UNIVERSITY OF PIRAEUS

POSTGRADUATE DEGREE PROGRAM
IN MARITIME STUDIES

" INTERMEDIARY BANKS IN A COMMERCIAL LETTER OF CREDIT TRANSACTION, ESPECIALLY IN SHIPPING TRANSPORTS: VARIOUS ROLES, FUNCTIONS AND LIABILITIES TO THE APPLICANT AND THE BENEFICIARY".

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1. INTRODUCTION

1.1. Banking and International trade transactions

Major banks can provide a variety of important services for customers engaged in export-import business; for example, carrying out collections; issuing letters of credit; various forms of trade financing; processing foreign exchange transactions; issuing and processing negotiable instruments; and providing guarantees of different kinds. They also function as sources of business information by reason of their wide, international networks of subsidiaries, branches and correspondents. The bank's function is to provide certain services for its customer, and otherwise it does not participate directly in the formation and execution of an export / import transaction[1].

In recent years there have been developments in clearing services interbank and in the range and importance of correspondent banking products and services. The new system of electronic funds transfer have been crucial innovations to enable banks to provide international movement of funds. In the world of international finance, electronic forms of clearing are basic components of correspondent banking.

Some examples of electronic clearing systems are: Society for Worldwide Interbank

[1] Baxter I., «The Law of Banking», 4th edition. Carswell, p.145,(cited in this paper as «Baxster»).

Telecommunication (SWIFT), a global opening system, established under Belgian law; Clearing House Interbank Payments (CHIPS), established in 1970 and operated by the New York Clearing House; Clearing House Automated Payment Systems (CHAPS), the UK interbank system[2].

1.2 Characteristics of letters of credit

The terms “documentary credit”, “letter of credit” and “commercial credit” are all in current use and no distinction need be made between them[3]. Commercial credits are most commonly used in connection with import and export transactions, where an exporter who contracts to sell goods to a foreign purchaser is unwilling to dispatch them in reliance on the purchaser’s personal credit, either because the purchaser is unknown to him or because his credit is uncertain. The purchaser, on the other hand may equally be uncertain about the exporter’s reliability, and, therefore, unwilling to part with his money before the goods are registered. What the exporter seller needs is an assurance,

[2] Ibid, p. 154.

[3] Jack R., «Documentary credits», Butterwoths, London, 1993, 2nd edition, papa. 1.2 (cited in this paper as «Jack»).

before he makes the shipping arrangements, that he will be paid after the shipment of goods. It is this need that the commercial credit is designed to satisfy[4].

A transaction under a commercial letter of credit, therefore, presupposes the case of a seller or buyer whose reputation is sound in his own country, but who is not sufficiently known in foreign markets, to enable him to rely on his reputation when selling or purchasing goods abroad. A compromise, therefore, has to be reached whereby the purchaser agrees in a contract of sale to procure the opening of a commercial credit by a reliable bank in his own country in favor of the exporter, and when the bank notifies the exporter of the opening of the credit, the exporter has an assurance, that when he dispatches the goods and tenders the shipping documents to the bank, he will be paid the purchase price by the bank[5]. It is of the essence to a banker's commercial credit that there is an antecedent underflying contract for the sale of goods or other contract which it is agreed that the price or other payment will be exchanged by mean's of a banker's letter of credit[6].

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[4] Goode R., «Commercial Law», 2nd edition, Penguin books, p. 962, (cited in this paper as «Goode»).

See also Arora A., Penn A., Shea A., «The Law and Practice of International Banking», Sweet & Maxwell, London, 1987, p.290, (cited in this paper as Penn, Shea and Arora»).

[5] Arora A., Penn A., «The Law and Practice of International Banking», Sweet & Maxwell, London, 1987, p. 290.

[6] Ibid.

It is to be mentioned that the popularity of letters of credit has fluctuated widely over the years.

The demand for letters of credit varies not only according to whether it is a sellers' or a Buyer's market and the degree of confidence felt by sellers in the creditworthiness of their customers but also on governmental controls. Where strict exchange controls are applied, the letter of credit tends to become more prominent, for it provides the exchange control authorities with a means of ensuring that payments due on exported goods are in fact received in the country of export[7].

It is apparent, that the international character of the transactions under a documentary credit imposes the need for a uniform regulation, aiming in reducing the differences in national laws, relating to credits. The Uniform Customs and Practice for Documentary Credits (U.C.P), published by the International Chamber of Commerce (I.C.C.) and adopted by banks in many countries confronts in a successful way the necessity for a uniform operation of documentary credits[8].

The U C P 500 defines the documentary credit:

[7] Goode, supra n 4, p. 965

[8] Jack, supra n. 3, para. 1.17, 1.21. The UCP 500 is the current edition, which came into effect on 1st January 1994.

ARTICLE 2: Meaning of the credit

For the purposes of these articles, the expressions «Documentary credits» are «standby Letter(s) of credit», 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 the order of a third party (the beneficiary), or is to accept and pay bills of exchange (Draft(s)) drawn by the Beneficiary,

or,

ii. authorizes another bank to effect such payment or to accept and pay such bills of exchange (Draft(s)),

or,

iii. authorizes another bank to negotiate, against stipulated documents, provided that the terms and conditions of the Credit are complied with[9].

[9] Article 2 of the UCP 500. Although the U.C.P. is of almost universal application, it does not have the force of law in the United Kingdom, and has to be incorporated into the contracts which form the basis of the credit. See Todd P., «Bills of Lading and Banker's Documentary credits», 2nd edition, LLP, 1993, p.25.

This definition requires explanation. Basically, at the request of the buyer, the issuing banker promises to pay the price of the goods to the seller against the tender of the relevant documents. The nature of the banker's undertaking varies: it may be an irrevocable promise or one subject to revocation. Moreover, the method of payment promised by the banker may assume three different forms. First, he may agree to pay cash when the documents are presented or at deferred date, such as 90 days after presentment. Secondly, he may undertake to accept a bill of exchange for the price drawn on him by the seller. Thirdly, he may agree to negotiate without recourse a bill of exchange drawn by the seller on the buyer. In the two last cases the documents must be attached to the seller's bill. In certain cases the seller may not be interested in a promise of a banker operating in the buyer's locality; in such cases the buyer may request his bankers to arrange that a credit be opened by the correspondent's in the seller's country[10].

1.3. Mechanism of documentary credits

A documentary credit transactions usually involves four parties. The first two parties are the buyer and the seller, who agree in their contact of sale that payment of the price is to

[10] Benjamin, «Benjamin's Sale of Goods», 4th edition, London, Sweet and Maxwell, 1992, p. 1454, 1455, (cited in this paper as «Benjamin»).

be effected by the furnishing of a documentary credit. In due course, the buyer instructs his own bank, which is the third party in the transaction and which in known as the «issuing bank», to open the required documentary credit. The party who arranges for the opening of a credit is refered to as the applicant and the party to whom the credit is addressed may be referred to as the «beneficiary»[11].

According to the court's ruling in ***Reynolds v. Doyle***[12] and ***Kates v. Hoppe***[13], a customer of a bank who requests it to open a credit is under a duty to pay it the amount for which it has accepted bills of exchange drawn by the beneficiary and must do this a reasonable time before the bills fall due for payment. This is to ensure that the bank has funds to meet the bills before it is called on to pay them. Apparently the customer / applicant need not put the bank in funds when the credit is issued to the beneficiary, even though the bank comes under an obligation to accept bills drawn by him and thus, ultimately, to pay them, at the time. It is, of course, possible for a bank to stipulate that its customer shall pay it the amount of the credit before or at the time it is issued, so that the bank is at no time at risk for having to use its own funds to pay the beneficiary[14].

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[11] Jack, supra n. 3, para 1.6.

[12] (1840), 1 M. & G. 753.

[13] (1850), 9 G.B. 541.

[14] Pennington R., Hudson A,. Mann J., «Commercial Banking Law», Macdonald & Evans, p. 362, (cited in this paper as «Commercial Banking Law»).

Usually the buyer / applicant undertakes to reimburse the amount paid by the bank to the seller / beneficiary. A clause – usually set out in bold letters – incorporates the Uniform Customs and Practice for Documentary credits, which is in this way made part and parcel of the contract. The back of the application form includes small print clauses which set out the general terms of the contract between the issuing bank and the applicant / buyer[15].

The next step in the transaction is the opening of the documentary credit, where the issuing bank notifies the seller of the opening of the documentary credit in his favor. It is to be mentioned that the documentary credit lists the documents to be tendered by the seller and sets out in detail all other terms with which the seller has to comply in order to obtain payment[16].

The fourth party in the transaction is the correspondent bank. While the issuing bank may deal directly with the beneficiary / seller abroad, it is more usual for the issuing bank to utilize the services of a bank in the country of the beneficiary, which may be referred to as the «correspondent bank».

[15] Ho Peng Kee, Helena HM Chan, EP Ellinger, «Current Problems of International Thade financing», 2nd edition, Butterworths, p.140, (cited in this paper as «Current Problems of International Trade Financing»).

[16] Ibid, p. 142.

Although the bank may be designated by the applicant pursuant to his arrangements with the intended beneficiary, it is more commonly left to the issuing bank to decide which bank it will use[17].

As a result, a bank in the seller's country is usually introduced into the credit contract, an intermediary contract, an intermediary bank, which usually accepts the instructions of the issuing bank. The liabilities and the functions which a correspondent / intermediary bank performs and consequently its legal position are the main topics, which are discussed in this paper. The rights and liabilities of intermediary banks, are governed by the contractual relationships created by the documentary credit itself, by the type of the letter of credit (i.e. confirmed credit or unconfirmed) and by the instructions which they receive from the issuing bank. As will be seen there are some functions which the intermediary may take upon itself independently of its relationship with the issuing bank[18]. But, if the correspondent does not follow strictly the issuing bank's instructions it not only loses any right to reimbursement but it is also liable in damages to the issuing bank. It may well find that bank will not accept any incorrect

[17] Jack, supra n. 3, para 6.1.

[18] Ibid.

documents and the correspondent bank will then have to sell the goods as best it can to recover its money[19].

Therefore, it is crucial to examine the two fundamental principles relating to letters of credit: (i) The doctrine of strict compliance and (ii) the autonomy of the credit. The correspondent bank is bound by these two principles and it is liable if it does not perform its function according to these two principles. Moreover, the interposition of a correspondent bank gives rise to various contractual relationships between the correspondent bank and the seller. No such relationship comes into existence in the case of an «unconfirmed credit». The interposition of a correspondent bank results also in the creation of a contractual relationship between the issuing bank and the correspondent bank. The nature of this contractual relationship, which varies according to the role assumed by the correspondent bank, will be discussed subsequently[20].

