CHAPTER-6

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The bank issues a letter if credit on the basis of an application made by its customer. The undertaking of the bank is to arrange payment to the beneficiary on compliance of the terms and conditions set out in the letter of credit. A contractual obligation is formed in this transaction. The bank’s undertaking is under an assurance of indemnity by the customer. The rights arising from this undertaking in favour of the issuing bank depends on the contractual relationship between parties involved in this credit. The letter of credit can be compared with the ordinary credit provided by banks. In such transactions bank adopts several methods to realise the loan advanced to the customer. Similar methods are adopted in letter of credit transaction also.

The rights of the issuing bank against correspondent bank are another aspect. The relationship between the issuing bank and the correspondent bank is that of principal and agent. When the issuing bank instructs the correspondent bank to pay the beneficiary the amount mentioned in the credit on behalf of it, the correspondent bank acts an agent of the issuing bank. As an agent of the issuing bank it has to observe the directions given to it by the issuing bank. The correspondent banker will get protection only if it comply strictly with the mandate given to it so that the issuing banker can invoke right of recourse against the customer. It is necessary to analyse the scope and ambit of the

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2 Id., p.68
functions of issuing bank and correspondent bank resulting in the invocation of these rights.

The undertaking of the issuing bank is absolute so long as the documents of title to goods which the sellers tender to the banker to receive payment are in order\(^3\). Sometimes problem may arise when beneficiary tenders non-confirming documents which go unnoticed by the issuing banker. In such situations the interest of issuing bank will get jeopardized. A detailed examination is required to identify remedy left to the issuing bank to make good the loss.

If there is a doubt regarding non-conformity of documents presented by the beneficiary, the banker will be ready to make payment on the basis of an indemnity given by the beneficiary. In that situations bank may have recourse against him and may hold him liable on indemnity\(^4\). The scope of this right is also to be examined.

Issuing banks' consent is required in order to effect the transfer of letters of credit. The transferee may be put to difficulties if the issuing bank refuses to effect a transfer of the credit at the request of the transferor beneficiary. The discretion given to the bank is accepted by the practice of trade\(^5\). Even if it consents to transfer, the extent and manner should also be accepted by the bank\(^6\). It is essential to analyse how far these rights are regulated by national and international systems.

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3 For example, see the observations of bankers, L. J. in Belgian Grain Co, v. Cox (1919), 1 L.L. Rep. 256. This undertaking cannot be termed as absolute. It is subject to certain exception recognized by courts though applied in limited situations like fraud.


5 See the U.C.P.600, Article 38 (a).

6 Ibid.
Rights of the Issuing Bank

The written agreement between the issuing bank and the applicant for the letter of credit is the basis of the rights of the issuing bank. If the bank acts in accordance with terms agreed, it has a right to be indemnified by the customer. The contractual right can be exercised by the issuing banker only if it strictly follows the terms and conditions agreed in the credit. If there is any deviation from any terms agreed it will lose its claim. The observations made by Lord Summer can be noted:

"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 almost the same, or which do just as well...".

If the corresponding bank which negotiates and pays the beneficiary believing that the documents are irregular, it should pass the documents to the issuing bank. Issuing bank should determine whether it will honor or refuse them. It must be done only on the basis of documents alone. The issuing bank is concerned itself to see that the documents appear regular on their face. But the legality of the documents presented is not to be examined by the issuing banker.

\footnote{In usual practice the written request form is available with bank and it is termed as contract for the parties to transact. See for discussion, A. G. Davis, The Law Relating to Commercial Letters of Credit, Sir Isaac Pitman & Sons Ltd., London (1963), p.58}

\footnote{Equitable Trust Co. of New York v. Dawson Partners Lid, (1927) 27 Lloyd's. Rep.49 at p.52.}
If the applicant fails to give clear and complete instructions regarding issue of the documentary credit, the issuing bank has different options. The U.C.P.600 reads\(^9\),

"Banks assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document, or for the general or particular conditions stipulated in a document or superimposed thereon; nor does it assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods, services or other performance represented by any document, or for the good faith or acts or omissions, solvency, performance or standing of the consignor, the carrier, the forwarder, the consignee or the insurer of the goods or any other person".

**Effect of Ambiguous Instructions given by Customer**

In letters of credit transaction the issuing bank is not concerned with the efficacy of any documents stipulated by parties. In *Midland Bank v. Seymour\(^{10}\)*, the instructions given by the buyer were ambiguous. Even then bank paid the beneficiary. Later when buyer refused to reimburse the bank, it took the plea that it acted upon the terms and conditions agreed between them. The court held that the bank was not in default as the instructions given were not clear. The facts of the case relate to shipping of rubbish materials by the seller. The buyer sued the bank on several issues. One of the issues related to the unauthorized acceptance of draft presented by the seller\(^{11}\). It can be seen that this decision was designed to protect the interest of the bank. The law always tries to protect the decision of the bank when the buyer gives unclear and

\(^9\) The U.C.P.600, Article 34.

\(^{10}\) [1955] 2 Lloyd's Rep. 147.

\(^{11}\) *Ibid.* Here the issuing bank accepted the draft after the expiry date though they argued that the buyer has accepted it.
imprecise instructions. The U.C.P.600 contains a special provision which disclaims for acts of an instructed party. It states,

"A bank utilizing the services of another bank for the purpose of giving effect to the instructions of the applicant does so for the account and at the risk of the applicant.

An issuing bank or advising bank assumes no liability or responsibility should the instructions it transmits to another bank not be carried out, even if it has taken the initiative in the choice of that other bank.

