgery or fraud. In the *Gian Singh* case,⁵² the credit required a certificate signed by one Balwant Singh. The beneficiary presented a certificate on which the signature of Balwant Singh had been forged. The applicant failed to make out a case of negligence against the bank for failing to detect the forgery. It was held that the issuing bank was bound to pay against the documents tendered and the applicant was bound to reimburse the issuing bank. The bank, however, is liable when it accepts fake documents that show an obvious irregularity, or when it knows that the documents were drawn up with the intention of causing loss to its customer.⁵³

Haggold⁵⁴ explains that it is possible for documents to be inconsistent, but in respects which will not necessarily be discovered by a reasonable care examination. This arose in *Credit Industriel et Commercial v. China Merchants Bank*⁵⁵ where one of the alleged discrepancies was a suggested inconsistency between the commercial invoice and the packaging list. The inconsistency was not detectable without performing mathematical calculations. Steel J rejected the alleged discrepancy on the

⁴⁹ *Midland Bank Ltd v. Seymour* (1955) 2 Lloyd's Rep. 147.

⁵⁰ Article 32 UCP 500.

⁵¹ Haggold (n22 above) 780.

⁵² (n48 above).

⁵³ Carr (n39 above) 277.

⁵⁴ Haggold (n22 above) 780.

⁵⁵ [2002] 2 All ER (Comm) 427.

ground that the exercise of reasonable care did not require any such calculations to be made. In rejecting the submission that the bank, which had carried out the calculations, was entitled to do so if such was their own practice and then to rely on any inconsistency thus unearthed, Steel J concluded that:

The issue of discrepancy cannot depend upon the degree of inquisitiveness within the bank. The identification of any inconsistency must flow from a consistency approach, [that is] steps that no reasonable bank would fail to take.

CHAPTER 4

4.0 THE ISSUING BANK

This chapter examines the exiting relationships between the issuing bank, which issues the credit, and its client the applicant, the beneficiary and also with other corresponding banks confirming or advising the credit, or acting in any other capacity as a nominated bank. All duties arising out of inter-bank relations, as concerns this presentation will be exhausted in this chapter.

4.1 The Issuing Bank and the Applicant

The extent of the duties of the issuing bank as regards the applicant, as with all other participating parties in documentary credits, are founded upon the nature of the relationship between the parties. The nature of the relationship between the parties is therefore of the utmost importance in determining to what extent there is a positive duty on the bank to act in pursuance of the successful completion of a documentary credit transaction.

Hugo⁵⁶ regards the relationship between the issuing bank and the buyer as essentially one of mandate, with the bank being the applicant's mandatory. 'The terms of the contract...are usually contained in the mandate which the buyer gives the bank. The mandate sets out the buyer's instructions in relation to the credit.'⁵⁷ This mandate will usually be on the bank's standard form which includes the UCP. In terms of the UCP the instruction for the issuance of the credit must be complete & precise and must state precisely the documents against which payment must be made.⁵⁸

⁵⁶ Hugo (n11 above) 26.

⁵⁷ Brindle and Cox (n36) 674.

⁵⁸ As above.

This relationship corresponds in large degree to the bank-customer relationship in the case of a cheque account, where ‘... the contract between bank and customer obliges the bank to render certain services ... to the customer on his instructions and for this reason it can be classified as a contract of *mandatum*.’⁵⁹ The distinction between these two lies in that the bank-customer relationship in documentary credit is expressly regulated to a larger degree than in the case of cheques,⁶⁰ and also that whilst a cheque is normally a specific mandate arising from a general mandate relationship, the same general relationship does not exist with documentary credits as each credit contains its own specific provisions and conditions.⁶¹ ‘The primary duty of the bank arising out of this contract is [therefore] to observe the terms of the client’s mandate.’⁶²

The duty of strict compliance has been dealt with in the preceding chapter but its relevant components will be considered in more detail. The issuing bank must strictly comply with the buyer’s instructions firstly in the opening of the credit, and secondly by operating the credit strictly in accordance with its terms.⁶³ In opening the credit, the bank must meticulously follow the buyer’s instructions and should not take a view on the importance of particular documents which the buyer has instructed it to require for presentation under the credit. Neither may the bank consider whether other documents will do just as well.⁶⁴ The duty on the issuing bank to act only in accordance with its client’s instructions was considered in *Midland Bank* case,⁶⁵ where Devlin J held that wherever a bank goes outside its mandate, then the bank is not entitled to recover from the buyer, even where the failure to adhere to its mandate, as in the present case, may be commercially unimportant.

⁵⁹ Malan, F. R. with Pretorius, J. T. & De Beer, C. R. *Malan on Bills of Exchange, Cheques and promissory Notes in South African Law* 2 ed (1994) Butterworths Durban 331-332.

⁶⁰ Goode, R. *Commercial Law* 2 ed (1995) Penguin Harmondsworth 998.

⁶¹ Stassen J C 1980 *Modern Business Law* 77 86.

⁶² Hugo (n11 above) 28.

⁶³ Carr (n36 above) 674.

⁶⁴ As above.

⁶⁵ (n49 above).

Where the issuing bank is dealing with an ambiguous instruction from its client, the bank is first and foremost bound by the duty of reasonable care, and will escape liability where its acts reasonably. Where an ambiguity is patent on the face of the instruction, the bank has an obligation to seek clarification from the buyer.⁶⁶ If the bank chooses not to seek confirmation from the buyer and in the process does not conform to the buyer's desires, it will not be entitled to reimbursement. The bank may however choose to confirm an ambiguous instruction in the interest of commercial expedience where it would be impractical for the bank to get clarification in time to perform its obligations. This aspect is explored in greater detail under the discussion covering inter-bank relations.

If it occurs that the buyer stipulates a condition but fails to specify the documents which are to be presented in satisfaction of that condition, Article 13(c) of the UCP 500 provides that '[i]f a credit contains conditions without stating the document(s) to be presented in compliance therewith, banks will deem such conditions as not stated and will disregard them.' The bank's duty to enforce its client's instruction is discharged where the condition is disregarded. This is based on the reasoning that in processing documentary credits the bank deals with, and should concern itself only with, documents.

In the operation of the credit the bank has a duty to pay only against documents which comply strictly with the credit. This means that non-conforming documents presented by the seller, or by a corresponding bank which has paid, must be rejected and the issuing bank must refuse to pay or reimburse as the case may be. If the bank proceeds to make payment against non-confirming documents, it is not entitled to reimbursement from the buyer.⁶⁷ In *Czarnowikow-Rionda v Standard*

⁶⁶ Carr (n36 above) 675.

⁶⁷ As above.

Bank,⁶⁸ it was stated there is also an implied limitation in the mandate that the bank will not pay in the case of clear fraud by the beneficiary.

Article 13(a) of the UCP⁶⁹ places a duty of reasonable care on the issuing bank in examining all documents stipulated in the credit in order ‘to ascertain whether or not they appear, on their face,’ to be in compliance with the terms and conditions of the credit. Although the duty of reasonable care is dealt with in greater detail in the foregoing chapter, it is important to note here that according to Steel J in *Credit Industriel*,⁷⁰ Article 13(a) imposes a passive obligation on the issuing bank to use ‘reasonable care to assess the absence of any apparent inconsistency on the face of the documents as opposed to an active obligation to establish the existence of complete consistency on the basis of the material contained on the face of the document.’

Van Delden⁷¹ identifies the following specific duties on the part of the issuing bank. It undertakes ‘... to issue the credit timeously in accordance with the client’s instructions, to receive and inspect the documents tendered by the beneficiary, to reject non-conforming documents, to accept and to pay against conforming documents, and to present the received documents to the client against payment.’ This serves as a summary of the duties that are expected of the issuing bank by virtue of its relationship with the buyer.

While the discussion has thus far dealt with the duties placed on the issuing bank, when the documentary credit is opened, the bank does not bear the full burden of the obligations in the processing of documentary credits. Certain corresponding duties befall the applicant once the issuing bank conforms to the documentary credit and fulfils its duties under it. The applicant for a credit is under a primary duty to put

⁶⁸ [1999] 2 Lloyd’s Rep. 187.

⁶⁹ See page 9 above.

⁷⁰ [2002] EWHC 173 (Comm).

⁷¹ Hugo (n11 above) 29.

the issuing bank in funds to meet the beneficiary's drafts before they become due.⁷² In the *Reynolds Case*⁷³ the court held that an applicant at whose request the credit is issued is under a duty to pay the issuing bank the amount for which it has accepted bills of exchange, a reasonable time before the bills fall due for payment. This is to ensure that the issuing bank has sufficient funds to meet the bill when they become due.

Although the applicant is not ordinarily required to put the issuing bank in funds at the time of issue of the credit, the bank may expressly demand that the applicant furnish it with the amount to be paid to the beneficiary under the credit before or at the time the credit is issued. This ensures that the bank does not at any time risk its own funds and is appropriate when dealing with an applicant who does not hold an account with the bank or whose credibility is questionable. If the applicant holds an account with the bank, the bank will request permission to debit the applicant's account to the value of the credit issued.⁷⁴

Where the applicant does not have an account with the issuing bank or has insufficient funds in his account to cover the amount of the credit or where the credit is issued at the request of a bank, the issuing bank may agree to advance the amount of the credit.