As it has already been pointed out above, after the opening of the credit the issuing bank notifies the beneficiary of the opening of the letter of credit. Then the correspondent bank advises the seller of the opening of the documentary credit by the issuing bank, and if required to do so by the issuing bank, adds its own confirmation. In the last type of case the correspondent bank gives the seller an undertaking of his own in terms similar to that of the issuing bank. Due to this fact it is necessary to examine issuing

[19] Hooley M. Sw., «The Law of International Trade», 2nd edition, CCH ed. Limited, p.131, (cited in this paper as «Hooley».

[20] Current Problems of International Trade Financing, supra n.15, p.142-143.

banker's duties. However, if the correspondent bank is not prepared to confirm the documentary credit, it must inform the issuing bank without delay. One of the advantages of the employment of a correspondent bank is that the terms of the documentary credit can be dispatched to him by telex or by cable and in code. This is speed and relatively inexpensive method of notification[21].

Next is the realisation of the credit. The seller ships the goods and acquires the documents specified in the documentary credit[22]. If the credit provides for the documents to be presented to a correspondent bank, as it usually the case, and that bank has accepted the documents, it will then remit them to the issuing bank[23]. When a banker accepts a set of complying documents tendered under a documentary credit, he is entitled to claim reimbursement of the amount paid to the beneficiary from the party who has instructed him[24]. Therefore, if the issuing bank finds that the documents conform to the credit, it will send a notice of refusal to the correspondent bank and will return them to it unless the buyer is prepared to waive the discrepancies which have now been found[25].

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[21] Benjamin, supra n.10, p. 1455, 1456.

[22] Ibid.

[23] Jack, supra n.10, p. 1956.

[24] Benjamin, supra n. 10, p. 1956.

[25] Jack, supra n. 3, para 1.15.

In the majority of transactions, the discharge of a documentary credit does not give rise to difficulties. Conforming documents are accepted and paid for while ones have to be rejected. In practice, the buyer is usually consulted before the faulty tender is refused. Frequently, as it has been pointed out above, he is prepared to waive the discrepancy involved. However, difficulties arise when documents, which appear regular on their face in the sense that they comply in their form with all the requirements set out in the credit and in the application form, are in realty either forged or false[26]. It is apparent that, despite their regularity in form, such documents are usually worthless as the buyer will have no use for the rubbish shipped instead of the goods.

The action in deceit, available against the dishonest seller, is of little value as such a vogue usually absconds before the fraud or forgery is discovered. The only question which arises is which one of the innocent parties to the transaction has to bear the loss[27]. Therefore, the rights and liabilities of a confirming bank relating to the concept of fraud under a documentary credit transaction need to be examined. Is the confirming bank liable if it has paid against forged documents? An attempt will be made in the course of this analysis to provide answers to this question.

In general, it should be stated at this point that the correspondent bank's legal position varies, according to the functions which it may perform. So, unless the

[26] Current Problems of International Trade financing, supra n. 15, p. 144, 145.

[27] Ibid.

correspondent bank is instructed to issue the credit itself (correspondent issuer), it may be asked to advise the seller / beneficiary of the opening of the credit by the issuing bank and of its items (advising bank) or it may add its own confirmation (confirming bank). Moreover it may on occasion act as a collecting bank or as a negotiation bank[28]. All these functions will be considered later in the course of this analysis.

Furthermore, it could be alleged that an intermediary bank may act as a reimbursing bank which undertakes to reimburse the bank, which has paid against tender of documents. The issuing bank may authorize an intermediary bank to perform this function. Therefore, it is necessary to examine the function and the liabilities of a reimbursing bank under a documentary credit transaction. By reimbursing another bank, the intermediary obtains rights and is liable for its omissions. Due to this fact, it is necessary to explore the legal position of a reimbursing bank. An attempt will be made in the course of this analysis to explain this legal position that an intermediary may obtain.

[28] Jack, supra n. 3, para 6.4, 7.1.

2. TYPES OF DOCUMENTARY CREDITS

2.1. Introduction

As it has been implied above the duties of a correspondent bank vary according to the type of the credit. (This occurs when a correspondent bank acts as a correspondent issuer or as confirming bank). Therefore, it is essential for the better comprehension of the correspondent bank's duties to analyze the two primary categorizations of credits: revocable and irrevocable credits, confirmed and unconfirmed credits.

2.2 Revocable and irrevocable credits

The most fundamental classification of documentary credits is their division into revocable and irrevocable credits. This classification is recognized in article 6 of the U.C.P., which also requires that all credits should clearly indicate whether they are revocable or irrevocable. In the absence of such indication the credit is deemed to be irrevocable[29]. Whether a documentary credit is revocable or irrevocable depends on the

[29] Previously, the position had been the other way.

terms of the promise by the issuing bank to the beneficiary[30]. Article 6 of the U.C.P. provides:

ARTICLE 6: Revocable v. Irrevocable credits

a. A Credit may be either

i. revocable

or

ii. irrevocable

b. The credit, therefore, should clearly indicate whether it is revocable or irrevocable

c. In the absence of such indication the Credit shall be deemed to be irrevocable[31].

Article 6.c is consistent with the view that it is suggested an English court would take, that an irrevocable credit must be provided where the underlying contract simply provides for payment by letter of credit. This is on the ground that a revocable credit provides no security[32].

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[30] Benjamin, supra n. 10, p.1464.

[31] Article 6 of U.C.P. Revocable credits were covered by Article 7 of the 1983 Revision.

[32] Jack, supra n. 3, para 2.4.

If the credit is revocable, the issuing bank can revoke the credit unless an authorized bank has made a payment, acceptance or negotiation or, where a deferred payment is to be made under the credit, if the authorized bank has made a payment, acceptance or negotiation or, where a deferred payment is to be made under the credit, if the authorized bank has taken up documents with appear on their face to be in accordance with the terms and conditions of the credit. Such a credit will not in practice be confirmed[33].

A revocable credit is one which may be canceled by issuing bank without notice. The issuing bank incurs no real commitment under such a credit, except that if the advising bank or some other authorized bank has accepted, paid or negotiated the credit prior to receiving notice of its cancellation, it will be entitled to reimbursement from issuing bank, which in turn will recoup itself from the buyer / applicant[34].
So, apart from the limited protection provided by the revocable credit, this type of documentary credit provides no undertaking by the issuing to the beneficiary at all. For even if the correct documents are presented and the bank has not until then decided to revoke the credit, it may do so and reject the documents. It might for instance do that if it thought that the financial circumstances of its customers, the applicant, had

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[33] Brindle M., «Law of Bank Payments», p. 427, (cited in this paper as «Brindle»).

[34] Goode, supra n.4, p.971.

deteriorated since the credit was opened. For this reason a confirmed revocable credit world ordinarily be a contradiction in terms, there being no effective undertaking to confirm[35]. A confirmation would mean something, however, where the credit provided for payment to be deferred: then the confirming bank would add its undertaking to that of the issuing bank which becomes irrevocable after documents have been accepted, that payment will be made in due course[36].

Under an irrevocable credit, the seller / beneficiary has the benefit of a contract with the issuing bank. If the credit is confirmed, he also has a contract with the correspondent / confirming bank. The undertaking becomes binding on the bank(s) upon receipt by the beneficiary of notice of the credit. The advising bank acts as the issuing's agent for the purpose of advising the credit[37]. If, therefore, the credit is incorrectly advised to the beneficiary by the advising bank, the issuing is bound by the credit as advised[38]. Article 9 of the U.C.P. sets out the equivalent undertakings which are given by a confirming bank. These undertakings are at the heart of a documentary credit, and they make the instrument the secure means of payment which is intended to provide[39].

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[35] Jack, supra n. 3, para 2.8.

[36] Ibid.

[37] The relationship between the advising bank and the issuing will be discussed later in detail.

[38] Bindle, supra n. 33, p. 427.

[39] Jack, supra n. 3, para 2.10.

Article 9 of the U.C.P. provides:

ARTICLE 9: Liability of issuing and confirming banks

(a) An irrevocable Credit constitutes a definite undertaking of the Issuing Bank, provided that the stipulated documents are presented to the nominated bank or to the issuing bank and that the terms and conditions of the credit are complied with:

(i) if the Credit provides for sight payment – to pay at sight;

(ii) if the Credit provides for deferred payments – to pay on the maturity date(s) determinable in accordance with the stipulations on the Credit;

(iii) if the Credit for acceptance:

(a) by the issuing bank – to accept Draft (s) drawn by the beneficiary on the Issuing Bank and pay them at maturity, or

(b) by another drawee bank – to accept and pay at maturity Draft (s) drawn by the beneficiary on the Issuing 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 pay 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, banks will consider such Draft (s) as an additional document (s).

(b) A confirmation of an irrevocable Credit by another bank (the «Confirming Bank») upon the authorization or request 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 at sight;

(ii) if the Credit provides for deffered 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 Draft (s) drawn by the Beneficiary on the Confirming Bank and pay them at 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 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 on the Applicant, banks will consider such Draft (s) as on additional document (s).

Both the issuing and confirming bank undertake to pay the beneficiary should the method of payment contemplated by the credit fail[40]. However, it may be questioned at what point the relevant undertakings becomes binding on the issuing and confirming banks. Clearly the credit must be communicated to the beneficiary, and it is suggested that it becomes binding at the moment. This consistent with Article 9. a which implicit suggests that the undertakings which it sets out become binding when they are given. This must be surely the intention of the parties[41]. It is also confirmed by Article 9.b.ii which provides that an issuing bank is bound by an amendment from the moment of its issue. There can be no distinction in this respect between the issue of a credit and the issue of an amendment. The alternatives is that the credit becomes binding when the seller has acted on it by doing something towards the performance of his contract – which might be the making of an arrangement to ship the goods, or commencing to manufacture or continuing to manufacture them[42].

[40] Brindle, supra n. 33, p. 429.

[41] Jack, supra n. 3, para 2.11.

[42] Ibid.

2.3 Confirmed and Unconfirmed Credits

At this point it is important to stress the fact that the use of the confirmed and unconfirmed credits assumes the existence of an intermediary / correspondent bank and that this distinction depends upon the legal position taken by the bank. In general, with a confirmed credit the advising bank adds its own undertaking to that of the issuing bank that payment will be made. But, if the credit is unconfirmed, it does not: the sole undertaking is that of the issuing bank[43].

So, as we have seen above, whether a documentary credit is confirmed or unconfirmed depends on the role assumed by the correspondent bank. If the correspondent bank is merely instructed by the issuing bank to notify the seller about the opening of the documentary credit by the issuing bank, the correspondent bank act as agent of the issuing bank[44]. In such cases the correspondent bank assumes the role of an advising bank. This kind of role, which may be assumed by the correspondent bank will be discussed later. So, when the correspondent bank undertakes only to advise the credit,

[43] Ibid.

[44] Benjamin, supra n. 10, p. 1965.

the commercial credit is unconfirmed on his part, although it may contain an irrevocable undertaking of the issuing banker[45].