A bank instructing another bank to perform services is liable for any commissions, fees, costs or expenses ("charges") incurred by that bank in connection with its instructions.

If a credit states that charges are for the account of the beneficiary and charges cannot be collected or deducted from proceeds, the issuing bank remains liable for payment of charges.

A credit or amendment should not stipulate that the advising to a beneficiary is conditional upon the receipt by the advising bank or second advising bank of its charges.

The applicant shall be bound by and liable to indemnify a bank against all obligations and responsibilities imposed by foreign laws and usages."

It is a well established principle that if the instructions given by the customer to the issuing banker regarding the document tendered by the beneficiary are ambiguous, the banker is not in default if he acts upon a reasonable meaning of the ambiguous instructions. But what is reasonable is a flexible concept and there is no specific law to determine its meaning.

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12 For instance, see the U.C.P.500, Articles 12 and 16.
13 The U.C.P.600, Article 37.
14 Supra n.9.
In the United States, the law seems to deny a right to the issuing bank to test the quality of goods. It tries to protect the interest of bank in case of unclear instructions. In *Maurice O'Meara Co. v. National Park Bank of New York*, the seller presented the documents describing the newsprint paper as required in the letters of credit. In fact the letter of credit did not require that a certificate from an independent laboratory should accompany the documents. The bank refused to pay on the ground that it had not got any opportunity to test the tensile strength of the paper. The seller argued that the issuing bank had no right to test the same. Though the decision was in favour of the seller denying such right to the issuing banker on the ground of independence principle, it raised several issues regarding the rights of issuing bank.

If the issuing bank is not having such right on the basis of its own interest and on the assurance of prompt payment against documents. The judgement delivered by McLaughlin contains the following observation.

"It has never been held so far as I am able to discover, that a bank has the right or is under an obligation to see that the description of the merchandise contained in the documents presented is correct. A provision giving it such right, or imposing such obligations, might, of course, be provided for in the letter of credit ...."

But if the letter of credit contained such provision, the banker will have such right according to the above observations. It is pertinent to inquire the scope of that right if the bank had such right to determine. This will put the

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16 Ibid.
17 Id. at p.633.
banker in troubles. It will be time consuming and there will be need for expert opinion. In such a situation the banker's will be unenvious.

In a decision of the Court of Appeals for the ninth circuit\(^{18}\), it was held that the issuing bank was under a duty to verify the buyer's complaint that the goods did not conform to contract specifications. However, jurists\(^{19}\) criticised this decision. It said:\(^{20}\):

"If banks were required to undertake their obligation, the result would be a destruction of the certainty of the promise embodied in the letters of credit. The seller's risk of non-payment would be increased and the buyer would be denied the assurance that the seller would not receive payment until he has presented to the bank the documents required in the credit letter".

If the proposition that in an irrevocable letter of credit the bank is under a legal obligation to inquire into the terms of sales is accepted the result would be destruction of the certainty of the promise embodied in the letter of credit. It is logical to assume that a bank may feel compelled to honor a customer's request to engage in various communications with the seller-beneficiary. The bank's conduct in the instant case may well represent common practice rather than an isolated incident.

However, the Uniform Commercial Code contains provision which protect the interest of bank issuing credit for the applicant if it honours a presentation as


\(^{20}\) Id., at p.844.
required by the law on letter of credit\textsuperscript{21}. Therefore, if the instructions that the applicant gives are clear and precise, the issuing bank has to act strictly with it. In cases of ambiguous instruction it is a matter to be decided through interpretations of courts.

**Issuing Banks Right against Correspondent Bank**

In normal situations correspondent bank pays the beneficiary and receives the document mentioned in letter of credit. There is no liability to pay if it only advises the beneficiary and its obligations are to ensure that the beneficiary is advised and the credit is delivered. The U.C.P.600 reads\textsuperscript{22},

"If a bank is requested to advise a credit or amendment but cannot satisfy itself as to the apparent authenticity of the credit, the amendment or the advice, it must so inform, without delay, the bank from which the instructions appear to have been received. If the advising bank or second advising bank elects nonetheless to advise the credit or amendment, it must inform the beneficiary or second advising bank that it has not been able to satisfy itself as to the apparent authenticity of the credit, the amendment or the advice".

Therefore the advising bank will take reasonable care to check the apparent authenticity of the credit which it advises. This is usually done by comparing the signature on the credit with the authorized signatures it maintains on file. Once the advising bank confirms the letter of credit the rights and liabilities will be changed. Apart from this the issuing bank has the right against correspondent banker to supervise. The correspondent banker must obey strictly

\textsuperscript{21} The U.C.C. Article 5-108 (i) provides, "An issuer that has honoured a presentation as permitted or required by this article: (1) is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds…".

\textsuperscript{22} The U.C.P.600, Article 9(o).
the instructions he receives as an agent. When the bank acts accordingly the contractual principles govern their relationship\textsuperscript{23}.

The correspondent bank must take reasonable care to ensure that the document received appear on its face consistent with the terms of credit. Then only they can claim reimbursement from the issuing bank. Issuing bank has got the right to reject the documents if they are inconsistent with the terms agreed by the correspondent bank. It is immaterial whether the correspondent bank paid to the beneficiary or not.

The difficulties that arise in this arrangement are due to receiving the instructions which are not clear. The term understood will be something which is not intended by the issuing bank. The U.C.P. tried to overcome this difficulty. It provides,\textsuperscript{24}

"If incomplete or unclear instructions are received to advise, confirm or amend a credit, the bank requested to act on such instructions may give preliminary notification to the beneficiary for information only and without responsibility. This preliminary notification is provided for information only and without the responsibility of the Advisory bank. In any event, the Advising Bank must inform the Issuing Bank of the action taken and request it to provide the necessary information. The issuing bank must provide the necessary information without delay. The credit will be advised, confirmed or amended, only when complete and clear instructions have been received and the advising bank is then prepared to act on the instructions."