The issuing bank will then rely on its right to be reimbursed the amount it pays under the credit together with its expenses and charges, and it may rely on any security interests it has over the shipping documents or the goods they represent to recover the amount which the buyer owes it.⁷⁵

⁷² Penn, G. A. Shea, A. M. and Arora, A *The Law and Practice of International Banking: Banking Law* Volume 2 (1987) Sweet & Maxwell London 335.

⁷³ (1940) 1 M. & G.753.

⁷⁴ Penn, Shea and Arora (n72 above) 336

⁷⁵ As above.

‘The obligation of the applicant to put the bank in funds is the counterpart of the bank’s obligation to honour the credit’⁷⁶ It therefore follows, as was stated in *Sales Continuation Ltd v Austin Taylor & Co. Ltd.*,⁷⁷ that if the bank renounces its obligation, either expressly or by implication, for instance as a result of ceasing its business or by going into liquidation, the applicant’s resultant obligation to provide it with funds is terminated, and subject to claims of the secured creditors of the bank, any sums paid by the applicant for purposes of the credit can be recovered.

Reimbursement to the issuing bank by the applicant is a vital element in the documentary credits system as it provides a means by which the bank recovers funds which it has advanced as credit on behalf of the applicant. The issuing bank’s right to reimbursement is dependent on it having conformed strictly to the instructions given to it in the application for the opening of the credit. Should the issuing bank exceed its mandate in any respect, however slightly, it loses its right to reimbursement. On the other hand if the applicant has put the issuing bank in funds prior to the seller’s draft being presented and the issuing bank departs from its mandate, the applicant is entitled to the return of his money, unless he has waived the right of strict compliance.

There is a limitation on the extent of the bank’s duty to follow the buyer’s instructions. The obligations of the issuing bank in as far as honouring the instructions of the buyer do not go beyond merely undertaking to take reasonable steps to ensure that the credit is provided to the seller in accordance with its client’s instructions. In other words, the issuing bank cannot guarantee that the credit will be opened in accordance with the buyer’s instructions. To do so may be impossible for reasons beyond the issuing bank’s control. For instance it may occur that the seller’s

⁷⁶ As above.

⁷⁷ [1967] 2 All E. R. 1092.

reputation is such that no bank in the seller's country will be prepared to guarantee the credit.⁷⁸

Brindle and Cox discuss other limitations on the bank's liability that emerges from the UCP⁷⁹. In the first instance Article 16 provides:

Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any message(s), letter(s) or document(s), or for delay, mutilation or other error(s) arising in the transmission of any telecommunication. Banks assume no liability or responsibility for error(s) in translation and/or interpretation of technical terms, and reserve the right to transmit Credit terms without translating them.

It is however suggested, and correctly so, that Article 16 does not absolve the issuing bank from responsibility for acts of negligence.⁸⁰

Secondly, Article 18 provides in relevant part reads:

- (a) Banks utilizing the services of another bank or other banks for the purpose of giving effect to the instructions of the Applicant do so for the account and at the risk of such Applicant.
- (b) Banks assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank(s).

This article therefore effectively protects the issuing bank against liability in respect of the acts of any correspondent bank, whether or not the issuing bank has itself chosen the advising bank. The buyer thus carries the risk of the acts of the corresponding bank. The issuing bank cannot however seek to rely on this article to force the buyer to take up documents which do not conform to its instructions.⁸¹

There is also an exclusion of responsibility for 'form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s),'⁸² and also for the

⁷⁸ Brindle and Cox (n36 above) 676.

⁷⁹ Brindle and Cox (n36 above) 677-679.

⁸⁰ Jack, Malek and Quest *Documentary Credits* 3rd ed. (2001) Butterworths Law, London, para.4.17 85.

⁸¹ Jack, Malek and Quest (n80 above) p88 para.4.20.

⁸² Article 15 UCP 500.

consequences of 'Acts of God, riots, civil commotion, insurrection, wars, or any other causes beyond ... [the bank's] control, or by strikes or lockouts.'⁸³

4.2 The Issuing Bank and the Beneficiary

The legal nature of the relationship between the issuing bank and the beneficiary of a documentary credit has been the subject of debate in both common and civil law jurisdictions. Various theories have been preferred to describe this relationship, each having different implications of the resultant duties of the parties to the credit. Below I will discuss the English position on this relationship, followed by the South African approach, and then proceed to look at the ensuing duties befalling the issuing bank, focusing mainly on those obligations relevant under South African law.

While the issue remains 'unresolved' in English law⁸⁴, Hugo⁸⁵ notes that the relationship has been assumed to be contractual. In *United City Merchants (Investments) Ltd v Royal Bank of Canada*⁸⁶ Lord Diplock accepted the contractual nature of the relationship between the bank and the beneficiary as 'trite law'. Under this contractual theory the documentary credit is an offer which the beneficiary may accept as the person to whom the offer is directed. This theory remains questionable on the issues of whether it is a unilateral or bilateral contract, the manner & time of acceptance, and the lack of consideration, which is an important element for a valid contract under English law.

Gutteridge and Megrah⁸⁷ in advancing the agency theory argue that:

⁸³ Article 17 UCP 500.

⁸⁴ Gutteridge, H. C. & Megrah, M. *The Law of Banker's Commercial Credits* 7 ed (1984) Europa Publications London 26

⁸⁵ Hugo (n11 above) 179

⁸⁶ (1983) 1 AC 168 (HL) 183H-183D

⁸⁷ Gutteridge and Megrah (n84 above) 33.

The parties contemplate that the seller is not content to rely on the buyer's ability or readiness to pay the price, but insist on payment being made in such form as will obviate the possibility of the buyer's failing to pay ... the seller, therefore requires the buyer to produce an independent promise of payment made by a bank ... If a contract of sale is entered into in these circumstances there does not seem to be any reason why it should not be held that the buyer has implied authority of the seller to arrange payment of the price to be made in the manner stipulated for.

The major criticism against the agency theory is that it does not conform with the intention of the parties to a documentary credit agreement.⁸⁸ Ellinger⁸⁹ further points out that if the buyer is regarded as the seller's agent rather than the principal, the principal parties to the contract would then be the issuing bank and the seller. The issuing bank's primary obligations will be to the beneficiary instead of the applicant, which is not the case with documentary credits.

Other arguments that have been advanced to explain the legal nature of the issuing bank- beneficiary relationship include the guarantee theory, contract for the benefit of a third party, and assignment or novation. Some non- contractual theories have also been given, which include estoppel and mercantile usage. All these have proved unsatisfactory in one way or another.

Despite the inherent difficulties, English courts seem to have accepted the contractual approach.⁹⁰ Hugo⁹¹ attributes this to that fact that the difficulties with the contractual approach 'are clearly limited to legal theory- they do not extend to legal practice.'

With regard to the legal nature of the relationship between the issuing bank and the beneficiary, South African case law clearly favors a contractual approach, as shall be explored below. According to Hugo, '...the South African law of contract is

⁸⁸ Jack R *Documentary Credits* 2 ed (1993) Butterworths London 81-82.

⁸⁹ Ellinger, E.P. *Documentary Letters of Credit* (1970) University of Singapore Press Singapore 81-82. (n86 above) at 182-183.

⁹¹ Hugo (n11 above) 206.

able to provide a satisfactory theoretical framework for the bank- beneficiary relationship which essentially succeeds in giving effect to the commercial expectations of the parties.⁹²

The English proposition that a documentary credit amounts to an offer by the bank to be accepted by the beneficiary, that is, the contractual nature of the banker-beneficiary relationship, has been accepted by the South African courts.⁹³ This is despite the failures in English law to effectively address the question of valuable consideration and the difficulty of construing a time and mode of acceptance which justifies the expectations of the parties.⁹⁴

Since *Conradie v. Rossouw*,⁹⁵ it has been accepted as settled law that the doctrine of consideration does not form part of the South African law of contract. The doctrine of consideration, whose function was to distinguish between binding and non-binding promises, can be equated to that of *iusta causa* in Roman-Dutch law. *Iusta causa* made a promise enforceable under Roman-Dutch law. Sir John Kotze⁹⁶ argues, however, that this does not mean *iusta causa* must be regarded as a separate element of a contract. *Conradie v. Rossouw*⁹⁷ has rendered the doctrine redundant.

The concept of *iusta causa* has been useful in the context of subsidiary contracts where it serves to explain the relation between the subsidiary contract and the main contract underlying it.⁹⁸ This is applicable for example in the case of a

⁹² Hugo (n11 above) 249.

⁹³ *Philips v. Standard Bank of South Africa Ltd* 1985 3 SA 301 (W); *Ex Parte Sapan Trading (Pty) Ltd* 1955 1 SA 218 (W); *Lomcroft Fabrics CC v. Nedbank Ltd* 1996 1 SA 812 (A)

⁹⁴ Hugo (n11 above) 235.

⁹⁵ 1919 AD 279.