But in certain transactions the seller may insist on obtaining a binding undertaking of a banker operating in his locality. In such case the issuing bank may ask the correspondent to confirm the documentary credit. The correspondent bank then adds its own promise to that of the issuing bank and the credit becomes a confirmed credit[46].

2.3.1 The role of the confirming bank where credit confirmed

Although the beneficiary under an irrevocable credit is protected against the buyer's insolvency (or other default), as long as only one bank (the issuing bank) is involved, acting as agent of the buyer and probably situated in the buyer's country of business, the seller can still be faced with the possibility of having to settle disputes in a foreign country should any problem arise. So, he may still be faced with the daunting prospect of litigating abroad, or at best entering a lengthy process of negotiations with a bank in a foreign jurisdiction. Quite apart from the uncertainties of litigating abroad, the expense in terms of witnesses etc., can be considerable[47]. In such cases the role of correspondent

[45] Ibid.

[46] Ibid.

[47] Todd P., «Bills of Lading and Banker's documentary credits», 2nd edition, Lloyd's of London Press

bank is significant. So, it is common to stipulate that an irrevocable credit, issued by a bank in the buyer's country, should also be confirmed by a bank in the seller's country of business. If the credit is confirmed the confirming bank is adding its own undertaking to that of the issuing bank. The documents are tendered to the confirming bank, and it is the confirming which undertakes the responsibility of paying the seller. This undertaking is enforceable independently of the position taken by the issuing bank, so that the confirming's obligation to pay does not, for example, depend on whether it can obtain reimbursement from the issuing bank[48]. If the issuing bank defaults the confirming bank can sue it, but cannot sue the seller for return of the money paid.
If the issuing bank goes into liquidation before reimbursing the confirming bank, again the confirming bank has no recourse against the seller[49].
To clarify the terms which are discussed here, it should be noted that a credit may be irrevocable without being confirmed, but a confirmed credit is always irrevocable. According to the U.C.P regulations (article 9.b.) a confirmed credit is one which the advising or some other bank is authorized by the issuing bank to add its confirmation. However, it is not uncommon for an advising bank to add its own confirmation and become a confirming bank without the authorization from the issuing bank in return for

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Ltd, 1993, p.18, (cited in this paper as «Todd»).

[48] Ibid.

[49] Ibid.

a commission from the seller himself[50].

2.3.2 Silent confirmations

As we have seen above, a confirmation is given «when the issuing bank authorizes or requests another bank (an intermediary bank) to add its own confirmation».This regulation is provided by article 9.b. of the U.C.P. However, the seller, the beneficiary of the opening of the credit, who receives a letter of credit, may require the correspondent bank to confirm the credit and agrees to pay the usual confirmation fees. This undertaking by the correspondent would constitute a «silent confirmation», which is very usual in practice. In such a case the correspondent bank's position is complicated by the fact that that the confirmation is issued at the request of the beneficiary, whose interest may be in conflict with the issuing bank's[51]. If a correspondent bank has confirmed a letter of credit at the request of the issuing bank it will be entitled to reimbursement by the issuing bank or other designated reimbursing bank. However, the position of the banks which confirm a credit at the beneficiary's request is less clear.

[50] Goode, supra n. 4, p. 971, 972.

[51] Benjamin, supra n. 10, p.1467.

Silent confirmation facilities commonly envisage that the silent confirmer will obtain reimbursement from the issuing bank in one or other of the following ways[52]:

1. By means of the silent confirmer exercising such rights as may be available to it as negotiation bank.

2. By the silent confirmer requiring the original beneficiary to take action in order to pursue its own rights for payment under the credit.

3. By the silent confirmer acting in the capacity of assignee of the original beneficiary's rights under the credit.

4. By the silent confirmer exercising rights of subrogation[53]. It is important to note that, if it is the case that any action against the defaulting issuing bank must be taken in a foreign country and under foreign law, appropriate legal opinions should be obtained. Even then, whilst foreign legal opinion might provide some comfort as to the silent confirmer's capacity to sue, the likely outcome of any litigation will inevitably be more difficult to predict[54]. Moreover, it should be observed that, under the concept of a silent confirmation, the correspondent bank acts as the beneficiary's request and it may depart

[52] Credit & Finance Law, volume 9 no 11, October 1997 p. 153-154.

[53] Ibid.

[54] Ibid.

from the issuing bank's instructions. In such a case the correspondent bank may have to account to its principal – the issuing bank – for any profit made[55].

Moreover, the confirming bank may lose its right to reimbursement if the applicant rejects the documents on the grounds of non – compliance with the terms and conditions of the credit. Therefore, the confirming bank has the duty to examine the documents [56] according to the doctrine of strict compliance.

3. THE DOCTRINE OF STRICT COMPLIANCE

The cardinal feature of documentary credit transactions is that one and the same mode of performance applies in all the ensuing contractual relationships. Performance is by the tender of the documents specified by the buyer in the application form and by the bank in the documentary credit[57]. The beneficiary should rather these documents to the correspondent bank, who should forward them to the issuing bank who is turn should tender them to the buyer. This peculiarity of the mode of performance has led to the establishment of the principle that in documentary credit transactions all the parties are

[55] Benjamin, supra n 10, p. 1467.

[56] The correspondent's duties when it advises, confirms, or negotiates and the relationships arising under its legal position will be discussed in the course of this analysis subsequently.

[57] Current Problems of International Trade financing, supra n. 15, p. 143.

concerned solely with documents are not with the goods[58]. However, the documents must strictly with the terms of the documentary credit. This has led to a dichotomy. If the documents comply with the specifies terms, the party who tenders them is entitled to payment. However, if the documents are faulty, payment has to refused even if it is proved that the goods themselves are according to specifications bargained for[59].

3.1. Strict compliance and the correspondent's legal position

The legal principle that the bank is entitled to reject documents which do not strictly conform with the terms of the credit is conveniently referred to as the doctrine of strict compliance[60]. This principle is fundamental, because it regulates the legal obligations of a confirming who has paid against documents and also the legal position of the advising bank. The reason underlying this principle (of strict compliance) is that the advising bank is a special agent of the issuing bank and the letter is a special agent of the buyer; if such agent who has a limited authority acts outside his mandate the principle is

[58] Ibid.

[59] Ibid. The concept of forged document will be examined later.

[60] Schmitthoff C., «Schmitthoff's export trade», Steven 9th edition, p. 406, (cited in this paper as «Schmitthoff»).

entitled to disown the act of the agent, who cannot recover from him and has to bear the commercial risk of the transaction[61]. Moreover, it is important to stress the fact that where a bank pays under a confirmed letter of credit although the documents tendered are defective, the principal – the issuing bank or the buyer, as the case may be –forfeits his right to refuse reimbursing if he ratifies the unauthorized payment[62].

In addition, it should be observed that the doctrine of strict compliance applies to all the contracts involved in the credit operation. It must be thus be observed by the buyer who procures the issue of the credit; the seller wishing to claim payment under the credit; the paying bank that seeks reimbursement from the buyer[63].

The doctrine of strict compliance of documents has been explained by Lord Summer in *Equitable Trust Co. of New York v. Dawson Partners Ltd* [64] : «it is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorized to accept are in the matter of the accompanying documents strictly observed. There is no room for documents which are

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[61] Ibid.

[62] Ibid, p. 409.

[63] Goode, supra n. 4, p. 992-993. The principle of strict compliance is best illustrated by the following cases: Equitable Trust Co. of New York v. Dawson Partners Ltd. (1927) 27 LI.L.R. 49, Bank Melli Iran v. Barclays Bank DCO (1951) 2 LI.L.R. 367, J.H. Rayner & Co Ltd v. Hambro's Bank Ltd (1943) KB 37. See also Hoyle, supra n. 19, p. 650, 651.

[64] (1927) 27 LI.L. Rep. 49, 52.

almost the same, or which will do just as well. Business could not proceed securely on any other lines. The bank's branch abroad, which knows nothing officially of the details of the transactions thus financed, cannot take upon itself to decide what will do well enough and what will not. If it does as it is told, it is safe; if it declines to do anything else, it is safe; if it departs from the condition laid down, it acts as its own risk»[65].

3.2 «Discrepancy»

Whilst the doctrine of strict compliance is, in itself, well entrenched and understood, there is little authority to explain the exact nature of a «discrepancy» or «irregularity». Undoubtedly, the exclusion of the principle that the *minimis non curat lex* suggests that any meaningful deviation in the documents from the requirements set out in the letter of credit constitutes a discrepancy and vitiates the tender[66]. *In Hing Yip Hing Fat Co. Lt. v. Daiwa Bank Ltd*[67] it was decided that a mere typographical error, and no discrepancy, when a document tendered to the issuing bank the beneficiary gave the name of the applicant for the credit as «Cheergoal Industrial Limited», when it should have been «Cheergoal Industries Limited». But where it is not clear whether the departure from the

[65] Current Problems of International Trade financing, supra n. 15, p. 144.

[66] Benjamin n. 10, p. 1539.

[67] (1991) 2 HKLP 35.

detail set out in the credit was deliberate of a mistake, the discrepancy justifies the rejection of the documents[68].

3.3 Strict compliance and the buyer's position

From the above analysis it is apparent that a bank (issuing, confirming or advising) has the obligation to reject non conforming documents. Otherwise it is liable for its omission. However, a bank may reject conforming documents in cases of fraud[69], or forged documents. If the documents tendered by the seller to the bank turn out to be false, the buyer may have an action against him in deceit or for a breach of contract. If the documents are waste paper, the buyer may, further, have against the seller a quasi – contractual action based on total failure of consideration[70]. What is the seller's position if the bank rejects the documents by reason of their non compliance with the terms of the documentary credit? It is clear that if, despite the bank's rejection of the documents,

[68] Hooley, supra n. 19, p. 652. See also Benjamin, supra n. 10, p. 1540, Beyene v. Irving Trust Co 726 F 2d 4 (1985). Benjamin explains sufficiently the meaning of discrepancy and provides many illustrative examples.

[69] Ibid. See below.

[70] Benjamin, supra n. 10, p. 1441.

the buyer accepts the goods, he is under a duty to pay[71].

The buyer cannot possibly accept the goods but claim that the bank's rejection of the documents discharges him from his duties to pay the price. The acceptance of the goods by the buyer has to be regarded as his waiver of any rights based on the discrepancies in the documents[72].

If the issuing bank or the bank which has been instructed by the latter to confirm the credit is unsure whether the documents presented under the credit strictly comply with the credit but the beneficiary contends that they do it may make a payment «under reserve» to the beneficiary to take an indemnity[73]. In order to reduce the likelihood of a subsequent dispute over the effect of the bank's acceptance of documents «under reserve», the paying bank, which may be an intermediary bank, and the beneficiary should expressly agree upon their respective rights and liabilities in the event that the documents are rejected by the applicant / buyer[74].

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[71] Ibid.

[72] Ibid.

[73] Brindle, supra n. 33, p. 430.