But the provision is not clear regarding the element of time. It says "without delay"\textsuperscript{25}. However to decide the "delay" was once subject to litigation.

\textsuperscript{23} Mark Hapgood (Ed.), Paget's Law of Banking, Butterworths, London (1983), p.624

\textsuperscript{24} The U.C.P.500, Article 12. However the U.C.P.600 does not contain this provision.

\textsuperscript{25} Ibid.
In *Bank Melli Iran v. Barclays Bank (Dominion, Colonial and Overseas)*, the correspondent bank paid against documents which did not comply with the terms of credit. When they forwarded these documents to the issuing bank to receive the reimbursement they remained silent. There was a delay on the part of the issuing bank to reject the document. This inadvertent delay was taken as ratification by the correspondent bank. It was held that the inaction on the part of issuing bank amounted to ratification.

Justice M. C. Nair said,

"There was considerable debate before me as to whether or not mere inaction or silence can amount to ratification. In my judgment, it is plain that mere inaction or silence may be evidence from which a jury might infer an intention to ratify."

Gutteridge criticizes this judgment and says that it deprives the issuing bank the right to complain of the payment against unsatisfactory documents. It was evidenced by the issuing bank that such delay was owing to pressure of work in the documentary credit department. These observations cannot be accepted in the light of modern letter of credit transaction. The provision should be clear as to the time limit for informing the correspondent bank regarding irregular document. Then only they can get reimbursement from customer. Therefore the U.C.P. 600 tried to clarify these difficulties by limiting the reasonable time to a maximum of five banking days.

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26 [1951] 2 Lloyd's Rep. 367
27 Ibid.
28 Supra n. 1.
29 The U.C.P. 600, Article 14 (b) reads, “A nominated bank acting on its nomination, confirming bank, if any, and the issuing bank shall each have a maximum of five banking days following the day of presentation to determine if a presentation is complying. This period is not curtailed or otherwise affected by the occurrence on or after the date of presentation of any expiry date or last day of presentation.”
The legal principle which determines the right of reimbursement is contained in the rules adopted by non-governmental agencies. They are given binding effect by incorporating them into the contract. The International Chamber of Commerce has published a number of rules dealing with the bank to bank reimbursement. It is for the issuing bank to initiate the reimbursement procedure. However these are inter-bank arrangements and these rules are not intended to override or change the provisions of the U.C.P. Moreover, the U.C.P.600 specifically incorporated bank to bank reimbursement arrangements. It provides certain guidelines to be followed by the banks in case if a credit fails to state that reimbursement is subject to the I.C.C. rules for bank-to-bank reimbursements. Accordingly it states,

"...i. An issuing bank must provide a reimbursing bank with a reimbursement authorization that conforms with the availability stated in the credit. The reimbursement authorization should not be subject to an expiry date.

ii. A claiming bank shall not be required to supply a reimbursing bank with a certificate of compliance with the terms and conditions of the credit.

iii. An issuing bank will be responsible for any loss of interest, together with any expenses incurred, if reimbursement is not provided on first demand by a reimbursing bank in accordance with the terms and conditions of the credit.

iv. A reimbursing bank's charges are for the account of the issuing bank. However, if the charges are for the account of the beneficiary, it is the responsibility of an issuing bank to so indicate in the credit and in the reimbursement authorization. If a reimbursing bank's charges are for the account of the beneficiary, they shall be deducted from the amount due to a claiming bank when reimbursement is

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10 See the Uniform Rules for Bank to Bank Reimbursements under Documentary Credits, ICC Publication No. 525. It came into force on 1st July 1996.
11 Id., Article 2 (a).
12 The U.C.P. 600, Article 13.
made. If no reimbursement is made, the reimbursing
bank's charges remain the obligation of the issuing
bank..."33.

Issuing Bank's Obligation under a Negotiation Credit

The negotiation credit34 may be issued in one of two forms. In the first
one it may be freely negotiable and in the other negotiation may be restricted to
one or more banks named in the credit. In either case the issuing bank's primary
obligation is to reimburse the negotiating bank if the negotiating bank has
complied with the terms of the credit.

It is the issuing bank that authorizes the negotiating bank35 to negotiate
against documents. The bank's undertakings are clearly predicated on the
assumption that the draft and documents will have been presented to the
negotiating bank and negotiated by that bank before presentation to the issuer
for payment. This raises the alarming possibility that the credit may fail to
provide payment despite the beneficiary's compliance with its documentary
stipulations. This possibility arises because the act of negotiation is voluntary on
the part of the nominated bank to decide whether the credit is restricted or freely
negotiable36. If the beneficiary is unable to persuade a bank to negotiate,
despite the documents are being in conformity with the credit, it appears that he

33 Id., Article 13 (b).
34 Negotiation means the purchase by the nominated bank of drafts or documents under a
complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before
the banking day on which reimbursement is due to the nominated bank. See the U.C.P. 600,
Article 2.
35 The bank which negotiates the bills or drafts under letters of credit is also known as nominated
bank or paying bank, see R.K. Gupta, Banking Law and Practice, Modern Law Publishers,
is unable to operate the credit. This disturbing conclusion derives judicial support from the decision of the Singapore Court of Appeal in the *Indian Bank* case\(^{37}\). Here the court ruled that since the presentation to the nominated bank was for collection, there had been no negotiation under the credit and the issuer thus incurred no liability thereunder. Unless, the nominated bank is the conforming bank, nomination by the issuing bank does not constitute any undertaking by the nominated bank to negotiate. The nominated bank's receipt for examination and forwarding of the documents does not make the nominated bank liable to negotiate. However the issuing bank is under an obligation to make necessary arrangements to pay the beneficiary if he tenders required valid documents under credit.