⁹⁶ *Simon van Leeuwen's Commentaries on Roman Dutch Law* (1886) Stevens & Haynes London 4 2 13.

⁹⁷ 'A good cause of action can be founded on a promise made seriously and deliberately and with the intention that obligation should be established' see Hugo (n11 above) 236.

⁹⁸ Goode (n60 above) 87-89.

cheque where the *causa* for a cheque may be the contract of sale underlying the issue of the cheque.⁹⁹

The implication is that should the underlying agreement for instance be void or cancelled, the *causa* for the cheque would fall away with the consequence that the cheque itself would be unenforceable. Although the *causa* doctrine is helpful in this type of situation, it is not indispensable. After all, generally speaking, the drawer of a cheque can hardly be said to have undertaken seriously and deliberately to be liable thereon in the event of the agreement underlying it (the *causa*) falling away.¹⁰⁰

Applying the above stated to documentary credits, Hugo notes that although the initial contract of sale between the applicant and the beneficiary, as well as the agreement between the issuing bank and its applicant to issue a credit, gives rise to the eventual undertaking of the bank towards the beneficiary of the credit. It is however of fundamental importance to note that neither of these agreements underlies documentary credits in the same sense as a contract of sale underlies a cheque issued as payment of the purchase price.

As stated in Article 3 (a) of the UCP 500, the bank's undertaking towards the beneficiary of a credit is independent of the contract of sale. The absence of *iusta causa* does not pose a problem under South African law of contract. Such obligation is possible in the case of a cheque. Documentary credits conform to the intention of all the parties. The documentary credit is therefore not a subsidiary agreement. The underlying consideration is simply whether the bank seriously and deliberately intended to be liable, and whether such undertaking was lawful.¹⁰¹

As with English law, the South African contractual theory as to the nature of the relationship between the issuing bank and the beneficiary is faced with the

⁹⁹ *Saambou-Nasionale Bouverining v. Friedman* 1979 3 SA 978 (A) 991F-G.

¹⁰⁰ Hugo (n11 above) 237.

¹⁰¹ Hugo (n11 above) 237-8.

problem of determining how and when the beneficiary accepts the offer by the bank, and subsequently when the bank becomes bound as against the beneficiary.

Documentary credits, in the absence of any indication as to whether the credit is revocable or irrevocable, 'shall be deemed to be irrevocable'.¹⁰² This irrevocability may arise either out of the offeror being bound by his unilateral declaration that the offer is irrevocable or the offeror can only be bound not to revoke contractually, by the acceptance of his offer not to revoke.¹⁰³ The traditional South African view is that an offer can always be revoked before acceptance unless the offeror is contractually bound not to do so. Christie who takes the view that a unilateral declaration by an offeror that the offer is irrevocable is effective under South African law criticizes this view.¹⁰⁴ This argument is premised on case law.¹⁰⁵

Hugo however maintains that the decisions in *Kotze v Newmont South Africa Ltd*¹⁰⁶ and *Anglo Carpets (Pty) Ltd v Snyman*¹⁰⁷ correctly reflect the South African positive law, and that an offer cannot by the unilateral declaration of the offeror become irrevocable. 'The necessary implications of this state of affairs is that the "irrevocable" documentary credit, if it is to be regarded as an offer, can, as in English law, only be irrevocable once accepted.'¹⁰⁸

Having established the irrevocable nature of the credit it is important to ascertain the point at which the issuing bank becomes bound to the beneficiary. This point marks the beginning of the relationship between the bank and the beneficiary. As a general rule in South African law of contract, the contract comes into existence

¹⁰² Article 6(c) UCP 500.

¹⁰³ Hugo (n11 above) 238.

¹⁰⁴ Christie, R. H. *The Law of Contract in South Africa* 2 ed (1991) Butterworths Durban 56-57.

¹⁰⁵ *Rose and Rose v. Alpha Secretaries Ltd* 1948 1 SA 545 (A); *Phillips v. Aida Real Estates (Pty) Ltd* 1975 3 SA 198 (A); *Building Material Manufacturers Ltd v. Marais NO* 1990 1 SA 243 (O).

¹⁰⁶ 1977 3 SA 368 (NC) 374E-G.

¹⁰⁷ 1978 3 SA 582 (T) 585G-H.

¹⁰⁸ Hugo (n11 above) 241.

at the moment and place the offeror learns of the acceptance of his offer. According to Kahn:¹⁰⁹

Acceptance takes place only when it reaches the mind of the offeror. The basis is the need for mutuality of will for the contracting parties, requiring according to the proponents of this theory- actual knowledge of the offeree's will by the offeror.

This rule is known as the information theory. It is abundantly clear though that the information theory is unsuited to documentary credits. The beneficiary does not inform the bank that he accepts the credit. In reliance on it he simply proceeds to arrange for the manufacture, procurement or shipment of the goods.¹¹⁰

It is now settled law that acceptance of an offer must be outwardly manifested. It is neither required that the offeror know of the acceptance, nor will mere mental acceptance suffice.¹¹¹ Wessels¹¹² stated this general rule as follows:

There is no doubt that, as a general rule, our law requires some manifestation of acceptance. ... There must be some express statement which reveals the intention of the offeree to accept the offer or else there must be some act which manifests that intention. ...

Applying this to documentary credit one can therefore argue that the bank is bound from the moment that the beneficiary in some way manifests his acceptance outwardly. Once the beneficiary begins arranging for the manufacture, procurement or shipment of the contract goods then the bank can be said to be bound.¹¹³ Once the beneficiary of the credit has accepted the issuing bank's offer, the bank becomes bound to the terms of the documentary credit as against the beneficiary from that time onwards.

¹⁰⁹ Kahn E "Some Mysteries of Offer and Acceptance" (1955) 72 *South African Law Journal* 246 255.

¹¹⁰ Hugo (n11 above) 242.

¹¹¹ Hugo (n11 above) 244.

¹¹² Wessels Sir J *The Law of contract in South Africa* 2 ed (1951) (Roberts A A ed) Butterworths Durban 30 par 105.

¹¹³ Hugo (n11 above) 244.

The issuing bank's undertaking to the beneficiary, as set out in article 9 (a) of the UCP 500, is conditional in the sense that the bank is only obliged to perform against the presentation of confirming documents.¹¹⁴ This means that, despite being bound from the time of acceptance of its offer, the issuing bank's duty to process the credit only commences upon the presentation of conforming documents.

Where the documents do not conform to the terms of the documentary credit the bank is free to consult the applicant, but must not send the documents to the applicant for inspection.¹¹⁵ Under Article 14 (b) of the UCP 500, the issuing bank has a non-delegable duty to carry out its own independent inspection of documents tendered under a credit to determine whether on their face they meet the terms and conditions of the credit.¹¹⁶ Article 14 (c) of the UCP 500 provides:

If the Issuing bank determines that the documents appear on their face not to be in compliance with the terms and conditions of the Credit, it may in its sole judgment approach the Applicant for a waiver of the discrepancy(ies). This does not, however, extend the period mentioned in sub-article 13 (b).

'The introduction under Article 14 (c) of an express liberty to seek a waiver in respect of discrepancies identified reinforces the autonomous nature of the issuing bank's inspection and determination obligations under Article 14 (b)'.¹¹⁷

The assumption under Article 14 (c) is that an approach by the issuing bank to the applicant is justified only when the issuing bank acts as an independent and trusted paymaster and not as an instrument of the applicant to refuse to pay. The contact with the applicant is therefore not justifiable if it is intended to allow the issuing bank and the applicant to make a joint decision on the discrepant documents. 'The decision to honour or refuse the documents must be the Issuing Bank's. The

¹¹⁴ Hugo (n11 above) 29.

¹¹⁵ Carr (n39 above) 282.

¹¹⁶ Bennett H.N "Stern Doctrine and Commercial Common Sense in the Law of Documentary Credits" *Lloyd's Maritime and Commercial Law Quarterly* 1999, 507, 510.

¹¹⁷ As above.

approach to the Applicant must be made solely to obtain his waiver once the Issuing Bank decided to refuse the discrepant documents'.¹¹⁸

This position is consistent with the decision in the *Banker's Trust Co Case*¹¹⁹ in which the Court of Appeal addressed and upheld, the legitimacy of consulting the applicant as to the acceptability of discrepant documents. Although this case dealt with the UCP 400, which did not specifically authorise such consultation, the decision remains applicable under the UCP 500 which explicitly permits the issuing bank to consult the applicant on whether to accept discrepant documents or not. The independence of the issuing bank's obligations from the applicant and the primacy of the bank's role are also reinforced by the view repeatedly expressed in opinions of the ICC Banking Commission that waiver by the applicant of all discrepancies does not oblige the issuing bank to accept the documents.¹²⁰

The UCP 500 gives the bank a maximum of seven days for examining the documents presented and advising on their conformity with the credit. Article 13 (b) states that:

The Issuing Bank ... shall... have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.

This imposes a duty on the issuing bank to process credits within the prescribed seven banking days.

In terms of Article 14 (c), any consultations with the applicant will not extend the time allowed for examining documents. Here there is a further positive duty on the issuing bank to act in securing a waiver from the applicant in the interests of facilitating the speedy processing of documentary credits.