[74] Ibid. In Banque de l' Indochine et de Suez SA vo JH Rayner Ltd, (1983) QB 711, the confirmin bank agreed to make payment «under reserve», on account of discrepancies in the documents.
However, the parties did not expressly agree on what would happen if the issuing bank rejected the documents. The buyers objected to the discrepancies and the issuing bank rejected the documents and refused to reimburse the confirming bank. See Brindle supra n.33, p.430.

4. THE AUTONOMY OF THE LETTER OF CREDIT

One of the primary functions of the letter of credit is to create an abstract payment obligation independent of and detached from the underlying contract of sale between the seller and the buyer and from the separate contract between the buyer / applicant and the issuing bank[75].

The correspondent bank is also bound by the principle of autonomy (or the independence principle), when it operates a credit.

According to the principle of autonomy the bank should not take account of any matters other than the terms of the credit and the documents which are presented to it[76]. Therefore, it is irrelevant to the bank whether the underlying contracts concerns the purchase of timber, oil, machinery or whether it concerns another transaction[77]. In *United City Merchants Ltd v. Royal Bank of Canada*[78], Lord Diplock stated in relation to a confirmed credit:

«It is trite law that there are four autonomous though interconnected contractual relationship involved[79]».

[75] Goode, supra n. 4, p. 987.

[76] Jack, supra n. 3, para 8.11.

[77] Schmitthoff, supra n. 60, p.404.

[78] [1983] I AC 168.

[79] Jack, supra n. 3, para 1.40.

The principles derives from what it is sometimes stated as a second principle, that a documentary credit is a transaction in documents and in documents alone[80].

However, the autonomy principle is not absolute. Fraud, whether in relation to the contract established by issue of the credit (i.e. fraud in the obtaining of the credit or the presentation of documents) or in relation to the underlying contract of sales entitles the bank if on notice of it to withhold payment.

The U.C.P. upholds the principle of autonomy of the credit. The articles provide:

ARTICLE 3: Credits v. Contracts

a. Credits, by the nature, are separate transactions from the sales or other contracts on which they may be based and banks are in no way concerned with or bound by such contracts, even if any reference whatsoever to such contracts is included in the Credit. Consequently, the undertaking of a bank to pay, accept and pay Drafts or negotiate and / or to fulfil any other obligation under the Credit , is not subject to claims or defenses by the Applicant resulting from his relationships with the Issuing bank or the Beneficiary.
b. A Beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the Applicant and the Issuing Bank.

[80] Goode, supra n. 4, p. 987.

ARTICLE 4: Documents v. Goods / Services / Performances

In Credit operations all parties concerned deal with documents, and not with goods, services and / or other performances to which the documents may relate.

Is to be noted that courts have consistently emphasized the importance to international commerce of the principle of the autonomy of the credit[81].

5. CONTRACTUAL RELATIONSHIPS UNDER A DOCUMENTARY CREDIT TRANSACTION

5.1 Introduction

As we have seen above, the two principles (the doctrine of strict compliance and the principle of the autonomy of the credit) are fundamental for the proper operation of the

[81] Power Curber International Ltd v. National Bank of Kuwait: [1981] W.L.R. 1233, Edward Owen Engineering Ltd v. Barcleys Bank International Ltd: [1978] QB 159-169, Hamzen Malas &Sons v. British Imex Industries Ltd: [1958] 2 QB 127. A brief analysis of these is provided by Schmitthoff, supra n. 60, at page 405 and by Hooley, supra n. 19, at page 648, 649.

credit as they regulate the rights and the liabilities of the banks involved in the documentary credit transaction.

An intermediary bank must always act according these two principles. If such bank departs from these two fundamental legal principles, it is liable for its omissions. The nature of the relationship between the intermediary / correspondent bank and the issuing bank will determine the correspondent's liabilities. Therefore, it is necessary to examine the contractual relationships and links arising under a documentary credit transaction in order to specify which contractual relationship is binding for the correspondent bank.

5.2 The network of contractual relationships

Under English Law, the Uniform Customs do not apply to contractual arrangements for letters of credit unless they are expressly included, but since it is banking practice always to provide that the Uniform Customs will be included as part of these arrangements, it would be a rare indeed to firm them not applicable in a contract subject to English Law. In most other countries the rule is around the other way, in that the Uniform Customs are incorporated automatically, even if no specific reference is made to them in documentation[82]. In addition to the U.C.P., the ICC has available «Standard

[82] Hedley W., «Bills of exchange and Banker's Documentary Credits», 2nd edition , L.L.P., 1994, p. 263, (cited in this paper as «Hedley»).

forms for Issuing Documentary Credits», so that the formal of the documentation can be standardized, as well as the rules governing the transactions[83].

The legal relationships which are created by the use of letters of credit were summarized by Lord Diplock in *United City Merchants Ltd v. Royal Bank of Canada*[84]. So, Lord Diplock said that: «It is trite law that there are four autonomous though interconnected contractual relationships involves:

(1) The underlying contract for the sale of goods, to which the only parties are the buyer and the seller;

(2) the contract between the buyer and the issuing bank under which the latter aggress to issue the credit and either itself or through a confirming bank to notify the seller and to make payments to or to the order of the seller (or to pay, accept or negotiate bills of exchange drawn by the seller) against presentation of stipulated documents; and the buyer agrees to reimburse the issuing bank for payments made under the credit. For such reimbursement the stipulated documents, if they include a document of title such as a bill of lading, constitute a security available to the issuing bank;

(3) if payment is to be made through a confirming bank, bank authorizing and requiring the later to make such payments and to remit the stipulated documents to the issuing

[83] Ibid.

[84] [1983] AC 168. See also Hedley, supra n. 82, p. 263.

bank when they are received, the issuing bank in turn agreeing to reimburse the confirming bank for payments made under the credit;

(4) the contract between the confirming bank and the seller under which the confirming bank undertakes to pay the seller (or to accept or negotiate without recourse to drawer bills of exchange drawn by him) up to the amount of the credit against presentation of the stipulated documents[85]».

United City Merchants concerned a confirmed irrevocable credit, and Lord Diplock clearly states that the third contract only arises where the credit is confirmed: an irrevocable credit, where is no confirming bank, consists simply of three autonomous though interconnected contractual relationships: the contract of sale, the contract between buyer and issuing bank and the contract between issuing bank and beneficiary[86].

However, it is to mentioned that there are in fact five contractual links between the parties where the credit confirmed[87]. So, the issue of an irrevocable confirmed credit involves the consideration of no less than five different contractual relationships named

(1) between buyer and seller (under the contract of sale),

(2) between buyer and issuing bank,

[85] Lord Diplock in the United City Merchants v. Royal Bank of Canada, [1983] AC 168.

[86] Todd, supra n. 47, p. 20.

[87] Jack, supra n. 3, para 140.

(3) between issuing bank and advising bank,

(4) between issuing bank and seller[88].

Moreover, it could be alleged that there is one more contract: the contract between the issuing bank and the confirming bank to provide reimbursement when the latter has paid against confirming documents[89].

5.2.1 The contract of sale

As it has been pointed out above, all these contracts are autonomous in that their terms are independent of each other. Therefore, nothing in the sale contract can effect the terms of the credit. So, the bank can not be affected by subsequent variations to the sale contract, or even perhaps its subsequent repudiation by the parties to it. The bank may be entirely unaware of any such variation or repudiation, and in principle its position should not be affected by it[90].

The contract of sale is the basis upon which the whole transaction begins. It is the agreement between the buyer and the seller, and will deal with all manner of topics

[88] Goode, supra n. 3, para 140.

[89] Ward A., Wight R., «Tortius Liability of an advising bank in the Letter of credit transaction» [1995] 4 JIBL.

[90] Todd, supra n. 47, p. 21.

apart from the terms of payment[91]. Due to this fact, banks can not be affected, by no means[92], by the contract of sale. However, the beneficiary's right to demand a letter of credit and the nature of the credit to which he is entitle, depends on the terms of the contract of sale. However, the beneficiary's right to demand a letter of credit and the nature of the credit to which he is entitle, depends on the terms of the contract of sale. The buyer / applicant, for his part, must ensure that the letter of credit issued to beneficiary is that prescribed by the contract. Therefore, the seller is entitled to reject an unconfirmed credit, if the contract provides for a confirmed credit[93].

5.2.2 The contract between buyer and issuing bank

This is the contract between the buyer and his – the issuing – bank, whereby the bank agrees to provide the buyer with the facilities. The bank, of course, in addition to issuing the letter of credit, might also be giving the buyer loan or overdraft facilities to

[91] Hedley, supra n. 82, p. 264.

[92] See the *fraud exception* below.

[93] Goode, supra n. 4, p. 995.

finance the transaction, and the agreement with the bank will, doubtless, provide for repayments on whatever terms are agreed[94].

However, once the issuing bank has opened an irrevocable letter of credit it is bound to pay, and the buyer can not give instructions to halt the payment. It is to be noted that several attempts have been made by buyers to obtain an injunction against their bankers to prevent them making payment, but the courts have been most reluctant to interfere with irrevocable letters of credit[95].

The bank must follow its instructions precisely, both in the opening of the credit and in the acceptance or rejection of documents which are presented under it. In that sense, it is under an absolute duty[96]. Therefore, in issuing the credit, the bank should mechanically follow its instructions. It should not take a view on the importance of a particular document which the buyer / applicant has instructed it to require for presentation under the credit, or consider whether another document will do just as well[97]. The buyer / applicant must reimburse the issuing bank if it has carried out its mandate. The bank may require the applicant to put it in funds before the payment. If he has not, the bank will usually take some sort of security from the applicant[98].

[94] Hedley, supra n. 4, p. 995.

[95] Ibid.

[96] Jack, supra n. 3, para. 4.9.

[97] Brindle, supra n. 38, p. 421.

[98] Ibid.

The result of the issuing bank's undertaking to open a letter of credit, is a direct contractual relationship between the issuing bank and the buyer[99]. Where payment is made not by the issuing bank but by an advising bank, or by some other bank authorized to negotiate under an open negotiation credit, then subject to the effect of article 18 of the U.C.P., discussed below, the issuing bank is responsible for the errors and omissions of the bank in question, which acts as its agent[100].

5.2.3. The issuing bank and the seller

A bank which has issued its irrevocable credit must, if the terms of the credit are complied with, pay the beneficiary unless it is authorized to pay someone else, such as an agent. A credit once communicated to and acted upon by the beneficiary can not be amended without the beneficiary's consent. Nor, it is submitted, can a bank which has issued its credit and communicated it to the beneficiary be required by the applicant to amend it, whether or not the beneficiary is agreeable[101].

[99] Arora, supra n. 5, p. 336.

[100] Goode, supra, n. 4, p. 998.

[101] Gutteridge H.C., Megrah M., «The Law of Banker's Commercial Credits», London, Europa Publications Limited, 1989, p. 64, 65 (cited in this paper as «Gutteridge Megrah»).