Another question that may arise is whether the nominated bank can claim a right of reimbursement from issuing bank if it does not actually pay beneficiary. The following arguments are advanced by some jurists\(^ {38} \).

Thus if value is given by the nominated banks on assumption of a risk, the issuer might not pay on documentary grounds. It might not be able to pay on insolvency or political grounds also. Then reimbursement should logically be available in respect of the negotiating bank despite the fact that the negotiating bank has not been paid.

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Correspondent Bank’s Right against Seller

The rights of the correspondent bank are evolved through judicial decisions. There may be provisions in the governing rules accepted by parties also. In case of inconsistent documents received from the seller, the correspondent banker can exercise the following rights:

a) Right to refuse payment

b) Pay and take an indemnity from the seller in respect of any loss or damage resulting from the deficiency in the documentation

c) Pay the beneficiary “under reserve”.39

These rights can be exercised by the correspondent bank in order to meet the immediate situation and to protect the interest of parties to the letters of credit. The position of the correspondent bank becomes more complex when the issuing bank subsequently rejects the document. The correspondent bank can claim repayment of money from the beneficiary if it has paid the beneficiary “under reserve”. But there is no exact meaning of the words “under reserve”.40

This provision was used in Banque De l'Indochine Et De Suez S.A. v. J. H. Rayner (Mincing Lane) Ltd41 In this case the confirming bank pursuant to a telephone discussion with the parties paid the beneficiary even though they had a doubt regarding the effectiveness of the document tendered. They paid “under reserve”. Later the buyer refused to lift the conditions and accept the document. The confirming bank sued the beneficiary for return of money paid to him “under

reserve". The beneficiary contended that they could not reserve their rights as done by the confirming bank and that the documents were not defective as found by the buyer. The decision of the court favoured the stand of the correspondent bank. It was held that they were entitled to get repayment from the beneficiary. The expression "under reserve" is not having any precise meaning and when that is used. Therefore the court must look to the intention of the parties. Kerr L. J.,42 said, the

"that payment was to be made ..., in the sense that the beneficiary would be bound to repay the money [to the Confirming Bank] on demand if the issuing bank should reject the documents, whether on its own initiative or on the buyer's instructions. I would regard this as a binding agreement made between the confirming bank and the beneficiary by way of a compromise to resolve the impasse created by the uncertainty of their respective legal obligations and rights."

There is no provision to pay "under reserve" in the U.C.P. The bank must give notice stating the discrepancies in respect to which it refuses the documents43. The legal principles are based on the terms agreed between the correspondent bank and the seller. The contractual relationship comes into existence when the correspondent bank pays. This principle is well established in United City Merchants44 case. In this case the contractual obligations of the parties were accepted in order to determine the dispute between them. However the seller did not have any right to sue anyone other than the correspondent bank. He could not intervene in the contract between the buyer and the issuing bank.

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42 Id., p.734.
bank⁴⁶. So this right can be exercised by the correspondent banker with utmost care against the beneficiary. There will not be direct connection between the issuing bank and the beneficiary.

Another view is that by confirming a credit by the correspondent banker does not guarantee the fulfillment of terms by the issuing banker. The undertaking given by the correspondent bank is independent. So the seller can turn against both banks in case of any breach. This can be inferred from the following provision of the U.C.P.500⁴⁶.

"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 National 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 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 drawer bank to accept and pay at maturity Draft(s) drawn by the Beneficiary on the Confirming Bank, in the event the drawer bank

⁴⁶ The U.C.P.500, Article 3(b) provides, "A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant and the issuing bank.

⁴⁶ Id., Article 9(b).
stipulated in the credit does not accept Draft(s) drawn on it, or to pay Draft(s) accepted but not paid by such drawer bank at maturity.

(iv) If the credit provides for negotiations to negotiate without recourse to drawers and/or bonafide 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)".

From the plain reading of this provision it can be inferred that the confirmation given by the correspondent bank is only additional to that of the original undertaking by the issuing bank.

However the U.C.P. 600 confined the undertaking of the correspondent bank in a very precise manner. It reads47,

"...A confirming bank is irrevocably bound to honour or negotiate as of the time it adds its confirmation to the credit48.

A confirming bank undertakes to reimburse another nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the confirming bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not another nominated bank prepaid or purchased before maturity. A confirming bank’s undertaking to reimburse another nominated bank is independent of the confirming bank’s undertaking to the beneficiary49.

If a bank is authorized or requested by the issuing bank to confirm a credit but is not prepared to do so, it must inform the issuing bank without delay and may advise the credit without confirmation50."

47 The U.C.P. 600, Article 8
48 Id., Article 8(b).
49 Id., Article 8 (c).
50 Id., Article 8 (d).
Apart from this the issuing bank needs to have clear assessment of the
document tendered by the beneficiary, when received from the correspondent
bank. This will help the bank to exercise its rights in an effective manner. The
right of the corresponding bank against the seller to insist for documents
mentioned in the letter of credit should be reasonable and clear. Whether this
right should include right of recourse to the seller beneficiary in the event of the
issuing bank's right against seller is to be determined.