¹¹⁸ del Busto (n30 above) 46-47.

¹¹⁹ [1991] 2 Lloyd's Rep. 443.

¹²⁰ Collyer (ed), *More Queries and Responses on UCP 500*, R 25, p.14; R 267, p. 27; R 268, p28.

Previously under the UCP 400 the two time obligations ran consecutively. Firstly, the bank had a reasonable time to examine the documents and arrive at a determination as to whether to accept them. In the event that the issuing bank rejected the documents, time then began to run with respect to the obligation to notify, without delay, the beneficiary tendering the documents of the rejection.

Under the UCP 500 these time obligations now run concomitantly. The reasonable time in Article 13 (d) is expressed to encompass not only the time for examining the documents and determining whether to accept them, but also the time for informing the beneficiary, who has submitted the documents, whether the documents have been accepted or rejected. While the obligation to notify rejection without delay, contained in Article 14 (d) (i), runs concurrently with part of the Article 13 (b) reasonable time, it constitutes a separate obligation on the issuing bank triggered by the a decision to reject the beneficiary's documents.

Where the issuing bank rejects the documents tendered, the bank has an obligation to inform the beneficiary of the reasons for rejection. The UCP stipulates that the beneficiary is to be notified, at the very latest, by the end of the seven days allowed for examination of documents.¹²¹ Article 14 (d) provides as follows:

- (i) If the Issuing Bank ... decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents. Such notice shall be given to the bank from which it received the documents, or to the beneficiary, if it received the documents direct from him.
- (ii) Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.

¹²¹ Carr (n39 above) 282.

This precludes the issuing bank from simply rejecting the documents without taking further action. Even when the bank rejects the beneficiary's non-conforming documents the bank still has an obligation to notify the beneficiary not only of the rejection, but also the reasons for the same.

Article 14 (d) places an obligation on the beneficiary to rectify the defects in the rejected documents or to resubmit them within the expiry period.¹²² The beneficiary may contact the applicant and inform him of the reasons for rejection and the applicant may agree to instruct the issuing bank to accept the documents as they stand. The beneficiary may also be able to persuade the bank to pay on the non-conforming documents. The beneficiary can achieve this by agreeing to indemnify the bank for loss or damage which the bank may suffer as a result of the lack of conformity of the tendered documents with the terms of documentary credit.

Where there is doubt whether the documents presented by the beneficiary strictly comply with the terms of the credit and the beneficiary contends that the documents conform to the credit, there is a duty on the issuing bank to ensure that the payment guaranteed by the documentary credit is made. This is achieved by the bank paying 'under reserve' to the beneficiary.¹²³

The bank will do so when it considers the beneficiary to be of good standing and able to make repayments if a difficulty arises or when it thinks that the alleged discrepancy is unimportant and the issuing bank and the buyer are likely to take up the documents in spite of it. In particular, the bank will be prepared to make payment under reserve if the beneficiary is a valued customer and a genuine dispute has arisen with him whether the documents are in order.¹²⁴

¹²² 'All Credits must stipulate an expiry date and a place of presentation of documents for payment, acceptance, or with the exception freely negotiable Credits, a place for presentation of the documents for negotiation. An expiry date stipulated for payment, acceptance or negotiation will be construed to express an expiry date for presentation of documents' UCP Article 42 (a).

¹²³ Brindle and Cox (n36 above) 682.

¹²⁴ D'Arcy L, Murray C and Cleave B *Schmitthoff's Export Trade: The Law and Practice on International Trade* (2000) Sweet & Maxwell London 207.

Although the expression 'payment under reserve' appears in Article 14 (f) of the UCP 500, it is not defined therein. Its meaning was considered in *Banque de l'Indochine et Suez SA v. J.H. Rayner (Mincing) Lane Ltd*¹²⁵ when Kerr L.J. said:

What the parties meant, I think, was that the payment was to be made under reserve in the sense that the beneficiary would be bound to repay the money on demand if the issuing bank should reject the documents, whether on its own initiative or on the buyer's instruction.

4.3 The Issuing Bank and the Corresponding Banks

Here the discussion will focus on the relationship between the issuing bank and the correspondent bank whose services may be employed in various capacities.

The correspondent may be employed merely to advise the beneficiary of the credit, or to confirm it.... the issuing bank may nominate another bank to receive the documents and to pay on its behalf.... the issuing bank may also employ the services of a correspondent to reimburse the paying bank.¹²⁶

Civil law jurisdictions such as Germany have had no hesitation in classifying the contract between the issuing bank and its correspondent, be it in the capacity of advising, confirming, nominated or reimbursing bank, as a contract of mandate in which the correspondent acts as the mandatory of the of the issuing bank.¹²⁷

According to English law, the relationship between the issuing bank and the correspondent bank is that of principal and agent. This means that when the corresponding bank has fully complied with the mandate it has the right to be reimbursed by the issuing bank, and if it has suffered any loss, or may suffer any loss by reason of complying with its mandate, it is like wise entitled to be indemnified by the issuing bank.¹²⁸

¹²⁵ [1983] Q.B. 711 at 733.

¹²⁶ Hugo (n11 above) 30.

¹²⁷ Penn, Shea and Arora (n72 above) 341.

¹²⁸ As above.

There is a broad consensus supported by scholars like Gutteridge and Megrah¹²⁹ that this is true of the relationship between the issuing bank and advising banks under South African law. The same is probably also true of the relationship between the issuing bank and the nominated banks.¹³⁰ The correspondent bank's right to payment and indemnification means that there is an analogous obligation on the issuing bank to make payment and to indemnify the corresponding bank.

There is a need, in the case of the relationship between the issuing bank and the confirming bank, to distinguish between the different functions of the confirming bank. Jack¹³¹ explains that:

The obligation of a confirming bank to pay ... is an obligation which it gives as a principal. This does not prevent it from acting in other respects as the agent of the issuing bank. ... The position is that in carrying out its functions, where appropriate, it will act in a dual capacity. In so far as its interests as a confirming bank are concerned, it acts as a principal: at the same time as regards the issuing bank it acts as agent. Thus in accepting documents and paying against documents it acts as a principal in relation to its obligations as a confirming bank, and it acts as an agent for the issuing bank with regard to the obligations of the issuing bank.

From this explanation it means that there is a positive duty on the corresponding bank, the confirming bank in this instance, to act in a manner that facilitates a successful payment under a documentary credit. This positive duty arises out of the obligation of the correspondent to advise or confirm the credit, or to reimburse a paying bank, in accordance with its principal's instruction.

With regard to the relationship between the issuing bank and correspondent bank, it would be misleading to suggest that under South African law the correspondent necessarily acts as the issuing bank's agent. The terms 'agent' and

¹²⁹ Gutteridge and Megrah (n84 above) 77-78.

¹³⁰ Jack (n88 above) 120.

¹³¹ Jack (n88 above) 121.

'agency' have been criticized for being somewhat confusing,¹³² and in *Totalisator Agency Board, OFS v Livanos*¹³³ Van Zyl J explained the terms as follows:

[i]t would appear that 'agency' is referred to, for the most part, in the sense of representation pursuant to authorization granted by the principal to the agent by virtue of which the agent performs a juristic act on behalf of or in the name of the principal. Should such juristic act be a contract entered into between the agent, on behalf on the principal, and a third person, the rights and obligations arising therefrom accrue to the principal and not to the agent, who acts merely and solely in a representative capacity.

Hugo¹³⁴ explains that in this sense, the agent is therefore a representative whose representative capacity arises from an authorisation which will typically arise from a contract of mandate. Thus the correspondent bank (mandatory) can only be regarded as the agent of the issuing bank (the mandatory), in so far as the mandate can be regarded as an authorisation to perform a juristic act on behalf of the issuing bank.

Not every mandate however gives rise to an authorisation to perform juristic acts. Although the advising and confirming banks can be considered mandataries, they are not the issuing bank's agents in the sense described above because they are not authorised to perform juristic acts on its behalf. 'Their mandate is to act as messengers.'¹³⁵ The word 'agent' can however be used in a wider sense to denote 'persons who have been instructed to perform some task, regardless of whether they have been clothed with authority to conclude a juristic act.'¹³⁶ On this basis the confirming and advising banks qualify as agents of the issuing bank and thus have a duty to give effect to the issuing bank's intentions as evidenced in the documentary credit.

¹³² De Wet J C (Revised by Du Plessis A G) "Agency and Representation" in Harms L T C, Pienaar G J & Rabie P J (editorial panel) *The Law of South Africa* First Reissue Vol 1 (1993) Butterworths Durban 97 (para 100).

¹³³ 1987 3 SA 283 (W) 291B.

¹³⁴ Hugo (n11 above) 31.

¹³⁵ Hugo (n11 above) 32.