It is worth mentioning that the letter of credit is independent not only of the contract of sale but also the contract between the buyer and the issuing bank. Usually, therefore, the bank is under a duty to accept a complying tender of documents and should not enter intro controversies between the buyer and the seller[102]. However, the issuing bank is not obliged to accept a set of conforming documents tendered by the seller if the bank is satisfied that the documents are in effect forged or fraudulent [103].

It is to be noted that, though the issuing bank opens the credit on the instructions of the buyer, its undertaking to the seller is given as principal, not as buyer's agent. The buyer is not even an undisclosed principal[104]. Issuing bank's role is analogous to that of a commission agent, authorized to conclude a contract with the seller but to do so on his own account, without bringing the buyer into a contractual relationship with the seller[105]. Therefore, the buyer can not be sued under the letter of credit if the issuing bank fails to honor its obligations to the seller / beneficiary[106].

[102] Current Problems of International Trade Financing supra n. 15, p. 154, 155.

[103] Ibid.

[104] Goode, supra n. 4, p.990

[105] Ibid.

[106] Ibid.

5.3 Inter- bank relationships

The above analysis illustrates the contractual relationships arising under a documentary credit transaction. However, it is to be observed that an intermediary bank can not be affected by these relationships. The correspondent's obligations are generated by its contractual link with the issuing bank.

As we have seen, in most documentary credit transactions the issuing bank engages a correspondent who operates in the sellers' locality. The correspondent bank is usually asked to assume one of the following roles. First, the issuing bank may instruct the correspondent bank to open the documentary credit in his own name. The only undertaking which the seller obtain in this case is that of the «correspondent issuer»[107]. Moreover, the issuing bank may ask the intermediary bank to advise the credit, or to add its own information. So, the correspondent bank may assume various functions and combine different roles. The rights and the liabilities of a correspondent bank vary, according to its function. In addition, the relationship between the correspondent and the issuing varies according to its function and its obligations.

By nominating another bank or by allowing for acceptance or negotiation in the terms of the credit, or by questioning a bank to add its confirmation, the issuing bank authorizes the other bank to pay, accept or negotiate, as the case may be, and to be

[107] Benjamin, supra n. 10, p.1526.

reimbursed accordingly[108]. The only defence the issuing bank can have to this obligation is if the other bank did not act on documents which on their face appeared to be within the terms and conditions of the credit[109].

The relationship between the issuing and the intermediary bank depends upon what the later is called upon by the issuing bank to do. As between the issuing bank and the intermediary bank the relationship is, unless otherwise agreed, that of principle and agent, so that when the intermediary bank has fully complied with its mandate it is entitled to reimbursement of any moneys it has properly paid[110]. It is further indemnified against any loss it may suffer by reason of its acting on the mandate[111]. However, there is a considerable dispute relating to the agency relationship between the correspondent bank and the issuing bank[112].

For the purposes of this analysis it is necessary to examine all the functions that an intermediary bank may assume, in order to discuss its critical role, its liabilities and the nature of its relationship with the issuing bank.

[108] Hedley, supra n. 82, 283.

[109] Ibid.

[110] Gutteridge & Megrah, supra n. 101, p. 78.

[111] Ibid.

[112] This dispute will be discussed later.

5.3.1 Advising banks

As stated above, the rights and liabilities of intermediary banks are governed by the terms of the instructions which they receive from the issuing bank. In short, the relationship between the issuing bank and an advising bank is that of principal and agent[113].

The Uniform Customs provide that a credit may be advised to a beneficiary through another bank (the advising bank) without engagement on the part of the advising bank[114]. In other words, the advising bank undertakes to issue an advise, usually directly to the seller / beneficiary, as the issuing's agent. The advising bank speaks on behalf of the issuing but does not undertake to do more than advising the credit[115]. The advising bank may also offer payment or negotiation facilities but such services are provided to the exporter as beneficiary of the letter of credit in addition to and distinct from the

[113] Gutteridge & Megrah, supra n. 101, p. 80.

[114] Baxter, supra n.1, p.160.

[115] Dolan F. J., «The Correspondent Bank in the letter of Credit Transaction», Banking Law Journal, volume 109, n. 5, September – October 1992, p. 404 , (cited in this paper as «B. L. J. 1992».

advising duty owed to the issuing bank, to transmit the terms of the letter of credit[116]. At this point is must be noted that, unless the advising bank issues its own confirmation of the letter of credit, that bank is not a party to the letter of credit and undertakes no obligation to fulfil the promise of payment it contains[117].

By adding its confirmation, the advising bank is giving its own undertaking that the credit will be honoured on due presentation. This undertaking is given by the advising bank as principal, not as agent for the issuing bank, still less as agent for the buyer. Moreover, the advising's undertaking is entirely distinct from that given by the issuing bank[118]. It is not a case of a joint and several liability in the part of issuing bank and advising bank. The issuing's promise and the advising's undertaking are separate obligations[119].

However, where a bank merely advises the credit it is submitted that it accepts no obligation ay all to the seller. The bank should undoubtedly set out its intention in the matter and if it limits its advise by stating that it is «without engagement on our part», the denial of further responsibility is clear on the face of the advise[120]. Therefore, in

[116] Ward A., R., «The Advising Bank in Letter of Credit Transactions and the Assumption of Agency», [1993] 10. J.I. B L.

[117] Ibid.

[118] Goode, supra, n. 4, p. 1004.

[119] Ibid.

[120] Gutteridge & Megrah, supra n. 101, p. 81.

order to safeguard its position, the advising bank must expressly state that the credit does not include an undertaking on its part. As between itself and the issuing bank, the advising bank may, however, be authorized to accept a tender and to make payment[121].

There is some force, in the argument that an intermediary / correspondent bank should not accept instructions to advise unless it is prepared to give wider effect to the credit. It is for the applicant and the beneficiary to decide the kind of credit by which payment is to be made and it is not for the bank to take a line, in the face of a clear mandate, as to what that mandate entails[122]. It is likely that the denial of responsibility would in the United Kingdom be construed literally, for the words do not permit of any other construction and if it is complained that the position is equivocal it rests with the International Chamber of Commerce to make it clear in the Uniform Customs which construction is intended[123].

5.3.2. Agency relationship

It is observed, that many commentators have already characterize the advising bank as

[121] Benjamin, supra, n. 10, p.1526.

[122] Gutteridge & Megrah, supra n. 101, p. 81, 82.

[123] Ibid, p. 82.

issuing's agent. So, according to Jack[124]: «...so far as the applicant for the credit is concerned (the buyer), the advising bank is to be treated as the agent of the issuing bank. The acts of the advising bank are therefore to be taken as those of the issuing bank for the purpose of determining any liability which the issuing bank may have to the applicant».

Moreover, in Bank Melli Iran v. Barclays Bank[125] it was argued for Bank Melli that their relationship with Barclays was that of banker and customer and not that of principal and agent. However, Mc Nair in rejecting the plea stated[126]: «In my judgment, both on the instructions of the document under which the credit was established and in principle, the relationship between Bank Melli, the instructing bank, and Barclays Bank, the confirming bank, was that of principal and agent».[127]

In addition, according to Hedley[128] «…it is the issuing bank which begins the inter – bank contractual relationships when it asks another bank, usually in the seller's country, to advise the beneficiary of the credit or to confirm the credit or whatever. The contract is made between the issuing bank and the advising / confirming bank when that bank

[124] Jack, supra n. 3, p. 72.

[125] [1951] 2 Lloyd's Rep. 367, 376.

[126] Jack, supra n. 3, p. 115.

[127] Ibid, [1951] 2 Loyd's Rep.376.

[128] Hedley, supra n. 82, p. 282, 283.

signifies its acceptance of the terms to the issuing bank. Until that time there is no contractual obligation on the advising / confirming bank at all»[129].Hedley take the view[130] that the relationship between the advising and the issuing bank is that of principal and agent.

Also, according to Gutteridge & Megrah[131]: «The relationship between the issuing and intermediary bank depends upon what the latter is called upon by the issuing bank to do. As between the issuing bank and the intermediary bank the relationship is, unless otherwise agreed, that of principle and agent».

From the above analysis, it is apparent that the traditional view of English commentators is that when notifying the exporter / beneficiary of the existence and terms of the letter of credit, the advising bank is acting as agent of the issuing bank[132]. Therefore, it is important to examine the authorities for agency.

In general, an agent has the authority to act of behalf of another (the principal) to affect the legal position of the principal and a third party[133].

The advising bank is acting as an agent within its apparent or ostensible

[129] Ibid.

[130] Ibid, p. 234.

[131] Gutteridge & Megrah, supra n. 77, 78.

[132] Ward A., Wight R., [1993] 10, J. I. B L., p. 432.

[133] Judge S., Cremona M., «Business Law», Mc Millan, p. 305, (cited in this paper as «Business Law»).

authority[134]. The leading case relating to the doctrine of apparent authority is ***Freeman & Lockyer v. Buckhurst Park Properties Ltd***[135], in which Diplock L.J. said: An «apparent» or «ostensible» authority… is a legal relationship between the principal and the contractor created by a representation, made by the principle to the contractor, intended to be and in fact acted upon by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the «apparent» authority, so as to render the principal liable to perform any obligations imposed upon him by such contract[136]. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation but he must not purport to make the agreement as principal himself. The representation, when acted upon by the contractor by entering into a contract with the agent, operates as an inhibition, preventing the principal from asserting that he is not

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[134] Jack, supra n. 3, p. 115, 116.

[135] [1964] 2 Q.B. 480-506.

[136] Reynolds, F.M.B., «Bowstead and Reynolds on agency», sixteenth edition, London, Sweet & Maxweell, 1996, p. 367, (cited in this paper as «Bowstead on Agency»). See page 366», Article 74 – Apparent (or ostensible) authority.

bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.»[137]

The essence of apparent authority is an appearance emanating from the principal. Therefore, the representation must be made by the principal, or by another agent authorized to act for the principal. It is usually said that a representation by the agent himself hat he has authority cannot create apparent authority, unless the principal can be regarded as having in some way instigated or permitted it, or put the agent in a position where he appears to be authorized to make it[138]. The representation seems to occur in three main ways. It may be express (whether orally or in writing); or implied from a course of dealing; or it may be made by permitting the agent to act in some way in the conduct of the principal's business with other persons[139].

As it has already been pointed out above, most commentators take the view that the advising bank is the agent of the issuing. However, there is a considerable dispute relating to this characterization. So, Dolan states that the adviser is a messenger and, as much, is best viewed as an independent contractor[140]. The adviser undertakes to pass

[137] Ibid. The ostensible or apparent authority is not really authority at all. The terms refer to the appearance of authority whether authority exists in fact or not. See Ward A., Wight R., [1993] 10 J.I.B.L., p. 433.

[138] Bowstead on Agency, supra n. 136, p.370.