Issuing Bank and the Seller

So long as the issuing bank is solvent and does not dispute the
intermediary's acceptance of the tender of documents the right of recourse can
be exercised by the issuing bank against beneficiary. The undertaking to pay by
the issuing bank is independent. The correspondent bank only acts on the
instruction of the issuing bank. When the documents are presented by the seller,
the correspondent bank pays him after the verification of the documents. These
documents are then forwarded to the issuing bank to get reimbursement of the
amount paid. There again the issuing bank has got the right to examine the
document. Problem will arise if the issuing bank finds out any inconsistency with
the documents which were not found by the correspondent bank. It can be
argued that unless there is a deliberate breach on the part of the seller for
inconsistency of documents, it is impracticable for the correspondent bank to
deny payment even if any discrepancy exists. It will be time consuming to detect
minor errors and to get confirmation. In this situation the banker can invoke a

51 See Notes, "The Letter of Credit as Protection for a Performer", 66 Yale Law Journal 903
(1956-57).
right of recovery from the seller against the payment made under mistake. Here again issuing bank can also invoke right, in the absence of the confirming banker after making the reimbursement to them. Similarly if there is a mutual mistake on the part of the seller and the bank which leads to make payment under the documentary credit the issuing banker has got the right to refuse payment. But if there is a mistake of banker and the seller is aware of the mistake he can't recover.

**Effect of Right of Waiver**

The bank is under a duty to examine the documents. When they are accepted by them in due course, the seller has the right to presume that the set is regular. He is entitled to claim that the bank has waived inquiry. Waiver is based on a decision by the bank to pay regardless of the state of the documents. The issuing bank has the right to waive discrepancies and pay regardless if they have the approval of the applicant. In order to waive a right, the waiver must be aware of the existence of the right to be waived. The issuing bank pays on the basis that the documents are goods. It does not realize that it has a right to recover the money paid. In common law it cannot both accept the documents and retain the right to reject them later. However this depends on the banks knowledge of its initial entitlement to reject the documents.

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52 Supra n. 1. at p.66
54 J.D. Murphy, "Documentary Credits and Rejected Documents", [1992] L.M.C.L.Q. 26 at p.29
56 The U.C.P. 600, Article 16 (b).
Right of Recourse

When a bank makes a payment in error the effect of its recourse from the payee needs to be examined in straight credit transactions and payment on a bill of exchange. It is also necessary to examine whether its rights are barred under international rules governing credit transactions.

Straight Credit Transactions

A straight documentary credit is essentially a bank’s guarantee of payment against specified document.\textsuperscript{57} Its duty is to pay when the beneficiary presents the documents to it. Once the bank undertakes payment in non-confirming documents a question will arise against whom the right of recourse can be exercised, is it against the beneficiary who present the non-confirming document or is it against the applicant of credit needs to be analysed.

In practice usually the payment in discharge of debt of applicant is made by the bank. But the documents must be non-confirming on their face\textsuperscript{58}. Nonetheless there are cases where for commercial reasons applicant cannot be sued. This is where the applicant is bankrupt. Here the bank is forced to pursue its remedies against the payee or beneficiary.

\textsuperscript{57} ICC Guide to Documentary Credit Operations (ICC) No.515 (1994). It provides a summary of the parties objections in choosing to effect payment by documentary credit.

\textsuperscript{58} The U.C.P.600, Article 14 (a).
Payment under Bill of Exchange

When the issuing bank accepts and pays a bill of exchange under letter of credit, three situations need to be considered. In situation where the draft is drawn on the issuing bank, the issuing bank has no right of recourse against the seller. The issuing bank acts as a holder when seller is the drawer and the buyer is the drawee. In these circumstances right of recourse is automatically excluded. The third situation is drawing the bill on the issuing bank by the applicant and the payee is the beneficiary. In Barclays Bank v. W. J. Simms Son & Cooke (Southern) Ltd., it was held that right of recourse is available to the issuing bank. This is because of the common law position that payment made under a mistake can be recovered under right of recourse by the bank. The facts of this case though different from letter of credit transaction, principle is applied in credit transactions also.

The payment by mistake is a case of unjust enrichment. In cases of unjust enrichment the bank can avail the subrogation remedy. It is an established principle of subrogation law that the purpose of subrogation is to provide restitution when the absence of restitutionary relief would yield unjust enrichment.

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59 See the Bills of Exchange Act, 1882, s.60
61 [1980] Q.B. 677
62 This is a statutory provision under the Uniform Commercial Code. See§ U.C.C. 5-117.
However Benjamin says that if the issuing bank commits mistake, right to recourse should not be made available to it \(^{64}\). There is no reason why a right of recourse should not to be made available against the issuing bank if has made a genuine liability mistake subject to the standard of restitutionary defences. In most of case of the letter of credit, the U.C.P. will prevent recovery \(^{65}\).

Thus the issuing bank can exercise right of recourse in letters of credit transaction subject to the rules of practice followed by them.

**Rights under Fraud Situations**

The issuing bank can exercise its right to refuse payment to the seller in case of fraud committed by seller. The fraud takes place in two situations mainly in relation to the goods and the other in relation to the documents. The issuing banker is more concerned in relation to documentary fraud. The bank has the right to reject for inconsistent document \(^{66}\). Similarly, if the bank exercised "reasonable care", it has got the right to get indemnified by the seller. In case the bank pays money under mistake of fact and the beneficiary is responsible for such fraud, the issuing bank can recover the money from the beneficiary. Such a right of recourse against beneficiary is based on the principle of implied warranty \(^{67}\). When the defects in the document are latent, the beneficiary

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\(^{65}\) See the U.C.P.600, Art. 16(b).