¹³⁶ Van de Merrwe S, Van Huyssteen L F, Reinecke M F B, Lubbe G F & Lots J G *Contract- General Principles* (1993) Juta Cape Town 176

The issuing bank has an obligation to ensure that its instructions under documentary credits and the credit itself are 'complete and precise.' Article 5 of the UCP 500 provides:

- (a) Instructions for the issuance of a Credit, the Credit itself, instructions for an amendment thereto, and the amendment itself, must be complete and precise.
In order to guard against confusion and misunderstanding, banks should discourage any attempt:
 - (i) to include excessive detail in the Credit or in any amendment thereto;
 - (ii) to give instructions to issue, advise or confirm a Credit by reference to a Credit previously issued (similar Credit) where such previous Credit has been subject to accepted amendment(s), and/or unaccepted amendment(s).
- (b) All instructions for the issuance of a Credit and the credit itself, and where applicable, all instructions for an amendment thereto and the amendment itself, must state precisely the document(s) against which payment, acceptance or negotiation is to be made.

Article 5 strives for the ideal by requiring generally that instructions for the issuance of a credit must be 'complete and precise,' and specifically that '[a]ll instructions for the issuance of a Credit itself ... must state precisely the document(s) against which payment, acceptance or negotiation is to be made.' The article also enjoins banks to discourage any attempts to include excessive detail in the terms of the credit. In an ideal world therefore, instructions would always be clear and unambiguous, but in the real world opacity and ambiguity are unavoidable.¹³⁷

The issue of unclear and ambiguous instructions was dealt with in the case of *Credit Agricole Indosuez v Muslim Commercial Bank Ltd.*¹³⁸ The issue for decision in this case was whether the documents stated in the credit were essential documents against which negotiation and payment were agreed to be made under the terms of the documentary credit, or whether they were merely documents that were to be forwarded to the issuing bank after negotiation had taken place. The Appeal Court

¹³⁷ Bennett H. N "Unclear or Ambiguous Instructions in the World of Documentary Credits" *Lloyd's Maritime Commercial Law Quarterly* 2001 p24

¹³⁸ [2000] 1 Lloyd's Rep. 275

held that the letter of credit left one with genuine doubt as to whether the documents to which it referred were stipulated documents essential to the operation of the credit. The credit did not, as required by Article 5, state precisely that the documents, in this case a weight and measurement list and a certificate of origin, were documents against which payment or negotiation were to be made. On this construction, the credit entitled the corresponding bank to receive payment from the issuing bank. It was also held that a banker could safely act upon a reasonable construction of ambiguous or unclear terms, and that it could therefore not be said that the corresponding bank was unreasonable nor should it be held liable for failing to make an enquiry before paying under the credit.¹³⁹

In his judgment Sir Christopher Staughton distinguishes three possible categories of documents. The first were the stipulated documents under Article 13 (a), which are also the documents against which payment was to be made under Article 5 (b). The second category includes those documents, not mentioned in the credit but included on presentation which would fall within the second paragraph of Article 13 (a). Accordingly these documents would not be examined by the corresponding banks and would either be returned to the beneficiary or passed on to the issuing bank without responsibility.¹⁴⁰ The third category is that of documents that might be mentioned in the credit but that do not fall within the category of stipulated documents. Although by definition their presentation could not be a pre-requisite to payment under the credit, presumably their non-inclusion might constitute a breach of the underlying contract or the credit might require that they be forwarded separately to the applicant. In so far as this category of documents is concerned the court reasoned that, since Article 5 required credits to state 'precisely' against which documents payment was to be made, any ambiguity in the terms of the credit should be resolved against inclusion within the category of stipulated Article 5 documents.¹⁴¹

¹³⁹ Bennett (n137 above) 24.

¹⁴⁰ As above.

¹⁴¹ Bennett (n137 above) 25.

The court in this case therefore concluded that the corresponding bank had acted legitimately in interpreting the credit in the manner it did.

In *Woodhouse AC Israel Cocoa Ltd SA v Nigerian Produce Marketing Co. Ltd*¹⁴² and *European Asian Bank AG v Punjab and Sind Bank*¹⁴³ it was established as a principle of the law of agency that an agent is entitled to place a reasonable interpretation on ambiguous instructions so that acts performed within such interpretation be viewed as authorised and be binding upon the principal. The corresponding bank, as the agent of the issuing bank, is therefore under a duty to interpret an ambiguous or unclear instruction reasonably and in a manner that allows the processing of the credit. A bank by adding its confirmation to a credit undertakes an independent obligation to the beneficiary of the credit that it later performs *qua* principal and not *qua* agent of the issuing bank.¹⁴⁴

A qualification has however been suggested to the above stated agency rule. Where the ambiguity is or ought to be apparent to the agent, the agent should seek clarification where possible.¹⁴⁵ The corresponding bank, as agent, would be entitled to rely on a reasonable interpretation only where it has reasonably overlooked the ambiguity or where it is not possible to seek the issuing bank's clarification.

In the *Credit Agricole Indosuez* case, it was argued that the confirming bank should have sought clarification of the requirements of the credit either on receipt of the request to add its confirmation or when considering the acceptability of documents tendered under the credit. The court however rejected this argument on the basis that to seek clarification before adding a confirmation would have not been commercially realistic under the circumstances. This shows an inclination on the part

¹⁴² [1972] A.C. 741.

¹⁴³ [1983] 1 W.L.R. 642.

¹⁴⁴ Bennett (n137 above) 25.

¹⁴⁵ (n138 above) at page 278.

of the court to interpret situations of unclear and ambiguous instructions in a manner that supports commercial expedience.

Since confirmation generates an independent obligation between the confirming bank and the beneficiary to honour the credit confirmed according to its terms, the opinion of a third party, the issuing bank, to that obligation on its content was of no legal weight. There could, accordingly, be no obligation on the confirming bank on presentation of documents by the beneficiary to obtain the opinion of a third party as to the required documents.¹⁴⁶ In Sir Christopher Staughton's judgment, the agency reasoning is distinguished from the analogous documentary credit principle, with the former being related to the initial question of the true construction of the credit and only the latter to the second question of how the confirming bank was entitled to read the credit.

The decision of the Court of Appeal is welcome in supporting confirming banks faced with difficulties created by the poor drafting of the issuing banks. Although in this case part of the decision fell on the issue of time constraints, under circumstances where the confirming bank has more time to consider whether to confirm the credit, Bennett¹⁴⁷ suggests that the confirming bank will be under an obligation to clarify the ambiguous instruction from the issuing bank. Failure to do so may result in the issuing bank losing its right to reimbursement.

It is submitted that the nominated bank authorised to pay the beneficiary on behalf of the issuing bank, and the paying bank authorised to reimburse the paying bank on behalf of the issuing bank, act as agents of the issuing bank.¹⁴⁸

¹⁴⁶ Bennett (n137 above) 26.

¹⁴⁷ As above.

¹⁴⁸ Eisemann, F. and Schutze, R. A. *Das Dokumentenakkreditiv im internationalen Handelsverkehr* 3 ed (1989) Verlag Recht und Wirtschaft GmbH Heidelberg 150.

From the preceding discussion it can thus be concluded that 'whether the corresponding bank is the issuing bank's agent or not, *vis a vis* the issuing bank it is a mandatory.'¹⁴⁹ The correspondent bank's legal position as against the issuing bank is akin to that of the issuing bank and the applicant. The correspondent's right to remuneration is therefore dependent upon it having strictly having complied with the mandate.

With regard to the issuing bank's obligation to reimburse the paying bank, documentary credits often include provisions for bank-to-bank reimbursements. The inter-bank relations that arise from bank-to-bank reimbursement arrangements create obligations for both the issuing bank and corresponding banks. By definition a bank-to-bank reimbursement is a means by which the issuing bank can honour its obligation to reimburse a confirming or negotiating bank which has paid against or negotiated documents tendered under the credit.¹⁵⁰

Previously reimbursements were regulated by the UCP 500. Article 19 (a) provides:

If an Issuing Bank intends that the reimbursement to which a paying, accepting or negotiating bank is entitled, shall be obtained by such bank (the "Claiming Bank"), claiming on another party (the "Reimbursing Bank"), it shall provide such Reimbursing Bank in good time with the proper instruction or authorisation to honour such reimbursement claims.

The ICC has however produced Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR) that came into force on 1 July 1996. The URR are complementary to the UCP, which they 'are not intended to override or change'.¹⁵¹

In terms of the issuing bank's obligation to pay the beneficiary upon presentation of conforming documents,

¹⁴⁹ Hugo (n11 above) 33.

¹⁵⁰ Bennett, H. N. "Bank-to-bank reimbursement Under Documentary Credits: the Uniform Rules" *Lloyd's Maritime and Commercial Law Quarterly* 1998 p. 114.

¹⁵¹ Article 1 URR.