[139] Ibid., p. 368.

[140] B.L.J., 1992, supra n. 136, p. 370.

information from the issuer to the seller. The adviser does not act as the issuer's agent, can not bind the issuer to terms the issuer did not agree to be bound to, and can not make the issuer liable for its misperformance. The adviser is, nonetheless, in privily with the issuer and may be liable to the issuer for the issuer's damages[141]. However, the adviser is not in privily either with the buyer or the seller, and should be liable for consequential damages the commercial parties suffer by virtue of the adviser's misconduct or failure to act. In short, the adviser should not be liable for consequential damages when it garbles or fails to deliver a message[142]. This rule will undoubtedly strike some as harsh, because it often leaves a disappointed and, perhaps, badly damaged seller or buyer without any remedy. However, according to Dolan, the rule is efficient. It imposes the duty to prevent loss on the parties best able to prevent it – buyers and sellers[143].

So, as we have seen above, the view that the relationship between the issuing and the advising bank is always accurately described as one of agency has been challenged[144]. Moreover, according to Alan Ward and Robert Wight the judgment of Mc Nair J. in

[141] Ibid.

[142] Ibid.

[143] Ibid.

[144] Ward A., Wight R., «Tortius liability of an Advising Bank in the Letter of Credit Transaction», [1995] 4 J.I.B.L., p.138.

Bank Melli Iran v. Barclays Bank[145] does not seem to have received the critical scrutiny it deserves. It is to be that Mc Nair J. refers to the relationship between an «instructing» and a confirming bank.This was the relationship involved in the litigation[146]. Bank Melli has instructed Barclay's to issue a letter of credit on its behalf: Barclays was therefore the issuing bank of and Bank Melli the applicant for the letter of credit[147]. So, it seems that the judgment of Mc Nair J. (that the relationship of the two banks is that of principal and agent) is based on a misunderstanding[148].

From the above analysis it is apparent that to characterize the advising bank as agent of the issuing bank without qualification is misleading because it is unlikely that the parties to the letter of credit transaction intend that the full legal consequences of an agency relationship should follow[149].

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[145] [1951] 2 Loyd's Rep. 367.

[146] [1993] 10 J.I.B.L., p. 433.

[147] Ibid.

[148] Ibid.

[149] Ibid. p. 435. This article (The Advising Bank in the letter of Credit Transactions and the Assumption of Agency) can challenge in a very sufficient way the traditional that the relationship between the issuing and the advising is always accurately described as one of agency. (See also Ward / Wight, «Tortious Liability of an advising in the Letter of Credit Transaction», [1995] 4 J.I.B.L.).

5.3.3 Advising on commercial letters of credit

As we have seen above, the correspondent's role will depend upon the instructions which it has received from the issuing bank. The intermediary bank may simply be asked to advise the credit to the beneficiary without being instructed to play any further part in the credit transaction[150]. By performing that function the correspondent becomes an advising bank. It is to be noted that the duties of the advising bank are much lighter than those of the confirming bank[151]. According to Section 5 – 103 (1) (e) of the U.C.C., the definition of an advising is «a bank which gives notification of the issuance of a credit by another credit[152]. Section 5 – 107 (1) of the Code stipulates than an advising bank does not assume any obligation to honor the beneficiary's drafts but that it does assume the obligation to be accurate in its advise[153].

The advise of a letter of credit must include the following particulars[154]:

(i) Name of the issuing bank, type of letter with number and date.

[150] Brindle, supra n. 38, p. 425, 426.

[151] Wunnicke B., «Standby letters of Credit», Wiley Law Publications, 2nd edition, para. 1.03, (cited in this paper as «Wunnicke»).

[152] UCC p. 5-103 (1) (e), 1977.

[153] Wunnicle, supra n. 151, para. 3.6.

[154] Purvis R., «The Law and Practice of Commercial Letters of Credit», Butterworths, 1975, para 1.1, (cited in this paper as «Purvis»).

(ii) On whose behalf the letter of credit is established.

(iii) The currency and amount.

(iv) The date up to which the letter of credit is valid.

(v) Shopping time.

(vi) (a) The term of the bill drawn under the letter of credit: Sight or acceptance terms.

(b) Whether the bill is to be known on a named bank or the buyer.

(c) Particular terms of payment to the beneficiary.

(vii) Whether the bills are negotiable at air –mail or sea – mail rates of exchange or TT (telegraphic transfer) rate.

(viii) The documents required to be presented, together with the bills.

(ix) A brief description of the goods.

(x) Port of shipment and destination of goods. (It is permissible also to nominate only countries of shipment and countries of destination).

(xi) Price of the goods and details of cost included in the price, such as Fob, C&F, of cif.

(xii) Whether part shipment and / or trans-shipment are permitted.

(xiii) Any special condition under the credit.

(xiv) Indication whether the credit is revocable or irrevocable.

(xv) Whether the letter of credit can be confirmed by the correspondent bank. When advising the letter of credit the advising must be accurate in the meaning that the advise

of a letter of credit addressed to the seller / beneficiary must include all the former elements[155].

At this point it is worth considering the technology banks employ is establishing an advised credit. Until recently, issuing banks generally initiated the advice of an international credit by telex, an electronic capability that accepts signals over telephone lines or their equivalent and prints out on paper at the office of the advising bank the information sent by the issuing[156]. Today, most international credit transactions begin with a transmission via Society for Worldwide Interbank Financial Telecommunications (SWIFT), a Belgian cooperative established by banks to carry their messages. SWIFT employs electronic data interchange (EPI) technology that permits the issuer's operator to key punch relatively few bits of information into the SWIFT system, which receives the information at the SWIFT switch and relays it to the adviser[157]. The adviser's computer programs then translate the input into a readable output on the advising bank's premises.

The system is remarkably quick and error free and effects small savings in high volume, which is to say that it effects significant savings for the letter of credit industry in particular and the international banking industry in general[158].

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[155] Ibid.

[156] Dolan, B.L.J. 1992, supra n. 115, p. 405, 406.

[157] Ibid.

[158] Ibid.

In advising letter of credit, if a bank gives negligent or unskillful advise, the question may arise as to whether it was part of the bank's business to advise to the extent that it did on a letter of credit[159].

The question of the responsibility of an advising bank should be regulated by the Uniform Customs or made clear when advising[160]. In general, the UCP provisions are recognized as a part of a contract, if there is an expressed reference to them. In some countries the UCP provisions are recognized as a commercial custom that can be very helpful for the interpretation. In case of absence of such references in the credit[161].

Article 7 of the UCP provides a regulation relating to the advising's liabilities.

ARTICLE 7: Advising Bank's liabilities.

a. A Credit may be advised to a Beneficiary through another bank (the «Advising Bank») without engagement on the part of the Advising Bank, but that dank, if it elects to advise the Credit shall take reasonable care to check the apparent authenticity of the Credit which it advises. If the bank elects not to advise the Credit, it must so inform the Issuing without delay».

[159] Purvis, supra n. 154, p. 72, para 4.0.
[160] Gutteridge & Megrah, supra n. 101, p. 82.
[161] Todd, supra n. 47, p. 239-244.

In short, the advising bank's responsibility is to takes reasonable care to check the apparent authenticity of the credit. Moreover, according to article 7(b) of the UCP:

b. If the advising bank can not establish such authenticity it must inform, without delay the bank from which the instructions appear to have been received that it has been unable to establish the authenticity of the Credit and if 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.

It is worth mentioning that even if the issuer and the adviser are both parties in an agreement that oblige the advising bank to advise letters of credit at the request of the issuing, such an agreement would not be enforceable by a beneficiary[162].

Article 7 of the U.C.P. indicates that a correspondent bank may or may not choose to advise a credit. In addition, the advising bank is acting without engagement on its part, which means, in practical terms, without confirming the credit. If the advising bank choose to advise a credit, it must take reasonable care to check the apparent authenticity of the credit, that is, whether or not it appears to be genuine, namely instructed by the

[162] Kurkela M., «Letters of credit under International Law», Oceana publications, para 4.8, (cited in this paper as «Kurkela»).

issuing bank which appears to have instructed and in the terms in which it appears that has occured[163]. In most situations, under English Law, a bank which advised a credit which it has not in fact been instructed to advise, would be liable for its breach of Warranty of authority[164]. If the advising bank can not establish the authenticity of the instructions, it must inform without delay the bank from which they supposed to have come. But it can advise this credit acknowledging at the same time that it has been unable to establish its authenticity[165].

There are two occasions when the advising's failure to perform its duties without error can cause loss. In the first, the advising bank fails to notify the seller of the credit or gives the notice in an untimely fashion; in the second, the advising errs in relaying the information[166]. In their case, the seller / beneficiary may not be able to assemble its documents in sufficient time to comply with the terms of the credit and, therefore, loses the benefit of a credit that the buyer attempted to establish as the underlying sales contract between the seller and the buyer[167].

[163] Jack, supra n. 3, p. 117.

[164] Ibid.

[165] Ibid.

[166] Dolan, B.L.J., 1992, supra n. 115, p. 422.

[167] Ibid, p. 423.

5.3.4. Judicial examples

As we have seen above, an advising bank does not assume any obligation to honor the beneficiary's drafts but that it does not assume the obligation to be accurate in its advise. *Sound of Market Street v. Continental Bank International*[168] is an important opinion with respect to the obligations of an advising bank. Sound of Market sued Continental International, the first advising bank[169]. However, the third Circuit held that an advising bank does not have a duty of timely transmission to the beneficiary. The appellate court reversed: «Thus, the only express obligation of an advising bank is to be accurate in its statement of the letter of credit»[170]. The appellate court concluded that the beneficiary should recover its damages from the account party. Moreover, the court held that the advising bank is the agent of the issuer and that the account party, not the beneficiary, is the third – party beneficiary of that agency contract[171].

[168] 819 F. 2d 384 (3d Cir. 1987).

[169] Wunnicke, supra n. 151, para 10.7.

[170] Sound of Market St. v. Continental Bank Int.1, 819 F. 2d 384, 390 (3d Cir. 1987). See also Wunnicke, supra n. 151, para 10.7.

[171] Dolan J., «The Law of Letters of Credit», Warren, Gorham, Lamont, 2nd edition, para 1.03, (cited in this paper as «Dolan»).

The Comments to New UCC 5-107 state: «When the adviser manifests its agreement to advice by actually doing so (as is normally the case), the adviser can not have violated any duty to advice in a timely way (because it has no such duty to violate).[172]

In *Merchants Bank v. Credit Suisse Bank*[173], the advising bank submitted documents to the issuer. The issuer dishonored because the documents did not conform. The issuing bank then asked the advising bank for authority to present the documents to the account party on a collection basis. The advising bank extended that authority, but the account party refused to pay[174]. When the beneficiary sued the advising bank, it settled and sought to recover the amount of its settlement from the issuer. On the issuing's motion to dismiss, the court held that the advising bank could proceed with a claim that the issuing, when it asked for authority to proceed on a collection basis, fraudulently failed to disclose the account party's precarious financial condition[175]. It was the beneficiary's theory that by authorizing the collection, the advising bank deprived the beneficiary of any rights against the issuer on the credit. The Merchants Bank case stands for the position that the issuer owes a duty to the advising bank when the

[172] Wunnicke, supra n. 151, para 10.7.