\(^{67}\) *Bank Russo-Iran v. Gordon Woodroffe & Co. Ltd.*, (1972) 116 S.J.921 as cited in Supra n.1 at p.138
assumes that the documents are genuine and contain no latent defects. However banker can exercise this right only on a clear proof of fraud by the seller.\(^6\)

**Right of Constructive Possession**

The documents received from the confirming bank changes the character of issuing bank. It can hold the documents under pledge. It is a kind of security where reimbursement is refused by its principal customer. When the bank acts as a pledgee, the document of title\(^6\) gives the bank the right to constructive possession. Once the bank gets possession and when reimbursement is refused, issuing bank can take delivery of the goods from the carrier. It has also got the right to sell.

It may be argued that the bank's interest in the goods as pledgee is a proprietary which can be enforced against third parties\(^7\). As a pledgee, the bank can repledge the goods without the pledgor's consent because the bank has a right to immediate possession of the goods as pledgee of the bill of lading. The bank has also got the right to recover damages in the tort of conversion from the carrier if the goods are delivered to someone else at the port of discharge\(^7\).

It is to be noted that this right as pledgee of the goods can be invoked only in cases of documents of title to the goods. If the letter of credit does not


\(^{6}\) *Bill of Lading is an example of document of title*

\(^{7}\) *Law of International Trade in Practice*, Inns of Court School of Law, Blackstone Press Ltd., London (1998) at p.90

include a bill of lading, the bank will not get proprietary rights. In case of other documents bank will not be assured of any security. Hence if a seaway bill is tendered by the seller as per the letter of credit, the banker will not be able to demand the goods from the ship. Even when the bank insist in the credit that seaway bill should contain name of the bank as the consignee, it is not possible to get a proprietary right. This document lacks negotiability. Hence in case of tendering of seaway bill, the bank will only be able to demand the goods from the ship in its own right if it can be shown that it is the party to whom the seller has instructed delivery to be made. The bank acquires contractual rights against the carrier merely on the basis of the fact that they are identified as consignee in the document. The possession of document may be relevant only to evidence the terms of the contract and not for acquiring rights under the contract.

In the case of multi-model transport document similar problems of seaway bill is encountered. But the endorsement of the document to the bank will enable them to demand delivery from ship. It is argued that when the U.C.P. authorizes bank to accept these documents, they are recognized as documents of title by mercantile customs. Banks would not accept a document which is not capable of being the subject of an effective pledge. Even if the letter of credit prohibits trans-shipment, banks will accept a multi-model transport document

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74 Ibid.
75 See the U.C.P.600, Article 17.
76 Supra n. 73 at p.480
which indicates that shipment will take place\textsuperscript{77}. How far this is practicable is an unsettled question.

**Rights of Issuing Bank against Transferee**

Letters of credit can be transferred only after obtaining consent from the issuing bank. The U.C.P. provides that "A credit can be transferred only if it is expressly designated as "transferable" by the issuing bank. Terms such as "divisible", "fractionable", "assignable" and "transmissible" do not render the credit transferable. If such terms are used they are to be disregarded\textsuperscript{78}. The discretionary power is given to the bank by the accepted practice of trade. Even when it decides to transfer, it can be transferred only on the terms and conditions specified in the original credits with limited exceptions mentioned in the U.C.P.\textsuperscript{79}.

One of the arguments raised in a case relating to transferable letter of credit\textsuperscript{80} was that an issuing bank has got a right to withhold consent to effect a transfer. This view is supported by the U.C.P. provisions. The issuing bank is not concerned with the transferee of credit.\textsuperscript{81} It is more concerned with the first beneficiary to get the required documents.

Issuing bank has got the right to insist indemnity from the transferee if payment is to be made on irregular documents tendered\textsuperscript{82}. Issuing bank has got

\textsuperscript{77} Supra.n.75.
\textsuperscript{78} Ibid.
\textsuperscript{79} The U.C.P.600, Article 38(g).
\textsuperscript{80} Bank Negara Indonesia 1946 v. Lariza (Singapore) Pte. Ltd. [1988] 2 W.L.R.374
\textsuperscript{81} Supra n.1 at p.168
\textsuperscript{82} Ibid.
right to get commission fees and expenses from the transferee\textsuperscript{83}. So also if the transferee tries to transfer the credit to a second beneficiary, the issuing bank has got the right to restrict such transfer. If transfer had already taken place, the issuing bank can refuse to accept it.

**Rights of the Issuing Bank: Indian Perspective**

The rights of the issuing bank in India depend upon the compliance with the terms of letters of credit they issue on an application from the buyer-applicant. While issuing an import letter of credit, banks in India should ensure not merely that the terms of the credit are in conformity with what the customer has asked for but also that they do not go against the current import and exchange control regulations\textsuperscript{84}. The issuing banks have right of recourse against the customer if they comply with the terms of credit they issue.

Similarly, the issuing bank has right to pay under reserve. If the documents presented under a credit are not entirely in conformity with its terms, instead of rejecting them the issuing bank can accept them on the strength of an indemnity from the intermediary bank and make payment. The issuing banks claim for refund of such a conditional payment on the documents when it is rejected by the buyer was considered by the Supreme Court in *United Commercial Bank v. Bank of India*\textsuperscript{85}. In this case the sale agreement was for the supply of 'Sizola Brand Pure Mustard Oil'. Accordingly beneficiary presented the

\textsuperscript{83} The U.C.P. 600, Article 38 (c).

\textsuperscript{84} Roshan Lal Anand v. Mercantile Bank Ltd, (1975) 45 Com. Cas 519 (Del.).