[u]nless the Credit stipulates that it is available only with the Issuing Bank, all credits must nominate the bank (the “Nominated Bank”), which is authorised to pay, to incur a deferred payment undertaking, to accept Draft(s) or to negotiate. In a freely negotiated Credit, any bank is a Nominated Bank.¹⁵²

If the bank nominated by the issuing bank adds its own independent undertaking to pay it becomes a confirming bank. On the other hand, the credit may be negotiable, in which case the nominated bank is authorised to purchase the documents without undertaking any obligation to do so. ‘Although the fact of nomination creates no obligation on the part of the nominated bank, the making of a nomination by the issuing bank generates an obligation on the part of the latter to reimburse the nominated bank if it pays or negotiates.’¹⁵³

The issuing bank may itself perform the reimbursement obligation. It may however be more convenient to employ an intermediary bank (the reimbursing bank), which will be authorised by the issuing bank to reimburse the nominated bank. The credit will also instruct the nominated bank to claim reimbursement from the intermediary bank. The issuing bank will in turn reimburse the intermediary bank.¹⁵⁴ This relationship gives rise to obligations on the part of the issuing, intermediary and nominated banks. The issuing bank must issue a reimbursement authorisation and also reimburse the intermediary bank. The intermediary bank has a duty to reimburse the nominated bank.

The reimbursing bank acts upon the instructions or authorisation of the issuing bank, termed the ‘reimbursement authorization.’ ‘The reimbursement authorisation fulfills the injunction placed on the issuing bank in UCP 500, Article 19 (a) to provide a reimbursing bank “in good time with the proper instructions or authorisation to honour such reimbursement claims”.’¹⁵⁵ Although the reimbursing bank discharges an obligation owed by the issuing bank as part of the documentary

¹⁵² Article 10 (b) (i) UCP 500.

¹⁵³ Bennett (n150 above) 114-115.

¹⁵⁴ As above.

¹⁵⁵ As above.

credit, the reimbursing party is not party to the credit under which it makes the reimbursement.

Article 3 of the URR provides:

A Reimbursement Authorisation is separate from the Credit to which it refers, and a Reimbursing bank is not concerned with or bound by the terms and conditions of the Credit, even if any reference whatsoever to the terms and conditions of the Credit is included in the Reimbursement Authorisation.

Similarly, in its definition of reimbursement authorisation, Article 2 (c) of the URR stipulates that the authorisation is “independent of the Credit”.

Article 6 (g) of the URR states that a reimbursing bank which is not prepared to accept a reimbursement authorisation must inform the issuing bank without delay. This imposes a duty on the reimbursing bank to inform the issuing bank when it is unable to comply with the reimbursement authorisation. Although Bennett¹⁵⁶ notes that this provision alone does not create a rule that failure to reject the reimbursement authorization results in a contractual obligation to comply with it and should thus be read merely as a statement of good banking practice, it is conceivable that a master agreement between the issuing and reimbursing banks could give the reimbursing bank the right to decline to offer reimbursements subject to notifying the issuing bank of the decision. Article 6 (g) of the URR is analogous to Article 9 (c) (i) of the UCP 500 which provides that a bank that is not prepared to confirm a credit when requested to do so must inform the issuing bank without delay.

In terms of its definition, a reimbursement undertaking is used by the reimbursing bank at the request of the issuing bank and constitutes an irrevocable commitment by the reimbursing bank to honour the reimbursement claim of a specified claiming bank, provided the claim strictly complies with the terms and conditions of the undertaking. There is an assumption here that the obligation owed

¹⁵⁶ As above.

by a reimbursing bank under a reimbursement undertaking is subject to fraud and illegality exceptions like those applicable in the context of documentary credits.¹⁵⁷

In the absence of a bank-to-bank reimbursement arrangement, the nominated bank can only seek reimbursement by tendering documents that conform to the terms of the documentary credit under which it seeks reimbursement. The obligations of the issuing bank only arise once the nominated bank has submitted conforming documents. In contrast, where a bank-to-bank reimbursement arrangement exists, there is no tender and examination of documents and enquiry as to whether the terms of the credit have been fulfilled. Both the UCP 500¹⁵⁸ and the URR¹⁵⁹ prohibit the issuing bank from making reimbursement under a bank-to-bank reimbursement conditional upon the claiming bank's tendering, to the reimbursing bank, a certificate of compliance with the terms and conditions of the credit.¹⁶⁰

The obligations of the issuing bank to reimburse the nominated bank under a bank-to-bank reimbursement, is therefore not premised on the submission of conforming documents, but arises consequent to the issuing of a reimbursement authorisation.

Hugo notes a scenario where the corresponding bank may in fact be the issuing bank. This occurs where the issuing bank does not itself issue the credit but instructs its correspondent to do so. The ensuing relationship between the issuing bank and correspondent is clearly one of mandate, and the correspondent is obviously not the agent of the issuing bank. This relationship correlates exactly with that between the applicant for a credit and the issuing bank.

¹⁵⁷ As above.

¹⁵⁸ Article 19 (b).

¹⁵⁹ Article 6 (c).

¹⁶⁰ Bennett (n150 above) 121.

Case law shows that the duties emanating from the relationship between the issuing bank and the correspondent bank, although based on the English law position that the correspondent is the issuing bank's agent, have been interpreted in a manner that is meant to facilitate the successful, effective and timeous processing of documentary credits.

In the case of *Bank Melli Iran v Barclays Bank of (D.C.O. Ltd)*¹⁶¹ the court held that an issuing bank waives its right to reject documents taken up by the correspondent if it delays in exercising that right for an unreasonable length of time from the time the documents are tendered to it, or from the time it has knowledge that the documents taken up by the corresponding bank do not conform to the conditions in the credit. Similarly in *National Bank of Egypt v Hannevig's Bank Ltd*¹⁶² it was held that if the issuing bank acknowledges the receipt of the documents without making any objections to them it waives its right to reject the documents and the corresponding bank is then entitled to reimbursement.

From the above argument it emerges that the banks, that is, the issuing, advising, confirming and nominated banks, therefore, have a large part to play in the processing of documentary credits.

¹⁶¹ [1957] 2 Lloyd's Rep. 367.

¹⁶² [1919] 1 Lloyd's L.R. 69.

CHAPTER 5

5.0 THE CONFIRMING BANK

This chapter will examine the relationship between the confirming bank and the applicant and the beneficiary. This chapter seeks to also discuss how this relationship shapes mainly the obligations of the confirming bank, and to a lesser extent, the duties of the applicant and the beneficiary.

5.1 The Confirming Bank and the Applicant

While there is a contractual relationship between the issuing bank and the confirming bank in the case of a confirmed credit, there is no such relationship between the applicant of a credit and the confirming bank. As a result, if the confirming bank exceeds its mandate by accepting or paying drafts that do not conform to the terms of a credit, it is not liable in damages to the applicant for breach of contract.¹⁶³ There is therefore no obligation on the confirming bank in the processing of the credit as a result of the existing relationship between the applicant of the credit and itself.

This position has been evident in case law across various jurisdictions. In *Orr and Baker v Union Bank of Scotland*¹⁶⁴ the court held that the applicant could not sue the confirming bank for paying forged drafts and subsequently refusing to honour genuine drafts presented by the beneficiary under the credit. This reasoning was expanded upon in *Equitable Trust Co. v Dawson Partners Ltd*,¹⁶⁵ where the court held that there is no agency relationship between the buyer as the principal and the confirming bank as its agent. It was held that an issuing bank could escape liability by arguing that the error committed by the confirming bank in accepting the documents was committed by that bank, as the buyer's agent. The court further held that in actual fact the confirming bank acted as an agent of the issuing bank and as such the

¹⁶³ Penn, Shea and Arora (n72 above) 340.

¹⁶⁴ (1854) 1 Macq. H. L. 512.

¹⁶⁵ (1926) 25L1. L. R. 90.

issuing bank was liable, as its principal, to the applicant. Since the applicant is not responsible for any errors committed by the confirming bank, such applicant cannot be treated by the issuing bank as bearing the risk of the confirming bank's defaults. It follows then that the applicant cannot claim against the confirming bank for any default which operates to the applicant's detriment.

*Calico Printers Association v Barclays Bank*¹⁶⁶ held that the confirming bank owes no duty of care to the applicant for the credit. Therefore, even if the confirming bank acts negligently, it is not liable to the applicant. The question that arises here is how the reasoning of the court in this case can be reconciled with Article 13 (a) of the UCP 500 as well as the common law duty of reasonable care. From the preceding discussion,¹⁶⁷ it appears that the duty of reasonable care is borne out of international banking practice and is one not peculiar to documentary credits. As such it should bind every bank in discharging its services regardless of the nature of the relationship under which such duty is to be discharged. The nature of the relationship between the confirming bank and the applicant under documentary credits should therefore not preclude this duty on the part of the confirming bank and the bank must nonetheless be required to exercise reasonable care when processing documentary credits.

Under American case law a confirming bank is liable to the applicant if it is guilty of fraud. An example would be where the confirming bank knowingly permits the beneficiary to draw under the credit for purposes not authorised. In *Oelbermann v National City Bank of New York*,¹⁶⁸ the bank confirmed a credit containing an anticipatory credit clause enabling the beneficiary to draw drafts on it in order to purchase raw materials to satisfy an underlying contract of sale, but the confirming bank allowed the beneficiary to draw against the credit in order to reduce its overdraft on a general account with the confirming bank. The court found that the confirming

¹⁶⁶ (1930) 36 Com. Cas. 71.

¹⁶⁷ See Chapter 3.

¹⁶⁸ (1935) 79 F. 2d. 354.

bank was liable to the applicant for fraud notwithstanding the non-existence of a direct contract between the parties.