[173] 585 F. Supp. 304 (S.D.N.Y. 1984).

[174] Dolan, supra n. 171, para 8.04.

[175] Ibid.

advising is acting as a collecting agent for the beneficiary[176].

First Commercial Bank v. Gotham Originals, Inc[177]., provides an example of how a bank's conduct may alter its status in a letter of credit transaction. In that case, a bank was initially designated as an advising bank; it, thereby, was in a neutral position, with the sole obligation of conveying accurate information of the issuance, amendment, terms, and conditions of the credit to beneficiaries. Thereafter, the bank accepted the signed drafts drawn under the letter of credit by the transferee-beneficiary, and by that action it became obliged to pay[178].

As we have seen above, the advising's obligation is to advise the credit within an ordinary care and skill; the bank is not negligent because it fails to exercise some extraordinary skill of care.

Moreover it is to be observed that where a person approaches a bank for advise in the matter of a letter of credit, the bank is taken by implication to know that the person approaching it relies on it for such advice. Where loss and damage have been caused by a negligent answer, the Bank will in all probability be liable[179].

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[176] Ibid.

[177] 64 N.Y. 2d 287, 475 N.E. 2d 1255, 486 N.Y.S. 2d 715 (1985).

[178] Wunnicke, supra n. 151, para 10.7.

[179] Purvis, supra n. 154, p. 72, 73.

The International Chamber of Commerce (I.C.C.) Banking Commission was requested to consider whether an advising bank could refuse to make a letter of credit available on the grounds that the beneficiary was not one of its customers. During the Commission's of the question, the comment was made «that a bank could not refuse to make a credit available without a valid reason for refusing»[180].

If the advising bank is only advising the credit, it should affix on its advice of the credit language similar to «This advice is sent to you without engagement on our part». Another example of an advising bank's language to the beneficiary might be: «At the request of the above named issuing bank, and without engagement on our part, we are enclosing [optional: an authenticated photocopy of] its letter of credit in your favour»[181].

5.3.5 The advising bank binds the issuing bank

In advising the credit bank acts as the issuing's agent. The most important legal consequence of this relationship is that the issuing bank will be bound by the credit as advised if the advising bank does not follow its instructions. The consequence is that, as

[180] Decisions (1975-79) of the ICC Banking Commision (ICC Pub. No 371 (1980), ICC Docs, 470/314, 470/323, (Oct. 21, 1977). Wunnicke, supra n. 171, para 10.6.

[181] Wunnicke, supra n. 171, para 10.6.

regards the beneficiary the issuing will be obliged to honour the credit as so advised. However, the issuing bank will not be bound if the advising bank is acting outside the scope of its usual or ostensible authority, or if the beneficiary knows that credit differs from the advising bank's instructions from the issuing bank[182].

As the advising is authorized on behalf of the issuing to pass the terms of the credit to the seller / beneficiary, the advising bank will bind the issuing bank even though it deviates from its instructions by, for example, failing to include in the terms of the credit a document called for by the instructions from the issuing bank.[183] For the terms of the credit as so advised by the advising bank will fall within the ostensible authority of the advising bank[184]. So the issuing bank will be liable and obliged to pay against documents even if the advising has failed to include in the terms of the credit all the necessary documents. But if it is the advising who has paid in accordance with the credit which it has advised, then the issuing bank may not be obliged to reimburse the advising[185]. In that scenario, the advising, given the fact that has already paid, will forward the documents, which has advised, to the issuing. The latter will not accept to reimburse the advising on the ground that the documents do not comply with its

[182] Brindle, supra n. 38, p. 426.

[183] Jack, supra n. 3, p. 116.

[184] Schmittthoff, supra n. 60, p. 283.

[185] Jack, supra n. 3, p. 116.

instructions. Therefore, if there is a breach of authority, the principal is not liable for the agent acts, in the sense that the issuing can reject the documents and decline reimbursement[186].

As it was stated above, one of the grounds for withholding payment is the non-compliance of the documents. So, the principle of strict compliance provide the issuing with a defense against the advising's claim for reimbursement; (this occurs when the advising has paid against documents which do not comply with the terms of the credit)[187].

Often, issuing banks will make it clear in the application agreement that they accept no responsibility for the advising's failure to advice or for is incorrect advice. It can be alleged that these efforts in the application agreement between the buyer and the issuing are an attempt by a bank to excuse itself from its own negligence, an act of exculpation forbidden by the UCC[188].

However this is not a case of a bank's exculpating itself, by contract or rule of law, from its own negligence, but a case of refusing to impose a duty

of care. The argument is that the law should not impose any duty and that, in fact, the

[186] Ibid.

[187] The principle of strict compliance has already been analysed above (Chapter 3).

[188] Dolan, B.L.J., 1992, supra n. 115, p. 427. (The UCC forbids contracting parties the power to disclaim the obligation of care prescribed by the Act UCC 1- 102 {3}).

UCC does not impose it[189].

To sum up, the issuing is liable to third parties (the beneficiary) for the acts of its agent but is not obliged, if the advising has not advise the credit in accordance with its instructions and has already made the payment, to accept the documents and reimburse the advising bank. But if the credit provides that payment to the beneficiary of the opening of the credit, is to be made by the issuing and the latter does not accept the documents, claiming that the advising bank did not advise the credit correctly, can the beneficiary sue the advising? The advising bank acting as the issuing's agent is not joining with the issuing in the obligation undertaken by the credit[190]. Therefore, it can be argued that, the relationship of agency between the advising bank and the issuing bank seems to determine the relationship between the issuing, the applicant and the beneficiary. Article 18 of the UCP regulates the nature of these relationships and the rights and liabilities of the parties involved in a letter of credit transaction.

ARTICLE 18: Disclaimer for acts on instructed party.

(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.

[189] Ibid.

[190] Jack, supra n. 3, p. 116.

(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).

(c).(i). A party instructing another party to perform services is liable for any charges, including commissions, fees, costs or expenses incurred by the instructed party in connection with its instructions.

(ii). Where a Credit stipulates that such charges are for the account of a party other than the instructing party, and charges can not be collected, the instructing party remains ultimately liable for the payment there of.

(d) The Applicant shall be bound by and liable to indemnify the banks against all obligations and responsibilities imposed by foreign laws and usages.

A question that may arise is, whether there is contractual relationship between the customer and the advising bank or not[191]. It seems that the Uniform Customs do not give a clear answer to that question. Article 18 b is trying to relieve banks from the possible liability towards the customer for consequential loss in international transactions[192]. It can be argued that the intended effect of this article is to relieve banks from liability, when dealing with each other. Article 18 b provides that bank assume no liability or responsibility, if the instructions they transmit are not carried out even if they

[191] Kurkela, supra n. 162, para 5.3.2.

[192] Hedley, supra n. 82, p. 282.

have chosen the bank is in default[193]. Although, there is no contractual relationship between the applicant and the advising bank, article 18 b provides that it is the buyer of the goods, who must indemnify the bank against all obligations and responsibilities imposed by foreign laws and usages. If articles 18a, 18b, 18d and the non – exhaustive character of the UCP are considered together, it seems that there is a strong argumentation for the existence of a contractual relationship, between the customer and the advising bank[194].

A rule relieving the advising bank of liability in the event of an erroneous advice will benefit commerce in general by keeping losses relatively low[195]. The seller that receives an incorrect advice may be put on notice. Often, the seller should immediately know that something is amiss and should arrange for an amendment. However, if the seller does not know that the advice is in error, it will prepare documents that confirm with the advice but that do not conform with the terms of the credit. The issuing, then, will receive discrepant documents and may dishonor[196].

[193] Kurkela, supra n. 162, para 5.3.2., Jack, supra n. 3, para 4.18.

[194] Ibid.

[195] Dolan, B.L.J., 1992, supra n. 115, p. 423, 429.

[196] Ibid, p. 424.

5.4. Confirming Banks

The function of Confirming banks has already been discussed above[197]. The correspondent / intermediary bank may be asked by the issuing to confirm the credit. The obligation of a confirming bank to pay, or to be responsible for payment if it is not itself to pay, is an obligation which it gives as a principal[198]. The confirming's position is that in carrying out its functions, where appropriate, it will act in a dual capacity. In so far its interests are concerned, it acts as principal: at the same time as regards the issuing bank it acts as agent[199]. The liability of a confirming bank to the seller / beneficiary must depend on the terms in which it gives its confirmation, but in general it adopts the obligation of the issuing bank as contained in the credit[200]. It is submitted that by confirming a credit, the confirming bank does not guarantee the fulfillment of the obligations of the issuing bank. The confirming bank gives an independent undertaking to the beneficiary so that the beneficiary may have the right to look both issuing bank and confirming bank[201]. However, if the confirming bank exceeds its mandate by accepting or paying drafts when the conditions of the credit are not fulfilled,

[197] See chapter 2.3.1.

[198] Jack, supra n. 3, p. 121.

[199] Ibid. See *Equitable Trust case*, (1927) 27 L.L.L. Rep. 49.

[200] Gutteridge & Megrah, supra n. 101, p. 82.

The issuing bank is not liable to the applicant[202].

It is to be noted that if a confirming bank takes up documents which do not satisfy the conditions of the credit, the issuing bank may reject them when the confirming bank passes them to it, and the confirming bank loses its claim to reimbursement. So, if the confirming bank pays over facially defective documents, it can not argue that is reasonably expects reimbursement[203].

5.4.1. Judicial examples

As we have seen[204] the issuing bank may reject non – confirming documents. However, in *National Bank of Egypt v. Hannevig's Bank Ltd* [205], the Court of Appeal held that if the issuing bank acknowledges the receipt of the documents without making any objection to them, it thereby waives its right to reject them, and can not do so later or resist a claim for reimbursement by the confirming bank[206]. Moreover, in Bank Melli

[201] Ibid.

[202] Pennington, supra n. 14, p. 369.

[203] Dolan B.L.J., 1992, supra n. 115, p. 432.

[204] See chapter 3.3.

[205] (1919), 1 Lloyd's L.R. 69.

[206] Pennington, supra n. 14, p. 370.

Iran v Barclays Bank D.G.O. Ltd.[207], the Court of Appeal held that an issuing bank waives its right of rejection if it delays exercising it for an unreasonable length of time from the time the shipping documents are tendered to it, or from the time it knows that documents which do not conform to the credit have been taken up by the confirming bank[208]

In Equitable Trust Co. v. Dawsen Partners Ltd.[209], the court held that where a confirming bank took up shipping documents which did not conform to the buyer's instructions as a result of an error in the transmission of the instructions by the confirming bank to one of its own branches, the issuing bank was responsible to the buyer, its customer, but it was entitled to be reimbursed by the confirming bank for the amount for which it was liable[210].