\textsuperscript{85} A.I.R. 1981 S.C. 1426. In earlier decision the Supreme Court had emphasized the principle that letters of credit are independent of the underlying transaction and the issuing banks obligation is not affected by a dispute between the buyer and the seller. See Tarapore & Co. v. Tractoro Export, Moscow, (1969) 1 S.C.C. 233.
agreed documents before appellant bank to receive payment. On examination of the documents it was found that the railway receipt covering the dispatch of goods described the goods as 'Sizola Brand Pure Mustard Oil unrefined'. Then the appellant bank refused to accept the document and agreed to make the payment to the respondent bank under reserve. Later the buyer refused to accept the discrepant document. Hence the appellant bank made a demand on the respondent bank to pay back the amount paid under reserve. The beneficiary also approached the court to restrain the respondent bank from making payment. The court held that unless documents tendered under a credit were in accordance with those for which the credit calls for the beneficiary cannot claim against him and it is the banker's duty to refuse payment. The court further emphasized that "the documents must be those called for and not documents which are almost the same or which seemed to do just as well". In the course of judgment the court made the following observations,

"The appellant presumably knew little or nothing about mustard oil. Banks are not dealers in mustard oil in such a case as this, but dealers in documents only. The appellant as the issuing bank was presented with documents and asked to pay a very large sum of money in exchange for them. Its duty was not to go out and determine the physical examination of the consignments, or employment of experts, whether the goods actually conformed to the contract between the buyer and the seller, nor even determine either from its own or expert advice whether the documents called for the goods which the buyer would be bound to accept. The banker knows only the letter of credit which is the only authority to act, and the documents which are presented under it. If these documents conform to the letter of credit [ ], He is bound to pay. If not, he is equally not bound to pay.... ."

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86 Here respondent bank was the bank which ultimately makes payment to the beneficiary.
87 A payment under reserve is understood in banking transaction to mean that the recipient of money may not deem it as his own but must be prepared to return it on demand. See Japson International v. State Bank of India, A.I.R. 1989 P&H 289.
88 Supra n.86 at p.1439
Therefore the issuing bank has the right to refuse payment if the documents tendered are not in conformity with those agreed\(^9\).

The issuing bank has right to claim reimbursement of the amount it paid to the beneficiary irrespective of any insurance coverage. In *Lakshmi Commercial Bank Ltd v. Hiralall & Sons*\(^9\), the bank opened a letter of credit in favour of a foreign seller at the request of the Indian buyer. The letter of credit was transmitted through negotiating banker in foreign country. The seller shipped the goods and presented the stipulated documents. The negotiating bank scrutinized the documents and found that they were in conformity with the credit and made payment. Later, the issuing bank claimed reimbursement of the amount it paid from the buyer. The buyer refused to pay on the ground that the ship carrying goods had sunk and the issuing bank should claim the amount from the insurance company. The Delhi High Court held that the buyer should pay the amount to the issuing banker. It emphasized that whether the ship sunk or sailed was not the concern of the issuing banker. If the ship sank, it was the buyer's business to pursue the claim against the insurance company even though the policy of insurance was in the name of the buyers as well as the issuing bank. The insurance policy was only a means of security in the hands of the banker. Though the bank had lodged a claim against the insurance company, that did not mean that the primary obligation of the buyer to pay the amount to the bank ceased.

\(^{9}\) Also see *AVN Tubes Limited v Steel Authority of India Ltd*, A.I.R. 1996 M.P.53.

Whether the issuing banks can be restrained from paying against similar documents tendered under letter of credit was considered by the Delhi High Court in two different cases. In one case, the court refused to grant injunction\(^9\). But in the other the court confirmed the already granted injunction\(^9\). The refusal in the first one was based on the obligation of an issuing bank. It was stated that it was for the bank to decide whether or not to pay against the documents tendered under the credit. If the bank wrongfully rejected documents that met the requirements of the credit, the bank would be answerable to the beneficiary. The court observed,

"...Needless to say that where the irregularity is obvious, the banker takes the document with his eyes open and should pay, if at all, only under indemnity or recourse, for he cannot look to his principal for re-imbursement if the latter refuses to accept the documents. Surely, the bank cannot be dictated by the plaintiff in this behalf although there may be a lot of common sense on its part to consider the objections raised by the plaintiff before accepting or rejecting the documents on the ground of discrepancies...".

On the other hand the decision which confirmed injunction was based on reason that the documents tendered were not consistent with the terms of the credit. The court in this regard was more concerned with the interest of parties than in the issuing banks obligation to the seller. In both the cases the certificates of weight and quality were held to be not what the credit called for. The documents did not expressly state how the surveyors assessed the quality of the goods or satisfied themselves as to the quality. Jain J.,\(^9\) remarked

\(^{9}\) Interadas Advertising (P) Ltd v. Bentrex & Co, (1983) 53 Com. Cas. 646 (Del.).
\(^{92}\) Interadas Advertising (P) Ltd v. Palmex Enterprises, (1983) 53 Com. Cas. 550 (Del.).
\(^{93}\) Supra n.92.
"the words "as tendered" in art 33 of the U.C.P. cannot be stretched to mean that whatever documents is tendered by the seller-beneficiary styled as a certificate of quality has to be accepted by the issuing or negotiating bank.... It must be a certificate of quality in essence and not in name only".

From the above discussion, it can be seen that courts in India expect banks to ensure the documents apparently meet the description with what they are in the letter of credit.

The rights of the issuing bank to claim reimbursement from the buyer depends upon compliance with the terms. In Indian Overseas Bank Ltd v. S.K.Ramalingam Chettiar\textsuperscript{94}, the Madras High Court discussed this aspect. In this case the issuing bank made payment to the seller on defective documents. The bill of lading tendered by the seller was defective. The letter of credit called for a clean bill of lading. But the bill of lading produced contained a special note which stated that the condition of packing of the goods was not clean. Apart from this the insurance policy was also defective since it did not cover the risk of theft and pilferage\textsuperscript{95}.