Similarly the English courts would hold the confirming bank liable in similar circumstances to the above and it would not allow the issuing bank, where it has deliberately committed a fraudulent act, to rely on the defence that no direct contract existed between the applicant and itself. 'The confirming bank's liability would be a tortious one either for deceit or for conspiring with the beneficiary to obtain payment under the credit without being entitled to it.'¹⁶⁹

*Hedley Byrne and Co. Ltd. V Heller and Partners Ltd*¹⁷⁰ laid down the further principle that a confirming bank may be held liable for negligent misstatements made to the applicant. Such statements include those made either directly or communicated through the issuing bank, or where it gives advice or information that it knows will be, or is likely to be, relied upon by the applicant. The liability in this latter instance is again, a tortious one, since there is no direct contractual relationship between confirming bank and the applicant. The fact that the applicant intended to rely on the negligent statement imposes a duty of care on the confirming bank towards him.¹⁷¹

As regards the applicant, the confirming bank therefore only has a duty of reasonable care that is based on international banking practice and also arises as a result of its own fraudulent activities. Since there is no contractual relationship between the confirming bank and the applicant there is no corresponding duty on the applicant, arising out of this relationship, in the processing of documentary credits.

¹⁶⁹ Penn, Shea and Arora (n72 above) 340- 341.

¹⁷⁰ [1964] A. C. 465.

¹⁷¹ Penn, Shea and Arora (n72 above) 341.

5.2 The Confirming Bank and the Beneficiary

The beneficiary's relationship with the confirming bank is essentially the same as that with the issuing bank.¹⁷² Where the credit is confirmed the beneficiary under the credit has the benefit of a contractual undertaking from the confirming bank. Such undertaking becomes binding on the bank upon receipt by the beneficiary of notice of the credit. Since the confirming bank acts as the agent of the issuing bank, if it confirms an incorrect credit, the confirming bank is bound by the terms of such credit.¹⁷³

The undertaking of the confirming bank is set out in Article 9 (b) of the UCP 500 which provides:

A confirmation of an irrevocable credit by another bank (the "Confirming Bank") upon the authorization of the Issuing Bank, constitutes a definite undertaking of the Confirming Bank, in addition to that of the Issuing Bank, provided that the stipulated documents are presented to the Confirming Bank or to any other Nominated Bank and that the terms and conditions of the credit are complied with:

- (i) if the Credit provides for sight payment - to pay on sight;
- (ii) if the Credit provides for deferred payment - to pay on the maturity date(s) determinable in accordance with the stipulations of the Credit;
- (iii) if the Credit provides for acceptance;
 - (a) by the Confirming Bank - to accept drafts drawn by the Beneficiary on the Confirming bank and pay them on maturity,
 - or
 - (b) by another drawee bank - to accept and pay at maturity Draft(s) drawn by the Beneficiary on the Confirming Bank, in the event the drawee bank stipulated in the Credit does not accept draft(s) drawn on it, or to pay Draft(s) accepted but not paid by such drawee bank at maturity;
- (iv) if the Credit provides for negotiation - to negotiate without recourse to drawers and/or bona fide holders, Draft(s) drawn by the Beneficiary and/or document(s) presented under the Credit. A Credit should not be issued available by Draft(s) on the Applicant. If the Credit nevertheless calls for draft(s) on the Applicant, the banks will consider such Draft(s) as an additional document(s).

¹⁷² See Chapter 4.

¹⁷³ Brindle and Coz (n36 above) 683.

When the beneficiary presents the documents under a confirmed documentary credit to the confirming bank, the bank must examine the documents to ensure that they conform on their face with the terms of the credit and decide whether to accept or reject the documents, on the basis of the reasonable care standard.

On receiving the conforming documents from the beneficiary the confirming bank has an obligation to make payment in accordance with the terms of the credit. Where the documentary credit provides for sight payment, the beneficiary is entitled to receive cash on presentation of the documents. In a deferred payment scenario, the cash payment will occur at a future date agreed by the parties in the credit, for example, '30 days after sight' or '60 days after shipment'. Once payment has been made the confirming bank has an obligation to transmit the documents to the issuing bank to further facilitate the successful finalisation of the whole transaction.

Like the issuing bank the confirming bank has a maximum of seven days for examining the documents in terms of Article 13 (b) of the UCP 500:

... the Confirming Bank ... shall ... have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.

Carr¹⁷⁴ suggests that the ICC arrived at the seven days for processing credit by taking current banking practice into account. In determining whether the time taken in processing credits is reasonable or not, English courts are guided by banking practice.

Article 13 (b) also places on the confirming bank a duty to inform the beneficiary whether the documents have been accepted or rejected. If the documents tendered by the beneficiary have been rejected for non-conformity with the terms of the credit, there arises a further obligation on the issuing bank to inform the beneficiary of the reasons for such rejection. Article 14 (d) provides:

¹⁷⁴ Carr (n39 above) 282.

- (i) If the ... Confirming Bank ... decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents. Such notice shall be given to the bank from which it received the documents, or to the beneficiary, if it received the documents direct from him.
- (ii) Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.

As discussed above, where the documents have been rejected by the confirming bank for not complying with the terms of the credit, a number of possibilities are open to the beneficiary. He may remedy the defects and resubmit the documents, provided he does so before the expiry of the credit. The beneficiary may also contact the applicant of the credit and inform him of the reasons for rejection of the documents, and get the applicant to instruct the bank to accept the documents as they stand.

The beneficiary

... may also be able to persuade the confirming bank to pay on the non-conforming documents by agreeing to indemnify the bank for loss or damage the bank may suffer as a result of the lack of conformity of the tendered documents with the credit terms.¹⁷⁵

Indemnity appears together with payment under reserve in Article 14 (f) of the UCP 500.¹⁷⁶

¹⁷⁵ Carr (n39 above) 283.

¹⁷⁶ 'Such reserve or indemnity concerns only the relations between the remitting bank and the party towards whom the reserve was made, or from whom, or on whose behalf, the indemnity was obtained.'

CHAPTER 6

6.0 THE CORRESPONDENT BANKS

The relationship between the correspondent banks and the applicant and beneficiary will be examined in this chapter. The correspondent banks will be considered in their various capacities as the advising, reimbursing, nominated, collecting and paying bank. In this chapter discussion on the correspondent bank excludes the confirming bank. It will focus on the obligations of all the parties as a result of the nature of their relationships. As already noted inter-bank relations will not be dealt with in this section as these have been dealt with above.

6.1 The Correspondent Banks and the Applicant

No contractual relationship exists between the applicant and the correspondent bank. According to Brindle and Cox,¹⁷⁷ it is unlikely that the correspondent bank owes a duty of care to the applicant. In *United Trading Corporation S A v Allied Arab Bank Ltd*,¹⁷⁸ a case that dealt with performance bonds, it was suggested that a duty of care cutting across the contractual framework might exist in similar circumstances. This was however doubted in *GKN Contractors Ltd v Lloyds Bank plc*.¹⁷⁹

In the United States the Court of Appeals for the District of Columbia Circuit held on compelling grounds that a corresponding bank does not owe a duty of care to the applicant under the UCP.¹⁸⁰

¹⁷⁷ Brindle and Cox (n 36 above) 700.

¹⁷⁸ [1985] 2 Lloyd's Rep. 554, at 556, 560.

¹⁷⁹ (1985) 30 B. L. R. 48 at 62.

¹⁸⁰ *Confecoos Texteis de Vonzela v Riggs NB* [1994] 3 Bank L.R. 38.

6.2 The Correspondent Banks and the Beneficiary

The relationship between the correspondent bank and the beneficiary depends on the role assumed by the correspondent bank.¹⁸¹ There is no relationship whatsoever between the reimbursing bank¹⁸² and the beneficiary. Similarly there is no duty on a nominated bank¹⁸³ to pay the beneficiary. ‘The bank nominated by the issuing bank to receive the documents and to pay the beneficiary is ... *vis a vis* the beneficiary, in no way bound to do so. This is an obligation as against the issuing bank.’¹⁸⁴

Article 10 (c) of the UCP 500 provides:

Unless the Nominated bank is the Confirming Bank, nomination by the Issuing Bank does not constitute any undertaking by the Nominated Bank to pay, to incur a deferred payment undertaking, to accept Draft(s), or to negotiate. Except where expressly agreed to by the Nominated Bank and so communicated to the Beneficiary, the Nominated Bank’s receipt of and/or examination and/or forwarding of the documents does not make that bank liable to pay, to incur a deferred payment undertaking, to accept Draft(s), or to negotiate.

For Instance where the credit provides that payment will be made by the nominated bank against presentation of the stipulated documents and the seller tenders conforming documents to the nominated bank, but the nominated bank then refuses to pay. Unless the nominated bank has confirmed the credit, the beneficiary’s only claim is against the issuing bank. This reaffirms the position that the nominated bank does not owe the beneficiary a duty to make payments.

¹⁸¹ Hugo (n11 above) 33.