5.4.2 The concept of fraud

As we have seen above, when the seller's documents comply on their face, it is the general and essential rule of letter of credit law that the bank undertaking to honour the

[207] (1951) 2 Lloyd's Rep., 367.

[208] Pennington, supra n. 14, p. 370, 371.

[209] (1926) 25 Lloyd's L.R. 90.

[210] Arora, supra n. 5, p. 338.

The seller's drafts does in fact do so. The critical exception to that essential rule arises in case of fraud[211]. Is the issuing bank obliged to take up a set of forged or fraudulent documents tendered by the correspondent bank? Is the correspondent bank entitled to reimbursement if the documents tendered by it to the issuing are regular on their face (but turn out to be false or forged)?

So, it is apparent that fraud, whether in relation to the contract established by issue of the credit or in relation to the underlying contract of sale, creates several problems which need to be solved. Therefore, it is a matter of a great importance to examine the concept of fraud under a letter of credit and the legal position of correspondent banks.

As it has already been analysed above, the function of the letter of credit is based on the fundamental principle that the bank is entitled to reject document which do not strictly conform with terms of the credit. So, bank, must accept only documents which comply with the credit. One more principle, that regulates the documentary credit transaction, is that banks are concerned with documents are not with goods.

Therefore, banks discharge their duty to the buyer by conducting a reasonable examination of the documents tendered under the letter of credit[212]. Moreover, one principle, which constitutes the law that governs the letter of credit is the autonomy of the credit. As we have seen above, by this principle is meant that documents presented

[211] Dolan, B.L.J., supra n. 115, p. 339.

[212] J.B.L., 1981, p. 259.

under a credit are to be considered in the context of the credit alone and without reference to the underlying contract between the applicant and the beneficiary[213]. According to article 14(a) of the UCP, banks are entitled to pay against the acceptance of documents which appear on their face to be in accordance with the terms and conditions of the credit[214]. Therefore, the letter of credit as a transaction is a paper transaction.

It is irrelevant to the bank, whether the underlying contract concerns the purchase of machinery or oil or whether it concerns another transaction[215]. The only case in which the bank should refuse to pay under the credit occurs if it is proved to its satisfaction that the documents, though apparently in order on their face, are fraudulent. So, there is an established exception to the bank's duty to pay, which is referred to as the fraud exception[216].

Therefore, if the documents tendered by the correspondent bank to the issuing bank are regular on their face, the correspondent is entitled to reimbursement even if the documents turn out to be false or forged[217].

[213] Jack, supra n. 3, p. 208.

[214] Ibid.

[215] Schmitthoff, supra n. 60, page 404.

[216] Ibid.

[217] Benjamin, supra n. 10, p. 1527.

First, this follows from articles 16 and 17 of the UCP. Secondly, in this regard the position of the correspondent banker should be similar to that of the issuing banker, who can claim reimbursement from the buyer against forged or fulse documents provided these are regular on their face[218].

In the case of the correspondent issuer and of the confirming banker this argument derives support from the general similarity between their respective contracts with the issuing banker and the latter's contract with the buyer.

In the case of the advising banker this view is based on the principle that an agent, who carries out his instructions with care and skill, is not responsible for defects he can not reasonably be expected to discover[219].

So, it is submitted that a correspondent bank is not responsible for the genuineness or truthfulness of documents tendered by it to the issuing bank. In so far as the documents comply on their face with the terms of the documentary credit, the correspondent bank is entitled to obtain payment against them even if they turn out to be false or forged[220].

This view derives support from article 9 of the UCP under which banks assume no responsibility for the genuineness of documents tendered by them.

However, just as in the case of the issuing bank, the correspondent bank should not

[218] Ibid.

[219] Ibid.

[220] Current Problems of International Trade Financing, supra n. 15, p. 171.

ignore a «red flag»[221]

5.5. Paying, Collecting, Negotiation Bank

The function of a paying bank is to effect payment of drafts presented under the letter of credit. A paying bank is specified by and takes its directions from the issuing bank[222]. The paying bank expedites payment to the beneficiary when no confirmation is required but the beneficiary's location is distant from the issuer's location. For convenience, the advising bank and the paying bank are often the same financial institution. The paying bank is unlike a confirming bank because a paying bank has no obligation to the beneficiary for performance under the letter of credit[223].

So the issuing bank may instruct the advising not only to advise the beneficiary of the credit's issuance but also to honor the beneficiary's draft on behalf of the issuing[224]. When the advising pays the beneficiary, it must examine the beneficiary's documents to

[221] Ibid.

[222] Wunnicke, supra n. 151, para 3.8.

[223] Ibid.

[224] The UCP uses the term «nominated bank» to designate the bank other than the issuing designated in the credit as the bank that will honour the seller's draft. See Dolan, B.L.J., 1992, supra n. 115, p. 406.

determine whether they comply with the terms of the credit[225].

Moreover, a correspondent bank which is requested by the beneficiary to present documents under the credit on the beneficiary's behalf is a collecting bank. The collecting bank acts as the agent of the beneficiary for the purposes of presentation and receiving payment[226]. This has the consequence that, if the documents are fraudulent to the beneficiary's knowledge, the paying bank, i.e the issuing or the confirming bank, will not be obliged to pay the collecting bank[227]. In cases of fraud it will be important to determine whether the bank is collecting in its own right having negotiated, i.e purchased, the documents from the beneficiary, or whether it is collecting as the beneficiary's agent[228].

The term «Negotiation Bank» is used to refer to a bank which acquires documents in its own right to be presented by it as a principal under a letter of credit which is a negotiation credit[229]. The purpose of the negotiation credit is to give to the seller the facility of selling to an authorized bank his right to present the documents and collect

[225] The advising bank is an information transmitter when it acts as adviser. It may well have an additional important function, that of payment ; but then it acts as payer. See Dolan, B.L.J., 1992, supra n. 115, p. 406.

[226] Jack, supra n. 3, p. 134.

[227] Ibid, p. 135.

[228] Ibid.

[229] Ibid.

payment , and a nominated bank which buys the documents then replaces the seller as the beneficiary and presents the documents and receives payment in its own right[230].

A bank which purchases the documents under a negotiation credit may be called a negotiation bank. The essential distinction from a collecting bank is that a negotiation bank holds the documents in its own right, where as a collecting bank holds them as agent for the beneficiary[231].

6. COMMISSION, CHARGES, REIMBURSEMENT OF THE CORRESPONDENT BANK

Both the issuing bank and the confirming bank are entitled to a commission or fee for the service tendered to the buyer. Most bankers in the United Kingdom make one charge at the time the credit is established and another at the time it is utilized[232].

It is to be noted that, where the correspondent bank's sole initial role is that of advising bank and it subsequently acts as a collecting bank for the beneficiary, or negotiates the documents from the beneficiary and presents them in its own right, it will

[230] Goode, supra n. 4, p. 1005.

[231] Jack, supra n. 3, p. 135.

[232] Benjamin, supra n. 10, p. 1497.

deduct its charges[233] from what it would otherwise pay the beneficiary. It is the general rule of agency law than an agent is accountable to his principal for any profits above his entitled remuneration from his principal[234]. It is suggested that an attempt to use this rule to require a correspondent bank to pay over these charges to its principal, the issuing, would be doomed to failure[235].

According to article 19a. of the U.C.P., the issuing bank is obliged to reimburse a bank which it has authorized to pay or to incur a payment undertaking pursuant to a credit. The reimbursement obligation may be performed directly by the issuing bank itself. Alternatively, it may be more convenient to employ an intermediary bank. The issuing bank will authorize the intermediary bank to reimburse the nominated bank and the credit will instruct the nominated bank to claim on the intermediary bank for reimbursement[236]. The intermediary bank will in turn be reimbursed by the issuing bank. This is the situation regulated by the Uniform Rules for Bank -to- Bank Reimbursements under Documentary Credits (U.R.C.). The nominated bank, or another bank collecting as agent for the nominated bank, is termed the «claiming bank» and the

[233] See the Opinions of the I.C.C. Banking Commission 1989/1991, p. 22, 23.

[234] Jack, supra n. 3, p. 133.

[235] Ibid.

[236] Bennett H., «Bank -to- bank reimbursements under documentary credits: the Uniform Rules», L.M.C.L.Q., 1998, p. 115.

intermediary bank is termed the «reimbursing bank»[237].

7. CONCLUSION

As we have seen above, under a documentary credit transaction, the issuing bank undertakes an obligation directly to the beneficiary of the credit to pay against tender of documents which conform to the terms of the credit (doctrine of strict compliance). However, unless the credit states that the beneficiary may seek payment from the issuing bank alone, the credit must authorize payment by at least one further bank, termed the «nominated bank»[238].

The Uniform Customs provide that a credit may be advised to a beneficiary through another bank, termed the «advising bank», without engagement on the part of the advising bank, but that bank shall take reasonable care to check the apparent authenticity of the credit which it advises[239]. If the bank confirms it undertakes all the obligations embodied in the credit[240]. In advising the credit, the advising bank acts as the issuing bank's agent. The issuing bank will not, however, be bound if the advising

[237] Ibid.

[238] Ibid.

[239] Baxter, supra n. 1, p. 160.

[240] Gutteridge & Megrah, supra n. 101, p. 101.

bank is acting outside the scope of its usual or ostensible authority, or if the beneficiary knows that credit differs from the advising's instructions from the issuing[241].

The liability of a confirming bank to the seller – beneficiary must depend on the terms in which it gives its confirmation, but in general it adopts the obligation of the issuing as contained in the credit[242]. In short, the intermediary as a confirming bank is obliged to honour the credit I the documents appear on their face to be in order, whether or not there has been a breach of the contact of sale[243]. It is to be noted that the obligation of the issuing bank (or the confirming bank) is to pay if the terms and conditions of the letter of credit have been carried out by the seller. By issuing or confirming a letter of credit, banks assume an obligation to pay, irrespective of any dispute which there may between the parties on the question of whether the goods are up to contract or not. (autonomy of the credit)[244]. The only exception to this rule is the concept of fraud under which banks are entitled to withhold payment.

From the above analysis it is apparent that the role of intermediary banks is crucial under a documentary credit transaction, as they may undertake to advise, confirm e.t.c. a credit. Their function and legal position are mainly dependent on the instructions which

[241] Brindle, supra n. 38, p. 426.

[242] Gutteridge & Megrah, supra n. 101, p. 101.

[243] Goode, supra n. 4, p. 1004.

[244] Baxter, supra n. 4, p. 161.

they receives from the issuing bank. In general, it can be strongly argued that their function in facilitating the operation of a credit is significant.

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