If the issuing bank has any objection to the acceptance of the documents it must inform the negotiating or confirming bank immediately before the negotiating bank made payment to the seller. Otherwise the issuing bank cannot refuse to accept the documents. This was made clear by the Delhi High Court in National Oils and Chemical Industries Ltd. v. Punjab & Sind Bank Ltd\textsuperscript{96}. This was a suit for injunction restraining the negotiating bank from making payment on

\textsuperscript{94} (1970) 2 M.L.J. 288.
\textsuperscript{95} The court pointed out that these risks were not automatically covered by a policy which covers perils against "pirates, rovers and thieves".
\textsuperscript{96} (1980) 50 Com. Cas. 390 (Del.)
the ground of non conformity with the terms of credit. The issuing bank had not raised any objection to the documents. Instead it informed the negotiating bank that the documents had been accepted by the buyer. The issuing bank sought to reject the documents only when the carrying vessel had sunk. The court observed that the issuing bank was estopped from claiming the amount. Similar view was taken by the Calcutta High Court in B.S.Aujila Co Pvt Ltd v. Kaluram Mahadeo Prasad 97. In this case the issuing bank failed to communicate the discrepancies in the documents to the negotiating bank within a reasonable time. It was held that irrespective of the question as to the conformity or otherwise of the documents with the terms of the credit, the issuing bank had forfeited the right to reject the documents since there was delay in communicating the same.

The importance given to the terms of the letter of credit by courts sometimes go against the basic nature of letters of credit. For example the Supreme Court in State Bank of India v. Manganese Ore (India) Ltd98 went to the extent of holding that the obligation of a bank to honour letter of credit is conditional upon the supply of quality goods in conformity with condition of the letters of credit. In this case the goods supplied were not of the specification and standard required under the letters of credit. So the bank refused to make payment against documents presented by the seller. The Bombay High Court directed the issuing Bank to make payment to the seller. The Supreme Court allowed the appeal filed by the issuing bank and held that it had no liability to honour the documents.

98 (1997) 4 Comp L. J.57 (S.C.)
The issuing bank is also liable to accept the bills of exchange if it adds confirmation on it. Once it agrees with the negotiating bank to honour the bills of exchange and accept that payment will be made on due date it cannot refuse payment even on the ground of fraud played by officers of the bank. Thus in *Virgo Steels v. Bank of Rajasthan* suit was for an unconditional leave to defend payment of the bill of exchange negotiated on the basis of an irrevocable letter of credit. The negotiating bank after receipt of the bills of exchange with documents sought confirmation from the issuing bank. The issuing bank confirmed the same. Later reimbursement was claimed from the issuing bank when the amount was paid by the negotiating bank. The issuing bank refused to pay. They alleged that some officers of another bank were involved in fraud and conspiracy. The court refused to accept this allegation. The court held that the issuing bank was bound by its own confirmation and if the documents were in order payment had to be made. The Supreme Court also made it clear that the issuing bank is not concerned with the disputes between the opener of the letter of credit and the beneficiary thereof. Its liability is solely based on the letter of credit terms.

**A Critical Evaluation of Rights of the Issuing Bank**

The issuing bank’s right to reimbursement is dependent on complying strictly to the instructions given by the buyer. To enforce this right it may realise any security interest it has in the shipping or other documents received from the beneficiary. Even though the bank may deliver these shipping documents to the

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99 A.I.R.1998 Bom. 82.
applicant, it is only for the purpose of processing the goods. Once the bank is put
with funds by the applicant, it becomes his exclusive property. The right of
reimbursement becomes effective only if the beneficiary is paid by the bank.
Even a slight variation from the mandate given by the customer will defeat this
right of the issuing bank. This influence can be drawn from South African
Reserve Bank v. Samuel & Co. Ltd, where the bank took up warehouse
receipts which simply stated that they were for certain quantities of maize
without identifying the source from which they had been acquired. The Court of
Appeal held that it was necessary for the bank to ensure that the maize for which
warehouse receipts were delivered was represented by shipping documents. The
bank lost its right to get reimbursement. Apart from this the U.C.P. does not
incorporate adequate duties to be exercised on the part of the issuing bank
towards the buyer applicant and restricts the buyer applicant's right to sue if the
issuing bank acts contrary to its undertaking under documentary credits.

However there is no decided case on the question with regard to the right
of reimbursement by the bank from the buyer if the bank pays against the
shipping documents which are not mentioned in the credit. If the bank is
negligent in not making adequate inquiries before concluding that the conditions
have been fulfilled, it will lose its right to reimbursement. If the parties follow the
U.C.P provisions, bank will lose its right to reimbursement only when it is
negligent. But if the rules are not mentioned, it is an open question for
litigation.

102 (1931) 40 Ll. L. R. 291
103 See the U.C.P. 600 Articles 13.
It can be ascertained from the case laws dealing with this aspect that the right of the issuing bank depends on its fulfillment of the agreed terms. These terms may vary from case to case. Determining the clear boundary describing the rights of the issuing bank is a difficult task. On the other hand if they are not specifically enumerated, a lot of uncertain situation will be crept in. Therefore it is necessary to harmonise the interest of parties.

The role of the corresponding banker also needs careful examination. The obligations they have to the issuing bank as well as other concerned parties are to be clearly mentioned. The task of the corresponding bank is very crucial when it acts as confirming banker.