¹⁸² The UCP makes reference to the reimbursing bank in Article 19 (a) which provides: ‘If an Issuing Bank intends that the reimbursement to which a paying, accepting or negotiating bank is entitled, shall be obtained by such bank (the “Claiming Bank”), claiming on another party (the “reimbursing Bank”), it shall provide such reimbursing Bank in good time with the proper instructions or authorization to honour such reimbursement claims.’

¹⁸³ Article 10 (b) (i) of the UCP uses the term ‘nominated bank’ to refer to any bank which is authorised to pay, to incur a deferred payment undertaking, to accept drafts, or to negotiate drafts and or documents under the credit.

¹⁸⁴ Hugo (n11 above) 33.

The relationship between the beneficiary and the nominated or paying bank can consequently be likened to that between the payee of a cheque and the drawee bank. In the event that the cheque is dishonoured the payee has no remedy against the drawee bank and can only look to the drawer for payment.¹⁸⁵ In the same vein, if the nominated bank fails or refuses to pay the beneficiary of a documentary credit, the beneficiary has a claim against the bank issuing the credit and not the nominated bank.¹⁸⁶

The beneficiary will, however, have a claim against the nominated bank if it dishonours a draft which it has accepted under a credit.¹⁸⁷ By accepting a draft there arises an obligation on the part of the nominated bank to pay the beneficiary

Although the advising bank may fall under the category of nominated banks, '[t]he position of an advising bank may be more complex.'¹⁸⁸

Where the advising bank is also the nominated bank, the reality will often be that such a bank is in fact prepared to pay or accept drafts, or negotiate or incur a deferred payment undertaking, as the case may be pursuant to the nominated bank's agreement with the issuing bank.¹⁸⁹

Here the advising bank has an obligation to pay the beneficiary and will be liable for failure to fulfill this obligation.

In the situation where the advising bank does not act as a nominated bank, complexity arises. Hugo¹⁹⁰ discusses this briefly. Under Article 7 (a) of the UCP 500 the credit is advised 'without engagement on the part of the Advising Bank.' This means that where this is the case there is no contractual relationship between the advising bank and the beneficiary and hence no obligations on the bank to make

¹⁸⁵ Malan (n59 above) 221 (par 142), 345 (par 207), 362 (par 211).

¹⁸⁶ Hugo (n11 above) 33.

¹⁸⁷ Brindle and Cox (34 above) 698.

¹⁸⁸ Hugo (n11 above) 34.

¹⁸⁹ Brindle and Cox (34 above) 698.

¹⁹⁰ Hugo (n11 above) 34-35.

payment to the beneficiary. On the other hand the same article requires the advising bank to 'take reasonable care to check the apparent authenticity of the Credit which it advises.' This imposes a duty of care on the advising bank.

The question that arises here is whether the extent of the advising bank's duty extends beyond this duty of care in Article 7 (a). The beneficiary relies on the information supplied by the advising bank in determining the documents that are required to receive payment under the credit. The issue is whether, in the event of the advising bank incorrectly advising the terms of the credit to the beneficiary, thereby causing him to present non-conforming documents, the beneficiary can upon rejection of the documents claim damages from the advising bank.¹⁹¹

Under civil law jurisdictions like Germany and the Netherlands the beneficiary has claim against the advising bank where it has erroneously advised the credit to the detriment of the beneficiary. English commentators support this view. Ellinger¹⁹² suggests that this position may be premised on the principle established in *Hedley Byrne & Co v Heller and Partners*,¹⁹³ that a professional is liable for negligent misrepresentation.

A contrary argument by Jack¹⁹⁴ holds that the question of negligent misrepresentation by a professional is unlikely to arise. The advice of the credit falls within the ostensible authority of the advising bank and therefore 'the advising bank's advice of the credit will have bound the issuing bank.' Jack goes on to add:

But if ... the issuing bank was in some way not bound by the credit advised, under English law the advising bank would be liable to the beneficiary for damages for breach of warranty of authority, that is, for breach of the

¹⁹¹ As above.

¹⁹² Ellinger E P "Documentary Credits and Finance by Mercantile Houses" in Guest A G (general editor) *Benjamin's Sale of Goods* 3 ed (1987) Sweet & Maxwell London 1435 (par 2260)

¹⁹³ [1964] AC 465 (HL)

¹⁹⁴ Jack (n88 above) 116

warranty which English law implies that every agent gives that he has the authority of his principal to act as he does.¹⁹⁵

The South African law position, as noted by Hugo,¹⁹⁶ is that the advising bank is not the agent of the issuing bank, and no such warranty can be said to exist. Hugo however suggests that the argument based on the professional liability established in the *Hedley Byrne* case is a distinct possibility under South African law. The recognition of the duty of care on the advising bank, the breach of which may in principle lead to delictual liability, brings South African law on par with the laws of England, Germany and the Netherlands in this regard. This would also be consistent with the recognition of such duty on the collecting bank in the collection of cheques.¹⁹⁷

It is submitted that the contradiction as to whether the advising bank owes the beneficiary a duty of care can be reconciled in the following reasoning. That the advising bank does not owe a duty to make payment to the beneficiary is due to the non-existence of any contractual relationship between the advising bank and the beneficiary in the same manner as between the nominated bank and the beneficiary. The duty of reasonable care is one, not based on the specific relationship existing between the advising bank and the beneficiary, but a duty that emerges out of international banking practice, professional responsibility and the common law duty on banks to act with reasonable care.

¹⁹⁵ As above.

¹⁹⁶ Hugo (n11 above) 35.

¹⁹⁷ Malan (n59 above) 413-433 (par 237-252).

CHAPTER 7

7.0 CONCLUSION

From the above discussion, what emerges to be of paramount importance in the determination of the extent of the bank's duty in processing documentary credits is the relationships between the various banks and the applicant and beneficiary, and amongst the banks themselves. It is these relationships that dictate the extent and set the parameters of the obligations of the bank.

All banks are bound by the duties of strict compliance and of reasonable care in examining and considering whether to accept documents tendered under a credit. The duty of strict compliance is one that is borne primarily out of banking practice. While having also developed through banking custom, the duty of reasonable care is also a common law obligation owed by banks to their clients.

The relationship between the issuing bank and the applicant is one of mandate with the bank being the applicant's mandatory. The issuing bank therefore has to observe the terms of the applicant's mandate. The issuing bank must timeously issue the credit in accordance with its client's instructions. When dealing with an ambiguous instruction the issuing bank has a positive duty to seek clarification. Where payment has been made against conforming documents the issuing bank is under a duty to present the documents to the applicant against payment. If the bank pays against non-conforming documents without having sought clarification or a waiver, then it loses its right to reimbursement. The applicant is therefore under a duty to put the issuing bank in funds to cover the amount of the credit issued in its favour to enable the bank to meet the beneficiary's drafts before they become due.

The issuing bank has an obligation towards the beneficiary to make payment upon presentation of documents that comply with the terms of the credit. The beneficiary must therefore tender conforming documents before such a duty on the

bank arises. Where the beneficiary submits non-conforming documents, the issuing bank can approach the applicant and seek a waiver which will allow it to accept the discrepant documents. This provision endeavors to allow for the successful completion of the documentary credit transaction.

Banks are required to examine documents submitted under the credit within seven days and advise on their conformity. Where the documents are rejected, the bank must notify the beneficiary accordingly and also furnish reasons for the rejection. It must also advise whether the documents are held at the disposal of, or are being returned to, the beneficiary. The beneficiary is entitled to rectify the defects in the documents or to resubmit the documents before the credit expires. The beneficiary may also seek the applicant's consent to have the issuing bank accept the defective documents. The beneficiary may indemnify the issuing bank accepting the defective documents against any loss the bank may suffer as a result of accepting the documents. In cases where there is doubt as to the conformity of the documents, the issuing bank has a duty to effect the payment guaranteed by the documentary credit by paying under reserve.

As with English law, South African law regards the relationship between the issuing bank and the corresponding banks as one of principal and agent. The correspondent bank has a right to reimbursement by the issuing bank when it has fully discharged its mandate. It also has the right to be indemnified by the issuing bank if it suffers loss in pursuit of its mandate. This means a corresponding right on the issuing bank to reimburse and indemnify the corresponding bank. The issuing bank has an obligation to ensure that the instruction it gives, and the credit itself, is complete, precise and unambiguous. It must also clearly state the documents against which payments will be made in terms of the credit.

Under bank-to-bank reimbursements, the issuing bank has an obligation to pay the nominated bank. The issuing bank may appoint a reimbursing bank to discharge this responsibility on its behalf. It must timeously provide the reimbursing bank with the reimbursement authorisation. The issuing bank then becomes liable to pay the reimbursing bank.

No obligations arise on the part of the confirming bank by virtue of its relationship with the applicant, except for the duty of reasonable care recognised in international banking practice. A contractual relationship does however exist between these parties. By confirming the credit the confirming bank has an independent undertaking with the beneficiary and therefore has a duty to pay upon receipt of conforming documents. The confirming bank must also inform the beneficiary whether his documents have been accepted, and where they are rejected to furnish reasons for the rejection.

In conclusion therefore, the banks have a large part to play in the processing of documentary credits. The duties of the banks are complemented by some obligations that arise on the part of the applicant and the beneficiary.

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